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DLX - Q2 2019 Deluxe Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2019 Deluxe Corporation Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded.

I would now like to introduce your host for today's call, Mr. Ed Merritt, Treasurer and Vice President of Investor Relations. Mr. Merritt, you may begin.

Ed Merritt - *Deluxe Corporation - Treasurer & VP of IR*

All right. Thank you, Sherry, and welcome, everyone, to Deluxe Corporation's Second Quarter 2019 Earnings Call. I'm Ed Merritt, Treasurer and Vice President of Investor Relations. Joining me on today's call is Barry McCarthy, our President and Chief Executive Officer; and Keith Bush, our Chief Financial Officer. At the end of today's prepared remarks, Barry, Keith and I will take questions.

I would like to remind you that comments made today regarding projections, financial estimates, management's intentions or expectations regarding the company's future performance and strategy are forward-looking in nature as defined in the Private Securities Litigation Reform Act of 1995.

These comments are subject to risks and uncertainties, which could cause our actual results to differ materially from our projections. Additional information about factors that might cause actual results to differ from projections is contained in the press release issued this morning as well as in the company's Form 10-K for the year December 31, 2018, and other filings we make with the SEC.

Portions of the financial and statistical information will be discussed during this call are addressed in more detail in today's press release, which is posted on our Investor Relations website at deluxe.com. This information is also furnished to the SEC on Form 8-K filed by the company this morning.

Any references to non-GAAP financial measures are reconciled to the comparable GAAP financial measures in the press release or as part of our presentation during this call.

Now I'll turn the call to Barry.

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Thanks, Ed, and good morning, everyone. This morning, we're going to provide you with our second quarter financial results and provide a third quarter outlook. We're tightening our revenue outlook and reaffirming our full year adjusted EPS outlook. We'll also update you on the exciting progress we're making in our transformation to restore organic revenue growth and strengthen our position as a trusted tech-enabled solutions



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company. We'll include details of our new, more focused strategy. We'll provide a status on filling the key leadership roles and update on how our new team is delivering on our commitments and outline of our infrastructure investments and expected benefits. While still early, our momentum is clearly beginning to build.

Similar to our last call, we had an unusual amount to cover today, so let's get started with highlights from our second quarter. Revenue grew 1.2% year-over-year, ending at \$494 million, well within our guidance range, but we are not satisfied with our organic growth. Addressing organic growth is at the core of our new strategy. We delivered diluted earnings per share of \$0.75 and adjusted diluted earnings per share of \$1.64. Adjusted diluted earnings per share ended at the top end of our outlook. Overall, we delivered a solid second quarter, hitting the financial targets we've set for the business while making significant progress on the transformation.

More on that in a few minutes. But first, let me turn the call over to Keith for more on quarterly results.

Keith A. Bush - *Deluxe Corporation - Senior VP & CFO*

Thanks, Barry. Compared to our guide, we delivered a solid second quarter financial performance. We produced strong operating cash flow to enable investment in our business, including making substantial progress in our transformation investments. Total revenue was \$494 million, a 1.2% increase year-over-year. While overall revenue was within our outlook, as Barry noted, we're not satisfied with our organic revenue performance, a decrease of about 3%.

As we outlined last quarter, we plan to resegment how we operate and report our business later this year as part of our overall strategy to drive organic growth. For now, we're continuing to operate and report results in the current segment structure.

Small Business Services revenue was \$308.5 million and declined about 2.9% in total or about 3.4% organically. Financial Services revenue was \$156.1 million. It grew nearly 12.1% in total but declined about 1.6% organically.

Direct Checks revenue was \$29.4 million, declining 5.8% year-over-year but performed slightly better than our expectations. Currently, our largest group of products is marketing solutions and other services, or MOS. For the quarter, MOS ended at \$215 million, growing to 43.6% of total revenue.

Checks ended the quarter at \$196 million, or 39.8% of total revenue. And forms and accessories was \$82 million, or about 16.6% of total revenue.

Diluted earnings per share for the second quarter was \$0.75 and includes aggregate non-GAAP adjustments of \$0.89 per share. When excluding these adjustments, adjusted diluted EPS was \$1.64 per share at the high end of our outlook. Last year, adjusted diluted EPS was \$1.67 per share. A reconciliation from diluted EPS to adjusted diluted EPS is included in our earnings release.

The fundamental health of the enterprise is strong, and we continue to deliver substantial adjusted EBITDA and free cash flow, allowing us to reinvest earnings back into the business to fund our transformation, while at the same time returning capital to shareholders through the payment of a regular dividend and common stock repurchases.

