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DLX - Q1 2020 Deluxe Corp Earnings Call

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MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by, and welcome to the First Quarter 2020 Deluxe Earnings conference call. (Operator Instructions) Please be about that today's conference call is being recorded. (Operator Instructions) I would now like to turn the conference over to your speaker for today, Mr. Ed Merritt.

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

Thank you, and welcome to the Deluxe Corporation's First Quarter 2020 Earnings Call. I'm Ed Merritt, Vice President of Corporate Finance and Treasurer. And 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'd like to remind you that comments made today regarding management's intentions, projections, financial estimates or expectations about the future strategy or performance of the company are forward-looking in nature as defined in the Private Securities Litigation Reform Act of 1995. These comments are subject to risks and uncertainties, including the risks related to COVID-19, which could cause our actual results to differ materially from projections. Additional information about factors that might cause our actual results to differ from projections is outlined in the press release today in the company's Form 10-K for the year ended December 31, 2019, and the Form 10-Q, which will be released in conjunction with our first quarter 2020 earnings as well as other SEC filings. Portions of the financial and statistical information that 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](http://deluxe.com). This information was also furnished to the SEC on Form 8-K filed by the company this afternoon. 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 Barry, Keith and I are working remotely from different locations today as are over 3,000 of our fellow Deluxers, supporting our commitment to safety and social distancing. For the first time, we're not sitting together for this call. While we believe we have all of the logistics for this event well planned, please bear with us in case we experience any technical difficulties.

Thanks in advance. And now I'll turn the call over to Barry.

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

Thanks, Ed, and good afternoon, everyone. I'm pleased to be with you today to share our first quarter 2020 results. Despite the unprecedented COVID-19 situation, we delivered a solid first quarter, and we've made meaningful progress implementing our One Deluxe strategy. Late in the first quarter, we saw a significant decline in revenue. We took immediate action to address revenue and related expenses. And as a result, we remain confident in our strategy, which we communicated previously. This afternoon we'll provide you with details of our first quarter operating performance, including the impressive 18% growth on our Payments business, an overview of how COVID-19 has impacted our business, the actions we've taken



## MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

to mitigate related risks and how we're planning for future growth. The progress we've made on our historic transformation into a trusted business technology company with 4 segments; Payments, Cloud Solutions, Promotional Solutions and Checks; an update on our One Deluxe approach to become a sales-driven revenue growth company, no longer solely dependent upon acquisitions for growth. And I'll end today with my perspective of what we believe all of this means for Deluxe going forward.

Throughout this call, we intend to provide plenty of perspectives. But given the uncertainty in the macro economy, we needed to stop short of providing a detailed outlook, either for the second quarter or full year, just as we announced on our press release on March 25, 2020. This is the first quarter that we operated and reported results in our 4 new segments, which is an exciting milestone in our transformation journey. During our Investor Day event in February, we shared with you the details of our new strategy. I'm pleased to report our strategy is not only protecting the company in this time of uncertainty, but positioning us to deliver consistent long-term revenue growth. We told you a year ago about some of the investments we're making in our business, and some of those investments allowed us to transition to work-from-home seamlessly. More on that later.

First, let's overview our business performance. For the full quarter, our revenue declined 2.5%. However, through January and February, total company revenue was running strong toward the top end of our internal expectations, and importantly, delivering sales-driven revenue growth. I cannot overemphasize the importance of this growth. We committed and we are delivering sales-driven revenue growth for the first time in nearly a decade in January and February pre-COVID-19. We think this is clear affirmation that our strategy can deliver long-term results for our shareholders.

More importantly, the result was achieved just a few months after building out our new leadership team and launching our new sales efforts. Our Payments segment was a particular standout during the quarter delivering new wins and showing year-over-year revenue growth of 18%. At the total company level, our revenue momentum turned downward in March when we saw gradual then significant decline in orders from the impact of COVID-19. The impact continued in April. We're starting to see the beginning of stabilization in the first days of May, suggesting the third and fourth quarters might see modest volume improvements from second quarter lows, but we continue to expect our results are likely to remain well below pre-COVID-19 levels through year-end.

