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VNTV - Q1 2016 Vantiv Inc Earnings Call

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PRESENTATION

Operator

Welcome to the Vantiv first quarter earnings call. Today's call is being recorded. At this time, I'd like to call over to Nathan Rozof. Please go ahead, sir.

Nathan Rozof - Vantiv Inc. - IR

Thank you. Good evening, everyone, and thank you for joining us today. By now, everyone should have access to our first 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 competitive position and first quarter operating performance. Mark Heimbouch will then deliver financial results, including our updated guidance for the second quarter and full year. Also joining us in the Q&A portion of today's call is Stephanie Ferris, who has been promoted from deputy CFO to become our next CFO.

Throughout this conference call, we will 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. Reconciliations of our non-GAAP pro forma financial information to the GAAP financial information appear in today's press release.



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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 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 statements disclosure in today's earnings release and in our periodic filings with the SEC. Additional details concerning our 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.

Now I'll turn the call over to Charles Drucker, our CEO. Charles?

Charles Drucker - Vantiv Inc. - CEO

Thank you, Nate, and thanks to everyone for joining the call this evening. I'm happy to announce another strong quarter for Vantiv and an exceptional start to the year. Given the strength of the first quarter and the high rate of organic growth that we've experienced across our business, we are raising our guidance for 2016.

During the quarter, net revenue grew 15% to \$431 million, as strong growth trends continue across the business. We are winning share and successfully penetrating the SMB market to our high-growth channels, contributing to strong organic growth.

Turning to the bottom line, EPS grew 24% to \$0.56, demonstrating the leverage and scale in our business model as well as our continued focus on efficiencies. Results exceeded expectations in both segments.

Within Merchant, net revenue accelerated to 17% and our high-growth channels continued to perform well and are becoming a bigger piece of that business. We also continue to see stable same-store sales trends and our sales pipeline remains strong.

Financial institutions also outperformed our expectation this quarter. Growth was 7%, reflecting continued strong execution as well as contribution from EMV card reissuance.

I'm pleased to announce that we completed the integration of Mercury's back-end processing. We migrated over 100,000 merchants to our platform during the first quarter. And we did it ahead of schedule, which shows the strength of our people and their ability to execute.

It isn't easy to integrate acquisitions into migrate transactions without disrupting clients, but our team has successfully executed the transition. We integrate our acquisition. It is part of our DNA and we continue to prove our ability to leverage our combined scale and distribution to accelerate net revenue growth and to expand our margins.

Converting the Mercury back-end also enables revenue synergies, including OptBlue as a catalyst for future growth. We are winning market share by building on our core strength and expanding into high-growth channels and verticals. Our core strengths include our scale, a unique portfolio of clients, and our broad distribution capabilities.

Scale enables us to make investments in new technologies and to spread the cost over more than 23 billion transactions, keeping us competitive on price and enabling us to earn best-in-class margins. We serve more than one-third of the top 100 national retailers in the United States; very few of our competitors can claim that and given our scale, we think that is a very defensible part of the market for us.

We are also penetrating the SMB market. We have added high-growth channels that target these merchants helping us win share and these high-growth channels continue to outperform, growing at above 20% again this quarter. Our breadth of distribution is also unique. We have 3,000 dealers and developer partners in the Integrated Payments.



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We distribute to more than 4,000 merchant branches and we have the strength in our traditional direct and ISO channels as well. We are aggressively expanding into fast-growing verticals, like healthcare, where we can bring together our assets from across the Company to create a unique solution for our clients.

Given the importance of technology in managing healthcare's complex revenue cycle, I believe that our expertise and Integrated Payments, combined with our industry-leading scale and breadth of offerings, truly differentiate us. We are already processing billions of dollars in volume for a variety of healthcare providers across our distribution channels and we have relationships with several healthcare ISVs.

Here, again, you can see the importance of our disciplined approach to integration. First, we acquired Mercury and ran the business with a focus on maintaining its strong partner and client relationship, ensuring that we continue to grow. Then we took the time to integrate it. We spent 18 months to make sure we got it right.

And now, we are going to expand its capabilities throughout our business to penetrate new verticals and develop unique solutions that our peers can't match. I mentioned healthcare, as an example, but we continue to identify other verticals where we see opportunities to leverage our strength and expand our position as a leader in payments.

Our results are compelling not only in terms of first quarter but also over the long term. The Nilson Report recently published its annual rankings of Merchant acquirers. According to the data, Vantiv has won more market share over the past five years than any other -- than any of our peers. We expanded from 13% market share in 2010 to over 19% market share in 2015. That's nearly 6 points in five years.

And while we are the number two acquirer today, we are within a billion transactions of number one and we are growing fast. We pointed to several catalysts on the fourth quarter call that gives us confidence in our ability to grow the business. Each of these catalysts are intact, including the contribution to grow from recent new client wins. Our sales pipeline is strong and we will begin the rollout of OptBlue to the Mercury portfolio later this year.

The last item I'd like to update you on is EMV. EMV card reissuance is contributing significantly to the growth in our FI business. We expect this to continue through the first half and then to trail off in the back half of the year as the segment returns to lower single digits organically.

In Merchant, we are working closely with our clients to enable EMV and while our conversations typically begin there, they often quickly expand to include Security & Fraud Solutions as well as other new technologies. The migration to EMV is complex but we have the people -- we have put the people and tools in place to help our clients upgrade to EMV as quickly as possible. We are seeing good rates of conversion among both merchants and issuers.

Finally, before I turn the call over to Mark, I would like to address the executive appointments that we have announced this afternoon. As you may have seen, we are expanding Mark's role and we are promoting Stephanie Ferris to CFO. In addition to his duties as COO, Mark is taking on increased responsibility within the Company to now include our product organization, where he will further enhance our ability to bring new products and services to the market.

