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Q4 2022 Deluxe Corp Earnings Call

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Deluxe Fourth Quarter and Full Year 2022 Earnings Conference Call. (Operator Instructions) Today's call is being recorded. We will begin by opening remarks and introductions.

At this time, I would like to turn the conference over to your host, Vice President of Investor Relations, Tom Morabito. Please go ahead.

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### Thomas C. Morabito *Deluxe Corporation - VP of IR*

Thank you, operator, and welcome to the Deluxe Fourth Quarter and Full Year 2022 Earnings Call. Joining me on today's call is Barry McCarthy, our President and Chief Executive Officer; and Chip Zint, our Chief Financial Officer. At the end of today's prepared remarks, we will take questions.

Before we begin and as seen on this slide, I'd like to remind everyone 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. Additional information about factors that may cause our actual results to differ from projections is set forth in the press release we furnished today in our Form 10-K for the year ended December 31, 2021, and in other company SEC filings.

On the call today, we will discuss non-GAAP financial measures, including comparable adjusted revenue, adjusted and comparable adjusted EBITDA, adjusted and comparable adjusted EBITDA margin, adjusted EPS and free cash flow. To streamline discussion of our ongoing business operations today and going forward, we will discuss both revenue and EBITDA on a comparable adjusted basis, which will exclude the inconsistency caused by acquisitions or divestitures in the prior periods. For purposes of full year 2022, this will exclude the partial year impact of First American and impact of the divestitures done throughout the year.

In our press release, our presentation and our filings with the SEC, you will find additional disclosures regarding the non-GAAP measures, including reconciliations of these measures to the most comparable measures under U.S. GAAP. Also in the presentation, we are providing additional reconciliations of GAAP EPS to adjusted EPS, which should help with your modeling.

Now I'll turn it over to Barry.

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

Thanks, Tom, and good morning, everyone. Deluxe delivered strong results for both the fourth quarter and full year 2022, further proving we've become a payments and data company, as we expect Payments will become our largest segment by revenue during the first half of 2023. This will be a key milestone in the company's history.

Before reviewing the results, let me take a moment to reflect on what was another strong year for Deluxe. Four key highlights from the year include: first, reporting our second consecutive year of sales-driven revenue growth, an achievement not seen over a decade, showing the strength of our One Deluxe model; second, the accelerating success of our payments and data business. In Payments, First

American continues to perform well in its second year as part of Deluxe, and we're expanding blended margins across the segment. In the data business, we recorded record revenue.

Third, strong performance in our print businesses, promo and check. Promo strongly rebounded after the impacts of COVID and supply chain disruptions, and Checks delivered its strongest top line performance in over 10 years. This performance shows the durability of demand for these solutions. Fourth, our ERP implementation went live with its last major release earlier this week. This key milestone marks the completion of our major corporate infrastructure modernization.

We also just announced the exit of our North American web hosting business, which was a nonstrategic business line, allowing us to further focus on payments and data. Chip will provide more details on the transaction. We've also changed the name of our Cloud Solutions segment to Data Solutions to better reflect the more focused operations of that business. Let me also take a moment to thank my Deluxers for another strong year for their endless dedication to our customers and for their continued commitment to making Deluxe a payments and data company. The sales team gathered last week for our sales kickoff, and the energy and excitement about 2023 was palpable.

Now on to the results. For full year 2022, comparable adjusted revenue was \$2.1 billion, up 5.2% year-over-year. Reported revenue increased 10.7%, above our guided range. Once again, this was our second consecutive year of sales-driven revenue growth. This is a key milestone. We continue to demonstrate the success of our One Deluxe model.

For 2022, all 4 segments demonstrated comparable adjusted revenue growth, an accomplishment which has not been seen in a very long time, so long ago, it's outside the range of available data. Total adjusted EBITDA dollars increased 2.5% from 2021, and comparable adjusted EBITDA was down 4%. Going forward, we remain focused on driving growth in revenue, adjusted EBITDA and free cash flow for the long term. All of our actions drive towards these goals, which in turn, we believe, will drive greater shareholder returns.

Moving on to some segment revenue highlights. For the full year, on a comparable adjusted basis, Payments revenue grew 4.7% and adjusted EBITDA dollars grew 8.3%, with margins expanding 70 basis points from 2021. Merchant Services revenue increased 4.4% on a comparable adjusted basis, in line with our longer-term expectations of mid-single-digit growth. The rest of Payments, which includes our receivables and payables business, grew nearly 5%, with growth across our product lines, primarily in digital payments and treasury management. Our pipeline continues to grow, and we continue to gain wallet share from existing customers as we remain on track for Payments to be our largest revenue segment in the first half of the year. As I said earlier, this will be another key milestone for Deluxe as we've now become a payments and data company.

Data had a strong year, growing comparable adjusted revenue 8.6% year-over-year as we continue to expand the business into noninterest rate-sensitive verticals. Promo had a solid year on the top line, improving comparable adjusted revenue 6.1%. We were also pleased with the improvement in margins as the year progressed, which Chip will detail later.