We've spoken with leading economists, and I've engaged with dozens of CEOs and experts seeking additional perspective. Our conclusion is that our results seem consistent with what others are seeing, and no one agrees on the shape or timing of a recovery. During the first quarter, we were not surprised that Promotional Solutions and Cloud Solutions experienced the greatest COVID-19 impacts. Both segments help businesses get started, operate and grow. And since many businesses closed, significantly downsized their operations or simply went into hibernation, these segments were materially impacted.

In addition to small businesses, we also provide discretionary products to large companies, and they canceled planned conferences, they canceled orders for those support products that we create for those conferences. In Promotional Solutions, Tom Riccio is doing excellent work adjusting the cost base in line with lower revenue levels and being opportunistic to adjust product offerings to existing customers. We saw a very sharp decrease in Promotional revenue in the middle of March by certain categories, declining as much as 45% from plan.

By geography, we saw the most prominent declines in the Northeast region of the country. We expect Promotional revenue to be materially impacted in the second quarter at a higher rate than the macro economy decline rates. And we expect to see only modest improvement as we move into the third and fourth quarters.

On a positive note, our Promo team has identified some new opportunities offering PPE solutions and brand wrappers cited for use in the real estate industry. The silver lining in all of this is that the segment level Promotional Solutions generates the lowest adjusted EBITDA margins of all 4 segments. As a result, weakness in this segment has a lower impact on our profitability and operating cash flow.

We experienced a similar COVID-19 impact in the Cloud Solutions segment, and Garry Capers too is doing great work, managing costs and positioning his business for a rebound. The businesses most impacted in the Cloud Solutions segment were data-driven marketing, incorporation services, logo design, web design and web hosting. In data-driven marketing, we've seen some financial institutions temporarily suspend marketing to consumers and small businesses. We expect cloud revenue to be significantly impacted in the second quarter, and a higher decline than the macro economy decline rate. But we believe we will see some rebound in the third and fourth quarters. We've developed a new cloud scheduling technology



## MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

for the banking industry to help banks better support their customers. And we've had particular optimism in data-driven marketing and have engaged with some financial institution clients in the design of recovering marketing programs for later in the year. Checks continued their secular decline in January and February, and a steeper decline began to accelerate in March, continuing into April. Tracey Engelhardt, our Checks leader; and Pete Godich, our Chief of Operations, have done a great job scaling down our plant operating expenses. We expect Checks volume to track with macro academic conditions, recovering to a more standard secular decline rate sometime in the fourth quarter.

Now a few comments on Payments, which continues to be our shining star. Mike Reed joined us in late November last year, and is already delivering impressive results. We're all very proud of the standout performance for Payments. In the first quarter, Payments grew 18%. This segment is benefiting from previously announced wins with Synchrony Financial and Fiserv as well as some other new business we signed. In the current environment, we continue to find new opportunities with Payments with many new and long-standing customers reporting our financial strength provides them with an additional level of comfort. Many of our competitors do not have this advantage.

We also announced the recently formed Medical Payment Exchange, we call MPX. Through a joint venture with ECHO Health, we solve a large-scale payment challenge, how to effectively and efficiently manage medical payments and disbursements. Our solution allows the explanation of benefits of the EOB to travel with the digital payment through email. The e-mail contains a secure check that could be printed and deposited like any other check, converted instantly for a digital ACH deposit or applied to many different payment types, like debit cards, PayPal and more. Correlating the EOB with the digital payment solves the intractable problem that has forced nonrecurring payments to remain on paper and reliant upon the postal service. Without an EOB connected to the digital payment, the cash application along with final settlement and reconciliation are nearly impossible. MPX has solved that problem, and we're now uniquely positioned to digitize this multibillion-dollar market. Based on what we see now, we expect to see continued strength in Payments, and we expect to outperform macroeconomic conditions in the second quarter and likely throughout the year.

Next, I want to share with you what we're doing to protect our employees and our business. In order to continue our support for our customers and operate the business, we've implemented work from home practices for all employees whose roles allow, including most of our customer contact center owner employees. We estimate more than 3,000 of our 6,500 employee owners are now working from home. To do this, we're utilizing one of the 6 new technologies we invested in last year to facilitate collaboration and communication. We told you last April, we were investing in our infrastructure. And as a result of those investments and new related technology, we were able to move to a work-from-home model in a matter of days for many of our employees, remarkably including our contact centers. Had we not made these investments on our formerly antiquated infrastructure, it would have been considerably more difficult for us to transition to a work-from-home model, and our customers would almost certainly have experienced disruption, impacting our revenue.