Reported EBITDA was \$86.5 million for the quarter and includes \$31 million of expenses related to restructuring, integration and other costs as well as non-GAAP adjustments. Excluding these amounts, adjusted EBITDA was \$117.5 million or about 23.8% of total revenue. Adjusted EBITDA declined about \$8 million, and adjusted EBITDA margin compressed 180 basis points.

Year-over-year compression resulted from mix changes in existing businesses, price concessions, attrition of existing business and the one-time impact from the migration of one of our web properties.

Moving on to the balance sheet and cash flow statement. At the end of the quarter, we withdrawn \$951 million on the credit facility, increasing from the beginning of the year, primarily due to additional common stock repurchases and planned investment spend.



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In mid-July, we completed an interest rate swap on our credit facility. We locked in 6 interest rates for \$200 million of debt, and we now have a mix of about 80% floating rate debt and 20% fixed-rate debt. As a result, we should see a 2019 interest expense benefit of about \$200,000 against 4 floating rates. Through the first 6 months, cash provided by operating activities was \$105 million and capital expenditures were \$32 million.

Free cash flow, defined as cash provided by operating activities less capital expenditures, was \$73 million in the quarter and declined by \$46 million from last year. The primary driver of lower free cash flow was lower adjusted EBITDA, the cash payment of certain legal-related costs and previously disclosed investments in our transformation.

In the second quarter, we repurchased \$29 million of common stock, bringing year-to-date share repurchases to \$79 million. We currently have about \$341 million of share buyback authorization remaining at the end of the second quarter. We don't provide an outlook for share repurchases, but we may continue to opportunistically buy stock in the open market from time-to-time. To the extent we generate excess cash, we plan to reduce the amount outstanding against our credit facility.

Moving on, our acquisition costs in the first half allowed us to make progress, integrating previous acquisitions into our business. We completed our integration of InkHead into our primary ERP, and with additional activity underway, on others. So we're advancing our acquisition integration as expected.

Looking ahead to our third quarter and full year 2019 outlook, we expect third quarter revenue to be in the range of \$490 million to \$505 million, and we expect diluted EPS to be in the range of \$0.69 to \$0.79 per share. We expect adjusted diluted EPS to be in the range of \$1.60 to \$1.70 per share.

For the full year, we are tightening our revenue outlook. We expect revenue between \$2.005 billion and \$2.045 billion, which remains in line with our previous outlook for low single-digit revenue increase from last year.

We expect diluted EPS in the range of \$3.45 per share to \$3.75 per share, and we continue to expect adjusted diluted EPS in the range of \$6.65 per share to \$6.95 per share for the year. We provide a reconciliation from diluted EPS to adjusted diluted EPS in the earnings release. But I think it's important to discuss the integration related adjustments of \$1.26 per share or about \$75 million for the year. This adjustment is for the restructuring, integration and other costs. In our previous outlook, we had already included approximately \$32 million or \$0.54 per share for these expenses that were previously underway. Based on our work we completed since the last call, we are increasing that total by \$6 million to \$38 million. The additional expenses are primarily related to severance and site closure activities. Our continued work to transform the company may result in additional restructuring expense as we progress through the year.

Additionally, on our last call, we announced we would incrementally invest between \$30 million and \$60 million per year for the next 2 years to transform our infrastructure and position the company for growth. Collectively, we call this program New Day.

We said we would provide a more refined estimate on this call, and consistent with that commitment, we are revising our 2019 estimate to a range of \$35 million to \$40 million, basically in the middle of the range we previously expected. So the \$75 million for restructuring, integration and other cost is the combination of the \$38 million I've previously discussed in this New Day investment of \$35 million to \$40 million. We identified a small amount of capital also required for the New Day investments, but we've reprioritized capital projects and are funding those investments within our CapEx guidance.

While additional work is necessary to fully scope out the full implementation plans for each investment, we've made substantial progress and are on plan to complete this work. The expected financial impact has been included in our third quarter and full year outlook. We are pleased with the progress on the New Day initiative. Here are a few highlights. Salesforce will be our single CRM platform to replace 15 separate CRM tools in place today. Salesforce will also be central to our e-commerce engine. Several portions of our business have already gone live since our last earnings call, and user acceptance testing began last week, ahead of schedule for other portions of the business.



