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VNTV - Q3 2016 Vantiv Inc Earnings Call

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PRESENTATION

Operator

Good day and welcome to the Vantiv third-quarter 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 third-quarter 2016 earnings release which can be found at www.vantiv.com under the investor relations section. During today's call Charles Drucker will begin by discussing our third-quarter operating performance. Stephanie Ferris will then describe our financial results and provide updated guidance for the fourth quarter and full year.

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.

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 statement disclosure in today's earnings release and in our periodic filings with the SEC.



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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 - President & CEO*

Thank you, Nate, and thanks for everyone to joining us today. I'm pleased to announce another successful quarter. I'm also happy to announce that we are raising our guidance again for the full year. Our ability to deliver superior organic growth speaks to the strength of our people and the consistent execution of our strategy, building on our unique competitive advantages including our scale, integrated platform and the comprehensive suite of services while continuing to expand into high growth channels and verticals. We are consistently winning market share and we continue to see strengths across our business. We're investing for the future and delivering strong results for shareholders by rolling out new products and technologies, expanding our share repurchase authorization and refinancing our debt.

I will walk through each of these items highlighting key areas of performance. First, the terms of our results. Net revenue grew 14% to \$491 million and EPS grew 20% to \$0.71. We continue to outpace the industry and mid teens net revenue growth compares to mid single digits for the industry. And our growth is all organic reflecting the strength of the business.

In merchant net revenue growth accelerated by 200 basis points to 17%. As both our traditional and our high-growth channels continue to outperform. We are winning SMBs for our high-growth channels. We are the market leader in integrated payments and we continue to gain share in merchant bank and e-commerce.

Within integrated payments we continue to have good success using our open platform strategy. Our goal continues to be to work with multiple software developers that allow merchants choice and able to choose the best point-of-sale solutions that fit their needs. We are continuing to have great success at adding new developers to our platform which is expanding our lead in the market. Particularly in the retail and restaurant verticals and we are successfully pushing into the healthcare vertical. Our leading network of partners continue to generate significant new business. We also deployed OptBlue within our Mercury portfolio which is generating additional net revenue growth.

Within merchant bank our value proposition is enabling us to continue to win new bank partners. For example we recently announced First Hawaiian Bank adding to our growing distribution network and creating opportunities for us to serve their existing customer base. In e-commerce we are one of the only acquirers that can truly offer on omni-channel capabilities. This is a big differentiator for us and helping us to win new business.

We announced Papa John's this quarter. They selected us to provide payment processing for e-commerce, mobile and its 3,300 locations. In addition to our omni-channel capabilities, Papa John's chose Vantiv because of our people and their reputation of serving clients which really makes us very proud.

Moving on from merchants our financial institution segment generated 1% net revenue growth. Slightly better than we expected. And this includes a full quarter impact from our strategic renewal with Fifth Third Bank as well as the benefits from EMV card reissuance.

I'm excited about our position in the market. We have the right strategy. We are in the right channels. And we are building on our advantages by making investments for growth. We offer competitive a suite of services to our clients with our platform and our scale we are able to quickly deploy new products and technology as they come to the market, giving our clients access to a full stack of features and functions. For example in addition to being the first to offer Verifone Carbon we also rolled out support for Apple Pay on the Web this quarter and we enhanced our in-app support of Android Pay.

Our comprehensive suite of security services is a differentiator for us, and our ability to upgrade clients quickly for EMV has continued to help us generate new business wins. In order to build on this advantage we are beginning to deploy EMV's new quick chip technology which will help our merchants speed transactions through check out. We also remain highly focused on executing on our capital plans, continuing to strengthen our company for future growth and driving strong returns for shareholders.



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Our capital allocation priorities remain unchanged. We continue to prioritize investments for growth including M&A followed by the return of capital including share repurchase. We have the confidence in the future of our business and we plan to strategically deploy our capital in order to maximize shareholder return. Our board of directors is supportive of our capital allocation priorities and increased our share repurchase authorization to \$300 million which we will use opportunistically. Lastly, we have improved our already strong balance sheet by amending and extending our existing debt which Stephanie will describe in a few minutes.

In summary this was another great quarter for us. Our financial results demonstrate the strength of our business model. Our recent wins continued outperformance across our businesses and our progress in deploying new technologies all show how well our people execute. Beyond the quarter our prospects remain bright. Our competitive position is strong and by executing on the capital plans we will continue to strengthen our company for the future. So with that let me turn it over to Stephanie to review our financial results and to update the 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 14% to \$491 million. Pro forma adjusted net income grew 19% to \$141 million and pro forma adjusted net income per share grew 20% to \$0.71. These results were driven by very strong performance across our business. Our merchant segment generated net revenue growth of 17% as transactions grew by 10% and net revenue per transaction increased by 6%, reflecting our continued success in the SMB market.