Here again, we're showing how our strategy and investments are yielding a return. For Deluxers working in one of our facilities deemed critical to the U.S. Payments industry, we have implemented additional protections, including employee wellness screening and increased facility cleanings. We've provided hand sanitizers and other protective gear, such as face mask and have implemented new social distancing procedures and incremental hourly pay increases as part of our Hero pay compensation. In short, I cannot be more proud of how the team has pulled together. It's nothing less than remarkable.

In March, we announced actions we had implemented to help counter the impact of COVID-19. Since then, we've taken further actions. Collectively, these actions include: reducing salaried employees base by 20%, which included mine, together with the balance of the executive leadership team and the cash compensation payable to our Board of Directors, canceling 2020 merit pay adjustments and suspended our 401(k) match contributions, delaying some capital expenditure projects, deferring most of our external consulting spend, and the furlough of Deluxers and facilities that lack product demand to remain open.

In mid-April, we expanded our furlough program to address some of our fixed operating and SG&A costs to better align our business with lower volume. Fortunately, Deluxe answered this disruption very strong, financially, with low net debt. In late March, as soon as we saw the initial declines in our business, we took action to enhance our financial flexibility. And we increased our borrowings on our revolving credit facility to \$1.14 billion. While our net debt remains unchanged, we're now holding cash of about \$300 million, and our quick expense actions have resulted in sustaining our cash balances through the month of April. Our leadership team holds daily status calls to review operations, then take measures to ensure employees are safe. And we continue to deliver the same high-quality of solutions and services to our customers. We're in frequent contact with

## MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

our Board of Directors and hold weekly status calls to keep the price of our challenges, progress and wins. We're doing so much more than what I just covered, but I think this gives you a flavor for the actions our leadership team is taking to steer us through uncharted waters while taking great care of our employee owners and our customers.

Now I'll turn it over to Keith, who will provide the details of our first quarter financial results, but I'll come back and share my thoughts on our strategy and how we're positioning ourselves for the recovery.

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

Thanks, Barry. Good afternoon, everyone. As Barry noted, in light of the current circumstances, we're very proud of how our teams have pulled together and rallied to help one another through the last few weeks. We delivered a solid performance in the first quarter, while simultaneously driving our business transformation forward.

Total revenue in the first quarter was \$486.4 million. Consistent with our Investor Day message, our business experienced sales-driven revenue growth in the first 2 months of the year for the first time in nearly a decade. However, as March unfolded, our business was significantly impacted by COVID-19, and we ended with revenue declining 2.5%.

First quarter results by segment included Payments revenue of \$77 million, growing over 18% or \$12 million above last year. Cloud Solutions revenue was nearly \$76 million and declined about \$2 million from last year. Promotional Solutions revenue was approximately \$143 million and declined about \$13 million from last year. And Checks delivered nearly \$191 million of revenue and declined about \$9 million from last year.

GAAP diluted loss per share for the first quarter was \$1.45, including asset impairment charges of \$90.3 million and restructuring, integration and other costs of \$19.7 million associated with the company's transformation.

I'll discuss the impairment impacting Q1 earnings in a moment. Excluding after tax non-GAAP adjustments of \$2.53 per share, adjusted diluted EPS and was \$1.08 and compared to \$1.54 in 2019. Reported EBITDA for the first quarter was a loss of \$27.9 million. Excluding about \$111 million of expense related to impairments, restructuring, integration and other non-GAAP adjustments, adjusted EBITDA was about \$83.3 million compared to \$113.7 million last year.

Adjusted EBITDA margin ended at 17.1% in the quarter, down from 22.8% last year. COVID-19 negatively impacted the quarter by approximately \$16 million of revenue and reduced adjusted EBITDA margin by approximately 120 basis points.

Before the effect of COVID-19, we estimate our adjusted EBITDA margin would have been 18.3%, right in line with what we had discussed at Analyst Day. Our adjusted EBITDA margin also declined from last year due to the items we discussed at Analyst Day, including revenue mix changes, onboarding new wins and transformation investments.

