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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Second Quarter 2020 Deluxe Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Mr. Ed Merritt. Sir, you may begin.

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

Thank you, and welcome to Deluxe's -- the Deluxe Second 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; Keith Bush, our Chief Financial Officer; and Jane Elliott, our Chief Communications and HR Officer. At the end of today's prepared remarks, Barry, Keith, Jane and I will take questions.

I would like to remind you that comments made today regarding management's intentions, projections, financial estimates or expectations about the company's future strategy or performance 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 risks related to COVID-19, which could cause our actual results to differ materially from our projections. Additional information about factors that might cause our actual result to differ from projections is contained in the press release issued today, in the company's Form 10-K for the year ended December 31, 2019, the Form 10-Q, which will be released in conjunction with our second quarter earnings release shortly, as well as other SEC filings.

Portions of the statistical and financial information that will be reported today will be addressed in more detail in today's press release, which is posted on our Investor Relations website at deluxe.com. This information will be furnished to the SEC on the Form 8-K filed by the company this afternoon. I'm told that EDGAR is currently down for filing SEC documents, but we'll furnish these as soon as their system's back up. 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.

Like last quarter, we continued to work remotely from different locations today and remain committed to safety and health-related protocols in order to keep our employer owners safe. Please bear with us should we experience any technical difficulties during this call, given our virtual status.

Now I'll turn the call over to Barry.

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

Thanks, Ed, and good afternoon, everyone.



Before we begin, I'd like to share with you, this will be Ed's last earnings call as he'll be retiring at the end of the year and will serve as a special adviser to Keith during that time. Ed has made many contributions to Deluxe over the past 7 years, and we thank him for his leadership and dedication, and wish him all the best in his retirement.

Also on the call with us today is Jane Elliott, Chief Communications and Human Resources Officer. Jane will lead investor relations, which will be integrated with all of our communications capabilities. Many of you have known Jane for many years, given her 2 decades of successful experience running IR at Global Payments, then earlier at First Data. We're in the process of conducting national searches for a permanent head of investor relations and a new treasurer, both roles currently filled by Ed. Keith, Jane, our new IR Leader and our new Treasurer, will work together with me to deliver meaningful insight into our performance.

We're proud of our strong performance in the second quarter in context of the pandemic. We delivered stronger-than-expected results with free cash flow exceeding last year. We delivered stronger-than-expected results with cash reserves. We restored margins into our target range just as we promised we would do. We estimate we delivered sales-driven growth, excluding COVID impacts, for the second consecutive quarter. We won new business at an accelerated rate and closed 4 of our top 25 targets, and we materially adjusted our company's infrastructure to position us to drive sustainable growth over the long term. We're so confident in our financial strength we've declared our regular dividend and paid down \$100 million on our revolver earlier this month. Our net debt is now at a 2-year low. All of this is compelling evidence our One Deluxe strategy is working.

Now here are some specifics on the summary. We reported revenue of \$410 million. April was the lowest performance at minus 28%. Performance improved materially over the remainder of the quarter, finishing down 16.9% and or \$84 million for the quarter. We believe we delivered sales-driven growth again in Q2, excluding COVID impacts. This follows our similar performance in Q1. You will recall prior to Q1 the company had not experienced sales-driven revenue growth in nearly a decade.

We also restored adjusted EBITDA margins to 20%, just as we promised to do pre COVID. We grew cash on hand by \$62 million, reducing our net debt to a level not seen in 2 years. Our Payments business grew at 12.6% and, in the first half, achieved our original annual plan despite COVID. Our 12-month sales pipeline expanded double digits to over \$50 million. We saw all-time record success in our telesales efforts. We accelerated our transformation momentum materially, including closing 20 of 65 locations or 30% of our real estate footprint.

Finally, we did all of this while supporting small business recovery and our communities, particularly our hometown, Minneapolis St. Paul, in the shadow of the tragic death of George Floyd. We stand strong on racial and social justice, and we're committed to being part of the solution.

