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- Q3 2014 First Data Corp Earnings Call

EVENT DATE/TIME: OCTOBER 29, 2014 / 2:00PM GMT



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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the third-quarter 2014 First Data financial results conference call. (Operator Instructions). Please note this call has been pre-recorded and there will be no question-and-answer session for today's call. As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to Mr. Rich Wilhelm, Director of Investor Relations of First Data. You may begin, sir.

Rich Wilhelm - *First Data Corporation - Director, IR*

Thank you, operator and good morning, everyone. I would like to welcome you to our third-quarter earnings call. Our Executive Vice President of Strategy, Planning and Business Development, Himanshu Patel, and Executive Vice President and Director of Finance, Michael Neborak, will lead the discussions of the third-quarter 2014 financial results. Himanshu and Michael will be referencing a slide presentation during their prepared remarks. A copy of the slide presentation, as well as our earnings release and supplemental analyst schedules are available on our website at www.investor.firstdata.com.

I would like to remind you that any forward-looking statements made during today's call are subject to risk and uncertainty. Factors that could materially change our current forward-looking assumptions are described in today's presentation and in our Form 10-K and subsequent reports on file with the SEC. We also will discuss items that do not conform to generally accepted accounting principles. We reconcile those measures to GAAP measures in the appendix in this presentation and as part of our quarterly results press release. With that, I will hand the call over to Himanshu Patel.

Himanshu Patel - *First Data Corporation - EVP, Strategy & Business Development, Public Affairs*

Thank you, Rich and good morning, everyone. Before I hand it over to Mike to go through the numbers in detail, I wanted to first step back and reflect on the business. First Data's transformation continues on multiple fronts. Since the last earnings call, we've posted another quarter of growth, announced further steps to improve our cap structure, kept our focus on innovation, expanded into new geographies and continued to attract top talent into the firm's leadership.

First, high level on the financials. Q3 saw 3% top-line growth and 5% adjusted EBITDA growth led by the Financial Services division, which saw 7% revenue growth, a record high for this segment since First Data went private. We continue to increase investments in the business, but a continued focus on expenses and positive operating leverage is allowing us to maintain healthy margin. We also announced this week that we'll be redeeming the remaining balance on the PIK note at the parent company, another important step towards improving and simplifying our capital structure following last summer's \$3.5 billion equity raise.

On the innovation side, it was a fairly busy quarter for us. We announced First Data's collaboration with Apple as part of its Apple Pay initiative, a new service that will enable secure, single touch payments via an iPhone at NFC terminals and for in-app purchases. Our involvement in Apple Pay was unique in its multi-faceted nature, spanning our physical and e-comm acquiring businesses, as well as our issuing business. Indeed, we were delighted to be able to support many First Data merchants and issuer customers through the last several quarters, allowing many of them to be the initial launch partners for Apple Pay.



Continuing along the theme of innovation, in Q3, we also completed the acquisition of Gyft, which we talked about at the tail end of last quarterly call, a digital gift card platform that we expect will transform the gift card industry for both businesses and consumers. Gyft allows businesses, large and small, to efficiently distribute virtual customize reward and loyalty offerings. Gyft provides consumers an innovative and low friction way to securely purchase and manage gift cards on their mobile device and to redeem them at thousands of retailers nationwide through existing POS systems. Gyft is already integrated into Clover and just recently in October, Gyft also became the first gift card solution to enable consumers to buy virtual gift cards with Apple Pay's in-app payment functionality.

It's worth stepping back and reflecting that, within the last two years, First Data has now acquired and integrated Clover, Perka and Gyft, three cutting-edge Silicon Valley/Silicon Alley startups and created and launched other great products such as Insightics, our merchant analytics platform.

We've also been active on the international front. In August, we announced the launch of Bin, our acquiring solution developed specifically for the Brazilian market. Brazil is a fairly attractive payments market from both a growth and profitability perspective and we plan to expand our presence there significantly in the coming years. All of this is evidence that we are serious about transforming First Data and fundamentally expanding the role First Data plays in global payments and commerce. While we have an unparalleled reach into merchants and financial institutions globally, we believe the opportunity to grow our customer base, expand into new verticals and to really increase our share of wallet with existing customers is still fairly substantial in the coming years.