In addition, we recorded bad debt expense of \$5.4 million in the quarter. Other items of note during the quarter included conducting goodwill and intangible asset impairment assessments resulting in noncash asset impairment charges totaling \$90.3 million in the quarter, primarily for the impact of COVID-19. The COVID-19-related noncash asset impairment charges totaled \$85.4 million in the quarter. This included \$63.3 million partial impairment of goodwill in the Promotional Solutions segment.

In addition, goodwill for the Cloud Solutions segment was fully impaired by \$4.3 million, along with certain intangible assets totaling \$19.7 million. Unrelated to COVID-19, we also recorded noncash asset impairment charges of \$5 million associated with an asset held for sale in the Cloud Solutions segment as well as a write-down of a customer list in the Promotional Solutions segment.

Moving to the balance sheet and cash flow statement. At the end of the quarter, we had drawn \$1.14 billion on the credit facility, which was an increase of about \$256 million from the beginning of the year. When we saw revenue begin to decline in March, we were very proactive in making the additional draw on our credit facility to further strengthen our liquidity. We expect to maintain the current level of debt on our balance sheet for the near-term until we have greater clarity on the rebound of the U.S. economy. It's important to note that our net debt has remained unchanged.



## MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

As a result of this action, we currently have about \$300 million of cash and short-term investments. This further highlights our basic financial strength.

The revolving credit facility matures in 2023 and has a total size of \$1.425 billion. The facility includes an accordion feature, allowing us, subject to lender consent, which we would expect to receive, to expand by up to \$285 million beyond the \$1.14 billion level we currently have drawn.

Alternatively, we believe we currently have the opportunity to access the capital markets for additional sources of liquidity, if necessary, enabling us to enhance our capital structure or attack compelling market opportunities. Based on what we have seen on the second quarter-to-date, we do not anticipate extended periods of negative cash flow.

At the end of the first quarter, our debt coverage ratio was 1.94x, which needs to be maintained below 3.5x and based on our credit facility covenants. Our interest coverage ratio needs to be above 3x and was at 9.79x at the end of the first quarter.

With regards to the recent government stimulus package, we are deferring tax payments based on recent legislation, allowing us to improve near-term cash flow. We have not accessed any government loan programs, and don't anticipate accessing the loan programs. However, we continue to monitor legislation to see if there are other offerings that may help us through this downturn.

For the first quarter, cash provided by operating activities was about \$18.6 million, and capital expenditures were \$6.4 million. Free cash flow, defined as cash provided by operating activities, less capital expenditures, was \$12.2 million in the quarter. The primary driver of the decline in free cash flow where revenue mix changes, which were materially compounded by COVID-19 impacts and previously disclosed investments in our business transformation.

During the first quarter, we repurchased \$14 million of common stock. And as we noted on our last earnings call, we plan to purchase less stock in 2020 than in previous years. We plan to pause additional stock repurchases in the second quarter. Our financial priority is to maintain strong liquidity and flexibility through the COVID-19 crisis, and we have made the decision to pause some of our capital projects in the near term. For example, we've slowed our S/4HANA in salesforce implementations. We've also taken additional cash preservation actions to minimize working capital requirements, including extending terms on payables, seeking discounts on certain contracts and delaying other nonessential purchases and spending.

As previously announced, we suspended our 2020 outlook. And consistent with that, we're not providing second quarter or full year guidance. Barry has already provided you general perspective on how we expect our 4 businesses to perform relative to the overall macro economy. We expect to resume sharing our specific outlook when we return to a more macroeconomic stability.

For all things considered, we delivered a solid first quarter. Our strategy is working. We delivered sales-driven revenue growth in January and February for the first time in nearly a decade. And we're taking the right actions to protect our company today and position us for the economic recovery to come.

And of critical importance, we believe we have adequate liquidity to get us through the COVID-19 crisis, despite what we know will be a very challenging year. Deluxe has a strong balance sheet, great leadership team and a deeply engaged and committed workforce of employee owners, enabling us to weather the storm.

Now I'll turn the call back to Barry.

