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VNTV - Q2 2016 Vantiv Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to Vantiv's second quarter 2016 earnings call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Nathan Rozof, Head of Investor Relations. Please go ahead, sir.

Nathan Rozof - Vantiv, Inc. - Head of IR

Good morning, and thank you for joining us today. By now, everyone should have access to our second quarter 2016 earnings release, which can be found at vantiv.com under the Investor Relations section. During today's call, Charles Drucker will discuss our strong second quarter operating performance, as well as our contract renewal and TRA terminations with Fifth Third Bank.

Stephanie Ferris will then deliver our financial results and provide updated guidance for the third quarter and full year. Throughout this conference call, we'll be presenting non-GAAP and pro forma financial information, including net revenue, adjusted EBITDA, pro forma adjusted net income and pro forma adjusted net income per share. These are important financial performance measures for the Company, but are not financial measures as defined by GAAP. Reconciliation of our non-GAAP pro forma financial information to the GAAP financial information appear in today's press release.

Finally, before we begin our formal remarks, I need to remind everyone that our discussion today will include forward-looking statements. These forward-looking statements are not guarantees of future performance, and therefore you should not put undue reliance upon them. These



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statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from what we expect. Please refer to the forward-looking statement disclosure in today's earnings release and in our periodic filings with the SEC.

Additional details concerning the business risks and the factors that could cause actual results to materially deviate from our forward-looking statements can be found in our annual report on Form 10-K under the headings risk factors and MD&A, and in our other filings with the Securities and Exchange Commission, which are available at sec.gov. I'll turn the call over to our Charles Drucker, our CEO.

Charles Drucker - *Vantiv, Inc. - CEO*

Thank you, Nate, and thanks to everyone for joining the call. This was a big quarter for us, continuing our pattern of success. Our results beat our expectations; we're raising our guidance for the year; and we renewed our largest strategic client, while also terminating TRAs.

Beyond the quarter, our prospects remain bright. Our competitive position is strong, and we continue to have several catalysts to drive future growth. We have a lot of great things to discuss today, so let me take you through it.

First on the quarter, net revenue grew 13% to \$480 million, and EPS grew 25% to \$0.70. In Merchant, net revenue grew 15%, outpacing the industry. And all of this growth is organic, supported by our superior business model. Our Financial Institution segment also outperformed this quarter, generating 7% net revenue growth.

Turning to the renewal, we renewed Fifth Third with an eye on the future. This is a strategic win for us for a number of reasons. First, it shows our commitment to building long-term relationships with our clients. With this renewal, we have extended our long-standing and exclusive relationship with an anchor client for 8.5 years through the end of 2024.

Second, this is a competitive business, with a high degree of operating leverage. It's important to have a big, stable base of transactions and revenue in order to go out and aggressively pursue new business. And this renewal gives us that. And third, Fifth Third is a key referral partner in our Merchant business. This renewal strengthens and reinforces one of our largest sources of new Merchant wins.

In addition to the renewal, we also agreed to terminate a portion of our TRAs with the bank. This includes an up-front payment plus options to terminate additional TRAs in 2017 and 2018. The combination of renewals and the TRAs create an additional \$0.06 of earnings for us next year. This is a big win for us, giving us confidence to raise our outlook for the rest of the year, while also creating upside for the future, and all of this is on top of a great quarter.

So looking forward, our outlook is bright, and new sales pipeline remains strong. And consolidation is happening in the industry. Which is creating opportunities for us to continue to win market share.

On the large Merchant side, I'm excited to announce that we won a portion of Netflix's payment business. Netflix chose Vantiv due to our unique suite of value-added services within the eCommerce space. We think this highlights our ability to win even the largest and most influential eCommerce merchants.

Our high growth channel also continues to outperform. They enable us to win market share by penetrating SMBs. Combined, our high growth channels grew above 20% again this quarter.

We continue to be the market leader in the integrated payment channel. Strong secular trends continue to drive SMBs towards this channel. We have a leading network of partners, which are generating significant new business, as well as creating an opportunity for us to penetrate their installed base.

Our eCommerce channel is also performing well. Customers continue to move more spending online, and we expect this trend to continue. We are also gaining momentum. Our scale, our Omni-Channel capabilities, and our unique value-added services are differentiating us in the market, and we are pressing that advantage to win new business.



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Lastly, Merchant Bank continues to be our fastest-growing sales channel. We continue to have success at winning new bank partners that will help us win market share, penetrate SMBs, and expand our geographic footprint.

So before I turn the call over to Stephanie, I'd like to touch a little bit on EMV. We've made great progress and are moving very quickly. We have accelerated our EMV enablement through the year and now more than half of our terminals are fully-enabled for EMV. EMV card reissuance is also nearly complete within our Financial Institution segment. This shows the strength of our system, as well as my team's ability to execute.

We are advocates for our clients, and complexity highlights our strength. We're on the front line with our clients every day helping them move forward. We leverage our scale to work closely with the networks on our clients' behalf. We are pleased with the positive steps that these and others have taken to ease the certification process. It helps us speed the path to EMV for our clients.

We are also working with the networks to implement quick chip technology. Our platform allows us to implement new technology quickly, including technologies like this that will help speed transactions through the check-out.

Lastly, while EMV is not an important financial driver for the Merchant segment, our ability to upgrade clients quickly is helping us to generate new wins, and it stands out as an area of success for us relative to our competitors.

So in summary, this was a great quarter for us. Our financial results demonstrate the strength of our business model, including our continued outperformance in the high growth channels, our Fifth Third renewal, Netflix win, and our progress with EMV, all show how well our people execute. I am very proud of our performance this quarter. And with that, let me turn it over to Stephanie to review our financial results and to update our guidance. Stephanie?