Stephanie has more than 20 years of financial experience, including several senior finance roles at Vantiv. In addition to her time in finance, she has also stepped in to run the Merchant Bank business from 2013 to 2015, where she significantly accelerated growth.

Since return to finance, she has served as our deputy CFO, so I expect a seamless transition. So congratulations to you both; your appointments are well deserved. Going forward, all three of us will participate on future earnings calls.

With that, let me turn it over to Mark to review our financial results and to update our guidance. Mark?



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Mark Heimbouch - Vantiv Inc. - COO

Thank you, Charles, and welcome to everyone who is on the call. I'd also like to take a moment and congratulate Stephanie on her promotion to CFO. I've worked with her now for the past several years and I'm highly confident in her ability to succeed in this role.

Turning now to the results, we had another very strong quarter. Net revenue accelerated to 15%, reaching to \$431 million. Pro forma adjusted net income grew 23% to \$110 million, and pro forma adjusted net income per share increased 24% to \$0.56 per share. Our Merchant segment generated net revenue growth of 17%, representing an acceleration from fourth quarter levels. The transactions grew by 10% and net revenue per transaction increased by 7%.

The growth in the Merchant segment reflects strong performance across the business, including in our high-growth channels, which continued to exceed our expectations. Same-store sales were strong at over 7%, as the impacts from the extra day, given leap year as well as the timing of Easter, came in a little bit better than expected.

Our Financial Institution segment also had an excellent quarter. Net revenue growth was 7%, primarily due to a 2% increase in transactions and a 6% increase in net revenue per transaction. In addition to continued strong execution, EMV card reissuance, the extra day given leap year, and the timing of Easter holiday all contributed to strong growth within the segment.

Turning to expenses. Total operating expenses, including sales and marketing, other operating costs, and G&A increased by 15% in aggregate during the first quarter, as we continued to invest in the business for future growth while maintaining our focus on efficiency. Below the EBITDA line, depreciation and amortization expense, excluding the impact of the amortization intangibles related to acquisitions, declined to \$21 million, which is consistent with the expectations in our guidance. Net interest expense was \$28 million in the quarter, also consistent with recent trends.

Moving to income taxes. Our pro forma tax rate was 23.5%, and including an \$18 million tax adjustment related to our TRAs, consistent with recent trends.

And finally, our average diluted share count declined to 196.8 million shares, down from over 200 million average diluted shares last year. This decline in share count was primarily due to the warrant cancellation transaction that we executed in December and demonstrates our commitment to opportunistically deploy capital in order to maximize shareholder returns.

Finally, I will briefly review our guidance for the second quarter and full year. Based on the current level of transaction trends and new business activity as well as taking into account our strong first quarter performance, we are raising our guidance for the full year 2016.

We now expect net revenue of \$1.82 billion to \$1.85 billion, representing growth of 8% to 10%. And we expect pro forma adjusted net income per share of \$2.58 to \$2.64 per share, representing growth of 15% to 18%.

For the second quarter, we expect to generate net revenue of \$460 million to \$465 million, representing growth of 9% to 10% and we expect pro forma adjusted net income per share of \$0.66 to \$0.68. We continue to maintain a consistent approach in terms of providing guidance, setting expectations that we have a high level of confidence in attaining.

We continue to expect Merchant to grow net revenue in the upper single digits to low double digits through the rest of the year, primarily driven by our expectations for mid- to upper teens rates of growth in our high-growth channels as well as our expectations for same-store sales growth to continue in the mid-single digits.

We similarly expect the core business within our Financial Institution segment to grow in the low single digits for the remainder of the year. While growth may again approach the mid-single digits in the second quarter, due to continued EMV card reissuance, we expect this impact to trail off in the second half of the year, as Charles mentioned.

Finally, our guidance excludes the impact of the potential future capital allocations, such as M&A, new TRA terminations, or share buybacks. I'll now turn the call back to Charles for closing remarks.

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Charles Drucker - *Vantiv Inc. - CEO*

Thanks, Mark. As you can tell, we are very happy with our performance in the first quarter. Our business is firing on all cylinders. We have the right assets. We have the right channels and we are winning market share. Vantiv continues to deliver strong financial results, as our team successfully executes our strategy.

Our results are compelling and they are attributed to our people. Our people do a great job and they have the power to propel us to new heights. All these factors gives us confidence in our increased expectations for the full year and keep us optimistic about our future.

Thank you all again, and let the -- operator, we are ready to open up the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jason Kupferberg.

Jason Kupferberg - *Jefferies LLC - Analyst*

Nice job here, guys. I wanted to ask about the integrated channel specifically. Obviously, it continues to grow at a very healthy pace for Vantiv and others in this space and wanted to get your perspective in terms of what inning, if you will, do you think we are in terms of penetration of this channel? Just trying to get a sense of how long we might be able to really sustain these kind of 15% to 20% growth rates in this channel?

Charles Drucker - *Vantiv Inc. - CEO*

Jason, we're -- it's Charles. We're still -- we are in the early innings. I think we have this -- both the embedded base and then also, with the cost of the hardware and software coming down, the addressable market continues to get bigger. I was just with Matt Taylor today and he's very excited and optimistic about the things that we're going to do. So, we are very bullish on this channel and also with the capabilities that we have, as a Company, continue to grow this into the future.

Jason Kupferberg - *Jefferies LLC - Analyst*

Okay. If we reflect back now over the past four to six quarters, certainly with the fundamentals and the execution here have both been really strong, so just wondering what sort of challenges do you guys now worry the most about because it does feel like both the segments are firing on most, if not all, cylinders?

Charles Drucker - *Vantiv Inc. - CEO*

Like -- so we feel very confident about our business and how the year continues to shape up well. We are excited because we continue to take share and we think we are in the right channels and we are winning in that SMB market. Obviously, there's still a lot of competition out there and it's really, Jason, just keeping up with the pace of change.