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

Thanks, Keith. So you've heard how our business was significantly impacted by COVID-19 in March. We immediately further strengthened our liquidity and began an intense focus on expenses to get them aligned to lower volumes. But I don't watch you to lose sight of some of the great accomplishments we had in the first quarter. We held our first ever company-wide sales kickoff meeting led by our strong new Chief Revenue Officer, Chris Thomas. He is bringing together our sales organization to strengthen our understanding of One Deluxe and further prepare our team



## MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

for our new go-to-market strategy. We held the largest customer event in the history of Deluxe, bringing together hundreds of our key customers across our entire portfolio of businesses, not just 1 or 2 areas like we did in the past. We used the opportunity to introduce these customers to all the new Deluxe has to offer.

We held our first Investor Day in over a decade, where we shared our strategy with investors and provided them with an opportunity to learn about our exciting new segments and to interact with each of the segment presidents. We had over 100 attendees at the event and the webcast have been viewed by hundreds more in the weeks since the event.

Now I want to move on to the longer-term and how our strategy positions us well for the eventual economic recovery. Recall, we shifted to a sales-driven growth model, which differs significantly from the past, when virtually all growth came from acquisitions financed by increasing debt and leverage. In January and February, our new strategy delivered sales-driven revenue growth for the first time in nearly a decade. We won 3 of the top 10 deals of the last decade in Q4 and won the fourth deal in Q1. Our sales momentum continues even with COVID-19.

Chris Thomas, our Chief Revenue Officer, has also trained our sales team and all the Deluxe has to offer, and we're seeing the wins continue as a result. As I mentioned earlier, Payments is a shining star and grew 18% in the first quarter. In Payments, we announced the joint venture with ECHO Health, called MPX or the Medical Payments Exchange. We've also formed the Deluxe Payment Exchange, which utilizes the same core technology created for MPX to address nonrecurring payments where paper is currently the only solution. And we expect to win new clients and treasury management, who recognize the value of our financial strength compared to some of our competitors. And we recently announced our relationship with Fiserv, which includes offering the Clover point-of-sale platform, physical and online payment processing capabilities, gift card services and more to -- for our small business customers.

In Cloud Solutions, we're having meaningful conversations with banks to develop marketing programs planned for later in the year. We've won new business in data driven marketing, and extended services, such as new mover and business lending marketing triggers to others. We won 5 new deals with banks to use our Banker's Dashboard Profitability Solution and MyCorporation launched a new e-notary solution.

In Promotional Solutions, we've identified new business opportunities, selling PPE to both new and existing customers and expect this business to bring in tens of millions of dollars of new revenue this year. And our brand management business continues to add new customers and expand service for existing customers. Our sales-driven strategy is clearly working. It's not just a theory. We're winning, and we have the new deals to prove it.

I think it's important to briefly touch on our capital allocation and cash conservation strategy. We took immediate action in March to further strengthen and expand our liquidity, and we continue to adjust our expense structure in line with revenue. We believe we are positioning the company to take advantage of the inevitable opportunities in the market that will be created as the economy begins to recover later in the year.

And as Keith mentioned earlier, we're closely monitoring the markets and may consider opportunities to enhance our capital structure, providing us more tools to seize opportunities presented by this dislocation.

We announced our first quarter dividend on April 30, delivering the clearest message possible about our financial stability. We told you earlier, we were suspending share repurchases in the second quarter.

In summary, we believe we delivered a solid first quarter, and our strategy is working. The COVID-19 crisis is putting extra light on the strength of our strategy and proving we're on the right track in both good times and bad.

Despite the painful impacts of COVID-19 and the challenging months ahead, we have the same aspirations for Deluxe today that we had just 60 days ago. We're transforming the company from a legacy check printer into a trusted business technology company, and our progress is impressive. While the path to a full economic recovery will obviously take time, we believe Deluxe will exit this crisis a better, stronger and more resilient company with dynamic and growing Payments and Cloud business and a vibrant Promo and Checks business. Our brand, our people, the reliability of our service and the strength of our balance sheet will drive our acceleration into the future.





MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

I can't conclude today without acknowledging, again, the incredible leadership, commitment and can-do spirit of our fellow employee owners. Our team is living our purpose of championing businesses so communities thrive, guided by our values of putting customers first, earning trust, creating what's next, delivering for shareholders and getting it done. My fellow Deluxers are accelerating our transformation while simultaneously delivering for customers through this crisis. Because of our team, I'm more confident than ever, the future of Deluxe is exciting and very bright indeed.

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

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Charles Strauzer of CJS.

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

Sorry, the question is a little bit spotty here, but working-from-home gets spotty at best, sometimes. Just -- I appreciate all the color you gave in terms of the kind of the -- of bridged outlook, if you will. But I wanted to just kind of get a sense from you when you talk to, particularly, your small business customers and some of the banking customers, what's the kind of the general sentiment about time line of the eventual recovery and some of the kind of the programs on the banking side and the fintech side that you think might come back first?

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

Charlie, I don't know that I can -- I have a crystal ball, I wish I did, but we believe that based on all the data we have and what we see in these very early days in February. So we think the likely shape of the recovery is most likely to -- I've heard it described as something like a Nike Swoosh, down and then back gradually over some period of time. Just how long that time is, I know is what you're asking, and I don't have a crystal ball to be able to tell you that. But we believe as the economy reopens, obviously, small businesses reopened, et cetera. We don't know how many businesses are closed. We suspect in (inaudible) permanently. We think and expect that a large number of businesses are simply in hibernation, and we're hopeful that they will restart their business. And then as we get through this, we're also hopeful and optimistic that there'll be new business starts, and we're particularly well positioned to help new businesses incorporate and get alive as they go forward. So I don't have a clear answer for you because I don't have a crystal ball, but we think that it will be something that comes back steadily over a period of time.

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

That's definitely fair, and I appreciate that, Barry. And when you look at some of the -- over the years, your ability to take cost out of the business, and it seems like it's continuing today, are the additional levers you think you can pull on the cost side to kind of help kind of ride through this storm more so than you've already kind of laid out?

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

Absolutely. So one of the hallmarks of our company is the ability to manage production facilities with great efficiency. That's one of the things the company has been great at for a long time. So we certainly exercised that at the end of Q3 and going in -- sorry, at the end of Q1 going into Q2, and of course, we'll do that through Q3 and Q4. I think one of the more interesting things here is I think just talks about the responsibility of our company and our management team. As soon as we saw that the market was likely to have this type of a challenge, we acted immediately. And we know that we moved earlier, we were one of the first businesses to move as aggressively as we did to control our costs. And we expect to do that going forward. Now specifically, are there other places we can go? I've told you, as long as I've been with the company, which is since the --





## MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

about 16 or 17 months, we are continuing to look at the structural efficiencies that we can get out of our organization. We think there's opportunity for savings in real estate. You know we've made big investments in our technology, and we think that can give us a boost. And then, of course, all the things we're doing on the process side of our business, the company, for a long time, was operated as a company of companies with a series of silos. And this is the first quarter when we're operating in our new segment with a unified go-to-market strategy, which is about One Deluxe. So we think that there continue to be structural savings that can be had as well as all the great things that are already in place and the levers we can pull that our volume depend on.

**Operator**

Our next question comes from Chris McGinnis with Sidoti.

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

And a nice quarter, and I hope you guys are all safe and your families are as well. To kind of continue -- just to continue on that vein, I think the expectation was margin pressure in the beginning of the year because of the investments to support the growth, and a nice job on that. I'm just wondering, I think the expectation was that those will come down a little bit as we went through the remainder of the year. Is that still expected given the difficulties on the challenges from COVID-19?

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

Let me answer the first part of this, and then I'll let Keith jump in and give you more color. We are still very optimistic about the long-term opportunities at our company to deliver margin expansion. We've said this for a long time that we are pointing the company to be a mid- single-digit grower with margins in the low to mid-20s. We still believe that is our target and an achievable target for our company. Obviously, COVID is going to have some impacts on us in the near-term. So we don't think that, that is going to prevent us from getting to our intermediate term targets there being in the 20s. Now is that going to impact Q2? I think, absolutely, it will, but it does not impact our ability (inaudible) to drill profits over the longer term. I will let Keith add something on that for more perspective.