Our financial institution segment reported net revenue growth of 1%. The net revenue growth was impacted by the compression from the Fifth Third Bank contract renewal, partially offset by the contribution from EMV and fraud related services of approximately 3 percentage points. Looking ahead to the fourth quarter we expect FI net revenue to decline modestly in the low to mid single digits, primarily due to the compression from the Fifth Third Bank contract renewal as well as lapping benefits from EMV in for the fourth quarter of 2015. When excluding these impacts the underlying FI business continues to grow in the low single digits.

Strong net revenue growth combined with our disciplined expense control enables us to continue to drive leverage in the model. Operating expenses were generally consistent with our expectations, sales and marketing expense increased by 16% during the quarter reflecting our continued success and ongoing investment in the fast-growing merchant partner channels. On an adjusted basis other operating costs increased by 15% and general and administrative expenses increased by 7%, which is consistent with our expectations to drive efficiency in the back office. As a result adjusted EBITDA grew by 14% in line with net revenue growth to \$237 million.

Our adjusted EBITDA margin during the quarter was 48.3%, which is consistent with both our second quarter and prior year levels. Below the adjusted EBITDA line our non-operating expenses were consistent with recent trends. Depreciation and amortization expense excluding the impact of the amortization of intangibles related to acquisitions decreased to \$18 million. Net interest expense was \$27 million and our pro forma tax rate was 26% including an \$18.9 million tax adjustment related to our TRAs, again all consistent with recent trends. Before I go through guidance I'd like to discuss the recent debt refinancing that Charles mentioned a few moments ago.

We amended and extended our loans at favorable interest rates, modestly increasing the amount of debt outstanding by approximately \$250 million while keeping our annualized interest expense flat with prior levels. Following the refinancing our debt consists of a \$2.5 billion term loan A maturing in October 2021, a \$765 million term loan B maturing in October 2023 and a revolving credit facility of \$650 million. Our finance structure leaves us with ample capacity to deploy capital to meet our priorities.

Turning to guidance. We are raising our full-year guidance to reflect increased confidence following several quarters of strong results. For the full-year 2016 we now expect to generate net revenue of \$1.89 billion to \$1.9 billion, representing growth of 12% to 13%. We expect to generate pro forma adjusted net income per share of \$2.67 to \$2.69 representing growth of 19% to 20%. For the fourth quarter we expect to generate net revenue of \$488 million to \$498 million, representing growth of 8% to 10%. And we expect to generate pro forma adjusted net income per share of \$0.70 to \$0.72.

Our guidance includes our expectation for merchant net revenue to grow in the low teens during the fourth quarter. We continue to expect our high-growth channels to grow in the mid-teens or better and for same store sales growth to remain in the mid single digits. Finally, as Charles



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mentioned our Board of Directors increased our share repurchase authorization to \$300 million. Our guidance does not assume any additional share buybacks. With that I will turn the call back to Charles for closing remarks. Charles.

Charles Drucker - *Vantiv Inc - President & CEO*

Thanks, Stephanie. To conclude we are very pleased with our strong results. Our ability to consistently deliver superior organic growth speaks to the strength of our people. They are dedicated to serving our clients every day helping them to navigate the complex payment landscape while maintaining a constant focus on execution. This sets us apart from our competition. Our growth and success reflects their hard work and I want to sincerely thank all of them for what they do every day.

I also want to reiterate that I'm excited about our position in the market. Vantiv has a unique competitive advantage that is unmatched by our peers, including our diverse distribution channels, our integrated technology platform and a comprehensive suite of services. We are investing in the future, deploying products and new technologies that will build on our strategic advantages, while also furthering strengthening our balance sheet and executing on our capital allocation priorities. So for all on the line, thank you for your time today and with that, operator, I would like to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jason Kupferberg, Jefferies.

Jason Kupferberg - *Jefferies LLC - Analyst*

Thanks, guys. Good morning. Another nice job here. I wanted to start with a question on the merchant side.

The rev per tran, actually it accelerated a little bit in the quarter which was meaningfully better than we had expected. I think ahead of what you were implicitly guiding, especially because you had I think the postal service deal ramping up so we had thought there would be some moderation in rev per tran. Can you talk about some of the dynamics that enabled that metric to accelerate and as we think about the potential sustainability of that or not in the coming quarters.

Stephanie Ferris - *Vantiv Inc - CFO*

Sure. Thanks, Jason. I'll take the question.

We did anticipate the US Postal Service ramping up in the third quarter. They started ramping up at the end of the third quarter. So that large amount of transaction which was mitigating the net revenue per tran in our guidance originally, that's moved into the fourth quarter.

So what you're seeing in the third quarter is continued expansion in the net revenue per tran consistent with what we have seen in the past couple of quarters not being impacted by that United States Postal Service conversion. We are going to see that start happening here in the fourth quarter.



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Jason Kupferberg - Jefferies LLC - Analyst

Okay. That's helpful. Turning to the balance sheet obviously some fairly new developments here with the incremental buyback authorization and you talked about the refinancing. Related to that any comments you can make about some of the recent media reports about Vantiv's potential interest in the sizable US asset that is out there?