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Our network capacity has successfully been expanded, and our Microsoft platform has been updated to the latest suite of collaboration tools, including desktop and mobile videoconferencing. We are already experiencing dynamic collaboration that provides for faster decision-making, and this will facilitate more travel expenses, previously possible.

Microsoft has advised us that our adoption of these tools has been among the fastest with any global client. We are not surprised, as it is yet another proof point about the new Deluxe. Workday implementation is on track to be operational by the end of 2019. This will replace multiple human capital management systems currently in place as a result of dozens of previously unintegrated acquisitions.

User acceptance testing began last week as well. And here, too, we are ahead of schedule. Cloudera was selected as our big data platform and Anaplan for enterprise planning. Both of these implementations are on track, and these platforms will allow us to operate far more efficiently and support our organic growth strategy.

The big remaining systems decision is the selection of a common ERP. As we've disclosed on our last call, the company has about 52 different systems operating today. We obviously have an opportunity to realize meaningful efficiencies by moving to a common enterprise-wide process with implementation of a modern ERP.

We have been actively evaluating alternative and best-in-class implementation partners, and we expect to reach a decision later this year. We recognized the complexity of implementing a new ERP, and we are being appropriately cautious and responsible on our pace. But we are confident in our ability to deliver. During future calls, we will update you on our progress and give additional visibility and timing of future investments.

Now I'll turn the call back to Barry.

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Thanks, Keith. I'm so proud of the accomplishments our team has made since I joined Deluxe late last year, and I'm glad to be able to walk you through some of the details on those efforts and accomplishments today.

I've asked much from the team, and they've delivered. While still early, we can feel our momentum beginning to build. I've had the opportunity to meet even more employee owners across our fine company, and their enthusiasm and their dedication to Deluxe is inspiring. I also had the opportunity to meet with a number of investors during the second quarter, and I'm grateful for the overwhelming investor support for our new, more focused strategy. I heard many of you ask for additional details about our strategy and our execution plan, and I'll provide you more today.

I want to be clear upfront. Previously, the company strategy was about diversification and using the company's great cash flow to buy inorganic growth. The company was very successful for a time on this pathway, and now we're ready as a company to realize the potential of those acquisitions.

However, as Keith highlighted earlier, the acquisitions have not yet yielded the organic growth the company expected. In 2018, prior to my arrival, the company repeatedly adjusted revenue guidance downward, primarily due to acquisition delays and acquisition underperformance.

As you can see from our New Day investments, we're now making the necessary investments to integrate these acquisitions then move the company to a modern technology platform. I understand the company had often discussed cross-selling and organic growth but had not made the investments in the systems, processes, talent or culture to drive that growth.

For example, the company has not had, had a sale for over a decade. We're addressing each of these head on now. It had become evident to me, our management team and our Board that a course adjustment was required to help us rehire the leading global strategy consultancy, to help find a better future, and we shared the results of that effort on our last call.

We're now aiming at a much more fundamental transformation than run a new diversification. Our new strategy is focused on winning with the existing customers, markets and product families. It's about profitable organic growth and focus on 2 key growth markets: payments and cloud.



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We will invest the outstanding cash flow from promotional products and check businesses into these growth areas, and we will supplement out our organic growth with targeted and strategic acquisitions. But we will no longer allow ourselves to be exclusively dependent upon acquisitions for growth. This more focused strategy requires us to change our go-to-market philosophy, many operational processes and critical underlying technology and systems. All of this is necessary to position the company for organic growth, which is at the very core of our go-forward strategy.

In 2023, we believe this new, more focused strategy will deliver a sustainable mid-single digit organic growth and adjusted EBITDA margins in the low- to mid-20s. In 2023, we expect the strategy to yield \$300 million of net new organic revenue for a total GAAP reported revenue of about \$2.3 billion.

Yes. We are undertaking material change. I have experience with this and have led organizations through similar transformations throughout my career. Through centralizing and streamlining processes, focusing on the customer and building a sales culture, I have consistently driven profitable organic growth. Consistent with how I've managed similar transitions in the past, we've established an experienced team of Deluxe leaders, solely focused on delivering the change. This internal Transformation Leadership Office, or TLO, is supported by world-class external experts from leading consultancies who provide another layer of expertise and insight.

We're leveraging their best-in-class implementation solutions and project management skills to drive the transformer -- transformation as efficiently as possible to minimize disruption in our core operations. We have a very methodical, practical and responsible process to manage change and resequence the initiatives to minimize risk.