Like many others, given the ongoing economic uncertainty, we will not provide a detailed outlook for the third quarter or the full year today.

Now on to deeper details on our encouraging results. Our business began to decline in mid-March and then began to stabilize in early May. That stability and improvement continued into June, although performance remains below pre-COVID levels. We expect total revenue in the second half to slightly improve sequentially from the second quarter unless there are worsening economic impacts.

Before I talk about the segment, I want to share details on our great progress in becoming a sales-driven revenue growth company. I'm very pleased to report that our One Deluxe approach is producing strong results despite the current economy. Our Chief Revenue Officer, Chris Thomas, has done a fantastic job with the rest of his team, turning this into a reality. We closed 690 deals with multiyear contracts already outperforming our pre-COVID sales plan. This includes 4 of our top 25 targets with several more verbal commitments from our top 25 target list. Some of these wins include Cambridge Financial for Promotional Solutions, expansion of our AT&T relationship and signing Optum Bank, importantly signaling our ability to win a new vertical for checks in the insurance industry.

We continue to expand our pipeline and have achieved record average order value in our telesales centers. Of course, it will take some time to onboard all of these wins. However, we are very proud that we're expanding our pipeline and closing new business at record rates despite COVID, giving us much optimism for our future.

We drove further sales innovation in early July, launching our small business advisory team, a new customer needs-based selling approach focused on helping small business stay at the forefront of their industry. Initially, we focused on selling to health care providers, helping accelerate their

digital capabilities and streamline operations. In a little over 2 weeks, the small new team has interacted with 572 small businesses in the health care industry, scheduled 182 follow-up discovery meetings and has already closed sales in each of our 4 segments.

While still early in this effort, we're seeing the power of our One Deluxe sales strategy. In April, we implemented several improvements to our Shop Deluxe e-commerce site focused on simplifying the customer experience and pricing options. These improvements generated increased revenue for checks and promotional solutions. This is another example of sales innovation. All of this demonstrates the speed and agility of the new Deluxe team and success of our One Deluxe strategy, neither of which are yet a year old.

Now on to our segment. Promotional Solutions and Cloud Solutions continue to experience the greatest COVID related-impacts. Both segments help small businesses directly and indirectly through enterprise customers get started, operate and grow. As a result of the overall economy, not surprisingly, our Cloud Solutions segment was most impacted. Promotional Solutions was materially impacted, but performed better than we had expected. We continue to expect cloud and promotional revenue profit or margin will be -- will significantly lag the recovery.

Now more on Cloud Solutions specifically. Garry Capers, our new division President, has done a great job aggressively managing costs while positioning for a rebound despite previous underinvestment in these businesses and the accompanying impairments. The part of the cloud business least impacted by the pandemic was our website design and hosting business. We quickly operationalized e-commerce sites for customers to shift their business online, as many brick-and-mortar businesses were significantly impacted by COVID. We also launched a digital signature capability our customers needed to execute online agreements.

A great example of rapidly adjusting to the changing COVID environment, Garry and team entered into a new relationship with H&R Block to provide our small business customers with advisory, tax preparation and online application for governmental funds. This is another example of how the new Deluxe thinks and acts like a tech company forging partnerships for success, something the old Deluxe wouldn't have considered.

Incorporation of logo services saw a decline in orders, however, not as much as originally expected since it appears many unemployed workers have started new businesses or turned hobbyist businesses into full-time jobs. This is consistent with the performance in our web hosting business. In data-driven marketing, we have continued to experience significant pandemic-related challenges as financial institutions pushed customer and small business marketing later into the year and into next. We have optimism for the ultimate rebound here and expect to see some additional revenue toward the end of the year as our customers see a plan to launch 2021 successfully.