Charles Drucker - Vantiv Inc - President & CEO

I'll jump in here. First of all M&A is really a core competency of ours. We do it really well as you have seen from the other acquisitions we have done.

We are able to integrate and move forward. So M&A is clearly one of our priorities. And basically like we said historically we look for growth M&A type of activities and shareholder return through maybe share buybacks.

But I tell you we are disciplined in our approach so something strategic comes up we will be looking at it but we are pretty disciplined stewards of capital. In general it feels -- I really can't comment on any kind of rumors of market speculation but I tell you that this is a core competency of ours that we do well.

Stephanie Ferris - Vantiv Inc - CFO

I would add on from a capital and balance sheet standpoint we feel really good about where we sit in terms of being able to deploy capital either through M&A or share buyback. We feel real good where we sit today.

Jason Kupferberg - Jefferies LLC - Analyst

Okay, then just a quick last one for me. Can you spell out for us in the quarter in Q3 what growth in the integrated channel was as well as the overall high-growth channels and any variance in that growth versus what you saw last quarter? Thank you.

Stephanie Ferris - Vantiv Inc - CFO

Sure. The high growth channels continue to perform very well near 20% for us, very consistent with what we have seen historically. Specifically for the integrated payments channel, they continue to be really strong.

Again also in the near 20% number range. So the high growth channels continue to perform very well for us, in fact they are a big driver obviously of the continued expansion of the net revenue per tran.

Jason Kupferberg - Jefferies LLC - Analyst

Okay. Thanks again guys.

Stephanie Ferris - Vantiv Inc - CFO

Sure. Thank you.

Operator

Bryan Keane, Deutsche Bank.



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Bryan Keane - *Deutsche Bank - Analyst*

Good morning guys. You mentioned strength to the traditional SMB market. How fast is that segment growing for you guys and what percentage of revenue now does that make up the SMB market of the merchant business?

Nathan Rozof - *Vantiv Inc - Head of IR*

Hey, Bryan, it's Nate. We don't break out revenue by size of merchant but clearly our traditional channels which include our direct sales forces as well as our [ISO] business continue to perform really well and actually out performing.

We typically expect those to grow in the low to mid single digits but we have seen better strengthen in that. Right? That's obviously inclusive of the SMB market. I think that new sales continues to perform well, which is enabling us to continue to grow the merchant business at such strong mid to high teens rates.

Bryan Keane - *Deutsche Bank - Analyst*

What is causing you guys to take share in SMB this year versus years past?

Charles Drucker - *Vantiv Inc - President & CEO*

We think we have been taking it the last couple of years. But I would say look our partnerships in the merchant bank has really been a [strain] for us. The wins of these sizable banks that we have really has had good referrals coming in and allows us to take share.

The integrated payment continues to do just great. They continue to add more developers and dealers. They are going out.

They are getting their software in and we are the beneficiary of it. I think the strategic channels we are in are really helping us drive that growth and we are kind of -- I'm very excited about it, not kind of am. Very excited about where we are going and how as we lean forward and look to the years we think we have great one runway in these channels.

Bryan Keane - *Deutsche Bank - Analyst*

Okay. And then just last one for me. We saw during the quarter that Chase announced a win with Walmart. Just curious on what the impact would be to you guys from a deal like that?

Charles Drucker - *Vantiv Inc - President & CEO*

Financially its --

Stephanie Ferris - *Vantiv Inc - CFO*

Financially it's not impactful to us. We have a contract with Walmart. We have had that for a number of years.

They are a really good client of ours. They have had multiple acquirers besides us as part of their group that they process transactions through. So financially really no expected impact to us.



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Charles Drucker - *Vantiv Inc - President & CEO*

Like Stephanie said, we have a great relationship with Walmart. They are one that has multiple providers. With their service and the way we work we win share, they are going to be a strong partner for the future.

We don't see this as impactful.

Bryan Keane - *Deutsche Bank - Analyst*

Okay. Congrats on the quarter.

Stephanie Ferris - *Vantiv Inc - CFO*

Thank you.

Operator

Ashwin Shirvaikar, Citi.

Ashwin Shirvaikar - *Citigroup - Analyst*

Thank you. Good quarter guys. Good morning, Charles and Stephanie.

My question is with regards to the FI business. It performed better than we expected. Can you comment on the EMV.

How much actually there remains to be done from your perspective and can you express that maybe in terms of number of cards issued and number of projects ongoing? Also, can you comment on the visibility into the value-added services, like fraud?

Stephanie Ferris - *Vantiv Inc - CFO*

Sure. The FI business did outperform our expectations. Primarily as a result of continued benefit from EMV and fraud services of about 3 percentage points. We do continue to expect that to tail down.

If you recall I had talked about the benefit of that in the second quarter being about 4 percentage points. As we think about the fourth quarter we really do expect that to tail down. It does continue to benefit us modestly as we talked about before.

We don't expect it to continue in any significant way. On the value-added services side from on FI standpoint I think we continue to cross that well. The business continues to perform excluding the Fifth Third Bank renewal and the EMV card reissuance really at the low single-digit levels as we expected.