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Complexity is good for us because we have the scale to bring across. But I always stay awake with the complexity of the businesses and the pace of change, so it's keeping our people motivated and keeping them focused. Like I talked about earlier, we go for a disciplined approach and I try not to make the lens real wide to chase all the shiny objects, and we narrow it down and our team has done an excellent job of that.

Jason Kupferberg - *Jefferies LLC - Analyst*

Understood. Just last one for me on expense growth in the quarter. I know it was 15%, matched the revenue growth. The expense growth was a bit higher than we were modeling, at least, and I'm just wondering if this is a situation where you took advantage of the revenue upside in the quarter to accelerate some of your investments. Or has there been any change in your full-year view of where expense growth and adjusted EBITDA margins will land?

Mark Heimbouch - *Vantiv Inc. - COO*

Jason, it is Mark. Yes, again, if you look back at the first quarter, the -- it was -- sales and marketing expenses grew a little bit higher than revenue. Some of that's due to continued investment in the channels as well as, frankly, the high-growth channels coming in above our expectations. So, it probably came in a couple percentage points higher in terms of net revenue growth than we would have expected for the second quarter.

And that's just for the high-growth channels, set aside the impact of Easter and Leap Day, so that contributed to that. If you look below the line, actually, I think operating expenses, while they continued to grow, we were really driving -- striving to drive efficiency in terms of consolidation of technology and platforms. As Charles indicated, we completed the integration of Mercury towards the end of the first quarter.

G&A, I think, actually has continued to start looking more and more like a fixed cost, so much lower growth. So we continue to expect scale and gain leverage in the business and to expand margins. In fact, I think -- we were looking back over the past several years, I believe this is probably the first year -- and I could be somewhat -- I could be incorrect, but I think this is the first year that we've actually seen EBITDA margins, year over year, come in stable.

Historically, the first quarter is always our lowest year in terms of net revenue performance and you have made some investment in the prior year in terms of technology and people that become somewhat a fixed cost. So that has always had an impact of putting a little bit more pressure on our first quarter margins, with margins subsequently expanding.

Jason Kupferberg - *Jefferies LLC - Analyst*

Okay. Thank you.

Operator

Ashwin Shirvaikar.

Ashwin Shirvaikar - *Citigroup - Analyst*

Thank you, guys, and congratulations.

Charles Drucker - *Vantiv Inc. - CEO*

Thank you.



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Ashwin Shirvaikar - Citigroup - Analyst

Also, Mark and Stephanie, congratulations to the two of you on your new roles.

Stephanie Ferris - Vantiv Inc. - CFO

Thanks.

Ashwin Shirvaikar - Citigroup - Analyst

I guess my question really is, with regards to, again, going back to integrated payments, and obviously strong growth, you mentioned investing in newer verticals. If you could step back, look at the end market and give us some idea with regards to how many verticals remain to be penetrated as you get into these newer verticals, what's the competitive outlook? I would imagine that, at this point, the verticals that you aren't in somebody else might be in, from a iPOS perspective, so do you anticipate that market becoming more competitive?

Charles Drucker - Vantiv Inc. - CEO

So, from a disciplined approach, and in the one that, right now, we are starting to focus on is healthcare. One of the reasons healthcare -- one, it is a big vertical and it is pretty fragmented, so no one really owns that vertical. So it allows us to help grab that share and utilize the tools at Mercury that had the ability to manage the clients, the easy APIs, and we think there's enough that we can grab and quickly take advantage of that share.

There's a couple of other verticals on the horizon for us that we will discuss in the future. But, right now, healthcare, in addition to going after an embedded base, is where we think our ability to grab share is more likely and it's not as -- it's fragmented so we can grab pieces of it that no one really owns that space now.

Ashwin Shirvaikar - Citigroup - Analyst

Got it. Okay. And just a question on the -- on one of the high-growth verticals, the Merchant Bank referral channel. Obviously, you guys have done a pretty outstanding job there with regards to signing new distribution opportunities with newer banks. Where do you stand with regards to the -- again, penetration question, with regards to that particular opportunity, if you could provide us an update in terms of number of branches converted versus new conversations you might be having with future partners?

Charles Drucker - Vantiv Inc. - CEO

So on that -- so we feel very strong around the pipeline and now, since Stephanie built a lot of that, let me let her address where we're at.

Stephanie Ferris - Vantiv Inc. - CFO

Yes, sure. So we feel really positively around the Merchant Bank channel, as you know, we got into it several years ago. We think we should be much bigger than we are. We think the opportunity is still very big for us and for us to take a lot of share over the next couple of years.

We are in the low- to mid-single digits in terms of market share there. We have about 4,000 referring branches today. They are all getting up and running and tend to take a time period to do that, but they are all performing very well. So we expect that channel to be very strong over the next several years for us.



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Ashwin Shirvaikar - Citigroup - Analyst

Got it. If I can sneak a quick numbers question. The timing of Easter, how much does that -- did that affect numbers in the quarter?

Stephanie Ferris - Vantiv Inc. - CFO

We think about Leap and Easter together, and thinking about that growing about 2 percentage points of growth for us in the first quarter.

Ashwin Shirvaikar - Citigroup - Analyst

Okay, so Easter might be a little bit more than half of that?

Stephanie Ferris - Vantiv Inc. - CFO

Sure.

Ashwin Shirvaikar - Citigroup - Analyst

Thank you.

Charles Drucker - Vantiv Inc. - CEO

All right. Thank you.

Operator

Dan Perlin.

Dan Perlin - RBC Capital Markets - Analyst

Thanks, guys. A couple quick questions. I guess one is on the management change, I'm wondering this -- the concept of new product expansion, is that, I guess, one, why now? Is there something that's embedded in that, that suggests that you want to be thinking about something more international and then there's actually more of a bigger M&A theme that we need to be thinking about there as you expand the role? Then I'll come back with my second question.