Finally, our check business improved 3.7% year-over-year, an incredible accomplishment. However, we are expecting the segment to return to traditional secular decline rates this year as we now lap the growth from key wins in 2021. As discussed on prior calls, our strategic investments in new print-on-demand technology will help us manage costs to match volumes, allowing us to maintain our strong margin rate in the segment as we return to normal secular declines. We're about halfway through the implementation of this new technology.

We're proud of both our fourth quarter and full year results, which highlight our progress. Deluxe is now a fundamentally different company than what we were just a few years ago with Payments, a strong secular growth business, soon to be our largest revenue segment. And we've proven our One Deluxe model delivers top line growth. This was achieved while simultaneously modernizing the company's entire infrastructure, navigating COVID and inflation, executing significant portfolio optimization and more.

Now I'll turn it over to Chip, who will provide more details on our financial performance.

**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Thank you, Barry, and good morning, everyone. Before we review the results for the quarter, I'd like to elaborate on the pending sale of our North American web hosting business. Last year, we sold our Australian web hosting operations. And upon completion of the latest transaction, we will have completely exited the hosting business. As a reminder, this business has historically been largely a white-label service offered through telecom partners, which did not allow for material cross-selling opportunities and did not fit within our overall portfolio. This pending deal also includes our logo business.

For the trailing 12 months, these businesses generated approximately \$66 million in revenue with adjusted EBITDA margins in the mid-to high 30% range. The web hosting business was previously fully impaired due to its capital-intensive nature and recurring revenue declines. This was further evidenced in the fourth quarter where revenue declined 8% year-over-year. 2023 revenue will be impacted by approximately \$45 million, and adjusted EBITDA and free cash flow each will be impacted by approximately \$20 million. These impacts are included in our guidance, which I'll discuss in a moment, and mostly affect our data segment with a very small impact to the promo segment.

I know there have been many changes to the portfolio recently, but they reflect a methodical effort to simplify and focus the business. For more information about the business exits and impact to guidance, please refer to the reconciliations in our press release and presentation. Additional details of the transaction can also be found in our recently filed Form 8-K with the SEC.

Now let's go through the consolidated highlights for the quarter and year before moving on to the segments. For the fourth quarter, total comparable adjusted revenue improved 1.2% to \$564 million. On a reported basis, revenue declined 1.2% year-over-year. We reported fourth quarter GAAP net income of \$19 million or \$0.44 per diluted share, up from \$14 million or \$0.32 per share in the fourth quarter of 2021.

Adjusted EBITDA came in at \$112 million, down \$3 million or 2.8% on a comparable adjusted basis from last year. Improvements in Payments, data and promo were offset by checks and employee benefit costs in the corporate segment. Comparable adjusted EBITDA margins were 19.9% and in line with our expectations. Fourth quarter adjusted diluted EPS came in at \$1.04, down from \$1.26 in last year's fourth quarter. This decrease was primarily driven by interest expense. As a reminder, nearly 60% of our debt is fixed rate, which should help insulate the company from future rate hikes.

For the full year, on a reported basis, we posted total revenue of \$2.24 billion, up 10.7% year-over-year and above our guided range. As Barry mentioned, comparable adjusted revenue increased 5.2% year-over-year. We reported full year GAAP net income of \$65 million or \$1.50 per share for the year, up from \$63 million or \$1.45 per share in 2021.

Full year adjusted EBITDA was \$418 million, up \$10 million or 2.5% as reported from last year. Adjusted EBITDA margins were 18.7%, down from last year's 20.2%, due to business mix and the impact of pass-through price increases to offset inflation. On a comparable adjusted basis, EBITDA dollars declined 4% for the year, and EBITDA margins were 18.5%, down from 20.3% last year. Full year adjusted EPS came in at \$4.08, down from \$4.88 in 2021, primarily due to higher interest expense, depreciation and amortization.

Now turning to our segment details, starting with our growth businesses, Payments and Data. Payments grew fourth quarter revenue 2.5% year-over-year to \$171 million, with Merchant Services growing 3.3% year-over-year. As we indicated on the last call, we anticipated slower growth for a few quarters as all of Payments was up against tough year-over-year comparisons. We do, however, expect growth rates to improve as the year progresses. Payments adjusted EBITDA margins were 21.6%, up from last year's 20.6%, largely driven by operating leverage in our treasury management business.

For the year, Payments grew revenue 33% year-over-year to \$679 million, driven by the acquisition of First American and sales-driven growth for stand-alone Deluxe. For the year and including First American, adjusted EBITDA increased 36.9% and adjusted EBITDA margins were 21.3%, up 60 basis points. On a comparable adjusted basis for the year, Payments revenue increased 4.7%. EBITDA increased 8.3%, and EBITDA margins were 21.4%, up from 20.7%. For 2023, we expect to see mid-single-digit revenue growth and adjusted EBITDA margins in the low to mid-20% range.

Data had another strong quarter. Comparable adjusted revenue increased 11% year-over-year to \$63 million. On a reported basis, data's revenue was up 0.3% from the fourth quarter of 2021. We once again saw strength particularly in our data-driven marketing business, delivering another significant revenue growth quarter. We specifically saw a few customers accelerate campaigns, pulling Q1 planned spend into Q4. As such, we expect the Q1 result to decline low single digits due to the timing shifts of these campaigns.