Stephanie Ferris - Vantiv, Inc. - CFO

Thank you, Charles, and thanks to everyone for joining the call. As Charles discussed, we had another very strong quarter. Net revenue grew 13% to \$480 million. Pro forma adjusted net income grew 23% to \$138 million, and pro forma adjusted net income per share grew 25% to \$0.70.

As compared to prior quarters, trends remained generally consistent across the business during the quarter. Our Merchant segment generated net revenue growth of 15%, as transactions grew by 9%, inclusive of mid-single digit same-store sales growth, and net revenue per transaction increased by 6%.

Our Financial Institution segment also had another excellent quarter. Net revenue growth was 7%, including approximately four points of growth from EMV card reissuance and fraud-related services.

Our operating expense trends also remained generally consistent with our expectations, which is to invest for growth in sales and marketing while driving operating leverage in the back office. Sales and marketing expense increased by 18% during the quarter, reflecting the success we are having within our Merchant partner channels. As adjusted, other operating costs and general administrative expenses increased by 8% and 6%, respectively, which is consistent with our expectations to continue to drive efficiency on these lines.

Below the EBITDA line, depreciation and amortization expense, excluding the impact of amortization of intangibles related to acquisitions, declined to \$18 million. Net interest expense was \$26 million and our pro forma tax rate was 26%, including a \$18 million tax adjustment related to our TRAs, again, all very consistent with recent trends.

Turning to guidance, our strong performance through the first half of this year, as well as our strategic renewal with Fifth Third Bank, increases our confidence in our future growth, and we are raising our guidance for the full year. For the full year 2016, we now expect to generate net revenue of \$1.85 billion to \$1.875 billion, representing growth of 10% to 11%, and we expect pro forma adjusted net income per share of \$2.61 to \$2.66, representing growth of 17% to 19%.



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Please note that the TRA terminations with Fifth Third Bank do not create accretion in 2016. This guidance increase reflects the performance of our core business.

For the third quarter, we would expect to generate net revenue of \$470 million to \$475 million, representing growth of 9% to 10%, and we expect pro forma adjusted net income per share of \$0.67 to \$0.69. Our guidance includes our expectations for Merchant net revenue to grow in the upper single digits to low teens. This includes our continued expectations for our high growth channels to grow in the mid-teens or better, and for same-store sales growth to remain in mid-single digits.

Turning to FI, we now expect net revenue to decline in the low single digits for the remainder of 2016. These expectations include our Fifth Third Bank renewal, as well as lapping the benefits of the EMB card reissuance in the second half of this year. We expect these trends to continue into 2017.

While we are not yet ready to provide formal guidance for 2017, the strong organic growth trends within our business, and our strategic renewal of Fifth Third Bank give us confidence in our ability to generate upper-single digit rates of net revenue growth next year on a total Company basis. This includes our expectations for continued strong growth in Merchant to offset the headwinds in FI.

In addition, we expect to continue to generate very high levels of free cash flow and remain committed to continue to strategically deploy capital in order to generate strong returns for our shareholders. As Charles mentioned, we expect the Fifth Third renewal and TRA terminations to create \$0.06 of EPS next year, plus we have the potential to add another \$0.06 of EPS in 2018 if we exercise our options to terminate additional TRAs with Fifth Third Bank. With that, I will now turn the call back to Charles for closing remarks. Charles?

Charles Drucker - Vantiv, Inc. - CEO

Thanks, Stephanie. To conclude, we are very pleased with our strong results in the second quarter. Our performance in the first half of the year, as well as the opportunities that we see ahead of us, gives us confidence to raise our guidance for the year.

I'm excited about our position in the market. Vantiv has a unique competitive advantage that is unmatched by our peers, including our integrated technology platform, our comprehensive suite of services, and our diverse distribution channel.

We renewed Fifth Third with an eye to the future. This is a strategic win for us. It shows our commitment to building long-term relationships with our clients, and it continues to give us a solid base to grow from. In addition, terminating the TRAs with Fifth Third creates another win for us, once again, demonstrating our commitment to strategic capital allocation and our ability to generate returns for our shareholders.

Finally, I want to thank our people. They serve our clients by helping them navigate the complex payment landscape, and they back it up by executing every day. This really sets us apart from our competitors. Our growth and success reflect their hard work and all they do every day for us and our clients. For those of you on the line, thank you again, and for sharing the time today.

With that, operator, we would love to open up for questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

We'll take our first question from Darrin Peller.



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Darrin Peller - *Barclays Capital - Analyst*

Thanks, guys. Nice job. Your merchant segment growth rate clearly has been consistently stronger than I think even you guys may have expected. Can you just update us again and break down a bit more granularity on the sort of the sub-pieces of that, when we as we start off maybe with the eCommerce and then go into the IPOS channel. What was the growth rates of each those two areas, and then just to carry on, the sustainability of IPOS, I know this comes up a lot, but given how long it's been now and how strong it's still growing, what do you see that in terms of the next let's call it 12 to 18 months.

Charles Drucker - *Vantiv, Inc. - CEO*

I'm going to talk about the sustainability, and I'll put it back to Stephanie just to talk generally about our high-growth channels. I feel really good about the eCommerce and integrated payments side of it. I think the question comes up every quarter about our sustainability, and we have a superb team out there. The way they service the network of clients, the ability to continue to grow, gives me confidence every quarter, and as I'm out there talking to our teams and seeing how they handle their customers, I continue to have confidence.

We are also seeing good shifts into the integrated software, so therefore the addressable market gets bigger. I have confidence in, and that's why you saw us talk about our continued confidence being able to grow it. eCommerce, we continue to win share, and I still continue to believe that we're still punching under our weight and we have a good runway and opportunity, and we're getting even better at this. The omni-channel aspect of this is also playing to our advantage. I feel good about those channels and our ability to sustain the growth in the future.

Stephanie, on the high growth?