Now on to our Promotional business. We have good news here. Tom Riccio, our division President of Promotional Solutions, radically cut costs and found a way to partially offset the volume decline with record speed. Tom and team introduced a new product line in a new market literally overnight. Tom saw an obvious opportunity with personal protective equipment, or PPE, but in mid-April, he had no market intelligence, customers or product supply. Tom quickly identified key customer targets, secured and leveraged our supply chain partners and equips-ed the sales organization to sell into our existing distribution channels. The result, we sold and shipped \$26 million of new revenue during Q2 and in a market we previously did not even know.

This demonstrates the new innovative thinking and speed of action in the new Deluxe. That also highlights the incredible power of our distribution reach, our new sales model and our newly integrated supply chain. None of these capabilities existed just 6 months ago.

One of my favorite client success stories is what we did to help RE/MAX, an existing promotional products customer. RE/MAX was looking for a solution to help sellers and buyers feel safe at property showings. We created RE/MAX-branded PPE kits for agents and clients to enable showings and sales. RE/MAX sent the kit information out to 65,000 retailers and quickly had orders for more than 90,000 kits.

Now on to Checks. As anticipated, the secular decline in the check business accelerated during the quarter as a result of the recessionary impact of COVID. Tracey Engelhardt, our Checks Division President; and Pete Godich, our Chief of Officer of Operations, have done an excellent job scaling our plant operating expenses to match current volumes. On a positive note, based on internal customer survey, over 50% of new check customers order checks as a result of opening an account tied to a new business start-up. While this is anecdotal, it does give us confidence that we're seeing some early economic rebound in new business formation.



Further good news. We have seen an acceleration of self-service digital order volume in the second quarter, driving improved profitability. Importantly, we are competitively winning new check customers. Our financial strength is a key factor in our accelerating sales success. We continue to expect check volume to partially track with the recovery in the second half of 2020 and ultimately return to traditional secular trends in 2021, consistent with how the business has recovered from previous recessions.

I want to pause and affirm the strategic importance of Checks to our business. In addition to outstanding margins and cash flow, our check client relationships are strategic, providing us with a robust and low-cost, cross-sell opportunity.

Now on to Payments. Our Payments business continues to shine brightly even amidst COVID. Mike Reed, our new Payments Division President, continues to drive double digit revenue growth, and, in the second quarter delivered 12.6% growth. This segment continues to benefit from previously announced wins with Synchrony Financial and Fiserv as well as from other new business we've signed. The Payments business is on original plan for the first half of the year. Delivering this well amidst the pandemic gives us much confidence in our long-term opportunities.

Importantly, our overall financial health is helping us win new Payments opportunities, too. We see new and long-standing customers shifting volume to the safety of the Deluxe balance sheet and our rock-solid service levels. We've quietly become a significant player in the receivables as a service ecosystem. Our receivables as a service platform is based on our robust industry-leading software, which plays a central role in the order to cash application cycle, including remote deposit capture, traditional lock box processing and electronic bill pay and presentment. Clients use our platform on-premise, hosted on our servers, or we can manage on their behalf on a fully outsourced basis.

Our platform already has massive scale. As I told you at Investor Day, our platform process is approximately \$2.8 trillion a year in annual payment volume, equivalent to 13% of the U.S. GDP. And the U.S. Federal Reserve relies upon our platform for payments reconciliation, too, and we still have plenty of room for growth.

None of this is wishful thinking. Over half of our receivables as a service revenue comes from the platform itself on a recurring revenue basis. By investing in our platform for growth, Deluxe has introduced automation, in which our customers utilize to reconcile their payments. For example, using AI technologies and product extensions like electronic invoice presentment and matching, we can digitize the process and reduce manual intervention by over 85%.

Our continued, deliberate market share gains and the traditional lockbox space is actually quite strategic. Each of these newly acquired customers will operate on our platform and has immediate access to all our current and future innovations. With every customer joining our platform, we extend our reach more deeply into major billers, financial institutions and fintechs. This gives us a clear leadership pathway in the emerging high-growth automation of order-to-cash application process. Consistent with this strategy, during the second quarter, we added several new financial institutions and new verticals, including nonprofit, insurance and education and multiyear deals for one or more of our receivables as a service platform products.