Data's adjusted EBITDA margin in the quarter increased 340 basis points year-over-year to 27.6%, which again relates to timing as well as operating leverage from strong DDM volume. On a comparable adjusted basis, EBITDA margins improved 300 basis points. For the year, the data segment comparable adjusted revenue increased 8.6% year-over-year to \$268 million. On a reported basis, data grew 2% for the year.

For 2022, data's adjusted EBITDA margins declined 130 basis points versus prior year to 25.5%, driven by business mix and the investments in our data platform. On a comparable adjusted basis, EBITDA margins declined 170 basis points.

For 2023, we expect to see low single-digit revenue growth on a comparable adjusted basis. We also expect to see comparable adjusted EBITDA margins in the low 20% range.

Turning now to our print businesses, promo and checks. Promo's fourth quarter revenue was \$154 million, up 3.1% on a comparable adjusted basis, driven by new sales wins and pricing actions. On a reported basis, revenue declined 1.5% year-over-year. Promo's adjusted EBITDA margins increased 100 basis points year-over-year to 19.3% but improved nearly 600 basis points sequentially as we benefited from continued pricing actions, stable supply conditions and normal seasonal upticks. On a comparable adjusted basis, EBITDA margin improved 50 basis points from the fourth quarter of 2021.

For the year, promo's revenue was \$563 million, up 6.1% year-over-year on a comparable adjusted basis or 3% on a reported basis. Adjusted EBITDA margins for the year were 14.1%, down 150 basis points and on a comparable adjusted basis were down 190 basis points. For 2023, we expect to see low single-digit comparable adjusted revenue growth and adjusted EBITDA margins in the mid-teens.

Check's fourth quarter revenue decreased 4.6% from last year to \$176 million as the business returned to expected secular declines, with Q4 results now lapping all the major new customer wins from 2021. Fourth quarter adjusted EBITDA margins were 42.5%, down 270 basis points year-over-year as we experienced off-cycle supplier price increases for both materials and logistics inputs, some of which are temporary seasonal base surcharges. We have factored these and future expected increases into our 2023 customer price increases. As a result, we believe the margin rate will improve in Q1.

Check's full year 2022 revenue was \$729 million, up 3.7% year-over-year. And adjusted EBITDA margins were 44%, down 210 basis points but consistent with our long-term expectations of mid-40% margins. For 2023, we are expecting mid-single-digit revenue declines and adjusted EBITDA margins in the mid-40% range. As Barry mentioned, our print-on-demand technology will help maintain margins, and we're about halfway through the implementation.

Turning now to our balance sheet and cash flow. We ended the year with a net debt level of \$1.6 billion, down from \$1.64 billion last year, demonstrating our continued commitment to pay down debt. Our net debt-to-adjusted EBITDA ratio was 3.8x at the end of the year, improving from 4x a year ago. Our long-term strategic target remains approximately 3x.

Free cash flow, defined as cash provided by operating activities less capital expenditures, was \$37 million in the quarter, up from \$34 million in the fourth quarter of 2021 due to improved working capital and lower cloud computing arrangement or CCA spend, partially offset by higher interest payments. This was also a sequential improvement from the third quarter. First quarter 2023 free cash flow is expected to be negative as it will be impacted by incremental interest expense, onetime expenses from our ERP implementation and annual employee compensation payments, but should improve as the year progresses. For the year, free cash flow was \$87 million, down from \$102 million in 2021 due to higher interest payments, cash taxes and working capital.

Our Board approved a regular quarterly dividend of \$0.30 per share on all outstanding shares. The dividend will be payable on March 6,

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2023, to all shareholders of record as of market closing on February 21, 2023. We are focused on taking a balanced approach to capital allocation. And as a reminder, our capital allocation priorities are to responsibly invest in growth, pay our dividend, reduce debt and return value to our shareholders.

Turning now to guidance. Today, we are providing our expectations for 2023, keeping in mind all figures are approximate and reflect the expected impact of the web hosting and logo divestiture: revenue of \$2.145 billion to \$2.21 billion, adjusted EBITDA of \$390 million to \$405 million, adjusted EPS of \$2.90 to \$3.25 and free cash flow of \$80 million to \$100 million. To be clear, on a comparable adjusted basis, 2023 revenue represents a range of negative 1% to positive 2% growth. The comparable adjusted EBITDA range represents negative 2% to positive 2% growth.

To further clarify, EPS is expected to decline year-over-year due to the full year impact of rising interest rates, incremental depreciation and amortization and an estimated \$0.25 impact from the announced divestiture. However, factoring in the impact of the divestiture, the free cash flow guide is an increase year-over-year on a comparable adjusted basis.

Also, in order to assist with your modeling, our guidance assumes the following: interest expense of \$120 million to \$125 million; an adjusted tax rate of 26%; depreciation and amortization of \$170 million, of which acquisition amortization is approximately \$75 million; an average outstanding share count of 43.7 million shares; and capital expenditures of approximately \$100 million. This guidance is subject to, among other things, prevailing macroeconomic conditions, including interest rates, labor supply issues, inflation and the impact of other divestitures.