As Keith outlined earlier, our team is doing a great job. We've already made measurable progress on key initiatives and remain on schedule and on budget. Importantly, we're advancing our transformation without missing a beat, delivering the quarter and year we've committed. This is the new Deluxe.

Now I'll move on to an update on the progress we've made implementing our business strategy. As we've discussed from the second quarter earnings call, in the future, we'll focus our efforts on 4 primary business areas: payments, cloud, promotional products and checks.

The first growth area is payments, a multibillion-dollar market growing at 10% to 15% annually. Our payments offering fits into 3 subcategories. First, treasury management solutions. We believe we can grow market share with our existing market-leading software and solutions. Additionally, we continue to see green shoots of opportunity and integrated receivable, which expand beyond financial institutions. We have a strong sales pipeline and a healthy backlog of customers in our implementation queue.

The second area is payroll, where our solution is a great fit for small business, one of our areas of greatest strength. And the third area is helping businesses, large and small, pay and get paid. Our new eChecks product is well-positioned in the fast growing disbursement space, and we're having great conversations with our small business clients about their payments needs.

The second growth area, cloud-based solutions, is also a multibillion-dollar market growing at double digits annually. Our interest in cloud is focused in 3 subcategories. First, cloud-based services, including loyalty offerings, logo design, profitability tools and bank accounts switching tool solutions.

Second, cloud-based web design and web hosting. We already have a strong presence in this space, hosting millions of websites directly and indirectly through partners. We've recently been selected as a preferred hosting and web service provider by Ingram Micro, a global and technology and logistics company operating in 64 countries, with 33,000 employees. We expect to announce more on this win in the near future. This is another example of the new Deluxe.

Third, cloud delivered data and analytics, such as those offerings from FMCG and Datamyx. We see year-over-year growth in this area in the second quarter, and we're beginning to see early signs of returning growth on the home mortgage refinancing market as a result of expectations for lower mortgage interest rates. We're excited with our strategy to expand data-driven marketing deeper into small businesses. It's showing early signs of success, and we'll provide updates on this business in quarters to come.



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As part of this acceleration, we recently signed a new deal with one of our existing strategic data partners, expanding the reach of our data within the small business lending vertical. Again, we see this as another early proof point about the new Deluxe.

The third area, promotional products, includes prints, retail packaging, banners, business forms and other promotional products designed to help customers manage and promote their brands. We're actively conducting national searches for the leaders of payments, cloud and promotional products and expect to have those positions filled later this year.

We're very pleased with the caliber of talent we are attracting with deep experience in each of these areas who want to be part of our transformation story. Prior to placing these new leaders, we have existing executive leadership assisting with our transformation, and I'm also deeply involved in the day-to-day operations in these areas.

The fourth area is checks. Tracey Engelhardt, an experienced Deluxe leader with deep industry knowledge will be our General Manager for Checks. Checks generate strong margins and cash flow, and with Tracey's leadership, we believe we can maintain this profitability and capture new market share.

Recapping our strategy. Our overarching objective is to position the company for an acceleration of profitable organic revenue growth. We believe managing our business in 4 key areas, payments, cloud, promotional products and checks, will allow us to focus much more clearly on the acceleration of organic revenue growth. Payments and cloud are multibillion-dollar markets with great secular growth trends and great earnings multiples. And importantly, these are markets where we have the right to win and where we already have significant business.

As an additional tailwind, we see opportunities in the markets we're in, with mega mergers and more in the fintech space specifically. We're positioning ourselves to benefit by having a fast and nimble company skilled at selling more to our existing customers. We are keeping our debt load to give us maximum flexibility to grow and respond to market opportunities.

I've heard a question from many of you about our approach to capital allocation and future willingness to accumulate debt to deliver our strategy. Here, too, I want to be very clear. This company is fundamentally healthy and has no need to take unnecessary risk. I have spent many years in a greatly overleveraged environment and have no plans or intentions of taking this quality company in that direction. You should expect to see it make fewer, more meaningful acquisitions over time to supplement our organic growth. Every decision will be taken in the view of maximizing shareholder value, with the least amount of risk.

Now let me give you an update on the progress and emerging momentum our team has from an operating perspective. First, sales. We announced this Monday that we have completed a national search for our Chief Revenue Officer and are pleased that Chris Thomas has joined Deluxe in this new role. Chris brings a breadth of capabilities to Deluxe to help us create a world-class enterprise selling organization.