We also advanced our capabilities with our diverse products and platform, which include the Deluxe payroll services and the new Deluxe payment exchange that we call DPX.

Bottom line. Revenue platform is robust. We're trusted. We have significant scale, and we have significant growth potential. Not surprisingly, we expect Payments revenue to we continue to outperform macroeconomic conditions in the third quarter and likely throughout the year.

Next, let me brief you on the health and safety of our team as I reported during our first quarter call, we continue to protect our employee owners and our business by continuing to promote health and safety-related protocols for our employee owners that are required to be physically present to deliver services to our customers. For over 3,000 of our employees owners, we continue to work from home, and we'll continue to do so through at least early September.

Before I pass this on to Keith for more detail, I want to reiterate our team made tremendous progress in the second quarter. Deluxe is financially solid. Our sales engine is working, and we have a bright future ahead.



Now I'll turn it over to Keith.

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

Thanks, Barry. Good afternoon, everyone. And congratulations, and thank you to Ed for your past leadership. Also congratulations to Jane. I look forward to deepening our strong working relationship.

As Barry noted, our One Deluxe strategy is working, and we continue to be proud of how our teams have rallied to become more innovative and agile than ever before. Given the challenging economic environment, we delivered stronger-than-expected results for the second quarter. We've also solidified our financial position while advancing our business transformation.

For the second quarter, total revenue declined 16.9% or \$84 million to \$410.4 million as compared to the same period last year. While we benefited from sales-driven growth, it wasn't sufficient to overcome the impacts of COVID. The pandemic impact was most acutely felt in Cloud Solutions, Promotional Solutions and Checks. Importantly, we took assertive actions in the quarter to address the loss of revenue and change in mix. These actions improved adjusted EBITDA margins by 330 basis points sequentially over the first quarter results to 20.4%. I will cover this in more detail shortly.

The second quarter revenue decline was partially offset by new wins. The reduction in revenue and change in mix did affect our results. Gross profit margin for the quarter improved 150 basis points from the prior year with a loss of lower-margin promotional revenue. SG&A expense as a percentage of revenue increased 340 basis points. While SG&A reductions of \$23.9 million were achieved during the quarter, these reductions did not match the pace of COVID-related revenue declines. In addition, we made the prudent decision to continue spending to onboard new client wins. Together, these changes reduced operating income by \$27.5 million to \$24.3 million for the quarter.

Also included in our results are a number of actions we took to provide cash preservation and cost reductions. Some actions were temporary. Others take and will continue to provide benefits over future periods. A summary of these actions includes: we pulled back on spend in many areas with targeted furloughs and a 20% salary reduction taken for nearly all deluxe salaried employee owners, including the entire leadership team and Board of Directors. We estimate these actions improved second quarter operating expense by about \$15 million.

We announced the closure of 20 of our 65 locations or 30% of our real estate footprint. The benefit of these closures will be ramped in future quarters. Additionally, we recorded a noncash asset impairment charge of \$4.9 million associated with our real estate restructuring.

In late June, we made the difficult decision to exit approximately 250 Deluxers as we implement our post-COVID operating model, resulting in severance charges of \$5 million with future period benefits. Our One Deluxe integration work continued in the quarter with our systems implementation and integration of businesses with an associated \$15.4 million of expense.

Regarding other nonoperating items, our interest expense declined \$3.1 million due to lower interest rates on higher borrowing levels compared to last year. We reported net income of \$14.9 million in the quarter, a decrease of \$17.7 million from the same period the prior year. Our adjusted EBITDA for the period was \$83.8 million, \$33.7 million lower than the same period last year. The adjusted EBITDA margin declined 340 basis points to 20.4%. This did represent a sequential improvement from the first quarter of 330 basis points.