There's a lot of demand for our value-added services. Charles, I don't know if want to --

Charles Drucker - *Vantiv Inc - President & CEO*

I think we continue the move we made awhile ago continues to pay off both in new sales that we have and then our cross-selling opportunity. So we are seeing pickup in some of the banks taking more products. The fraud aspect continues to be highlighted especially helping to navigate



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through EMV and then the next thing is navigating them through as EMV cards are out there more and more terminals are out there, banks have to deal with more transactions moving to e-commerce or the Internet and us helping them navigate that through.

So we're seeing good success in both our cross selling of the [card] products we are well ahead of the curve on the EMV cards and that will tail off. We actually feel solid about the business and good visibility into how we can see the business unfolding as Stephanie gives general expectations around it.

Ashwin Shirvaikar - Citigroup - Analyst

Got it. Second question. With regards to -- you guys have talked about the healthcare opportunity. But then so have several of your competitors.

I'm thinking can you provide us an update with regards to where you stand. Is it primarily an organic push that you were thinking of for that [in] organic opportunities? Can you comment on that?

Charles Drucker - Vantiv Inc - President & CEO

Yes. So it is a -- our focus with healthcare is really leveraging off the Mercury element type of platform and taking these advantages to new verticals. It's primarily organically -- I never rule out if there was opportunities to help move those connections forward because we have this great infrastructure. This great service structure.

Product speeches that are rich that we were able to buy and integrate with our integrated payment. So we are making traction. We are having good success with developers that are coming to us.

We are seeing traction but it's very fragmented so if there's names or developers they are -- that's the good and bad part about this business. It's fragmented in general the integrated and we are able to capture them and bring them all. But highlighting a few names people won't really recognize them.

We are making good traction. Matt Taylor and team over there are very focused on that not only the strong winds and the successes we are having in what I will call core integrated payment the verticals that they are going into gives me confidence for sustained growth into the future.

Ashwin Shirvaikar - Citigroup - Analyst

Thank you guys.

Operator

Vasu Govil, Morgan Stanley.

Vasu Govil - Morgan Stanley - Analyst

Hi. Thanks for taking my question. I guess, first just quickly I think I heard that you guys had OptBlue [was rolled] out this quarter and now it is benefit on the merchant services segment.

I think it rolled out perhaps a quarter sooner than we were expecting. Would you be able to help us quantify what the benefit there was?



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Nathan Rozof - *Vantiv Inc - Head of IR*

Hi, Vasu, it's Nate. The OptBlue has been rolled out into the Mercury portfolio this quarter. We haven't broken up the exact benefit but I think it's pretty consistent with what you have seen our peers experience in the past, you know in terms of a couple percentage points of uplift.

Again that applies to the Mercury portfolio. We have deployed OptBlue in our other portfolios previously.

Vasu Govil - *Morgan Stanley - Analyst*

Got it. Could you spend a minute on how we should think about the dealings of revenue growth next year. You have given us some preliminary expectation.

Surely the first quarter is going to be tough comp quarter. Within merchant services particularly are you expecting the double digit pace of revenue growth throughout the quarter or will we see some durability there.

Then on the FI side, do we have an update on timing for when the Capital One contract will sort of deconvert?

Stephanie Ferris - *Vantiv Inc - CFO*

Yes. So I think in terms of 2017 we feel good about the guidance we gave in the second quarter which is upper single digits for net revenue and mid-teens EPS growth. At this point we are not going to walk through how we think about the quarters. We would come back to you in January time frame or February and give you a view towards the quarters but certainly we are having really strong performance this year.

We don't expect that to decelerate but there are going to be tougher comparables year-over-year. But we are really confident in the business. You can see the organic growth that is happening in the business that is really being driven by new business across all channels, so, feel really strong about it.

On the FI side of things I think we talked about and are still consistent with way we talked about it last quarter which is thinking about it declining in a low single digit standpoint -- I'm sorry, upper single digit number. And as you think about the quarters there, because of the grow over of [EMV] this year as well would primarily be down in a more significant way in the first half of 2017 versus the back half of 2017. But not yet ready to give you a quarterly split but we will give you that we come back on at the when we come back on at the end of the year.

Vasu Govil - *Morgan Stanley - Analyst*

Thank you. I appreciate that color.

Operator

Tien-tsin Huang with JPMorgan.

Tien-tsin Huang - *JPMorgan - Analyst*

Hi. Thanks. Just looking for an update on the merchant bank channel and how that performed in the quarter and how the pipeline backlog looks ahead?

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Charles Drucker - *Vantiv Inc - President & CEO*

Pipeline continues to look very strong in the type of banks that are in the [75 to 150/200] type of branch bank so we are bidding on those. The pipeline looks strong. We are confident about wins and then like I said in the past we are bidding on larger ones and they kind of have had an ebb and flow.

We are hopeful. But our focus is on the midsize banks that we are very successful helping those banks. And I think that channel is going to continue to outperform and grow.