Stephanie Ferris - *Vantiv, Inc. - CFO*

The high-growth channels, you are right, continue to do really well for us, grew 22% in the second quarter. We'd expect that to continue, mid teens or better, as we do an outlook. merchant bank, as we said, is our fastest growing of the high-growth channels. The integrated payments business is consistent with the overall high-growth channel growth expectations, teens or better. And then eCommerce, we continue to see trending in the mid-teens growth for us. So, you're right, they do continue to do very well for us, and as Charles said, the sustainability we feel really good about.

Darrin Peller - *Barclays Capital - Analyst*

When we look at strategic acquisitions going forward, given where you are now, obviously in a good place from a growth standpoint, just remind us again what you would be interested in going after? There's been some media reports over some acquisition opportunities with regard to either the merchant side or even maybe is there anything you can do to fill the hole on FI, or does that even make sense to keep that strategic business? Is that strategic enough to keep going forward? Thanks, guys.

Charles Drucker - *Vantiv, Inc. - CEO*

First of all, we like the FI business, but as you continue to see, we're investing heavily in the merchant side, and FI continues to become a smaller part of our business. It has strategic aspects that we get to cross sell to merchant bank and other type of products. When I think about future with data analytics, you get to see the whole [stream] of payments, so it's a very important business. Our merchant segment is growing very fast.

In the US, we feel like all the pieces and parts and my team, I got to tell you, people look lightly, but you can have all the pieces and parts, but if you don't execute and really have the passion to take care of your customers, you don't always see these types of results. And my people execute. So, we have all the pieces and parts. If there's opportunities to do consolidation at what we think are good returns, those are the things we would entertain. Also, international would be something that we would entertain in the future.



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The good part is that we get to be selective on how we want to deploy and how we integrate. It's been over two years from the Mercury, the last acquisition we did, and we're very good at doing acquisitions. I think it's part of the road map.

Darrin Peller - *Barclays Capital - Analyst*

Quickly, how much more is left on the TRAs? And then I'll turn it back to the queue. Thanks again, guys.

Stephanie Ferris - *Vantiv, Inc. - CFO*

In terms of the TRAs for Fifth Third Bank?

Darrin Peller - *Barclays Capital - Analyst*

In other words, in general, after this deal, is there anything left on the balance sheet?

Stephanie Ferris - *Vantiv, Inc. - CFO*

They've sold all their existing TRAs to us that are available to them right now, but I would remind you now that there's an incremental \$1.2 billion of potential TRAs that get generated as they exercise and sell down their shares.

Charles Drucker - *Vantiv, Inc. - CEO*

Thanks, Stephanie. Good job, guys.

Stephanie Ferris - *Vantiv, Inc. - CFO*

Thanks.

Operator

We will now take our next question from Jason Kupferberg.

Jason Kupferberg - *Jefferies LLC - Analyst*

Good morning, guys.

Charles Drucker - *Vantiv, Inc. - CEO*

Good morning.

Jason Kupferberg - *Jefferies LLC - Analyst*

Hi. I just wanted to see if you can start by elaborating, Charles, on some of the comments I think you made about share opportunity as a result of industry consolidation. I just wanted to see if you could go a little deeper there. Are you seeing some distracted competitors that you're able to capitalize on?



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Charles Drucker - *Vantiv, Inc. - CEO*

So I would say, first of all, we think we have been focused on shifting share, and we've demonstrated our ability to shift share. Any time in general, the market has distractions going on with one, consolidation, but two, EMV is creating an opportunity that merchants get to question that says if I have to shift to another processor, if I have to do a conversion, or if EMV is an upgrade opportunity, we think we're undistracted right now, and we can laser focus our sales force to continue to win and shift shares. So the point there gives me confidence in our ability to continue to grow in those mid-teen type of numbers on our high-growth channels, and also in our core business to win.

Jason Kupferberg - *Jefferies LLC - Analyst*

Okay. That's helpful. And then congrats on the Netflix win. Certainly sounds interesting. Does that move the needle at all this year, or is it a needle-mover in 2017?

Charles Drucker - *Vantiv, Inc. - CEO*

I think it's a combination of, we've become such a size in general, maybe not in that eCommerce section, I'd love to be bigger, and we'll work to be bigger. With the amount of transactions that we process, it's not a overall needle-mover. What it is, it just demonstrates when you get, just like in our brick-and-mortar large national spaces, you get more key names like that, demonstrate the confidence that we have the products to be able to bring more clients over in the future. That's a key to that win.

Jason Kupferberg - *Jefferies LLC - Analyst*

Okay. And then just last from me, obviously sales and marketing expenses running a bit hot because of all the success you're having through the various distribution channels in merchant. So, if this top line momentum continues, do you still think pro forma EBITDA margins can be up year over year in 2016?

Stephanie Ferris - *Vantiv, Inc. - CFO*

I think so. We talked a little bit about the impact of the FI headwinds coming through in the third and fourth quarter. You will continue to see us drive leverage in the back office. I think you saw the back office, other operating and G&A start to moderate out as well. We are seeing some efficiencies there. We would expect those to continue, but given some of the headwinds in FI, we would expect EBITDA margins to be very stable for the rest of the year, sequentially with the second quarter.

Jason Kupferberg - *Jefferies LLC - Analyst*

All right. I'm going to turn it over. But thanks for the sneak peek at 2017. It looks like that's right in line with what the street is modeling on revenue, so appreciate that.

Stephanie Ferris - *Vantiv, Inc. - CFO*

Perfect.

Operator

We'll take our next question from Vasu Govil.



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Vasu Govil - *Morgan Stanley - Analyst*

Thanks for taking my question. Congrats on the Fifth Third renewal. Any changes in economics there to call out that are notable?