Before I review the segment results, I want to point out that we are in the process of filing an 8-K this afternoon with our historical quarterly segment views for 2019 and 2018. And as Ed mentioned at the opening, we are currently experiencing problems with EDGAR services, and it's causing a delay in getting this posted, but we'll get it out there as soon as we can.

Now on to the second quarter results by segment compared to the same period the prior year. Payments revenue grew 12.6% to \$72 million and grew faster than the overall market. The strongest performance was a 20.5% increase in treasury management platform revenue. Additionally, as you would expect, we experienced softness in our payroll business as a result of increased unemployment. Adjusted EBITDA margin decreased to 21.6%, primarily due to costs related to onboarding client wins, which we expect to continue in the back half.

Cloud Solutions revenue declined 31.7% to \$54 million from last year. Revenue for data-driven marketing solutions declined 50%, as financial institutions suspended data-driven marketing campaigns in the quarter. Web and hosted solutions experienced less declines of about 14% related to the loss of customers previously discussed and the impact of COVID. And adjusted EBITDA margin increased to 26.2% as cost reductions outpaced revenue declines, along with revenue mix improvements.

Promotional Solutions revenue declined 24.2% to \$118 million. This segment has the lowest margins, and the reduction in revenue had the least impact on our profitability and operating cash flow. While significant expense reductions were achieved during the quarter, adjusted EBITDA margins declined 260 basis points.

Check revenue declined 14.9% to \$166 million. We expect slight improvement for the rest of the year. Adjusted EBITDA margin decreased to 49.8%. Year-to-date, cash provided by operating activities was \$109.7 million and capital expense expenditures were \$27.1 million.

Free cash flow, defined as cash provided by operating activities less capital expenditures, was \$82.6 million in the quarter, an improvement of \$9.8 million. The primary drivers of stronger free cash flow were lower cash taxes, improved working capital and a reduction in capital investments.

During the second quarter, we did not repurchase any shares of common stock. And as we noted on in our last earnings call, we plan to purchase less stock in 2020 than in previous years.

Cash balance in the quarter grew by \$62 million to \$372 million, driven by cash flow from operations with no new borrowings. Our outstanding credit facility balance remained at \$1.14 billion at the end of the quarter. Net debt decreased to \$768 million, the lowest level since the second quarter 2018.

As a reminder, the revolving credit facility matures in 2023 and has a total size of \$1.15 billion. The facility includes an accordion feature allowing us, subject to lender consent, which we would expect to receive to expand by up to \$275 million to \$1.425 billion facility size. Our financial covenants related to this facility continue to have substantial cushion.

As discussed, the impact of the pandemic event significantly changed our revenue mix. Importantly, in the second quarter, we were able to remain in the range of our long-range profit expectations. We improved adjusted EBITDA margins by 330 basis points over the first quarter results, consistent with our earlier expectations.

As previously announced, we have suspended our 2020 outlook, and we are not providing third quarter or full year guidance. Barry has already provided a 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 the environment becomes more stable and predictable. While we remain cautious about the pace of recovery, we believe we've taken the actions necessary to preserve and stabilize the company's financial strength and to position the company for long-term growth.

Looking forward, our financial priority will be to maintain this financial strength while simultaneously continuing our historic business transformation. Since the end of the quarter, we've taken a number of additional steps toward these objectives. We believe these actions further signal our confidence in the durability of our business model and the future potential we can unlock with the transformation that is already well underway.

We've made the decision to selectively resume certain capital projects and continue important systems implementation work, including the S/4HANA and Salesforce implementations. Since the end of the quarter, we reinstated salaries impacted by the 20% pay cuts. While this will be a headwind in the back half of the year as compared to the second quarter, we feel the improvements in our liquidity position achieved in the first half provide us with the financial strength to take this action.