He has past experience at DXC Technology, Hewlett Packard and Pegasus Logistics Group, where he built and transformed the global sales organizations to accelerate organic growth and transform the corporate culture to be very sales driven. His experience is a great match for our strategy, and we're pleased to have a leader of Chris' caliber join the world-class team we are building to help define and shape our sales culture.

As Keith mentioned earlier, we announced our relationship with Salesforce as our enterprise CRM platform. With a single view of our customer and data insights previously unavailable to us, we will identify substantial cross-selling opportunities across the millions of our existing customers. I recently participated in the Salesforce Investor Day in New York, giving me the platform to share our fundamental transformation story with tech investors.

Even before Chris's arrival, we can begin implementing a new discipline into our telesales centers to rapidly test new scripts, offers and promotions, which we expect will yield measurable improvements and cross-selling results. Additionally, we have closed several important deals, including Ingram Micro and data deals I mentioned earlier. You will hear more in the coming weeks about our exciting progress.

Second, product and innovation. We've also made progress strengthening our product innovation and development teams. We brought all product development activities under 1 Deluxe leader to provide consistent innovation and product delivery. For the first time, we'll have common



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methodologies and commercialization practices, enabling us to unlock the full potential of our products. We're currently developing new solutions to support our treasury management and e-payment initiatives and more. We are moving at great new speed.

For example, in Q2, we developed an extension to our epayments product offering, called Print+ Mail. Print+ Mail combines the speed and convenience of sending an electronic payment with the experience of receiving a physical business check. The end recipient controls this entire experience. With just a click, Print+ Mail automatically generates and prints high-security paper checks from our secured processing facilities and mails them for our customers the same day.

Within the first few weeks since launch, we brought up more than 500 customers on this new capability and expect to continue to enhance the offering through the rest of the year. Clearly, this is also evidence of the new Deluxe. Additionally, under Amanda Parrilli, our new Vice President of Strategy and Planning, we're establishing a new portfolio of management program to further focus our investments and accelerate organic growth.

Third, efficiency. I said before we'll self-fund much of our go-forward investments and structural efficiencies. We've made great progress for the second quarter rationalizing operations, closing certain real estate locations and simplifying processes, allowing us to redeploy resources to accelerate growth. Earlier, both Keith and I gave our perspective on our platform investments that will not only help us accelerate our growth but should deliver material savings over time.

The fourth area of focus is culture. We hired Jane Elliott to be our Chief Human Resources Officer, who has led through similar transformations during her career. We're reorganizing the executive leadership team to align with our new strategy. We've initiated a broad organization restructuring to reduce the number of management layers we've added before and expand areas of control. The new organization will be nimble, provide clear accountability and results and faster decision making.

In April, we made all North American Deluxe employees shareholders and the impact is already exceeding my expectations. We're seeing a whole new level of dialogue focused on teamwork and creative problem-solving. Our employees are fully aligned with shareholders and motivated and rewarded to think and act like owners because every North American employee is now an owner.

Today, we've given you the highlights of the changes underway and the momentum we're building. We're delivering the performance results we promised even as we aspire to do better in the future. We're working at a rapid pace to transform the company, to drive organic growth.

I know you probably have more questions, and I want to update you on our plans for an Investor Day. We're tentatively planning our Investor Day for February 2020, which will allow our new GM to get established and provide you with detail about their exciting businesses. We will organize the event to showcase our new management team, our strategy and incredible products. We even included live product demos. We will set up a save the date e-mail along with more detailed agenda later in the year. Between now and next earnings, you should expect to hear us publicize details of key wins and new partnerships. These will be more examples of the new Deluxe.

In closing, our momentum is clearly emerging, and our transformation is well underway. It won't happen overnight, but my optimism for our future continues to grow, and I'm more energized and excited about our opportunity than when I joined just 8 months ago.

Now Keith, Ed and I will open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Charlie Strauzer with CJS Securities.



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Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

Please, can we just have a little discussion about the New Day investments, and I appreciate giving some more clarity there, but maybe drill down a little bit more for us if you could and explain the split there of the \$35 million to \$40 million in terms of expense versus CapEx. And -- or is the CapEx on top of that amount? And how should that progress through the back half of this year as well?

Keith A. Bush - *Deluxe Corporation - Senior VP & CFO*

Sure. So this is Keith. Thanks, Charlie. That guidance was for expense. So there is capital, in addition to that amount, but we were able to reprioritize what was already in our capital plan to accommodate for that.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

Got it. So basically, I know you're not spending any additional CapEx, but is there a breakout of the CapEx of what the -- what's related to New Day?