Stephanie Ferris - *Vantiv, Inc. - CFO*

I think what we've said is, as we thought about the contract renewal, as well as the TRA terminations, the combination of those, we would expect to generate \$0.06 of EPS growth in 2017. No impact in 2016.

Charles Drucker - *Vantiv, Inc. - CEO*

Our growth and where we see the business has allowed us to absorb that and raise the guidance in 2016.

Vasu Govil - *Morgan Stanley - Analyst*

Got it. Then I guess thanks for the commentary on 2017. In the FI segment, one of your larger clients decided to switch to a competitor. Do we know the timing of when that starts impacting the FI business growth? And can you provide any context as to why this client chose to leave Vantiv on the FI side soon after joining as a partner on the merchant side?

Charles Drucker - *Vantiv, Inc. - CEO*

We don't know timing. Sometime in 2017, that, that client will potentially move a portion of their business. I think to me, you never like a client to move, but it's not for any particular service lack or other things on our side. Potentially, clients do things for other type of strategic type of reasons, but it's nothing that's a trend or anything that gives me pause on our FI business.

Vasu Govil - *Morgan Stanley - Analyst*

Great. And just last quick one, on Integrated Payments, it seems like the health care vertical has got the attention of many players, and you guys have also spoken about that being a focus. Can you walk us through what you need to do differently to target this vertical versus what you've been targeting previously, and are there any external catalysts that are making the health care more attractive now?

Charles Drucker - *Vantiv, Inc. - CEO*

I think, so a couple things. One is we've already now, so what we needed to do is we needed to shift our business development activities towards integrated providers in health care. The reason why it's attractive, it's a fast-growing market, and it's very fragmented. So no one really has a big market share, but I got to tell you, our Integrated Payments group has gotten traction. We've had recent wins of third-party providers moving business, as far as programming to us that will add business in the future, so we think with the model that we have out at Integrated Payments, our ability to support these health care providers, bring value-added services, this is another vertical we're going to focus on, and we will be successful in this. These are the things that give us confidence of our ability to continue to grow this business rapidly.

Vasu Govil - *Morgan Stanley - Analyst*

Great, thanks very much.



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Operator

Moving on, we'll take our next question from Bryan Keane.

Bryan Keane - Deutsche Bank - Analyst

Good morning, guys. I just want to ask about the FI business going forward, to make sure I understand it. The guidance I think is for negative low single digit, so (technical difficulties) revenue growth. So I'm just trying to figure out, I think you said EMV. Does the four points we saw on EMV completely go away in the third quarter? Or is there still some carryover in EMV in the back half of the year? And secondly on Fifth Third, what kind of impact does that have on that revenue growth rate in the back half? Thanks.

Stephanie Ferris - Vantiv, Inc. - CFO

Yes, as we think about expectations for FI and decline in the low single digits for the third and fourth quarter that's really the combination of our expectations that the benefits of EMV and fraud we saw in the first and second quarter moderating, and not being very impactful in the back half of the year. As well as the impact of the Fifth Third Bank contract renewal.

Bryan Keane - Deutsche Bank - Analyst

Okay. Is there a way to quantify that? It would look like the Fifth Third renewal is probably having almost a mid single-digit type impact on the (multiple speakers) --

Stephanie Ferris - Vantiv, Inc. - CFO

I think the way to think about it is EMV and fraud services drove about four percentage points of growth in the first and second quarter. We don't expect to see that growth in the third and fourth quarter. And so on top of that, we would expect to see some Fifth Third Bank compression come through the FI line, so driving it down to the declining mid single digits. Does that help?

Bryan Keane - Deutsche Bank - Analyst

Yes, that helps figure it out. So, if you look at the implied guidance for the year, 4Q looks like a deceleration. I think it comes out to be like 3% to 8% revenue growth given the full-year guidance, and that would be a deceleration from the numbers you've been putting up, plus the guidance in 3Q. Is there anything to think about in 4Q that causes a deceleration, or is that just some conservatism?

Stephanie Ferris - Vantiv, Inc. - CFO

There's nothing specific to think about with respect to the deceleration, other than what we've articulated around EMV slowing and the Fifth Third Bank renewal. Certainly in the back half of the year our expectations around our high-growth channels are in the mid-to-upper teens, which we've seen higher growth than that, in the first and second quarter. We expect same-store sales growth to continue to be stable. As a result of that, we do feel pretty confident in our outlook for the rest of the year.

Charles Drucker - Vantiv, Inc. - CEO

And I feel good about sales, where we're going, how we're boarding, and how the channels are performing.



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Nathan Rozof - *Vantiv, Inc. - Head of IR*

I think the guidance would imply on a total-Company basis upper single-digit rates of growth for the fourth quarter.

Bryan Keane - *Deutsche Bank - Analyst*

Yes, okay. Just looking at [some of the] low end of the range. All right. Great. Thanks so much. Congrats.

Stephanie Ferris - *Vantiv, Inc. - CFO*

You bet. Thanks.

Operator

We'll take our next question from Ashwin Shirvaikar.

Ashwin Shirvaikar - *Citigroup - Analyst*

Good morning, Charles, good morning, Stephanie. My first question is, given the Fifth Third contract we're going a couple more years here [until] 2019 previously, was the renewal previously contemplated in guidance or was it moved forward? Perhaps because of the other client loss or other reasons? And just staying with FI, can you remind us of the magnitude of EMV benefit the last four quarters so we can properly monitor the rollover?

Charles Drucker - *Vantiv, Inc. - CEO*

First of all, large clients and anchor clients, you always start negotiating and talking to them early. So it wasn't contemplated in the original guidance. We've had strong growth in our core business and the opportunity to put a long-term strategic deal together with one of our largest partners, I think is an extraordinarily good move for our Company. It locks in clients as far as we're all aligned to really go aggressively after the business.