Earlier this month, we made the decision to pay down \$100 million on our credit facility. We've now drawn \$1.04 billion on our credit facility and continue to maintain substantial liquidity. Furthermore, the company's Board of Directors approved a regular quarterly dividend of \$0.30 per share on all outstanding shares of the company. The dividend will be payable on September 8, 2020, to all shareholders of record as of the close of business on August 24, 2020.



I'm very pleased with our quarterly results in light of the pandemic. Our financial position is strong. Our strategy is working. We are well positioned to accelerate our transformation, to drive growth and deliver shareholder returns.

Now I'll turn the call back to Barry.

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

Thanks, Keith.

I want to build on your comments about our strength and reiterate a remarkable 2 -- second quarter achievements. Importantly, our One Deluxe strategy is working. We're delivering sales-driven revenue growth and becoming a trusted business technology company. Our customers are engaging with us more deeply as we help customers of all sizes grow and navigate their new reality. Continued transformative actions taken to streamline our operations and footprint also drive benefits in the years ahead.

Our financial position and ability to generate cash flow is strong. As a result, our confidence in our ability to achieve our long-term goals is unchanged by this crisis even if the time line has been extended. While we're not providing outlook for 2023, we continue to believe we will be a company over the long term with mid- single-digit revenue growth and margins in the low to mid-20s. We're proud of our progress, and we're confident in our bright future.

Before we get to Q&A, I want to recognize the exceptional contribution of my fellow Deluxers. The team has risen to the unprecedented challenges of COVID and continue to deliver for our clients without interruption. While others may have focused on their difficulties, our team just went to work. That is the character of a Deluxer, living our purpose, values and ownership culture every day because we're all shareholders, too.

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

QUESTIONS AND ANSWERS

Operator

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

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

First, I just want to say thanks to Ed. And it's been a pleasure working with you over the years and we wish you the very best in retirement, sir. And with that, just a couple of questions for you guys. When you look at the kind of progressive improvement you made since April, how much do you think that's attributable to some of the stimulus actions that are out there from the government? And should stimulus kind of fall short next week? As the Senate in-house kind of wrangle back and forth, do you think that could be another speed bump along the way here to recovery? Or do you think that's something that you can kind of work through?

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

So Charlie, we can't precisely measure the impact of stimulus, but 2 points for you. One, we have seen, across our business, improving stability, which gives us confidence about the future and the remainder of the year. Clearly, the stimulus has had some impact. But again, it's difficult for us to be able to measure specifically what that direct impact was on the business. But we're very confident that if there's additional shock in the back half of the year, we've got a playbook that's tried and true, and we have options to keep the company healthy.

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

That makes sense. And then, Keith, maybe for you on the breakdown on the revenue growth or declines in the quarter. Could you share with us the organic numbers as well?

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

So think of all of it as -- we aren't reporting organic any longer. So it's all sales-driven revenue is how we think about it. So none of it is -- there's no acquisitions in there. So that's -- I would take that as organic contraction.

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

Excellent. That's helpful. And then, Barry, when you look at just some of the recent success you've had in the payment side, winning business there, what are kind of the factors driving your wins there? And is it -- if you think it's a share gain thing, where you just have been more competitive and have a more compelling offering? Or do you think it's your competitors maybe saying that, you know what, it's a business they don't want to be involved anymore depending on the scale that you have?

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

You know what? Actually, I think it's 3 things, which I'll tell you the strength of our company and the work we've done already. First, we believe we have the strongest product offering in the marketplace. On a side-by-side comparison, we win, and we know we're winning business because of the quality of our products and the level of service we provide.

Second, we do believe we are winning share, not because people are not interested in the space. We have plenty of other competitors in the space, but our product is better, and we've ramped up our sales organization. So we're just having more conversations with people than ever before. And so that leads us to additional sales results.