Tien-tsin Huang - *JPMorgan - Analyst*

All right. Great. I just wanted to -- I am sticking with merchant again. Just the sales and marketing expense line.

Should that track in line with net revenue growth going forward or should can we see that tick up again? Just trying to get a good proxy for growth there.

Stephanie Ferris - *Vantiv Inc - CFO*

Yes. I think you should expect it to grow in line or slightly higher than revenue growth. If you think about where a lot of our growth is coming from in those high growth channels are really partner-centric and so you are going to see a higher sales and marketing expense there as we continue to be successful in those channels as well as we continue to reinvest in the sales and marketing distribution channels to continue to drive revenue growth. So as you're thinking about it I would expect it to be in line or slightly above net revenue growth.

Tien-tsin Huang - *JPMorgan - Analyst*

Okay. That makes sense. Last one, ISO. Traditional ISO channel, how is that. Is it still holding up a little better than thought?

Charles Drucker - *Vantiv Inc - President & CEO*

Yes. It's still holding up better. Like I have said, I think our ISOs we have worked very closely with them to give them the tools to take advantage of EMV.

It gives us where their performing confidence in our guide for generally next year through 2017. I still think that 2018 becomes more challenging to our ISOs. I guess I'm pretty happy with the work my people put up in front of it educating and giving them the tools to help them execute on the smaller client base is really paid off and they are performing better than our expectations.

Tien-tsin Huang - *JPMorgan - Analyst*

Thank you. Great results here. Thanks.

Charles Drucker - *Vantiv Inc - President & CEO*

Thank you.

Stephanie Ferris - *Vantiv Inc - CFO*

Thank you.



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Operator

George Mihalos, Cowen and Company.

George Mihalos - Cowen and Company - Analyst

Great. Thanks. And let me add my congrats on another very strong quarter.

Charles, I wanted to ask you for about two years now you've talked about the strategic channels growing mid-teens or mid-teens or better. You've consistently outperform that and you are sort of in that [20%] range again, in some cases better than that. Is there anything that gives you pause that those channels, that the strategic channels in aggregate can continue to grow at this out sized 20% pace?

Charles Drucker - Vantiv Inc - President & CEO

As I look at and we are out there with our partners and their addressable market getting bigger and the connections that we have with them and how we deliver products, pieces and functions, I am very bullish on the channel going forward. So from a personal standpoint I think it has -- we are still in the early innings and good runway. Obviously the lower large numbers I think it's going to grow very well.

But my two people here with me remind me that the lower large numbers play in but I think the addressable market, the things that team -- I keep going here. The ability to execute and the ability of the people to really put the hat of our customers on really sets us apart than just a processor that is moving transactions.

And across my Company our teams highlighted in particularly in this question my IP team really highlights that. So I'm very confident where we are going.

George Mihalos - Cowen and Company - Analyst

Okay. Great. I appreciate that color and hopefully I didn't get you in trouble with Stephanie and Nate.

Charles Drucker - Vantiv Inc - President & CEO

I just get a look or two here.

George Mihalos - Cowen and Company - Analyst

I figured. As a quick follow-up, Stephanie, as we think about modeling revenue and EBITDA kind of going forward without looking for specific 2017 guidance but should we broadly be sort of be thinking about a convergence around revenue and EBITDA growth? And then additional upside from an EPS perspective given all the measures your taking below the line?

Stephanie Ferris - Vantiv Inc - CFO

Yes. I think that's fair. Although you should expect to see us continue to grow EBITDA a little bit faster than revenue as we continue to drive leverage into the business.



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I mean our other operating G&A lines we should continue to get leverage on that. I think you should expect to see us grow in line or slightly better between revenue and EBITDA and then absolutely as we think about taking capital actions and deploying capital but continue to expand below the line.

Operator

Dan Dolev with Nomura.

Dan Dolev - Nomura Securities - Analyst

Hey, thanks for taking my questions. Nice quarter. I overheard that you mentioned creeping in your focus on the restaurant market. Can you give us an update on the competitive landscape especially vis-a-vis a very restaurant-centric competitor that is known to be lower priced?

Charles Drucker - Vantiv Inc - President & CEO

Yes. I think what you heard is that two of our big verticals restaurant, retail and the integrated payment states also pushing into healthcare and some other verticals. The key to this business is how do you service your clients and do you give them reason to want to move business different places?

Part of the thing that went aboard Mercury is they are very intertwined with customers and it is not only about transactions. They help think forward. We are actually from my perspective with dealers, we are actually advancing in that. We have clarity in how we operate.

We have clarity in the people that we have. So Matt running that with his business, the seats have not changed. I'm feeling good -- with these groups, just like banks and their partner channel.

It seems like it could all be about price but it's really about the whole package and can you help them go forward and that's what we really excel in. Now we have the scale to be able to compete against anyone on that but the other components really take it over the top and that's why we have had continued success.

Dan Dolev - Nomura Securities - Analyst

Thank you. My follow-up is on the way you do the taxes and the TRAs. From my conversations there's been maybe some concern that the way you get the tax benefit may get scrutinized down the road. Can you give us assurance that, that won't happen?