To summarize, we are pleased with the fourth quarter and full year 2022 results. Our sales pipeline continues to expand with new customers, and we continue to see increased growth from our existing customer base. We look forward to continuing the momentum in 2023, a year which we expect to be highlighted by continued revenue growth, increased operational efficiencies and increased free cash flow.

Operator, we are now ready to take questions.

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### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Your first question comes from the line of Lance Vitanza from Cowen.

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**Lance William Vitanza Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst**

Kind of a lot to unpack here, but let me start with the web hosting and logo divestiture. Did you call out the EBITDA margin on the asset sale?

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

We did. We said that it was mid to high 30s. And as you know, Lance, that is a business that was a consumer of capital, and it was in decline. We also mentioned that in the fourth quarter, revenue in that segment declined 8%.

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**Lance William Vitanza Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst**

So -- right. So it was \$65 million of revenue and then kind of like \$25-ish million of EBITDA, something in that range, in that general vicinity. And I guess -- and that was for the trailing 12 months. Where I'm going with this, Barry, is I'm thinking about your adjusted EBITDA guidance of \$390 million to \$405 million, which right on the face of it, it looks like it's down versus the \$418 million that you printed this year -- or for 2022. But if we add the \$25 million-ish, right, from the asset sales, then we're sort of -- we're getting to that slight EBITDA positive that you talked about in the 8-K filing. Is that sort of the right way to think about it?

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**Chip Zint Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance**

This is Chip. So as you have time to digest this, you'll see at the back of our earnings release and slides, we provided some information that will reconcile that for you, especially on the guidance side. But your back-of-the-napkin math is roughly right, around \$25 million of

EBITDA for a full year. We are, of course, modeling into our guidance only 3 quarters of impact. That's where we get the roughly \$45 million revenue impact and approximately \$20 million EBITDA impact that I just referred to on the call. But all of those things, plus the impact of last year's exits rolling forward, are reconciled in the back. And that's why we thought it was important to move just comparable adjusted dynamics so that it can be much more transparent on how the business is doing on an apples-to-apples basis.

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**Lance William Vitanza Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst**

Okay. Great. Maybe moving on to the data segment that continues. You mentioned during the call continued diversification into noninterest rate-sensitive verticals. And I'm wondering, how much of the data segment -- again, on a go-forward basis, how much of that data segment currently is in noninterest rate-sensitive verticals?

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

Lance, I don't think we've ever provided sort of the sources of revenue at that level. But the reason that business continues to perform well in a period of rising interest rates, I think, is because those noninterest rate sectors or categories are experiencing really attractive growth rates that are more than offsetting things that were highly sensitive like mortgage. And if you look back in our history, you can see previous interest rate cycles like this, that business was pretty significantly impacted, and we're actually showing growth. And so I think that gives you a good sort of direction that it's increasingly about noninterest rate-sensitive categories.

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**Lance William Vitanza Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst**

Is it possible to talk a little bit about which of those noninterest rate-sensitive verticals present the most obvious or most compelling opportunities for Deluxe? And are there any examples of recent wins to call out, anything along those lines?

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

Yes. So I mean, I'll give you 2 parts to this. The business historically was focused on the financial services industry. And within the financial services industry, dollars are being shifted in those financial services companies away from interest rate-sensitive things like mortgages towards things like certificates of deposit, normal DDA accounts, high-reward credit cards, other solutions that the financial institution is attacking to deliver their own growth. And we've shown an ability to move into those sectors, away from the interest rate-sensitive area.

But beyond that, we've also moved into and are providing now campaign services to a very wide range of solutions. Everything from one of the largest online retailers to insurance companies and others that are interested in growing and finding new customers. And the focus on all of this really are businesses that have high lifetime value for a customer. And the reason the solution is valuable to them is that it's giving -- we are providing to that company a very, very high converting lead list so that company can invest materially in its marketing plans with the confidence that it will turn into new customers. And we're growing the business because we're just really, really good at it.

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**Lance William Vitanza Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst**

That's helpful, Barry. A quick question on the checks side. Margin was a bit weaker than we had expected. How has the margin performance compared to your own expectations? And was there anything going on in there that drove -- in the quarter that drove margin performance one way or the other that's worth kind of calling out? And I apologize if I missed that during your prepared remarks.

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**Chip Zint Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance**

Yes. It's Chip again. So you're right, the 42.5% for the quarter was a bit below our expectations. We mentioned kind of 2 factors. There were 2 out-of-cycle supplier price increases that we experienced, both on the material side and on the logistics side. Logistics specifically was more of a seasonal-based surcharge that will correct itself now in the start of the year, but the out-of-cycle price increases obviously happened. They're out of cycle, which means as we set our final forecast for the year, we didn't see them yet. And so that was a bit of a surprise. But as I said, we'll be able to bank those increases into this next price increase early in the year. And obviously, it's very great that the overall portfolio was able to offset that issue and deliver the results exactly where we thought they would be.