And last but not least, we continue to strengthen our management with the addition of top talent and related changes to our senior management. We recently announced that Barry McCarthy, who did a great job turning around our FS business, has been tapped to lead Network Solutions, which will include Star, our prepaid businesses and TeleCheck. Taking over for Barry will be Andrew Gelb, our new head of Financial Services. Andrew joins us from Citibank where he spent nearly two decades in multiple geographies, most recently running Citi's treasury and trade solutions business in North America. In addition, we're also pleased to announce that Adam Rosman has joined First Data. Adam joins us as our new General Counsel. He was most recently General Counsel for Willis Group. Dave Money, who has done a terrific job building First Data's legal team over several years will become Vice Chairman prior to his retirement.

And on the International side, Sanjiv Das will now lead our international segment. Sanjiv joins us from Citibank where he most recently ran Citi's mortgage business. Sanjiv succeeds John Elkins who will now serve as Chairman of International for First Data.

To sum it up, it's an exciting time to be at First Data. The rate of change going on within our Company is unprecedented, whether it be the rollout of innovative new products, new ways to reach customers or expansions into new verticals and geographies. Our employees feel it and our customers and partners within the industry are seeing it firsthand. It's still early days in our view, but we're excited about the growing momentum within the Company and with that, I'll hand it over to Mike to walk through the numbers in detail.

Michael Neborak - *First Data Corporation - EVP, Director of Finance*

Thank you, Himanshu, and good morning, everyone. I'm going to start on slide 4 and work through the quarterly results. Consolidated GAAP revenues were \$2.8 billion, up 3% on higher revenue from merchant and card services and an increase in reimbursable debit network fees, postage and other, the majority of which are margin-neutral pass-through fees and that loss attributable to First Data was \$235 million compared to a loss of \$220 million in the prior-year period.

Within these results, I want to highlight a few items. First, the quarter was adversely impacted by a \$260 million charge for the extinguishment of debt \$3.5 billion equity raise earlier in the quarter. Net income was also materially impacted by other income. Other income increased due to the absence of a derivative loss in the prior-year period, as well as a foreign exchange reevaluation benefit on non-US-denominated debt in the quarter. Income taxes also improved primarily due to a reversal of a valuation allowance that was taken in the quarter.

As you know, we manage the business using adjusted revenue, which is modified for various items such as the exclusion of pass-through debit network fees and postage. We believe this presentation is more meaningful in terms of understanding our performance, margins and related operating metrics. Adjusted revenue for the third quarter was \$1.8 billion, up 3% versus the prior year, with continued growth posted in our Financial Services and International segments. Adjusted EBITDA was \$656 million, up 5% compared to Q3 2013. Expenses were up 2% as we continue to

invest in the business while at the same time continuing to drive revenue growth and improved operating leverage. In spite of continued investment in the business, margins were 37% or flat versus the prior-year period.

Now let's move into the segment performance starting with Merchant Solutions on slide 5. Revenues were \$920 million, flat compared to last year, while EBITDA was up 1% to \$413 million. Margins were 45% for the quarter, also flat versus last year. We remain focused on operational efficiency and have been able to balance cost reductions with continued investment in the business primarily in our small Merchant Solutions area.

Turning to revenue, in core merchant acquiring, which counts for the largest majority of the Merchant Solutions business, revenues were up 3% as we're starting to see merchant suite products contribute to our revenue growth. Product revenue was down 5% primarily impacted by the sale of EFS and the decline in check volume. More specifically, revenue in the prepaid business was down high single digits versus the prior year due to the \$13 million negative impact on the sale of EFS. Absent that headwind, underlying new business and growth from existing clients continue to show year-over-year growth as our money network payroll cards continue to deliver strong growth from increased activity and usage.

Now turning to the results of the Financial Services segment on slide 6. Strong performance continues in that segment as revenue increased 7% versus last year, the best top-line growth in this business since going private in 2007. We are continuing to see the benefits of new business and solid growth in volumes. Top-line growth combined with expense discipline is driving solid margins and highlights the positive operating leverage in this business. Expenses were up \$4 million or 2% as we've lapped the actions we took in the second quarter of last year to simplify and streamline the organization to reduce cost. You can still see the benefit of these reductions in the steady EBITDA improvement reflected in the chart on the bottom right of this slide.