Nathan Rozof - Vantiv Inc - Head of IR

Sure. It's Nate. Stephanie, I'll start off and if you want to chime in.

Stephanie Ferris - Vantiv Inc - CFO

Yes.



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Nathan Rozof - *Vantiv Inc - Head of IR*

So those cash tax benefits that we have related TRAs and those are long-lived assets. Those will provide -- continue to provide cash tax savings on a go forward basis. I think in terms of the way that we present our taxes -- I mean clearly as we move from a gas pro forma basis we are showing the company on a fully distributed basis, which includes our reflection of a 36% tax rate. This is obviously higher than we are paying today.

Because that's what we think we pay as a standalone company, US domestic filer, post Fifth Third sell-down of Anthem stock. And then we have the cash tax benefits that will continue for 15 years thereafter regardless.

Stephanie Ferris - *Vantiv Inc - CFO*

I think we think about them together as an effective tax rate for which we would be if we were fully consolidated.

Nathan Rozof - *Vantiv Inc - Head of IR*

Yes. The only last thing I would add is there is frankly incremental opportunity in the future as the bank continues to sell down it will generate incremental tax cash benefit in the future.

Dan Dolev - *Nomura Securities - Analyst*

Okay. Thank you very much.

Operator

Dave Koning, Baird.

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

Yes. Hey guys, nice job crushing it. My first question, just the math around -- I guess and it really Tien-tsin's question with the ISO channel.

If your total merchant's segment is growing 17% high-growth channels are near 20%, it means that the traditional ISO channels must be growing 10%-plus which seems pretty aggressive and very good obviously. But maybe you can talk to a little more if that is right and how they actually grow that fast?

Stephanie Ferris - *Vantiv Inc - CFO*

Yes. I think -- I will start and if Charles wants to talk a little bit more about ISO. But broadly across our entire base this quarter we saw really strong transaction growth not just in the high-growth channels, but in the traditional.

Including ISO as well as direct. So I think as you saw that in terms of transactions going up from second quarter to third quarter. We really had strong transaction growth across all of the business lines.

ISO specifically they do tend to -- they are doing very well. Charles has mentioned previously the fact that they have EMV terminals to sell has really breathed some new life into what they had to take to market. And they continue to do very well for us. Charles?



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Charles Drucker - *Vantiv Inc - President & CEO*

I would just add, look, I think what you have to think about is our execution around new sales coming in is a big part of that. (technical difficulty)
Pretty much all of our channels are hitting very well.

And we are taking advantage of the opportunities that are out there. With EMV changes which you know will carry through 2017 and I think 2018 will be -- won't have as much advantage there but the security, the tokenization, the tools that we are putting in our salesforce hands is really allowing us to be very successful across the channels.

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

Okay. Great. I guess my follow-up question historically Q4 in your merchant segment you have often grown 5%, 6% sequentially -- or something around there. The way the guidance is setting up this quarter your guiding for something in the lower single, like 1% sequential growth in merchant. Was there something in Q3 that almost was one-time or elevated that makes it harder to grow as fast in Q4 or is this just kind of the pattern of sudden guidance that you feel extremely comfortable with?

Stephanie Ferris - *Vantiv Inc - CFO*

Yes. I think we -- so look we took I really consistent approach to guidance for the fourth quarter. I will remind you that our fourth quarter is a really -- it's a big season for us in terms of it's the holiday season. There's a lot of transactions and revenue come through that season.

It's historically been a little volatile. I would say there is no one time in the third quarter we are concerned about that would not be there in the fourth quarter. The business continues to do well.

Are we expected to do well? We are lapping the benefit of -- and the prior year of Capital One. I would say we have been more consistent with our past practices.

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

Okay. Great. Thanks. Good job.

Stephanie Ferris - *Vantiv Inc - CFO*

Thank you.

Operator

Dan Perlin, RBC Capital Markets.

Dan Perlin - *RBC Capital Markets - Analyst*

Thanks guys. Good morning. Just a couple quick ones. For the -- you are talking about the various channels.

I am wondering, is there a way to parse out merchant growth by your same store sales versus share gains? Clearly you guys are obviously a share gainer but I'm trying to get a sense, are you seeing a pickup in the overall backdrop within the merchant community that you are dealing with in particular or are you really just going to push it into the channels in the share gain? Then I have a follow-up.



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Stephanie Ferris - Vantiv Inc - CFO

Sure. I will take that. Same-store sales growth for us was really consistent in the third quarter with the second quarter. So the outperformance that you are seeing us have here of the organic growth is really a result of new business and share gain.

Which has been really consistent with what we have had over the past couple of quarters. I think that's been pretty -- the same-store sales growth is pretty consistent also with the industry. It's really new business driving a lot of that outperformance.

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

That's fantastic. Can you remind us what level of leverage you are comfortable with when you think about M&A and there is clearly debate up on you guys as to whether or not you should do something domestically versus international. I am just trying to get a sense of your appetite around that. Thanks.