**Lance William Vitanza *Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst***

Just the last one for me, I promise. Just on corporate expenses, they were up again about 5% year-over-year. Is that just sort of the inflationary environment? Or is there anything in particular going on there? And really more to the point, I guess, it looks like you're running close to 9% of revenues on that corporate line, and it might even be higher on a comparable adjusted revenue basis. But I'm just wondering if that's sort of the right -- is that the right percentage for a company this size? Or is there -- is it -- should we be thinking that maybe there's some improvement there to come? Or no, is this just kind of a good level that you guys are happy with? Anything you could say there would be helpful.

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**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Sure. So turning to the quarter, I think you got to recall, we've mentioned a few times throughout the year that we restored our 401(k) match earlier this year. That's been weighing on the corporate segment. So when you really look at the growth year-over-year, mostly a function of that. There's puts and takes across the other areas, other increases related to inflation, offset by operational efficiencies. But net-net, the real driver year-over-year in the fourth quarter was that 401(k) match.

As we look forward to 2023, you are right. I would tell you, as you're thinking about your guidance and your modeling, you have to roughly model somewhere around \$200 million or roughly 9% of revenue to get to the ranges we provided, and let me just give you a little bit of context what's going on there. We continue to deal with inflation. It's a factor of the environment. We've got the investments in the technology. We've mentioned it a few times. We also have the function of the divestiture. And once we divest those assets, there will be some stranded costs that are corporate in nature that will come back to the corporate cost center. And so all of those things equally look like we are kind of staying flat, which we know is not where we need to be.

So I'll just reiterate that this remains a major focus area for us. Getting cost out of the corporate segment is one of the most strategic factors for us as we get into the year and look to overdeliver our results and overdrive our internal plan. And so I would just advise you to kind of model it as this 9% roughly or \$200 million for now, but know it's a major focus of ours. And we think we can make progress as the year goes on to try to bring this spend down.

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**Operator**

Your next question comes from the line of Charlie Strauzer from CJS Securities.

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**Charles S. Strauzer *CJS Securities, Inc. - Senior MD of Sales & Research***

I'd like to talk a little bit about the divestiture yesterday in the web hosting business. And if you look at the sale earlier in the year of the Australian piece, it seems the sale -- kind of the all-in sale price was below where this business was bought back in May of 2008. And it seems the price tag is a little bit low, but wondering there what transpired in terms of what potential kind of shopping -- kind of a go shop, if you will, in that process.

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

So Charlie, you're right. The company acquired those assets before -- quite a while ago. But you'll recall that in 2019, we had fully impaired -- between 2019, early 2020, we fully impaired the asset entirely because the marketplace for that business had changed so materially. And as we look to the future, really recognize that of those businesses, web hosting really weren't a fit and a match with becoming a payments and data company. And we went to market looking for suitable buyers, a very robust process, very robust process. And we came out with what we think is a fair transaction. And it avoids for us the ongoing need to put significant capital into the business in a business with secular declines and a much better fit for the acquirer because they're in that, that's their core business. And they have leverage and scale from adding our portfolio to their business, something we just -- it was a profile and an opportunity we didn't have.

And so we took the opportunity to divest that. We think it will be very focusing for the company. You heard us say that we're changing the name of the segment from cloud because it was a distributed set of assets. And now it's very, very focused on our data business, which is what we've been saying is the jewel of that business for some time. And we think that makes it much more clear. And we think it's a good outcome.



**Charles S. Strauzer *CJS Securities, Inc. - Senior MD of Sales & Research***

Got it. And then staying on the topic of divestitures, are you planning to potentially divest more businesses going forward here? Or are we kind of at the tail end of that process?

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

We will continue to look at the portfolio for pruning opportunities. But Charlie, if the question really is, are you going to look to us to lop off 1 of the 4 legs, check, promo, data or Payments, I think we're at the place where we feel confident that's not on the horizon here.

**Charles S. Strauzer *CJS Securities, Inc. - Senior MD of Sales & Research***

Makes sense. And then looking at the guidance for the year, pretty wide range of outcomes there at the high end on revenue growth, given that we're going into potentially a recession here with inflation and higher interest rates kind of in the forecasts. What gives you confidence there that the high end of that range and kind of what are some of the assumptions behind the guidance overall?

**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Yes, I appreciate the question, Charlie. It's Chip. I would just say, I think the high end of the range, what gives us confidence is just the execution and success we've seen over the last 2 years, the ability to cross-sell within the portfolio, the way we've invested in the products over the last few years to improve the functionality, the market attractiveness of it, to build a robust pipeline and just continuing the sales momentum.

So if I think about from a revenue side, I mean, obviously, we did our range responsibly for all the right reasons. You mentioned there still is uncertainty, and you don't know what's going to happen. But we look at that top end and think it's very achievable. As you flow it down, obviously, the ranges get a bit wider as you go down my list of things I guided because of the uncertainty, and room for variance can get larger and larger. But we just feel good about where the company is positioned, the internal plan we've established and just being able to execute on the momentum we've had the last 2 years from a top line perspective.