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

Thanks, Barry. So when you're looking at the information that we provided you, we've given you some insight as to what we're seeing. We don't have a perfect visibility on how that's going to translate into the rest of the year. But as you're looking, Chris, at the back end of March, when we indicated that there was about \$16 million impact on the revenue, that was about -- that translates to about 120 basis points impact to EBITDA margin on the quarter. So if you extrapolate that out, that's a pretty good indication about what the impact is on our profit in the near-term. That, obviously is -- obviously, that's coming out at a bit less than what our gross profit is, and that takes into account all that Barry had just described of very aggressive actions that we've taken to take costs out of our SG&A functions as well. So we're properly scaling the business above the line in our cost of goods as well as in our SG&A.

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

Great. No, I appreciate that. And thanks for that info. Maybe just touching on any top line and some of the categories. Barry, one of the things you mentioned is as we get into the year on the Payments side, I think the later in the year, you maybe said -- you talked about growth may be slowing a little bit. I don't know if that was the correct term, but what would temper the expectations since they're so strong right now in the economy to slow those trends?



MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

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

Well, to be clear, we expect -- and what I had said was that we expect the Payments business to materially outpace what's happening in the broader economy. And the reason for that is several folds. First of all, we have new products that I described, that are helping bring us into new markets and digitizing existing pathways. And we can do it a far more efficient way. And that's what the MPX program is all about, digitizing health care payments. So we also are winning, just saying, a very large number of customers in our Lockbox Integrated Treasury Management Solution. And the reason for that is, a, we're really good at it. And b, our financial stability is very attractive to large billers and financial institutions that are looking for a partner for the long term. And so it's a great example of the fact that our company is so strong that our balance sheet and the strength of our products and solution help us win new business. So we continue to see opportunities for new products. We see opportunities for growth in our existing products. We've sold a number of deals that we expect to continue to come on over the course of the year. But it's difficult to say exactly what that number is going to be, except that we're very -- remain very optimistic about that growth for the rest of the year.

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

Okay. Fair enough. And then just on the Cloud side, the number looks pretty strong, up until (inaudible) up until March. Was that growing or was that seeing organic growth as well up until COVID?

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

The Cloud business has many different elements, and they all were performing differently. They were performing well within our expectation that we've talked about at Investor Day. And we are pleased with where the Cloud businesses were collectively going into COVID. Obviously, those businesses were impacted as a result. So we're particularly optimistic about the recovery in the data businesses. We're already (inaudible) financial institutions about their recovery marketing programs, and we see financial institutions planning to be aggressive in going to market as the crisis saved in a sense that, that will be very good for our data business as we come out of this. And then we think other businesses there will recover more naturally with the recovery in the economy process.

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

Sure. Okay. And then I guess just COVID has been here for a little bit. I know it's still early in terms of hitting the economy, but how have you changed maybe some go-to-market strategy to kind of -- you talked about you got a strong balance sheet, maybe stronger than some other competitors. How are you contacting kind of new customers at this point to maybe take some more shares that given kind of disruption in the marketplace?

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

So we have good news on 2 sides there. One is really for the first time, our company has a fully integrated go-to-market strategy, where we can talk to a customer about the range of solutions that Deluxe can deliver to our customers. So instead of having a few sales people that are very deep on one particular product, we have hundreds of sales people that can go to the -- can go to customers and talk about their range. Not the need to go longer on something more specifically, we have specialists that can do that. But Chris Thomas, as our new CRO, we think it's the first time this company has had a CRO in at least 10 years, that's as far back as we can see, is pulling together the entirety of the sales organization, so that they can have that view. One of the comments I made earlier was that we had our first ever sales kickoff meeting back in January. So we have all of the sales leadership and all of the salespeople together in one place hearing the entirety of our story. And people left that session really inspired to go power whole stores. People were learning about Deluxe Solutions that we've had for years, but they never knew even existed. So we're taking our story to the marketplace in a holistic way. So we're just having much broader conversations with existing customers than we ever had before. Now the other side of this is we're also in a good position that we're getting inbound calls from some of our competitors' customers that are concerned about their financial stabilities. And if you look at our balance sheet, you can see in our income statements, and you understand the history of our company is being financially sound for its lifetime. And it's pretty clear why a customer would want to come to the safety of Deluxe, not only because our balance sheet is strong and our cash flow is good, but we just have -- we have a superior product in the marketplace. So we think we're the beneficiary on multiple levels here. First of all, pillar go-to-market strategy, great leadership from an experienced senior sales leader as Chris



MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

Thomas, an integrated whole story, the One Deluxe story about all of our business is not in individual silos. And then the strength of our company attracting customers that are worried about some of their current providers. It's actually an incredibly good story, and I bet you heard it. I hope you heard this in my comments, the fact that we have closed 4 of the top 10 deals of the last decade in the last 2 quarters. 4 of the top 10 deals of the last decade, we closed in 2 quarters, and we had weren't even really operating on the new segments until this quarter, which just gives us an enormous amount of confidence about our strategy being right, that we're on the right path, and, yes, COVID is here. And yes, we're dealing with COVID. We got out first, we moved quickly, we're going to handle COVID, and we're positioning the company to come out of the other side incredibly strong. And we just have the wins to prove it. There are the excitement and enthusiasm in I think in our team to go win more business is incredible. We get e-mails now, daily about wins. I think I got 3 today before this call. So it's an exciting time for Deluxe to be out selling our products and services. We're just uniquely well positioned. Our segments help a lot, our CRO helps the time having clear leadership reach one of our segments, really, I think, helps a fantastic story for us.

Great. Thank you. Keith, I think you wanted to provide a little more clarity on a couple of the points that are on the slide deck and in your comments.

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

Great, Barry. Thanks. That would be helpful. And if you could, on Slide 17, I just want to be clear that the total COVID-related noncash asset impairment charges totaled \$85.3 million in the quarter, and that did include \$63.3 million as a partial impairment of goodwill in the Promotional Solutions segment. And for the Cloud Solutions, we're really talking about web hosting. That reporting unit was fully impaired by \$4.3 million with certain intangible assets, totaling \$17.7 million. And then, Ed, if you could, on Slide 18, the point we're trying to make here is that while we drew down our credit facility, and net debt did increase about \$20 million in the quarter. But we are currently holding a strong cash position in the \$300 million area. And so net debt remains largely unchanged from the end of March. And that really was the highlight of our focus here. Thanks, Ed.

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

You know what? So why don't I take this back, and that's probably a great place for me to start the conclusion. I say thank you for joining us. But I want to leave you with 5 key takeaways. And Keith was making one of them there. First, we're financially strong. We've taken the necessary steps to secure our future. Second, we delivered a solid first quarter despite COVID impacts. Third, our strategy is working. During both January, February, pre-COVID, we delivered sales-driven growth for the first time in a decade. And I say it again, we delivered sales-driven growth for the first time in a decade. Our Payments business grew an impressive 18%. We think this is clear evidence our strategy is working. Fourth, while we're experiencing material revenue declines in the first part of Q2, we're confident that the business will recover and grow over time. And importantly, we have the financial wherewithal to sustain our business and get to the other side of this temporary downturn. Finally, over our proud 105 year history, our company has led through multiple crises, (inaudible) of the Great Depression, 2 World Wars and more. Through every one of these crises, our company has grown stronger and better. And this time is no different. Yes, we have a strong balance sheet and ample cash reserves. So what makes Deluxe so special as the character of my fellow Deluxers, finding a way to meet the customers' needs in good times and bad, that's our Deluxe character and winning attitude shining through that's lighting our pathway to even greater future success.

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

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

Thanks, Barry. Before we conclude the call today, I'd just like to remind the following conferences in the second quarter where management will be participating. On May 20, we'll be participating in the virtual Needham Technology and Media Conference. And on June 3 and 4th will be at the Baird 2020 Global Consumer, Technology & Services conferences. These conferences will be virtual from what I'm told.

If there are any other questions or if an investor has some questions they want to talk to me, Barry, Keith, please call, please email. I know without travel schedules right now, it's tough to get a hold of this maybe, but we will absolutely make as much time as possible to speak with you on any topics you want to talk about.



MAY 07, 2020 / 8:45PM, DLX - Q1 2020 Deluxe Corp Earnings Call

That's it. Thanks for joining us. And that concludes the Deluxe First Quarter 2020 Earnings Call. Thank you all. Bye.

#### Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you for participating. You may all disconnect.

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