Stephanie Ferris - Vantiv Inc - CFO

Sure. I will cover where we are comfortable and I will let Charles talk to international versus domestic. We have been really comfortable -- or we are really comfortable in the 3 to 4 times range and we delever a turn a year. We obviously, for strategic acquisition historically have gone above 4 and were comfortable doing that if there is something very strategic for us like Mercury.

We're really comfortable where we sit right now. We have a lot of ability to deploy and increase capital and go up from there. And I will let Charles talk about domestic versus international.

Charles Drucker - Vantiv Inc - President & CEO

I would echo Stephanie with free cash flow we get comfortable for the right acquisition leveraging up. We continue to look both domestically and look opportunities international. Basically, like I said before we're going to be -- as you look domestically a lot of the domestic will be roll ups type of pieces that might have some strategic pieces to it.

But we're going to be good stewards of our capital. We always compare what a share repurchase is versus a pure roll up. We're going to be opportunistic about both share repurchases or M&A and our goal is to deploy the capital that we have. We have great free cash flow and we are very comfortable with the leverage and going up to the right things.

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

I guess I lied. I have one more follow-up. In relation to the deals as part of your business model is predicated off of having this great scales model relative to your competitors.

International seems to be much more fragmented. I'm really just trying to figure out your appetite for much larger scale deals international. Thanks.

Charles Drucker - Vantiv Inc - President & CEO

International a lot of times our focus is going to be around where the high-growth channels like e-commerce type of companies that allow us to follow our clients and take advantage of multiple countries through the e-commerce type of gateway. For the right opportunities we will look to leverage our scale and utilize those scale capabilities.



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

Thank you.

Operator

Jason Deleeuw, Piper Jaffray.

Jason Deleeuw - *Piper Jaffray - Analyst*

Yes. Thanks. Good morning. I was hoping to get an update on the iPOS channel strategy for e-commerce payments and working with developers. Just kind of update us on what Vantiv is doing there and kind of any changes in your strategy?

Charles Drucker - *Vantiv Inc - President & CEO*

Our strategy continues to move forward. We are winning shares. We are brining new verticals like the healthcare vertical.

We are working with our clients closely on upgrading their software for EMV capabilities. I would say the iPOS areas because with the shift it is probably one of the lower risk type of areas. We are working closely with our dealers and developers to make sure that they are EMV capable which I think allows us to get into the embedded base of customers because it is event driven.

So we're pretty focused group that we don't scatter shots everywhere and say we want to be in every single vertical. We jump into a vertical. We mind the ones that we have that still have runway but there are several verticals that we are doing well in and strategy continues to move forward.

EMV is helping our clients software get EMV capable. Many of them are. A lot of them still need to do the software change out.

Very optimistic. This channel has been a home run for Vantiv just like we said when we did this, the combination of taking our other products features and functions whether it is gift card, whether it's our scale, whether it's our capabilities along with the things that when we bought Mercury and Element they had with the relationship, the network, the connectivity.

It's really paid off. I think that has been a very good success and demonstrates our Company's capability.

Jason Deleeuw - *Piper Jaffray - Analyst*

You guys had also mentioned that there is a lot of aspects to the iPOS channel and when we think about the referrals and the commission shares with the various partners whether by different industry verticals or VaRs verse ISVs. Is there a big difference in the referrals from one pair of iPOS to another or generally are the commission shares that you have are they generally same across the whole channel?

Charles Drucker - *Vantiv Inc - President & CEO*

So generally I would say that when I think about the iPOS world it's about the dealers and developers wanting us to help them grab this addressable market so they can sell their software into is and they differ and little bit within -- they are pretty consistent in the iPOS world. But the pressure or the aggregate amounts going up has not really changed as much because what they look for us is, can we deliver value that allows them to sell and deploy their software faster?



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If the answer is yes, that's more important today. Fast forward five years down the line when now the markets are saturated and everybody has it, you know there is probably pressure. Right now -- there is always pressure but right now it's around us helping them grow and take advantage of the market opportunities.

Jason Deleeuw - *Piper Jaffray - Analyst*

Great. Thanks for all of that.

Operator

Jim Schneider, Goldman Sachs.

Jim Schneider - *Goldman Sachs - Analyst*

Good morning. Thanks for taking my question. Congratulations on the strong results.

I was wondering if you could maybe talk to the pipeline of national merchants that you see coming up over the next 12 months. Both in terms of the ones you already have that may be coming up for renewal and other portfolios that you don't have today that you know are going to be coming up for bid. And talk about whether anything has changed in terms of the competitive landscapes for those bids?

Charles Drucker - *Vantiv Inc - President & CEO*

I would say the renewal track is pretty consistent. So there's nothing I'm seeing in the renewal track change. We have great relationships with our clients.

The focus around the renewals over the last year and going into this season has continued to be EMV compliance, helping them get their point to point encryption and tokenization. Helping them navigate. Just the different abilities to route transactions that merchants have today and really leveraging our capabilities to route transactions.