Charles Drucker - Vantiv Inc. - CEO

I had a first -- just to as the first question is that we pride ourselves in building bench strength and talent, and being able to promote and expand. So this is all about continuing to expand the bench strength in our team, giving Stephanie and Mark more opportunities within the organization. Now, within product, within Mark's organization, the closer we put engineering in product and working with the business line, continues to make us more nimble to execute and grab opportunities.

Because what I'm really excited is there's going to be a lot of various new things, whether it is EMV, the security that we want to use those capabilities to be nimble to the market and fast and continue on that. As far as international, international is always in our sights and our roadmap. But we've said we're going to be disciplined for the right opportunity coming up and I think we are good stewards of the money -- of our capital. And like Mark said in his closing, our guidance does not include any type of potential M&A, TRAs, or share repurchases.



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Dan Perlin - *RBC Capital Markets - Analyst*

Okay. So the management change doesn't have anything to do with what's on the horizon in terms of international expansion.

Charles Drucker - *Vantiv Inc. - CEO*

It is about continuing to elevate the people and build bench strength.

Dan Perlin - *RBC Capital Markets - Analyst*

Great. Now, a lot has been said around the integrated channel. I don't hear that much about e-commerce anymore from you guys. What's the update there?

Charles Drucker - *Vantiv Inc. - CEO*

E-commerce is performing strong. We continue to win share. I guess we talked about the integrated because it's still the bigger piece of the high-growth channel, but it is contributing very well. We are going toe to toe. We are winning share and we are happy with the performance of that channel and that's a good point. Maybe we should, for the future, because we -- sometimes you start focusing on the bigger piece inside of the high-growth, which has been the Merchant and the integrated, but e-commerce is doing well also.

Dan Perlin - *RBC Capital Markets - Analyst*

It is a high-quality product. You've got a lot of good stuff going on.

Charles Drucker - *Vantiv Inc. - CEO*

I hadn't thought about that, but yes. (Laughter).

Dan Perlin - *RBC Capital Markets - Analyst*

The last quick one I had for you, this expansion into healthcare. Two things -- can you narrow down a little bit the area of focus within healthcare? I mean, that's a huge area. I know a lot of people are focused on it, some big players, in particular. And then, how do you think about the addressable market there when we look at the true opportunity and how much time Matt is spending there? Thanks.

Charles Drucker - *Vantiv Inc. - CEO*

Yes, so practice management is the first aspect of it. We think there's a lot of integrated software partners that some Matt has familiarity with and we've brought some over that's starting to see volume move. But that's the first aspect, you are absolutely right, because inside that vertical, there's multiple verticals, or practice management is where we are focused first.

Matt's done a great job of hiring people in his organization so he's able to -- what we do a good job is, and sometimes people lose track is, there's the core engines and the core pieces you need to make sure the trains run on time and you produce. So he focuses amount of time still mining that embedded base and then has hired good people, along with his direction to be able to point them.

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So we try, we're -- look, we have a lot of execution on our side so it's very important that we continue to take advantage of the base and do that. So Matt is -- it's about bringing strong people into the organization. He's done a great job around that.

Dan Perlin - *RBC Capital Markets - Analyst*

Excellent. Thanks.

Operator

Darrin Peller.

Darrin Peller - *Barclays Capital - Analyst*

Thanks, guys. First, congrats to Mark and Stephanie. Both of you, congrats on your roles.

Stephanie Ferris - *Vantiv Inc. - CFO*

Thank you.

Darrin Peller - *Barclays Capital - Analyst*

Just wanted to start off, just to be clear. I mean, you're running with revenue growth of mid-teens now while you have -- obviously, you have tougher compares later in the year. You also have the US Post Office coming on and off [balloon] benefits starting in the second half.

So I guess I just wondered if you guys can just walk us through what, if any, variables may positively or negatively impact your growth rates, just understanding there's been a nice conservatism in your 8% to 10% guidance. Anything -- any sort of items we should beware of that could have a pretty outsized impact on the growth potential?

Mark Heimbouch - *Vantiv Inc. - COO*

No, I think -- it's Mark. I will take this and Stephanie can chime in. I think that our longer-term view in terms of Merchant is, it's upper single digits to low double digits in terms of growth and FI. As we've continued to say, on an organic basis, it's probably lower single digits. So we always try and maintain a balance around those expectations.

But, to your point, the first quarter, we saw tremendous growth. And we've tried to break it down to everybody to understand some of the reasons for the strong performance in first quarter. Obviously, we've pointed to the impacts of the calendar items and then, second, the overperformance, really, in our high-growth channels.

Now, that is likely to continue for some period of time and -- but our approach has been to continue to maintain a pretty steady way in terms of providing guidance and expectations. Whether you want to -- whether you consider that to be conservative, we just have taken on an approach to be very consistent and set expectations that we're very comfortable with.

Darrin Peller - *Barclays Capital - Analyst*

All right. Makes sense. Look, just a quick follow-up on the FI side, again, the growth rate has been obviously strong, with a big contribution also from EMV. I guess, just can you help us understand how much of that is EMV specifically? I'm not sure if I missed it before.



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And then, the organic sustainable growth rate there, when you start to anniversary that, and I know there's been fraud products that have helped you guys for a little while now, a couple years almost probably. I think you should be starting to anniversary the rollout of some of those fraud products, so just help us understand what we really should expect, longer term, on that front? Maybe low-single digits, or flat, or what would be helpful?

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes, I think I can take that one. So, in the first quarter, EMV and fraud-related services impacted about 4% of the 7% growth, really consistent with what we saw in the fourth quarter. If you recall, we called out 3% of an impact there, so 4% of an impact in the first quarter.

You're right, we do expect EMV to continue to be strong for us in the second quarter, likely not quite as strong as what we've seen in the first quarter and the fourth quarter, as we get through the end of our EMV card reissuance for the majority of our portfolio there.