And then when you get to the EBITDA, it just can't be said enough how much we're going to focus on cost out, cost efficiencies, operating leverage, the corporate cost center, as I said, and just get very maniacally focused on our cost profile so that we can make sure we deliver that EBITDA result and start to grow EBITDA even more. And that will obviously help our deleveraging.

**Charles S. Strauzer *CJS Securities, Inc. - Senior MD of Sales & Research***

Got it. Great. Quick housekeeping on the check side. Just in terms of your volumes, how did the declines look there? And then what should we think about in terms of volumes for the full year?

**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

On checks, so I mean, checks did return to secular declines again in the quarter. So if you think about kind of volume-price dynamics, it's a little bit more difficult to describe here. Obviously, price continued to be a function of the revenue because we took pricing actions throughout the year that rolled forward. But after we lapped all the customer wins, we did return to kind of normal secular decline. So we still had volume increases despite that. But when you net it all out, net reduction in revenue, which is what we're anticipating will be the same for 2023. So we're forecasting mid-single-digit declines but the ability to keep margin in that mid-40% range.

If I take checks aside and look at the other 3 segments, we continue to see a nice blend of volume and price. It was actually nearly 50-50 once again for the quarter. So just excluding the secular decline aspect of the business, we just continue to see a really good healthy mix of volume and price, and that gives us confidence going into 2023 as well.

**Charles S. Strauzer *CJS Securities, Inc. - Senior MD of Sales & Research***

Great. And then lastly, just can you repeat on the -- what you said about Payments growth for the year and margin expectations there. I missed that.

**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Yes. So Payments we see as a mid-single-digit grower for the full year. We do think it's going to be maybe a little bit lower in the first quarter, and then it will pick up some steam as it gets into Q2 and beyond. And that's a function mostly of just some year-over-year comps that we're coming up against. But we do believe it's going to be mid-single digit on the revenue side.

On the adjusted EBITDA margin side, this is an area that this business is finally really starting to show the value of why we love it so much as it's starting to get operating leverage. And so low to mid-20% margins. I think if you look at the trend of that business over the last few quarters, you're starting to see this operating leverage that we've been talking about. And so we're feeling pretty good about the ability to, of course, grow to mid-single digits and then also just get EBITDA expansion, which would be nice to help hit that overall EBITDA guidance and offset the declines in checks that we're planning.

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**Charles S. Strauser *CJS Securities, Inc. - Senior MD of Sales & Research***

Great. And then just lastly, what should we be thinking about assumption-wise for share-based comp for the year?

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**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Share-based comp, give me just a second. I would say somewhere around \$25 million would be what I would assume.

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**Operator**

Your next question comes from the line of Marc Riddick from Sidoti.

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**Marc Frye Riddick *Sidoti & Company, LLC - Business and Consumer Services Analyst***

So I was wondering if you could talk a little bit -- and I appreciate all the details that you've already provided. I was wondering if you could talk a little bit about thoughts on potential head count adjustments for the year. You've talked about trying to keep the costs under control, but I was sort of wondering about maybe where you might stand as far as adding head count and sort of maybe talk a little bit about any investment initiatives for the year.

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

Sure. So on head count, we are very disciplined about managing head count. And we go through periods of pruning, including one earlier in January. But we are not a company that has historically just done across-the-board reductions. But we're very disciplined at managing, particularly professional staff.

So I think that the rest of the question really is how do we think about cost management for the rest of the year and going forward. And the thing I would really tell you is we really focused on getting revenue growing in the company, and we've now proven the company is capable of that. Some people didn't think we would actually deliver that, but we've now delivered it for 2 consecutive years. And the next big thing we grow, in fact, is profitability. And particularly, the corporate cost center is a particular target. And we're going to be very disciplined and thoughtful, just like we have on the portfolio and just like we have been on growing revenue and to attack that next to help us expand the profitability of the company from here.

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**Marc Frye Riddick *Sidoti & Company, LLC - Business and Consumer Services Analyst***

Great. And then I was wondering if you could talk a little bit about it, and you touched on some of the customer behavior that you're seeing, given the environment that we're functioning in here. I was wondering if you could talk a little bit about if there are any particular industry verticals or pockets that are a little stronger than others. Or is it pretty much the behavior that you're seeing largely across the board with customer verticals?

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

Well, what I would tell you is that overall, we're seeing very durable demand across our entire portfolio of services. We are seeing some shift between verticals or between different periods where volume is up or down modestly by sector or time period. But in aggregate, we continue to see strong and continuous demand for solutions. And that's -- you can see that in our performance from a revenue perspective.

**Marc Frye Riddick *Sidoti & Company, LLC - Business and Consumer Services Analyst***

Great. And then I guess the last thing I was sort of thinking about is, I wanted to sort of circle back on the commentary that you had on the divestiture and sort of the opportunity for future pruning. I was wondering if you could talk a little bit about maybe on a bigger picture, maybe what you're seeing with the opportunities of -- within the M&A pipeline, sort of thoughts on current valuation and whether that's -- if you've seen any changes there, any greater willingness of folks to engage or if that's changed much over the last few months given the recessionary environment.