We're not dealing next year with renewals, so we can actually focus our whole sales force efforts on taking new merchant banks, and we have our clients protected. This was a fair deal. I mean, the contract was struck seven years ago and I feel really good about this. This is our Company looking at future in the forward and being proactive, working with our partners, to reach something that give us confidence of consistent revenue and EPS growth in the future, so I'm pretty excited about this.

Stephanie Ferris - *Vantiv, Inc. - CFO*

Ashwin, I would just step further on, was it implied in our guidance previously? No, it wasn't. As Charles said, our strong operating performance this year really enabled us to offset the impacts of this really strategic client renewal that we're really excited about. And with that, we were even able to raise guidance. It wasn't contemplated, but we're thrilled to be able to mitigate the impacts of it because of the core-growth rates being so strong in the business. Then for your EMV question on modeling, the fourth quarter of last year, we saw three percentage points of benefit from EMV and fraud services and the first and second quarter this year, four percentage points. So as you think about your model, hopefully that helps.

Ashwin Shirvaikar - *Citigroup - Analyst*

Okay, yes, that does. And I agree on your point on the spend of the business. Going to the merchant-preferred channel, can you comment on expectations from this particular channel? I believe you had a good win recently through the California Bankers' Association. Are you pretty much sort of strategically moving from, you know, the high-profile type, you know, very large-bank wins that you announced over the last year, year-and-a-half, to just doing a lot of small ones and rolling them up? Is that sort of the idea here?



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Charles Drucker - *Vantiv, Inc. - CEO*

It's a combination. So we've continued to win mid size, smaller to mid size, and the difference is, the large guys come up lumpy, so they're typically -- you're working almost two to three years out on some of the large guys, because of the ability to move and various [kinds] comes up at different times. With other regional banks that could come up, you would suspect, or even large national banks that come up, you would suspect that we would bid aggressively but these, they're more lumpy, that would come.

So we are focused -- our bread and butter are those, you know, 100 branches to 500 to 600 branches, but we have an ability to take on large clients also. They just come lumpier, but I'm -- the wins that we're getting in the mid size right now, as we continue to work on the large guys who will become available in the future.

Ashwin Shirvaikar - *Citigroup - Analyst*

Very good. Thank you, guys. Congratulations.

Charles Drucker - *Vantiv, Inc. - CEO*

Thank you.

Stephanie Ferris - *Vantiv, Inc. - CFO*

Thank you.

Operator

Moving on, we'll take our next question from Tien-tsin Huang.

Tien-tsin Huang - *JPMorgan - Analyst*

Good morning, good results here. Just on the Fifth Third, just to better understand it, any change on the merchant referral side? Whether it be cost? And also just going forward, are there stem-function changes in pricing as they qualify maybe for volume discounts down the road?

Charles Drucker - *Vantiv, Inc. - CEO*

So basically, I think like anything else, the contract was done seven years ago, market environments change, so I think I'm actually even more excited that there's even better alignment on them on the merchant referral side that allows them to share differently as they perform even better than they are today.

Stephanie Ferris - *Vantiv, Inc. - CFO*

Yes, and I would also add to that, just thinking through that, it would actually likely be a net benefit to us because increased referrals obviously drives a lot more merchant new sales, so we would see the benefit of increased merchant referrals and new sales offsetting any of the residual payment we would make to them.

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Charles Drucker - *Vantiv, Inc. - CEO*

Last thing, I would say that from -- compression without talking about, it basically will be stable throughout the life of the contract.

Tien-tsin Huang - *JPMorgan - Analyst*

I got it, so stable plus sounds like more motivation to drive referrals.

Charles Drucker - *Vantiv, Inc. - CEO*

Yes.

Tien-tsin Huang - *JPMorgan - Analyst*

And giving them a little bit of skin in the game as well. That makes sense. It's a strong channel. That's why I wanted to make sense -- Last one related to this one, no change in terms of, you know, your ability to reach out and work with other merchant bank partners in terms of --

Charles Drucker - *Vantiv, Inc. - CEO*

Nope. Nope. We continue to really focus on growing that channel.

Tien-tsin Huang - *JPMorgan - Analyst*

Good to get it done. I guess everything else, trend-wise, looked great. Anything to call out, whether it be new-merchant adds from the Mercury book or even maybe attrition as well, any surprises in reaction to some of the changes? Whether it be EMV or OptBlu? Doesn't sound like it, but figured I would ask.

Stephanie Ferris - *Vantiv, Inc. - CFO*

I would say what we've been talking, really, really stable trends in terms of across the board from all the components of revenue. As Charles said, new business continues to drive the organic growth rates. Attrition continues to be very stable to slightly better, so trend-wise, looks really good. Charles, do you have any -- ?

Charles Drucker - *Vantiv, Inc. - CEO*

I'd say the sales force and the new wins that we are getting, and we'll be boarding, very strong wins. Names that you would potentially recognize and a lot of names you won't, that really contribute to our confidence in our ability to take share. So we feel good about that pipe. And also the wins that we put on the books.

Tien-tsin Huang - *JPMorgan - Analyst*

Last one, I promise, just the Netflix win, is that US only? Sounds like it's a portion of the business. Is there a chance to scale that up?

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Charles Drucker - *Vantiv, Inc. - CEO*

Portion of US only, that's correct. And there's always a chance to continue to scale that up based upon how we perform. Our track record has proven our ability to perform very well, so, you know, I feel good about that win.

Tien-tsin Huang - *JPMorgan - Analyst*

That's great. Good work. Thank you.

Operator

Moving on, we'll take our next question from Jim Schneider.

Jim Schneider - *Goldman Sachs - Analyst*

Good morning. Thanks for taking my question. Congratulations on the solid results. I was wondering if you could talk a little bit about the scale in your sales and marketing expense. I know you've been investing there on that line. Can you maybe talk about at what point you start to get a little bit more leverage in the sales and marketing expense and when it might start to under run the growth in merchant? Or will you plan on continuing to scale that investment with the merchant revenue growth?