So we would expect a little bit higher growth in the second quarter but then returning to low-single digits in the third and fourth quarter, as we have finished out our EMV card reissuance and lap a lot of those fraud-related services that we put into the books last year. So, hope that helps.

Darrin Peller - *Barclays Capital - Analyst*

Okay. All right, guys. That's very helpful. Thanks very much.

Operator

David Togut.

David Togut - *Evercore ISI - Analyst*

Thank you. And let me add my congratulations, Mark and Stephanie, for your promotions. Just to follow up on the Merchant business. You've given a granular sense of growth rates expected on the FI side, as the EMV card issuance cycle starts to tail off. As you look at the Merchant base, what percentage of your merchants have upgraded to chip card terminals?

And then, in connection with that, can you give us a sense of how you expect the demand for security and fraud solutions to proceed after the chip card terminal upgrades have finished in your Merchant base?

Charles Drucker - *Vantiv Inc. - CEO*

It -- so, from a terminal, we're slightly below half of terminals are EMV enabled. So we have, like I've talked before, a runway that I think takes you through into 2017. So we have more to continue to accelerate that. From a security piece, I think the combination of our EMV as a catalyst, but point-to-point encryption and tokenization continues to increase.

So as our clients are converting, we are putting the whole -- in most cases, the whole suite together. So we think that demand continues to go because EMV itself does not prevent any type of card breaches and other components. Point-to-point encryption and tokenization is really the safest way. So we're seeing, with our clients, the demand. Now, EMV has a liability shift that people are just pushing quicker to, but that demand for the security product isn't going to continue to be a staple in what we're selling.

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David Togut - *Evercore ISI - Analyst*

How does the sales process for a point-to-point encryption work through the integrated payments business as it compared to your direct sales channel?

Charles Drucker - *Vantiv Inc. - CEO*

It's -- it all depends upon the provider. It -- a lot of times, it depends on when we're picking up the transaction from the swipe or from when the ISV develops it. So some ISVs where we've developed from the swipe all the way through, some ISVs from when we pick up the item.

So the integrated side with that has -- it's probably more in the early innings where a lot of core retailers are potentially in -- they are still in the early innings but an inning or two ahead. So, it is working with each individual software developer.

David Togut - *Evercore ISI - Analyst*

Understood. Thank you very much.

Operator

George Mihalos.

George Mihalos - *Credit Suisse - Analyst*

Great. Thanks, guys, and let me add my congratulations on a very nice quarter. Looking at the growth in Merchant in the first quarter, even if we back out Easter and the Leap Year, so you -- it sort of implies you grew 15% up from the 14% in the fourth quarter. Can you maybe dig a little bit more into what accelerated from fourth quarter into first -- into -- in the first quarter? Was it iPOS? Was it the non-Fifth Third Bank channel? Just any more clarity you can provide there.

Stephanie Ferris - *Vantiv Inc. - CFO*

Sure, happy to. So, our high-growth channel has continued to perform very strong in the first quarter, like Charles mentioned on the call, up to 20% plus, which was above our expectations. In addition to that, we did see, across the entire portfolio, really strong same-store sales growth, a percentage above what we had seen in the fourth quarter. So those two, in addition to the benefits of Easter and Leap, really helped drive the benefits we saw in the Merchant business in the first quarter.

George Mihalos - *Credit Suisse - Analyst*

Okay. So it seemed pretty broad based?

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes, it did.



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George Mihalos - *Credit Suisse - Analyst*

And then, also the commentary on the market-share wins, which I think are pretty evident, given the type of growth you're posting. Can you talk a little bit about what you're seeing in the pipeline, both on the SMB side and then also, large national merchants, kind of what's going on there?

Charles Drucker - *Vantiv Inc. - CEO*

I mean, we -- our pipeline is strong. We are bidding in the large national merchants space, we are in the mix for a lot of clients that we have. I think our ability to bring clients up quickly on EMV, point-to-point encryption and tokenization has really given us -- we believe, compared to some of our competitors -- advantages because of our platform that we can convert them in a fast manner.

On the SMB, we're -- I mean, in the integrated space, we are winning business there and continue to shift volume. Our Merchant Bank channel, as it ramps up, and we're -- these banks are starting to light up because a lot of times, the banks have these long-term relationships. And as we get that business bankers to call on them, we are winning in that middle, small/middle market type of client. So pretty bullish around where new sales are going and our ability to continue to win share and continue to move up the ranks of being the top acquirers.

George Mihalos - *Credit Suisse - Analyst*

Great. Thanks, guys.

Operator

Tim Willi.

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

Good afternoon. Congrats, everybody. The -- in the Internet business, or e-commerce, I guess Charles or Mark, could you talk about any particular verticals or areas where you're seeing stronger performance or opportunity open up, whether it be small business, large business, the whole marketplace phenomena, which seems to really be getting legs and can be quite a large market, just any thoughts around those topics?

Charles Drucker - *Vantiv Inc. - CEO*

We're pretty -- we've had good success and I talk first of all, we have a lot of web-only clients that in digital and some of the other areas that have been growing very well for us. Our omni-channel has actually picked up a lot where we've had the brick and mortar and, like I talked about a year or so ago, the contracts that are with other players are coming up. And we're able to do the omni-channel capability to do the web side of it. That's actually accelerated well. So I wouldn't -- there's no -- I'm trying to think if there's any particular vertical, Mark or Stephanie, that --?

Mark Heimbouch - *Vantiv Inc. - COO*

No, I'd say it does tend to be web-only type clients. In our large national or mid-market, we do continue to process the volume for those guys, omni-channel, so be it. But there's just been continued market-share gains. I would say they tend to be a little bit larger clients. We haven't had the same focus, or haven't focused so much on the smaller client, the web only.