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

The broader M&A market, I think, has been fairly frozen for some period of time. We're seeing maybe a little bit of a slight thaw in that. And I think our perspective for our business is we really like the core assets that we have in Payments and data, and we feel like we've got plenty of runway there. And our first objective is, of course, invest in the company for its success and continue to pay down debt.

So are we going to be active in the M&A market to acquire assets, which is where I think you're going? The hurdle rate for that kind of a transaction would be really, really high right now with the interest rates. And I think that we believe that valuations are still a little bit frothy. So you never say never. But we like the businesses we have. And we like our pathway to continue to pay down debt, and we see that sort of as the first and primary pathway.

**Operator**

Your next question comes from the line of Chuck Nabhan from Stephens.

**Alexander Blake Neumann *Stephens Inc., Research Division - Associate***

This is Alex Neumann on for Chuck here. Sorry if I missed the callout, but did you give expectations for revenue growth for the data segment in '23, given some of that pull forward of revenue from Q1? And then just some of the drivers behind that revenue growth for the year, that would be great.

**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Yes, Alex, it's Chip. Yes, we did. So for the full year, we're expecting low single-digit revenue growth. And it's important to note that we refer to that as on a comparable adjusted basis because that one will obviously have the change in the divestiture occurring over time. So we'll continue to reconcile that and give you guys that. But for the full year, we see low single-digit growth. That's a bit slower than what we saw across the data segment this past year, but that's because this past year was such a large growth year. I mean, that business grew north of 20%. It's -- obviously, we just know that it's a high hurdle to clear.

The first quarter specifically we're expecting to be a little difficult just because of those handful of campaigns that shifted into the fourth quarter out to the first quarter and kind of depleted the pipeline just a bit. The team continues to work their pipeline, their list of deals. But we do know that the start of the year may be a little slower. But we don't see any reason that, that business can't grow low single digits for the full year.

**Alexander Blake Neumann *Stephens Inc., Research Division - Associate***

Okay. And then just within the Merchant Services, could you speak to what you're seeing in terms of what's on the ground from your SMBs and what volumes are looking like and just the overall health?

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

So I think in the merchant business overall, we continue to see robust volume, and there's lots of media attention about and speculation on what's happening in SMBs. But I think overall, we're seeing pretty solid volume there. And our fourth quarter delivered exactly what we expected it to do. I'm sure you've seen the Commerce Department numbers for December, but we didn't experience that. We delivered the quarter in the way we expected to deliver it. So we feel like the variety of business we have there and the market verticals where we compete helped balance each other out in good times and in tough times. We feel like that's a pretty solid business right now.

**Operator**

Your next question comes from the line of David Silver from CL King.

**David Cyrus Silver *CL King & Associates, Inc., Research Division - Senior VP & Senior Analyst***

Yes. I think I have a -- first question would be on your free cash flow forecast, and then I'd have a maybe a more strategic question about SaaS-generated revenue. Regarding your free cash flow, the \$80 million to \$100 million range you provided, I mean, I've noticed that, that's kind of in the range over the last 2 years. And I think the term is kind of maybe a flywheel. But is it the case that should operating results exceed your budget, you may increase your discretionary spending and kind of keep your free cash flow within that targeted range? Or alternatively, if results fall a little below target, would you cut back on investments, let's say, either capital spending or working capital, again, to kind of keep that free cash flow within a targeted range? I mean, how should we think about that free cash flow target in terms of flexibility there or how inviolate it might be?

And then secondly, on your CapEx spend, let's say, of \$100 million, can you remind me what the sustaining portion of that is versus what you would consider discretionary spend?

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**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

David, it's Chip. So on your first question, so the guidance of \$80 million to \$100 million, keep in mind, we're kind of approximating that the divestiture is roughly a \$20 million impact to that. So all things equal, that's a guidance range of more \$100 million to \$120 million based off apples-to-apples, which you'll see is getting us back to kind of our -- towards our historical range that we were 2, 3 years ago despite all the increases in interest costs. So I think that's a good place to land.

To hopefully answer your question, though, when we set the investment target for the year, whether it's the \$100 million CapEx or anything we may do inside the P&L, we actually look to achieve those, if not underspend those. We don't look to throttle up discretionary investment just because the results are trending better. We view those as kind of starting points, and we're going to do our best to spend our money wisely, come in under and make sure we can overdeliver the free cash flow the best way possible because there's many of others who go (inaudible). Whether it's interest expense or taxes, we know we have to manage this. So I wouldn't be concerned that if operating results trend better that we're going to throttle up investment. That's not what we would do.

And to answer your last part of the question, in the guide of \$100 million, I would think of it as kind of roughly \$40 million to \$45 million of that is kind of the sustaining, we call it KBR, keep the business running side, with the rest of it, the kind of \$55 million to \$60 million, being growth related. So high level, 60-40 growth to maintenance capital. And as you know, we're doing the print-on-demand upgrade in checks. So that's something that we're halfway through. So over time, that work will go down. And we just continue to invest responsibly in our growth products with payments and data and to try to make the company more efficient.