Keith A. Bush - *Deluxe Corporation - Senior VP & CFO*

We didn't break that out specifically. As we move forward and look at the ERP platform, I think there's more of an opportunity for capital treatment, but in these, no.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

Got it. And do you plan to call that \$35 million to \$40 million as kind of your one-time non-GAAP expenses in -- when you calculate the adjusted EBITDA?

Keith A. Bush - *Deluxe Corporation - Senior VP & CFO*

So Charlie, that's for this year. But I didn't hear the full part of your question.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

No. I was just saying like when you back out things for adjusted EBITDA, will you be backing out that -- these investments as well?

Keith A. Bush - *Deluxe Corporation - Senior VP & CFO*

Yes. Exactly. That's included since we took out the \$75 million.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

Got it. And how should we think about the progression of that \$35 million to \$40 million at the back half of the year in your Q3 versus Q4?

Keith A. Bush - *Deluxe Corporation - Senior VP & CFO*

So probably about 2/3 in the rest of the year.



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Operator

And our next question comes from Jamie Clement with Buckingham.

James Martin Clement - *The Buckingham Research Group Incorporated - Analyst*

Barry, as you all think about enterprise selling, what are some of the initial high-priority, high-potential verticals that you all think you're going to be focusing on?

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Great question. And we've been very public that we -- our 2 primary markets are small business and financial services or financial institutions. But we think there are other enterprise classes where we think we have a special right to win, which include health care, real estate and construction. We already had a great footprint in those markets, and our products seem to have great take up there, and we think there's great growth prospects for us. But I want to be clear, Jamie, we're -- that's where we're starting. We -- there's others. For example, we had a nice total rating in automotive as another sector. And as we dig deeper here and as Chris goes longer, he's been here for 3 days now, I think we'll find additional market verticals. And clearly part of our strategy will be to deliver solutions that are targeting specific market verticals.

James Martin Clement - *The Buckingham Research Group Incorporated - Analyst*

Okay. Just a couple just independent questions. If I look at the checks business, page 14, 4% to 5% decline, you have in the checks column. I think typically, the company has guided to declines that are a couple of hundred basis points higher than that. Greater than that. I think in the quarter, you were maybe, checks revenue, I think based in your chart, was maybe down 8%, but like Direct Checks was actually surprisingly strong, I think, compared to where it's been. So can you help me kind of give the -- can you give us some updated thoughts on the checks business and going forward and projected rates of decline and that sort of thing?

Ed Merritt - *Deluxe Corporation - Treasurer & VP of IR*

It's Ed. Yes. So we've seen a couple of quarters where Direct Checks has been a little stronger than what we've expected. Where I think the difference is maybe in the past is we make sure, first of all, we're guiding to check revenue or check units, so you got to make sure which one we're talking through. But the pricing is really where we are seeing a little bit of competition. I think we've seen checks performed fairly well that we said in the last couple of calls even that it's tougher to raise prices in the check space, but the business is solid. We still see it continue to -- it's still declining, but it's declining to a pretty measurable rate, and we're able to forecast it fairly well.

James Martin Clement - *The Buckingham Research Group Incorporated - Analyst*

Yes. No, Ed. What I'm just kind of getting at is I think that -- like I just -- I did the math quickly here, and I think your checks revenue was down 8.4% only during the quarter. Why on the chart on page 14 is the rate only 4% to 5%?

Ed Merritt - *Deluxe Corporation - Treasurer & VP of IR*

You know what? I wasn't looking at it. I'm not sure if that's a good question.

James Martin Clement - *The Buckingham Research Group Incorporated - Analyst*

Okay. No problem. We can move on. Sorry. Barry, other big picture kind of question about kind of multiyear targets, and what you laid out on this call was potentially \$2.3 billion of revenue, low- to mid-20% margins. I want to bring this up because this question has come up to me.

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Simple math. If one were to take a theoretical 2023 of \$2.3 billion and multiply that by 22.5%, you get to about \$518 million of adjusted EBITDA. That's not far from where you all were in 2017 and 2018. And given the momentum that you're seeing and all the initiatives that you guys are undertaking, are you really trying to send a message that like goal scenario 3 years from now that your EBITDA is only going to be flat versus where it was last year? Because that doesn't sound to me like what you're saying. You sound much more optimistic than that.