Charles Drucker - *Vantiv Inc. - CEO*

Yes, so we haven't been downstream as much as more of a mid-sized to larger, and our future intention will be to more downstream.



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Tim Willi - Wells Fargo Securities, LLC - Analyst

Okay. Great. And just a follow-up. In terms of the discussion around value-added products, et cetera, obviously security, EMV, you've highlighted and those have been good contributors now for quite awhile. Are there any other areas or products that seem to be showing signs of life or elevated levels of interest that could potentially also come on to the extent that you lap pretty favorable environment around the security discussion, et cetera? Is data, or marketing, any of that kind of stuff improving, or is it not?

Charles Drucker - Vantiv Inc. - CEO

So, I know it's still a tradition, but our gift card and some of the closed-loop stuff that we were able to introduce into the Mercury portfolio and then, especially now, that it is on our back end, there were several of our core products that we've chose -- just like the OptBlue, not to introduce, because it wasn't on our back end. So I think, in the iPOS area, gift card and penetrating more in that.

I believe data analytics and -- will be something that we are going to do extraordinarily well at in the future but it's still in the early stages. And then, we do a good job of how we route transactions for our client. We call it prime routing that we have very analytical views about how transactions move, debit transactions, between networks that we do a good job -- it differentiates us that we're able to share in some of the savings that a Merchant may have, which helps us maintain the margins that we have and differentiate us.

Tim Willi - Wells Fargo Securities, LLC - Analyst

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

Operator

Bob Napoli.

Bob Napoli - William Blair & Company - Analyst

Thank you, and good afternoon. A question on -- another question on integrated, but when you bought Mercury years ago -- and I think you performed certainly what we would have expected from the time you bought it on the growth side -- but the penetration rate, Mercury's penetration rate of their dealer/developers was somewhere around a 10% range.

And I wondered if you've been able to track that metric and been able -- have you made a lot of progress in expanding that? And what is the remaining opportunity within the penetration of the current dealer/developer base that you do have?

Charles Drucker - Vantiv Inc. - CEO

So I don't know that number. I mean, it's really Matt and we continue -- we are winning more dealers and developers than we have in the past. So we continue to win our shares, because as I just pointed out, there's -- the end merchant coming but winning the dealer and developer and being easy for them to work with and connect is key.

So we have been accelerating that and, I mean, we talk about embedded base, but I don't know if we have a -- if I have a number on the universe and what penetrated into that, because it's so fragmented. Some of them are very small. I don't have that and that might be a follow-up question for Nate in the future. But all I can tell you is that we're -- we win -- we're winning more than over the last couple of years when Mercury was a standalone.



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Bob Napoli - *William Blair & Company - Analyst*

Okay. Then a follow-up question, just on -- I mean, obviously, your balance sheet is deleveraged, continues to deleverage very rapidly. At this point, from an investment perspective, what areas would -- are of the highest priority to you? Is it further expansion within the US? Is it further expansion internationally, or is it still just doing more with the tax agreements? What are your thoughts on the balance sheet deleveraging and the priorities for an M&A-type of investment?

Charles Drucker - *Vantiv Inc. - CEO*

So, using our balance sheet is to continue to support growth and look for strategic type of acquisition, whether it is international. The US, we filled out the strategic products but there could be also opportunities, but it's, really, our first focus is around growth. And figuring out how we continue to have this sustainable growth that we continue to demonstrate. And we think we have the assets to continue that but M&A or growth is our first priority.

After that, the TRAs are very accretive. It takes two parties, the Bank recently sold one last year and if we meet on those and they become available, that would be a good place to deploy. Share repurchases would be another place to deploy. I think we've shown a discipline in that we're not prone to just keep the cash on our balance sheet, but growth is actually -- growth is where our first priority is and we will continue to be. But we will deploy.

Bob Napoli - *William Blair & Company - Analyst*

Last question, just quickly on the tax rate. It came in a little bit lower than what we had modeled for the quarter. What would be a reasonable number to use for 2016?

Mark Heimbouch - *Vantiv Inc. - COO*

So the way to model taxes is to continue to use a base rate of 36%, with a tax adjustment of \$18 million per quarter through the remainder of 2016.

Charles Drucker - *Vantiv Inc. - CEO*

That was similar to what we had last --

Mark Heimbouch - *Vantiv Inc. - COO*

That's right.

Charles Drucker - *Vantiv Inc. - CEO*

So it's pretty much the same.

Bob Napoli - *William Blair & Company - Analyst*

Perfect, thank you very much.



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Operator

Bryan Keane.

Bryan Keane - *Deutsche Bank - Analyst*

Hi, guys. A lot of my questions have been asked, but just a couple follow-ups. On EMV, I heard it was about 4 points of the growth in FI. How much is it pushing up growth in Merchant?

Mark Heimbouch - *Vantiv Inc. - COO*

It's really not in terms of how we think about the revenue. I mean, I think we're probably taking some market share because we have solutions for the client. But, frankly, the revenue we generate from terminal sales is insignificant. So it's not -- as you think about the -- whether it is a question around growth in revenue per transaction or value-added services, and we're not out charging extra for EMV. It may be contributing to market share gains, but by itself, it's not an important element in terms of the rate of growth --

Charles Drucker - *Vantiv Inc. - CEO*

Now, I would say that's EMV -- but security, tokenization, point to point is -- will be growing and as we've talked about it, as clients convert, it continues to give us confidence in the back half and going into 2017. Because, as they convert, we will start to see value-added transaction, but it is all about how we're maintaining and seeing our -- the margins. So the EMV part, like pure terminal and stuff, no, it is not really our DNA.

Mark Heimbouch - *Vantiv Inc. - COO*

Actually, the runway for security, tokenization, encryption -- that's got a pretty long runway left on it.

Bryan Keane - *Deutsche Bank - Analyst*

Well, I know there's some Merchant acquirer fees being tacked on for non-compliance for EMV, so I don't know if you guys are doing that like some of the other acquirers and if that's helping boost results?