Stephanie Ferris - *Vantiv, Inc. - CFO*

Yes, I think that, you know, given how strong the high-growth channels are performing, which is a really, really good thing, you would expect to see us to continue to invest in sales and marketing. For them to be in line or maybe even slightly above net revenue growth. You know, a lot of that being driven by the high-growth channels.

There are a couple of them that have partners there that obviously increase the selling and marketing expense. We will always do everything we can to continue to invest in sales and marketing because it does drive the high level of organic growth rates we've been experiencing.

Jim Schneider - *Goldman Sachs - Analyst*

Thanks. Then maybe a question on the ISO channel. What's your expectation for that channel as we head through the remainder of the year and to the extent you can see into 2017 at all and provide us any kind of color, that would be great.

Charles Drucker - *Vantiv, Inc. - CEO*

Just, the ISO channel continues to benefit from the EMV. And we are seeing good results coming out of that channel. We partner very well with our ISOs, and we've given them a great set of tools to go out and take shares. We've been happy with the ISOs performing.

That EMV is going to trail through 2017, and then we will see what 2018 opens up. But boy, the channels that we have are just performing extraordinarily well, and our sales forces are seizing the opportunities. So we're very positive on all our channels.

Jim Schneider - *Goldman Sachs - Analyst*

But you still expect to see kind of a positive low single-digit growth rate in ISO?



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Stephanie Ferris - *Vantiv, Inc. - CFO*

We do. We expect that to be mid single digits as we look forward. As Charles said, it's grown a little bit stronger than that but we do still expect it to be a mid single-digit grower for us.

Jim Schneider - *Goldman Sachs - Analyst*

Thank you.

Stephanie Ferris - *Vantiv, Inc. - CFO*

You bet.

Operator

Moving on, we'll take our next question from Craig Maurer.

Craig Maurer - *Autonomous Research LLP - Analyst*

Good morning. I was just wondering, I apologize if this has already been asked, I've been jumping back and forth on a few things. Dynamic routing, seems like that should be at the forefront, considering where we've seen recent lawsuits and other things out there. Discussing EMV routing and whatnot. How do you feel about that product going forward and its ability to win you further large merchant contracts, especially if Visa has to give up on their choice of authentication and acceptance?

Charles Drucker - *Vantiv, Inc. - CEO*

First of all, we've always been out there being able to help our clients reduce their overall acceptance costs. We think we are the best in dynamic routing, and our relationships with all the networks and our merchants and our partnerships allow us to, on the fly, dynamic route each and every transaction that we have, so we believe that's going to continue. It's going to become even more important to both networks associations and us, and we think that's a huge competitive advantage for us.

People talk about it. We execute it. We do it. And we're recognized by our clients for being able to do that. So that's a key ingredient, and that will continue in the future.

Craig Maurer - *Autonomous Research LLP - Analyst*

Thanks.

Operator

Moving on, we'll take our next question from George Mihalos.



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George Mihalos - *Credit Suisse - Analyst*

Great, thanks, and let me add my congrats on another nice quarter. Wanted to ask, given that you guys are obviously ramping a lot of new business, I know you still have at least one large client ramping in the back half of the year here, how should we be thinking about the revenue-per-merchant transaction, 2Q to 3Q? I mean, typically, it goes up. Should we continue to expect that this year?

Stephanie Ferris - *Vantiv, Inc. - CFO*

I think you're exactly right. We expect a very large client to ramp up in the third and fourth quarter. I think expectations from a net revenue-per-transaction standpoint, you would expect them to be flat year over year. As we bring that large client onto the platform. Very consistent with what we saw when we brought on other really significant large clients.

George Mihalos - *Credit Suisse - Analyst*

Okay. Great. And just as it relates to the merchant bank channel, I think the last number I have there is about 4,000 branches. Any update you can provide there, maybe where you would expect to end this year?

Nathan Rozof - *Vantiv, Inc. - Head of IR*

So we don't guide to merchant bank branches. We continue to add branches each quarter, so we're now above 4,000 branches. Continuing to march forward, but no forward-looking guidance, George.

Charles Drucker - *Vantiv, Inc. - CEO*

I would tell you that the pipeline and the wins that continue to come, I feel good about. And then as we land more wins and then we reaffirm things like Fifth Third reaffirming their confidence in us through an extended, lets us laser focus on some renewals coming up in the future with some of our competitors.

George Mihalos - *Credit Suisse - Analyst*

Okay, great. Just last question from me, obviously if things are going very well, you're investing more, seems like in sales and marketing. To the extent, if you were to see any sort of a slow down in the future in 2017, is it fair to say that there's a fair amount of discretion in some levers that you can maybe pull on the expense side to help you mitigate any potential slow down?

Stephanie Ferris - *Vantiv, Inc. - CFO*

So we don't anticipate anything slowing down, as we talked about. We continue to see really high organic growth rates within the merchant business. And excluding the couple of items we talked about with FI, even FI continuing in the mid single digits, excluding those couple items. But to the extent we do see any kind of slowdown, we obviously have the best margins in the industry. Those are absolutely key to us. We have a lot of operating leverage. You'll continue to see us drive operating leverage. And we have a lot of control around our back office, as well as our sales and marketing, so we absolutely could do something there to the extent we ever saw a slow down. But just to reiterate, we don't see it at all, so that's our expectation.

Charles Drucker - *Vantiv, Inc. - CEO*

And I would say, I've been fortunate to have a very strong management team that understands the industry very well, so we're always understanding what type of opportunities, and if there are shifts, how you best able to take advantage of those positively and then we come out of a world and



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we've all grown up, that we have leverage to become more efficient in the future. So what you saw also with the Fifth Third is our ability to balance our risk/reward. So I feel good about if things change, our ability to do positive things.