EBITDA in the third quarter was \$185 million, up 14% and the EBITDA margin improved to 50%, up 3 percentage points on positive operating leverage. Drilling into the revenue components, processing revenue was up high single digits versus the prior-year period on a continued increase in active credit and retail card accounts on file and increased debit issuer transactions. Output services showed strong growth versus the prior year in both print and plastic. And although card production related to the EMV issuance has not fully ramped up, we have a solid pipeline and expect to see those volumes pick up later this year and throughout 2015.

Now to slide 7 for a review of International. Reported revenues for the quarter were up 4%, continuing to show solid growth year-over-year and up 6% on a constant currency basis. Within the major businesses, on a constant currency basis, merchant-acquiring revenues were up 5% on volume growth and increased terminal sales while issuing revenue grew 6% on new card portfolios and organic growth. EBITDA was \$127 million, up 1% compared to the prior-year period and up 4% using constant currency. Expenses rose \$17 million, or 6%, driven in part by investments in the business, primarily in Latin America where we are launching our acquiring business in Brazil. Margin for the third quarter was 28%, down a point versus the prior year, again reflecting investments in the business.

Let's look at revenue growth on a constant currency basis in each of the regions of our International business. Revenue in EMEA, our largest region, was up 4% on solid transaction growth in acquiring and the continued year-on-year benefits of new card portfolios in the issuing business. Asia-Pac revenues were up 2% as strong volume growth in acquiring was offset by continued declines in our Australian ATM business. Revenues in Latin America and Canada were up 13% on transaction growth and terminal sales boosted by price inflation in Argentina. This growth was offset by a client loss in Canada in the prior year.

Now let me turn to the balance sheet. Slide 8 provides a roll-forward of cash. We ended the quarter with \$386 million in cash and cash equivalents and available liquidity of \$1.1 billion. We had no borrowings outstanding on the revolver. Cash interest payments were \$630 million, approximately \$64 million more than the prior-year period primarily due to a timing shift of interest payments from the repayment of debt in the quarter. For 2015, we anticipate cash interest payments of approximately \$1.6 billion, down \$129 million compared to our estimate for 2014. Our capital expenditures totaled \$165 million in the quarter and \$410 million year-to-date versus \$352 million year-to-date last year. These reflect investments in the business, infrastructure, application development and security.

Now I'd like to take a few minutes on First Data's capital structure on slide 9. As you recall from last quarter's announcement, the Company raised \$3.5 billion in private equity, which closed in July. The proceeds from that equity raise, along with the \$350 million we raised when we repriced the \$5.7 billion in term loans, were used to redeem \$2.2 billion of bonds at the operating company and \$1.25 billion of the 14.5% PIK notes at the



parent company level and we recently provided notice that we will be redeeming in December the remaining \$232 million of principal balance of the 14.5% holdco PIK notes. With these actions, total debt is reduced by \$3.3 billion, including the holdco debt, improving net leverage by 1.3 turns, lowering annual cash interest payments by \$228 million and reducing annual pretax interest expense by nearly \$473 million at holdco. We have a weighted average interest rate of 7.4% across the debt and as of September 30, approximately 80% of our debt was fixed rate or swapped to fixed rate providing a measure of protection if interest rates begin to rise.

Continuing to strengthen the Company's capital structure and liquidity position paves the way for us to invest in and provide the solutions that enable our clients to grow their business and we've made good progress towards this goal in the quarter. Our support of Apple Pay and our acquisition of Gyft, along with our other merchant suite solutions -- Clover, Perka, Insightics and Loyalty -- bring innovations to our clients around the globe.

Lastly, on our financials, I want to make you aware of a change to our second-quarter adjusted EBITDA. You will recall that last quarter we took a \$12 million reserve for an uncollectible receivable in our International segment. We have decided to treat this as an addback in the second quarter for purposes of adjusted EBITDA. This change was made to conform to management's internal presentation.

And finally, as we approach Veterans Day, on behalf of First Data, I want to thank the men and women who have served in our Armed Forces. First Data has a long history of supporting and honoring veterans through our veteran hiring program and our commitment to veteran-owned businesses. And with that, Himanshu and I would like to thank you for joining us today. Have a great day.

Operator

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

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