Charles Drucker - *Vantiv Inc. - CEO*

They -- we are -- so EMV in certain parts of your portfolio, there's different risk profiles and it is a very minimal amount. Is that right, Stephanie? It's pretty --

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes, the amount we charge for that is really not (multiple speakers) --

Charles Drucker - *Vantiv Inc. - CEO*

Yes, we're not -- we're -- I feel like as acquirer, we've got to work hard to educate and get our merchants to get up to the EMV standard so that they are protected and we eliminate fraud as much as we can in the industry. So, and our philosophy is it not making -- we don't make a lot on the terminals. We try to get it out there so that our attrition rates, we do the right thing for our clients and then we bring other products. But there are some items but it's not in the Merchant, it's not a big part of what we have.



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Bryan Keane - Deutsche Bank - Analyst

Okay. And then, in Merchant segment, the normalized growth rate is about 15% but the guidance is for -- going forward, is kind of for high single, low double. What would cause that growth rate to decelerate like that? Because right now, it's coming along pretty well.

Stephanie Ferris - Vantiv Inc. - CFO

I think Mark mentioned earlier, our approach to guidance has been consistent, talking about our Merchant expectations in the midterm to be in the upper and low-single/double digits. So as you think about some of the outperformance in the first quarter beyond Easter and Leap Day and the 2 percentage points, we did see higher growth in high-growth channels themselves. And so we would expect potentially some outperformance there compared to our guide. But again, be -- continue to be very consistent with our expectation for Merchant, and that's probably the reason why you're seeing a difference between the first quarter and then our out-quarter expectations.

Charles Drucker - Vantiv Inc. - CEO

(Multiple speakers). Go ahead.

Bryan Keane - Deutsche Bank - Analyst

I was just going to ask about revenue per transaction in Merchant. Has that changed much going forward?

Stephanie Ferris - Vantiv Inc. - CFO

We are expecting slight expansion, like you would see in the second quarter compared to the first quarter. But then, as we talked about, we bringing on the United States Postal Service in the back half of the year. So you would expect to see the revenue per transaction flow -- or be flat on a year-over-year basis.

Charles Drucker - Vantiv Inc. - CEO

I was going to say, as our sales force is performing out of the Company's performance, as we look, it gives us confidence of our ability to deliver.

Mark Heimbouch - Vantiv Inc. - COO

So, Bryan, we're not -- just to be clear, we're not sitting here and pointing to increasing rates of attrition or a loss of market share. We feel pretty -- really confident about the business, it's doing really well. And we have made an adjustment from the first quarter, the 4 percentage points that Stephanie has talked about in terms of the Merchant net revenue growth. We feel highly confident that the business is doing really well and continues to grow very well.

Bryan Keane - Deutsche Bank - Analyst

Okay, very helpful. Last question, just the OptBlue, that's going on to work for you, is that -- would that be material in the second half or when will that start showing up in the results?

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Charles Drucker - *Vantiv Inc. - CEO*

It will start showing up towards the second half, latter part of the year, and help us through into 2017 so it gives us confidence and continued catalyst to help us have consistent growth rates.

Bryan Keane - *Deutsche Bank - Analyst*

Okay. Congrats on the great results.

Charles Drucker - *Vantiv Inc. - CEO*

Thank you.

Operator

Tien-Tsin Huang.

Tien-Tsin Huang - *JPMorgan - Analyst*

Hi, thanks. Just on the Mercury --

Charles Drucker - *Vantiv Inc. - CEO*

Hi, Tien-Tsin.

Tien-Tsin Huang - *JPMorgan - Analyst*

Hey. How's it going guys? (Laughter). I don't bother changing it, by the way. (Multiple speakers). It's just that's how it's spelled, that's how it's pronounced. If I were born a little bit later, it would be spelled with a J but that's a whole different story. Just quickly on the Mercury conversion, you can cut that over to your platform. It sounds like the back-end stuff is done. I think that was the hardest part. So, what's left to do on the integration in order for you to hit your targets from here? On the Mercury integration side?

Charles Drucker - *Vantiv Inc. - CEO*

There are always small parts of the integration. There's always one-off type of things in a big portfolio. But the -- a good majority is done and now we're into just general -- special things that are around the edges. So I think a good majority of --

Mark Heimbouch - *Vantiv Inc. - COO*

I mean, we're past the biggest part. We will always continue to try and refine and drive efficiency in CRM-type systems, back office, and some of the front-end work. But we're past the big chunk of work.

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Tien-Tsin Huang - *JPMorgan - Analyst*

All right. Good. Glad to hear. The -- separately, just on the competitive front with all the consolidation, right, with Global Heartland closed and pieces transfers. Do you think of this as opportunity in the short run? Or do you still think of it as status quo because it's always pretty competitive out there?

Charles Drucker - *Vantiv Inc. - CEO*

So, I have really good competitors and the leaders and the people running those businesses are very strong. They know the business well. However, I do know, just like when you do any type of acquisition and you have to do consolidation, it could distract some other companies, which could leave the door open for opportunities for us to take advantage of market-share opportunities.

So, high respect for those companies; they have really good businesses. But we're -- there's a good amount of disruption happening that we intend on focusing our sales force because we think we are in a great position.

Tien-Tsin Huang - *JPMorgan - Analyst*

Good. Okay. Last one. Just the -- I guess the ISO piece of it. Obviously the growth channel is doing well, integrated doing well -- as you've discussed a lot. What's happening on the ISO side? Is that the other side of the trade versus integrated, or is it still holding in?