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**David Cyrus Silver *CL King & Associates, Inc., Research Division - Senior VP & Senior Analyst***

My next question is maybe a little more strategic or philosophical. But Barry, you've taken a number of steps over the last couple of years to transform your company into, as you pointed out today, a payments and data company. I'm just wondering, underneath that, there's different kinds of revenue generation. And I think in your slide deck, the emphasis on SaaS-driven revenues has been increasing pretty steadily over time.

And I'm just wondering, beyond the headlines or the column headings of payments and data, whether underneath that, there's also targets or goals for SaaS-driven revenues, which I consider more stickier and more relationship-based versus maybe transactional sales of -- onetime sales of services to companies that might handle the service themselves. So what are your goals maybe for that maybe more differentiated SaaS-driven revenue where maybe there's a service -- differentiated service component in there that could make for more durable revenue streams, stickier customers and that kind of thing?

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

So that is a really insightful question, and it goes right to the very core of our sort of corporate strategy, which is we are trying to build the payments and data businesses because by their nature, they are stickier businesses. So for example, in our receivables and payables business, customers choose and adopt one platform to run their -- and build their business upon. And increasingly, they're choosing our platform. So we have a number of banks that are reselling our receivables platform as a branded version of their bank. So you don't know that it's Deluxe providing the solution. You know that it's the bank providing a solution to their customer.

That is extremely sticky because once the customer has a commercial bank relationship with the bank and they are using our platform to manage their receivables and payables, that customer doesn't attrit. And that's driven by delivering a great experience and set of tools, a software-as-a-service type model where that customer is building their business on the platform. And that's obviously where we're making our investments as a company. We are going to launch later this year improved tools for our receivables business that will give us really attractive, really easy-to-use tools for the customer. We've invested in our platform for our data business, which someone was asking earlier about how we're diversifying the business. It's because we've invested in our platform. That's allowed us to grow that business into new business verticals.

So we're not here to say that we're a software-as-a-service company. We're absolutely clear, though, that we are moving the company towards a much bigger percentage of revenue from recurring revenue where businesses are building their business on our platform. It's completely true in our receivables payables business. It's the foundation in our Merchant Services business, and it's the very foundation and core of what's happening in data. So it's absolutely where the company is going and going forward, we're making our investments for growth.

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**David Cyrus Silver *CL King & Associates, Inc., Research Division - Senior VP & Senior Analyst***

Yes. Okay. I mean, I've just noticed with a number of my companies the difficulty in procuring sufficient IT resources. And I thought the way you're already interacting with them, it would kind of be a natural opportunity for your company over time.

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**Operator**

And we have a follow-up question from the line of Lance Vitanza from Cowen.

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**Lance William Vitanza *Cowen and Company, LLC, Research Division - MD & Cross-Capital Structure Analyst***

Just 2 quick follow-ups that I forgot about. The first is on the proceeds from the web hosting sale. I know that there's about \$10 million or so in the 8-K that's sort of deferred, I think, over a 6- to 12-month period from the time you close it. And I'm just wondering, are there -- is that like an earn-out? Are there any sort of performance-related contingencies there that we should be aware of?

And then my second question is just with respect to the Payments business. I'm wondering if you could kind of step back and walk me through the margin outlook in 2023. And I apologize, I think you mentioned that you had some opportunities there. But if you could recap that for me, that would be great.

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**Chip Zint *Deluxe Corporation - CFO, Senior VP & VP of Corporate Finance***

Lance, this is Chip. I'll take both of those. So on the sale of the web hosting business, so we announced a base sales price of \$42 million in our 8-K the other day. \$32 million of that is kind of a payment to occur at time of closing with the other \$10 million 180 days later and 360 days later, I believe. Neither of those \$10 million are contingency-based. There is up to another \$10 million, which could take the total sale price up to a max of \$52 million, those are contingency-based subject to performance obligations. And so look at the sale price as a range of \$42 million to \$52 million. The \$42 million, it will happen, and it has the second and third payment, which is just a timing factor as the business transitions over.

The question about Payments, yes, you're right, we did talk about that a bit. So we are forecasting EBITDA margin rates in the low to mid-20s. But I think what I said is if you look at the last few quarters, you're starting to see that business realize operating leverage. Margins are expanding. That's a function of the volume growth. We like that business because as volume grows, it can come at an incremental margin rate because of the way the platform business work. We were -- we've got operational efficiency in our treasury management business, specifically lockbox, that's improving profitability there. And then, of course, as we continue to take price, to keep up with inflation, that's helping as well. So all things equal, this is a business that we believe will expand margins nicely in 2023.

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**Operator**

And there are no further questions at this time. Mr. Tom Morabito, I turn the call back over to you for some closing remarks.

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**Thomas C. Morabito *Deluxe Corporation - VP of IR***

Thanks, Rob. Before we conclude, I'd like to mention that management will be participating in the Truist Securities Technology, Internet & Services Conference on March 7, 2023, and the Sidoti Virtual Small-Cap Conference on March 22. Thank you again for joining us today, and we look forward to speaking with you in May as we share our first quarter 2023 results.

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**Operator**

This concludes today's conference call. Thank you for your participation. You may now disconnect.

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