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

I think we are much more optimistic. I mean, our message -- we're trying to be very clear that we think that we will deliver net of check declines, an incremental \$300 million of profitable revenue to the company in calendar year 2023. So the company outperformed that. We're optimistic and hopeful, but we also want to be realistic in setting expectations that we're just at the beginning of our transformation. Our new sales leader has been here 3 days, and we are starting to go forward.

And we are -- the reason we're focusing the 2 segments that we've highlighted, which are payments and cloud, because not only do they have strong secular growth, if we can just plant our flag and stand in the intersection, which we believe we have a right to do, and a bigger basis than we have the day we win because those sectors grow. So sectors also have a terrific margins, and we think that combination gives us the fuel to deliver what we think is a reasonable promise.

James Martin Clement - *The Buckingham Research Group Incorporated - Analyst*

Okay. That's very fair. And I totally get that it's early. I just -- it's like if people just do the simple math based on those bullet points, it's not like a massively compelling number versus all the opportunities that you can have in the momentum you're building. That's the reason why I was pointing it out.

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

I get it, Jamie. And they're -- we've been very purposeful at targeting these markets because they give us great opportunity. We're early, so we're in the business of meeting or beating expectations, so we don't want to set outside of the expectations too early.

Operator

Our next question comes from Chris McGinnis with Sidoti & Company.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

I guess just thinking about the organic growth coming along at some point here. A lot is happening with integration and changes within the business itself. I guess how long do you think you should see organic growth return to the model? Since seemingly, the company was close to it at some point, and you referenced that obviously earlier and with -- there's some headwinds there. But now that you have everything in place, it's going to take some time to implement all these initiatives, but when do you see or think the expectation of organic growth returning to the model?

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Yes. Thanks for the question. I think there's actually two parts for that question. I want to answer both of them. The first part of the question is, and it was a follow-up question from the last time we were all together about our company's ability to execute against our technology initiatives. I hope you heard very, very clearly from us today that we are exceeding or on track or exceeding our expectations and our own schedules and doing better than budget on each of the technology platforms that we are investing in. So we are doing exactly what we said we were going to do on exactly the schedule we were going to do it on exactly the price points we said we were going to deliver it. So that part of the execution, I think



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we feel very, very confident about. Much of the work will be completed this year. We told you several of the initiatives will be completed in this calendar year with go live dates at the first of the year. We feel very confident about that.

Second, which is when to expect organic growth and when does this deliver for organic growth? Again, Chris has been here now, 3 days. But even before Chris got here, we started working on initiatives to drive organic revenue growth and cross-sell in our telesales center as well as in parts of our sales organization. And I'm optimistic that, that will start yielding some early results next year. I can't give you any forecast about how much or how fast, but we would expect to see some fruit from that labor next year. And I think as we get closer next year, Chris gets more established and has better visibility and insight into the pipeline. We will give you updates as this unfolds.

James Martin Clement - *The Buckingham Research Group Incorporated - Analyst*

I appreciate that. And then just one more -- a follow-up question. You mentioned partnerships in some of the meetings we had. I was just wondering how does that look going forward? And how do you -- I didn't hear it today [off end], maybe I missed it in your commentary, but can you just talk a little bit about that and how the opportunity is for you?

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Yes. Well, I mean I think the first one I point at is Ingram Micro. So Ingram Micro becomes a customer of ours. So really they're a partner where they're going to take our products. They're going to replace existing products they have in their suite and replace them with our products, and then we become essentially marketing partners to deliver our solution to their customer. We love that model because we're able to leverage the great relationship and the terrific brand that companies like Ingram has -- the relationships they have with our customers, and we have great products and service and solutions delivery, and we make partners.

Coming soon, we'll be able to tell you more about the data deal that I announced, which is also about a partnership. But we also think there's many -- one of the distinctions between, I think, the old strategy of the company and the new strategy is the old strategy was very focused on having to own and control an asset in order for it to yield value. In the new strategy, we really look at partners as a way to go much faster to generate new revenue, leveraging the best of what is available, combining it with we have, which is an unbelievable, unmatched customer reach. I'm going to remind everybody, 5 million small businesses, 4,800 financial institutions, 4 million plus websites that are hosted on our platform. Nobody, I mean, there is no one that has this type of scale and reach that we have.

So by packaging our products together, putting them together in compelling solutions and offerings, along with those partners that we will be building over time, we think we've got a great distribution channel and a great way to reach small businesses and financial institutions with more products and services.