Charles Drucker - *Vantiv Inc. - CEO*

ISO -- I've said, at least with our ISO portfolio and the strength of our ISO leaders and how we work with them, EMV continues to give them -- give strength in there that allows them to continue to grow. I do believe that, as you flow through 2017 -- because I think the terminals and the EMV and the opportunities, as you go through 2017, it will put some challenging pressure. But, right now, boy, our ISOs are -- the leaders there, they're doing a good job and we're seeing positive growth out of that business.

Mark Heimbouch - *Vantiv Inc. - COO*

The other thing I'd add to that is we've seen -- we talk about same-store sales type trends, they've been very stable now for an extended period of time. And I think you're just seeing that across the business.

Tien-Tsin Huang - *JPMorgan - Analyst*

All right. That's great. Thanks for the update. And congrats to you, Mark and Stephanie. Happy for you both.

Mark Heimbouch - *Vantiv Inc. - COO*

Thank you.

Stephanie Ferris - *Vantiv Inc. - CFO*

Thank you.



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Operator

Dave Koning.

Dave Koning - *Robert W. Baird & Company, Inc. - Analyst*

Hey, guys, nice job.

Charles Drucker - *Vantiv Inc. - CEO*

Thank you.

Dave Koning - *Robert W. Baird & Company, Inc. - Analyst*

I guess, first of all, just as it relates kind of to Tien-Tsin's question, I guess the Mercury transition, I guess, late Q1, it sounds like was the timing. How does that incrementally benefit Q2? Is there like a revenue lift, a cost and margin lift? Like what -- and maybe how big of a Q2 benefit might that be, relative to Q1?

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes, Dave -- it's Stephanie. We had been talking about a \$7 million to \$10 million worth of synergies in 2016. We're on track to hit those. We do believe most of those synergies will flow through net revenue, frankly, that those benefits were -- are in our expectations for the second quarter. We did nicely integrate in the first quarter and saw a little bit of benefit from that, but those second quarter expect -- or benefits are in the expectations that we set out there.

Dave Koning - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And then, that's good. Secondly, so ISO and traditional channels, it sounded like they are both growing, is that still low-single digits?

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes, the traditional channels are growing in the low-single digits. The ISO channel, like Charles said, is growing a little bit stronger than that, given the ability for them to continue to sell the EMV and the terminals. But low-single digits for the traditional.

Charles Drucker - *Vantiv Inc. - CEO*

ISO has done a good job in the SMB market, the smaller and then and using that and they have been able to win share and take it from other clients -- other processors.

Dave Koning - *Robert W. Baird & Company, Inc. - Analyst*

Great. And then, finally, to clarify a yield question from before, in the Merchant segment, it sounded like you said yield should be up, I think, sequentially in Q2 and then stable the rest of the year. Do you mean then stable with Q2, in Q3 and Q4?



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Stephanie Ferris - *Vantiv Inc. - CFO*

I apologize, so, yes. So I would expect revenue per transaction to be up sequentially in Q2 slightly, and then flat, effectively, in third and fourth quarter.

Charles Drucker - *Vantiv Inc. - CEO*

We're talking about on a year-over-year basis.

Mark Heimbouch - *Vantiv Inc. - COO*

Year-over-year comparison, right?

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes, thanks for clarifying.

Mark Heimbouch - *Vantiv Inc. - COO*

So, year-over-year growth rate will be positive in the second quarter. Probably not quite as high as it was in the first quarter and then leveling off in the back half.

Stephanie Ferris - *Vantiv Inc. - CFO*

Correct.

Dave Koning - *Robert W. Baird & Company, Inc. - Analyst*

Great. All right. Thanks a lot. Nice job.

Operator

James Friedman.

James Friedman - *Susquehanna Financial Group - Analyst*

Hi. Thank you. I was wondering -- I know you have some supersize merchants to stand up in the second half, like the Postal Service. Stephanie and Mark, I was wondering, are there any one-time costs in advance in launching a merchant like that? And then I just have one quick follow-up.

Stephanie Ferris - *Vantiv Inc. - CFO*

We very successfully onboard large merchants. I mean, you've seen us do it very successfully with respect to Wal-Mart and Discover and lots of things in our history. We don't have significant one-time costs. Mark's team is able to do that with the conversions team that we have and IT team. So, no. No incremental cost with bringing those clients on in the back half of the year. It's a muscle where we've got to --



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Charles Drucker - *Vantiv Inc. - CEO*

Yes, that's muscle core DNA. We do that well.

Stephanie Ferris - *Vantiv Inc. - CFO*

Yes.

James Friedman - *Susquehanna Financial Group - Analyst*

Got it. And then, Charles, I just wanted to reference some of your market share comments. You decomposed what Nilson said about Merchant side. I was wondering how you think about market share on the FI side? It's -- because it seems like you're -- correct me if I'm wrong, but you're heavier in debit issuer processing than credit. It is hard to know what's going on with that end market. Any qualitative thoughts about the performance of that market will be helpful. Thank you.

Charles Drucker - *Vantiv Inc. - CEO*

Yes, you're absolutely right. We are more -- we're a debit shop, we're not a pure credit shop. We have a little bit of credit, but it's mostly debit. And there's really no good place where that reports debit as a whole. A lot of times, we just report by the number of banks. We have about 1,400 banks in our market share. And we're holding our own in that market share. And one of the challenges, some of the banks, they are just not -- they're not investing at this point as heavily in debit as credits.

But we continue to win and hit the numbers that we think it's still -- we think it's a low-single digit type of grower but it is a very good business. That's important. But there's no particularly good market share reference point like the Nilson Report that you can reference.

James Friedman - *Susquehanna Financial Group - Analyst*

Thank you.

Nathan Rozof - *Vantiv Inc. - IR*

Terrific. Well, thanks, everyone for joining the call today. If you have any additional questions, please feel free to reach out to us using the contact information available on our Investor website, and we will be happy to help you with those. So, thanks again, everyone. Have a great evening. Good-bye.

Operator

Thank you. That does conclude today's conference call. We do thank you for your participation today.



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