George Mihalos - *Credit Suisse - Analyst*

Great. Thanks, guys.

Operator

Moving on, we'll take our next question from Tom McCrohan.

Tom McCrohan - *Sterne, Agee & Leach, Inc. - Analyst*

Hi, thanks. Great quarter, guys, congratulations on the trends. I had a question first on the FI segment, and then I had a follow-up on merchant. For the FI segment, the renewal with Fifth Third, it looks like an eight-year deal. Can you just confirm the old one was also eight years? And secondly, the percent of revenues that Fifth Third represents in the FI segment today, and how does the renewal impact that, is it directly going up or down?

Nathan Rozof - *Vantiv, Inc. - Head of IR*

Sure. First thing, Tom, just on the contract, so the original contract was a 10-year deal that we signed in 2009, that was set to expire mid 2019. We've extended that relationship by an additional 5.5 years to the end of 2024, so we've got 8.5 years from now on that contract. As Charles mentioned, one of our largest clients now extended for a very long period of time. We're going to shy away from giving specific commentary on the economics of the deal itself, but obviously strategically very important, and we think positions us to continue to drive this business and grow and chase new wins, you know, through this period of time.

Tom McCrohan - *Sterne, Agee & Leach, Inc. - Analyst*

Okay. My follow-up is on just structurally how the industry is changing. This is a merchant-side question. So given what JPMorgan has done in terms of creating this hybrid network, Vantiv doesn't issue any cards, to the extent that this trend takes off where other issuers want to replicate that kind of structure, how does Vantiv play a role? Can you remain independent and help a large issuer create a structure like that without being owned by an issuer? I think you know where I am going with that. Can you speak to that and how are you positioned in that evolving structural change that is going on in the industry?

Charles Drucker - *Vantiv, Inc. - CEO*

I think, yes. First of all, I think we can compete in that. Right now, if you're referring to interchange, we don't see any banks sacrificing their interchange. If that would occur, we think Visa and MasterCard, we have to level the playing field on that potentially, but having market share, that's why we think scale matters. The connections that we have to the large clients, the mid-size clients, it matters because it's so hard to move clients if a company like us is servicing those clients well.

So we think, you know, if that changes and there's opportunities we can partner with people, we can do various things, so I'm confident in our ability. I would tell you, I think this could drive some consolidation in the industry because the complexity of EMV security, and also some of these things in the future, not every company can do that. I think only a handful of them, and I think we're one of those handful, and we're going to continue to press our advantages. So having this market share and us grabbing even more market share is going to continue to be on focus for us and important for the future.



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Tom McCrohan - *Sterne, Agee & Leach, Inc. - Analyst*

Thank you.

Operator

We'll take our next question from Tim Willi.

Tim Willi - *Wells Fargo Securities, LLC - Analyst*

Thank you, and good morning. I had a couple of questions on eCommerce. The first one was, I think if I remember correctly, you guys historically focused on sort of large enterprises with the [Lidel] platform. I'm just curious as you build out IPOS, the bank referral and those channels are targeted a bit more to the SMBs, are you seeing, you know, any pick-up in momentum around those types of merchants and their aspirations for mobile or eCommerce? That's my first question, and then I had a follow-up.

Charles Drucker - *Vantiv, Inc. - CEO*

The answer is, we typically have been targeting mid size to larger type of clients, and we are seeing more through the omni-channel capabilities that smaller clients want that online presence and today, we're able to bring that capabilities by extending some of our core platform pieces. But we are seeing that more, and we're continuing to be positioned through the omni-channel capabilities to take advantage of that, but where a lot of the growth is coming from is from the mid- to large-size players today.

Tim Willi - *Wells Fargo Securities, LLC - Analyst*

Okay. And my follow-up was, you know, as part of the whole eCommerce, mobile commerce discussion, I guess, you have sort of the rise of the platforms, if you will, aggregators and PayFacs. If you could address that portion of the market, and your capabilities, and the momentum you are seeing there as opposed to direct sales to a USPS or a Netflix, but more to platform-type companies that are enabling smaller merchants, or not-for-profits, however you want to describe it. Just any thoughts around that part of the market and your success.

Charles Drucker - *Vantiv, Inc. - CEO*

We're seeing success in both, and what you might refer to, you hear us call about PayFac or aggregation, we do have aggregation models. From our perspective, some start-ups, smaller clients are very expensive to manage or source or the sales cost, and some aggregators are potentially better equipped for that, and we've been enabling through our PayFac, so we can bring some scale to the PayFac and also be able to have it a very plus for us.

Also, when we develop a product, we can also sell products into that field. So we're utilizing both aspects of it. The PayFac world has been growing on the small end well, and then usually what we see is that when a client gets a little bigger, they need more features and capabilities that we've been very competitive with.

Tim Willi - *Wells Fargo Securities, LLC - Analyst*

If I could just throw a last follow-up on that, just competitively, how does the sort of aggregator PayFac-competitive landscape look, given that we are now sort of three to five years into this new market? Have you seen competition intensify? Have people sort of dropped off to the side of the road for any variety of reasons around funding or capabilities or risk management that makes them less competitive? Anything to note there?



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Charles Drucker - *Vantiv, Inc. - CEO*

Are you talking about how we compete to provide PayFac services to others? That's the beauty of our integrated system. There's only a handful, a couple that can really bring those capabilities. So we see the competition to win PayFac still remain in a just a couple of providers. We are selective, from a risk-management standpoint, of who we go after, and we're very thoughtful about who we go after in the PayFac world, we're not a high-risk company. We're not a high-risk company, so there are a lot of areas and industries that we just won't do. If you're referring to competition in the PayFac, it's still centralized around a couple of people that have the skills and capabilities to do that, and we continue to win there, and we think it's a small piece of our channel right now, but it has a good, fast growth. Yes.