And the third thing that I would tell you is that the -- this crisis has highlighted is that the value of and the strength of our balance sheet is a compelling value proposition in addition to the quality of our product is helping us win business.

So we believe we have the best product. We have a strong balance sheet, and we have a sales organization out there now selling. So we're pretty confident we're winning share. And again, as I said earlier, the reason we think that's so important is, strategically, the more people we bring on to our platform, the bigger base we have to sell additional product and service as this migration continues towards automation of order to cash and receivables. So we think we're incredibly well positioned there. And by winning more market share here, it really helps us both near term, right, with immediate income, but also for the long term, giving us a bigger and bigger market share in the -- to go chase and deliver additional product and service.

Operator

(Operator Instructions) We have a question from Chris McGinnis of Sidoti & Company.

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

A really nice quarter in -- could we maybe just keep -- in the last question, just kind of keep on that. Just has the competitive dynamic changed at all? I mean, it sounds like, obviously, you're taking a lot of steps to transform the business and really drive growth. Or is the competitive landscape maybe tempered because of COVID and you're just really executing at a higher level and taking advantage of that? Can you just maybe talk a little bit about that across the industry or across all your different segments.



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

Yes, I'd be happy to talk about it. You know what, we? See all the same players in the marketplace that we saw before October. So we have continued to advance our product, and we did that some of last year. We continue to make enhancements this year, and we are better able to tell that story to our customers because we now have a sales organization that's fully engaged and ready with tools to go tell our story to customers and really take the fight to the Street where we can go win. So I think we are doing a much better job telling our story and showing the competitive differentiation we can offer to our clients, part 1; and part 2 in many parts of our business, where customers are thinking about long-term relationships. It is a huge advantage to partner with Deluxe, given the strength of our balance sheet and the cash flow we have and the quality of the product. So not only do we have a better product, we're able to bring that product to market and explain our story better than ever. And we've put icing on the cake by having an incredible balance sheet and great financial stability, which we think gives us an additional and material competitive advantage.

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

Okay. And I guess just with the new wins on the larger side in some of the enterprise clients, is that more cross-promotion or cross-selling capabilities that you're adding? What's been the change in approach to driving the new customer wins, especially the larger ones that you've won later?

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

You know what? This is one of the most exciting things about our transformation, among many exciting things. Because we -- in the middle of the COVID crisis, we not only sold new enterprise-class deals, we sold in-market verticals we've not sold before. We created products, got them lost in-market, booked \$26 million of revenue in record time and really in no time, all within the same quarter. But the wins are both new to the company, but they are also cross-selling to existing customers. So I mentioned earlier that we sold additional service to A T&T. They're a long-standing clients of ours, an important client of ours, and we're able to expand the relationship. And there are a number of other wins where we have an existing relationship, and we've actually been able to expand the relationship. It's one of the things we said we were going to do last year, and we're actually doing it, where we have existing customers by going to the customer and telling the whole Deluxe story, that's the whole point of our One Deluxe strategy, going to the customer, telling the whole story, but, more importantly, listening to what their needs are, we can help solve their problem.

So what might have been a sales opportunity for one product in terms of the sales opportunity for multiple products, simply because we can tell the whole story, and we are training our teams to better listen to what the customer needs are, so we can help solve problems. It sounds very simple, but it's very fundamental in how we've changed the go-to-market approach here. And it's a pretty massive change. We have a sales organization that's now trained across the entirety of our product suite. They can get to the second base in a baseball analogy. And if they need additional support and health, we still have sales specialists that can come in and help them close the sale. So we are getting the best of all of Deluxe while maintaining what were our specialty expertise and bringing that to the customer to win.

So it's all of those things at the same time. We're able to settle into new market verticals because our sales engine is working. We're able to deliver -- create and deliver and sell new products that we didn't have even in quarter, and we're able to sell existing customers additional products across our portfolio. That's why we feel so good about our future. Yes, COVID is COVID. But we said we were going to execute to a sales team, and we had. We said we're going to deliver sales-driven revenue growth, and we have. We said we're going to improve our operating efficiency of the company, and we have. We directly addressed our real estate footprint in quarter. So we put all those things together and put together with all the results we've already reported, and I think it becomes pretty clear that our long-term prospects are very, very side.