Operator

And our next question comes from Charlie Strauzer with CJS securities.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

Just a quick follow up. Just on the FS segment. The recent acquisitions of FMCG and Datamyx have been challenged and it's the way that, I guess, to put it from last year. I just want to see if there's any progress kind of going -- kind of an update there and how that's progressing back hopefully towards the right way.



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Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Yes. So -- I mean, I would take them separately, but what I would tell you is overall, that we are pleased with the progress that we're making with those assets. Those assets were disappointing in their performance in 2018. FMCG, specifically, grew, it just didn't grow at the rate that the company, I think, has expected to. And specific to Datamyx, as interest rates continue to decline, we believe that positions Datamyx for nice growth acceleration because of the position we have and the quality of the service we provide and the relationships we have with those mortgage lenders. So we expect to see steady improvements and growth in those businesses as we go forward.

Charles S. Strauser - *CJS Securities, Inc. - Senior MD of Sales & Trading and Analyst*

Great. And then REMITCO, the recent acquisition, how has that been performing since you had your hands on it, so to speak?

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

REMITCO, I think, is doing fine, and what really like about the REMITCO assets combined with our WAUSAU software, it really puts us in a truly unique position in the marketplace. WAUSAU, as you know, is the leading software that many billers, the de facto leader for financial institutions and other billers that are managing lockbox operations and receivables. It is the standard that is what most people use.

So now in addition to having the industry standard software, we're actually able to bolt on services with that. We're actually able to operate lockboxes on behalf of clients. We see a nice opportunity here to grow market share as financial institutions look to outsource that solution to a third-party that's got more scale and honestly can do it at a better rate as well as the billers that are looking for efficiencies.

So we think the combination of having the software and the WAUSAU services to deliver that gives us a great opportunity going forward. And then of course, that becomes our launchpad for the future of integrated receivables, which is not just lockbox operation or taking check payments, but it's all the things around accepting recurring payments, et cetera. And we think it gives us a great position for we think is coming next. So great near-term and growing share as we win some outsourcing business. And we think it gives us great positioning for the future for where things come next throughout integrated receivables.

Operator

Speakers, I'm showing no further questions in the queue at this time. I'd like to turn the call back over to Mr. Barry McCarthy for any further remarks.

Barry C. McCarthy - *Deluxe Corporation - President, CEO & Director*

Well, thank you, everyone, for participating on the call and for your questions. So in summary, here's where I'd like to leave us. First, our momentum is building. Our sales culture is starting to show initial signs of success. We have a new sales leader, key wins to announce shortly, a growing pipeline, a new and improving telesales model and a nice treasury management backlog awaiting implementation.

Two, our new strategy is focused on payments, cloud, promotional products and check, and we have material business in each area already and a right to win in each.

Three, we're changing our go-to-market strategy to drive organic growth by investing in the systems, processes, talents and culture. We're on track and on budget, rolling out our new enablement technologies.

Four. We began to rationalize our realistic footprints and reduce the complexity and layers of our organizational structure so it could be more nimble and move forward much faster than previously possible and drive more organic revenue growth.



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In closing, I'd like to thank our exceptional Deluxe employee owners who give their all every day to deliver for our customers and shareholders. I'm grateful for their commitments and together, we will unlock the incredible potential to become the new Deluxe, a trusted, tech-enabled solutions company.

Now I will turn the call back to Ed for some final comments.

Ed Merritt - *Deluxe Corporation - Treasurer & VP of IR*

Thanks, Barry. Jamie, you had a question. I do want to respond to that. I think you were asking about the 4% to 5% decline in checks. When we've got the slide in the investor deck and in the presentation here that shows long-term, we expect that market in the check space to go down 4% to 5%. I think what you're looking at is a quarterly result, which by quarter, we have promotional activity, we've got client wins, we've got pricing. So by quarter, you can see the check revenue decline more or less than the ongoing rate. But I think the answer to your question is you're comparing it quarterly at an estimate to what we expect the market to do over the long term. If that's not it, we can chat about it later.

But in closing, I just want to let everybody know we've got some conferences coming up. We were at the conference in New York City. CJS Securities have their 19th annual New Ideas Conference. And we attended that, so thank you for that. On September 19, we'll be in New York at the CL King 17th Annual Best Ideas conference.

And while not a third quarter event, we do hope that you can join us at our Investor Day in February 2020. And we plan to provide you some more details in the coming months regarding the timing and the location of that exciting event. Thank you all for joining us, and that concludes the Deluxe Second Quarter 2019 Earnings Call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may all disconnect, and have a wonderful day.

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