Tim Willi - *Wells Fargo Securities, LLC - Analyst*

Great. That's all I have. Thanks very much.

Charles Drucker - *Vantiv, Inc. - CEO*

Thanks.

Operator

Moving on, we'll take our next question from David Togut.

David Togut - *Evercore ISI - Analyst*

Thank you, good morning. Good to see the 6% increase in net revenue per transaction in merchant services. Just revisiting a prior question, how should we think about this growth in terms of breaking it down into apples to apples, price increases versus positive price mix, as you grow faster in the SMB channel?

Stephanie Ferris - *Vantiv, Inc. - CFO*

Yes, I think, you know, our high-growth channels continue to perform in the 20% range. If you think about those, the integrated payments business as well as the merchant bank business, that's really success into the SMB space. So I would think about that being the primary driver for the expansion in net revenue per tran, which is really continuing to go down market and win in the SMB space.

Nathan Rozof - *Vantiv, Inc. - Head of IR*

Just to add on to Stephanie's comments, if you look at the USPS coming in the back half of the year, we're clearly driving a lot of improvement in rate to be able to absorb the impact of a large client coming in, which typically is running at large national rates, so the outlook for our rate in the Merchant business would continue to be, as we've said, stable to up. We expect large clients to make that lumpy, but in this case we have a large client coming in and it looks like rates going to be more flattish for a few quarters as they come on board, and then we'd expect the trend to continue.

David Togut - *Evercore ISI - Analyst*

Just to follow up on that, Nate, if we look at your preliminary 2017 guidance of high single-digit revenue growth, what does that assume for net revenue per transaction in the merchant business?

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Nathan Rozof - Vantiv, Inc. - Head of IR

Yes, so it would be more stable in the first half of the year, ramping in the back half. On a year-over-year basis.

David Togut - Evercore ISI - Analyst

Got it. Okay. That's helpful. Just a quick final question, I'm curious, Charles, your thoughts on the recent thaw in the relationship with PayPal and Visa around tokenization and not trying to steer Visa card holders toward ACH. Any thoughts on the impact that might have on eCommerce growth broadly, and any impact on Vantiv?

Charles Drucker - Vantiv, Inc. - CEO

So, yes, at this point, I mean, it's still coming out more on the details of that. I don't see it having any impact on us. I mean, potentially, there could be more just general card volume happening, but, you know, I think, you know, I don't know enough specifically about it to have comments, but I -- it doesn't -- nothing in that makes me feel differently about our growth or ability to go after the market.

David Togut - Evercore ISI - Analyst

Thank you very much.

Operator

We'll take our final question from Bob Napoli.

Nathan Rozof - Vantiv, Inc. - Head of IR

Bob, you there?

Bob Napoli - Piper Jaffray - Analyst

Yes, sorry about that. Just my question, I mean, obviously, you know, a lot of things are going right here, and just, you know, what is the -- what is your biggest concern? What are you most worried about going into 2017 and 2018? What can slow down the momentum? Especially in those high-growth channels?

Charles Drucker - Vantiv, Inc. - CEO

I mean, well, I mean consumer spend has an impact on us because of our large transactions, that's always on the top of the mind. You know, we try to think of things that, you know, if there's regulations or things that could change, but what we do is a good job. I really think I have a strong management team around me. We try to look forward and then create opportunities that we're really good at executing on, that if something came up.

So EMV, we'll see what happens with EMV as far as, you know, I think through 2017, it feels good. As far as, you know, our ability for tailwinds, we're continuing to get success through OptBlu, through the integrated payments. Hard to say, besides same-store growth, we're actually a very highly accountable management team, that we think most things are in our control, and if we focus and execute, we're going to have success. So that's quite frankly what I love about our team.



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I don't say it enough, but people don't realize how much our team, not just my direct reports, but throughout the entire Company, they deliver every day, which makes my job easier. They're thinking forward for the customers, we're bringing ideas, we're a flat Company and these guys make the difference, and too many times people underestimate how your key people across the entire organization does that. Very long-winded, but passionate about our people and passionate about how they take care of things.

Bob Napoli - *Piper Jaffray - Analyst*

On the Mercury business and platform. I know you talked about high-growth channels in particular, but now that, that platform is integrated, and you talk about the growth, have you started executing on the growth of value-added services? Is Mercury continuing -- within that channel, I know the merchant business is doing very well. But is Mercury still generating, you know, the growth above 20%, and again maybe if you could talk about the value-added services now that the back end is integrated?

Charles Drucker - *Vantiv, Inc. - CEO*

Another quarter above that 20% mark, and I think not only new dealers and developers coming to us, getting into their embedded base of clients is winning, and then also bringing tokenization, encryption, helping them navigate EMV, simple things like a gift card program, where they had one, but we have more scale associated that can bring it more competitive to the markets. Those things are happening.

So we're seeing good cross-sell. You know, you'll see announcements on security pay, pays that we do, and we think it's a good, and our developer programs that we have, even though it's easy to get into it, we continue to make it easier to work with us. I'm -- that channel gives -- a lot of our channels, but that channel gives me continued confidence that with the ranges that we put out there, we'll continue to hit.

Bob Napoli - *Piper Jaffray - Analyst*

Great. Thank you very much. Appreciate it.

Operator

And at this time, I would like to turn the conference back over to our speakers for any additional or closing remarks.

Nathan Rozof - *Vantiv, Inc. - Head of IR*

Perfect. Thank you. Thanks, everyone, for joining the call today. If you have any additional questions, please reach out to us using the contact information available on our Investor website, and we'll be happy to help you. Thanks again, everyone. And good-bye.

Operator

That will conclude today's conference. We thank everyone for their participation.



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