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

Great. I appreciate that color. And I guess just around the small business, that new team you were talking about was kind of largely focused on health care. Is that going to move to other verticals or other kind of markets going forward? And how long has that team been in place? And can you just provide a little bit more color? It sounds like an interesting opportunity.



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

Yes. So think about this as our first step towards having market vertical specialization. And we thought that we saw an opportunity. We intended to go down this path. We saw an opportunity immediately in health care. We set up a small team. And we got pretty immediate results, which I shared with you. And so we're very optimistic that, that pathway will continue to bear fruit in health care where it's aimed today. But proving that successful, we think that there's no reason that can't expand and we get even more vertical focus in our sales organization going forward. So we'll be able to bring the best of our product with a very specific focus on a type of customer. And again, we should be able to do even better than by showing understanding what a typical group of customers' needs might be and showing how our products can help them solve common problems. It is sort of the next step of the evolution of becoming a world-class sales organization.

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

Okay. Sounds like an exciting opportunity. Just a couple more, I apologize. Just on the small business side, are you heavily weighted on and one kind of vertical itself? Or is it pretty widespread? If you don't mind just highlighting that real quick.

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

With 4.5 million small businesses, of course, we have a very, very broad distribution of customers. And in our small business portfolio, we certainly have some concentration, but I don't think about us having overt concentration in any one of them. Certainly, different levels of penetration by segment or vertical. But we don't think we see anything in our portfolio that says we're over -- extremely overweighted in one place or another.

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

Great. I appreciate that. And then, Keith, just a question around, one, the margin profile for maybe -- I don't know if you can talk a little bit about next quarter. It sounds like some costs are coming in with the new business wins. And then maybe just on the SG&A levels of -- in relation, I guess, if you think about from Q2 upwardly as we head into Q3 and the back half of the year. Any color you can provide on?

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

Yes. You know what? Unfortunately, given the uncertainty in the market around COVID, we can't give specific guidance. In my comments, I gave general direction about what I thought would happen, which we think that Cloud and Promo will lag the recovery. We think the Checks will largely follow recover maybe slightly slower, and we have a lot of optimism for the growth continuing in Payments. And I think we showed in the second quarter our ability as a leadership team. And just -- I know you know this, but it's a new leadership team. The team didn't exist in its current state until thanksgiving of last year, and -- that then we can manage the expense really well, and we expanded margins 330 basis points sequentially from Q1. So I feel pretty good about our ability to manage margin. Obviously, in this marketplace, it's very hard to predict. But we -- based on what we can see now, we told you how we feel slight improvements sequentially from the second quarter going forward.

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

And again, great quarter, and good luck in Q3.

Operator

(Operator Instructions) I'm showing no further questions at this time. I'd like to turn the call back over to Jane Elliott for any closing remarks.



Jane M. Elliott - *Deluxe Corporation - Senior VP & Chief HR Officer*

Thanks, operator. This is Jane Elliott. Let me wish Ed well in his retirement. And I look forward to his continued partnership in the transition, and I look forward to working again with so many new and existing friends on this call and in the future.

Before we conclude today's call, I'd like to mention the following conferences in the third quarter where management will be participating. On September 16, we will be virtually participating in the CL King 18th Annual Best Ideas Conference. And on September 23 or 24th, not exactly decided yet, we'll be at the virtual Sidoti 2020 conference.

Thank you, everyone, for joining us on our Deluxe Second Quarter 2020 Earnings Call. We look forward to sharing more good news about our accelerating transformation next time. And in the meantime, stay healthy and safe.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you for Participating, and you may all disconnect. Have a great day.

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