We do an extraordinary job I think we do the best in the industry along that. New clients, the pipeline is strong. We continue to have success in winning, Papa John's being one of them.

We have other ones that are not always announced that we have so it continues to be strong. We have strong competition out there. But there's only a few of us who can do this very well.

There are probably two acquirers that are taking market share there and we are one of them. We still have good success.

So I'm optimistic. Our base -- we are bringing value to the new base -- I am optimistic. We are bidding on them and I don't see a big change in -- if you are asking if our win-loss ratio has changed, we still continue to have a very strong win ratio.

Jim Schneider - *Goldman Sachs - Analyst*

That's helpful. Thanks. Maybe turning to the merchant bank channel. Clearly you've been adding a lot of partners there. Giving traditionally you have been kind of under leveraged to that channel.



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Can you maybe talk in terms of within any given partner whether there are things that you are doing in terms of best practices to drive higher productivity at various branches versus what some of your competitors are doing? And maybe can you give us some kind of metrics about within individual partners what the growth rates are?

Charles Drucker - *Vantiv Inc - President & CEO*

Yes. I will give you high levels. I am not going to give you individual partners. (laughter) Good question.

Look, I think where our strength comes with a lot of these banks is that we are able to offer products up and down the stacks. So if they are doing a syndicated deal and they have a big commercial deal, we can do the highest level of clients and we can do that and then we can go down to that small merchant that they just did a business loan too. So our ability to go up and down the stack really makes us different.

So what we are doing is we are out there with the bankers. We are showing them a path with what I will call [merchant] as a wedge product that they can talk about a product that has features and capabilities that these midsize banks can compete with the largest banks in the country and the world.

So we are having good success is not only the new business that they are getting when someone comes in for a new account, but also really helping them focus on their embedded base. So clients that they've had in the past that they have the whole bank relationship but not the merchant acquiring, a lot of times because they just didn't ask or they did not have the product or features that we have.

So it's pretty exciting and some of their larger banks are really the richness of the data and how they can align the business banking, the commercial banking along this channel has actually I think has been a really good thing and on that path even though we are doing really well, we are still in the early stages. I think what happens with banks is once you have success and the bankers talk to each other and they say -- hey this is a great product let's get that in it helps us, it just accelerates. Word-of-mouth is actually big in a branch network and we do that really well.

Jim Schneider - *Goldman Sachs - Analyst*

Thank you.

Operator

Bob Napoli, William Blair.

Bob Napoli - *William Blair & Company - Analyst*

Thank you. Good job on conservative guidance once again. In order to keep this momentum going, what are the key investments and new innovation that you need to make over the last few years.

One thing that is very clear is that there is still massive amounts of innovation going on in this market segment. Not just in the US but around the world. Where do you need to invest to make sure you not only maintain your leadership but expand it over coming years?

Charles Drucker - *Vantiv Inc - President & CEO*

A couple things. One is we have to make sure that we are able to support some of the products and things that our clients want. So when you see us talking about the wallets even though the wallets and the mobile capabilities have not just leapfrogged in the consumer world, over time the mobile will.

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Our enablement of the Apple, the Android or whatever wallet our clients demand, and our ability to do it quickly. Our ability and it's still there to maintain security, keep them on the edge.

How does tokenization transpire? How do things along those lines happen? How do we help protect the clients?

Enhancing routing capabilities and continue to see as whether it's legislation, whether just as global gateways happen is big. In the e-commerce space it's about how do we help the client understand how their ops work? How their -- we have done a really good job about how to help them when cards get replaced.

So those types of features and functions. It doesn't sound sexy but the back office. How we integrate.

How we send information. What's the raw data files that they can do that makes back office life easy for them. It doesn't sound as sexy up front but it means a lot in the back end.

So there is a lot of runway that we can do. Also scale is going to carry the day. And I do believe the industry will consolidate over time because scale and complexity carries the day.

And we like scale and complexity. It's a good thing for us because we can deliver more value to our clients.

Bob Napoli - *William Blair & Company - Analyst*

All right. Thank you. Just on follow-up on this innovation internationally.

I know you get questions about scale and acquisitions internationally. But there is a lot of small high-growth companies I am sure you're talking to a number of them very innovative -- would you look internationally to make small acquisitions that added technology and innovation as a first move or do you need a scale investment to move internationally?

Charles Drucker - *Vantiv Inc - President & CEO*

We have capabilities in e-commerce and integrated payments when you think of technology. And if there are companies that give us strategic capabilities, it will have to have some type of scale to it because we are not starting companies from scratch international.

It doesn't have to have huge scale to it, but if it has that sweet spot that we are good domestically with the e-comm, we are good domestically with integrated payments, or there were other things, we would look to entertain that. Obviously we are one of the companies that have a balance sheet today that have capability or dry power to do acquisitions, share repurchases and I love that flexibility. Stephanie and her team did a really good job extending and allowing us to have that flexibility in our lending facility.

Bob Napoli - *William Blair & Company - Analyst*

Thank you very much. Appreciate it.

Operator

David Togut, Evercore ISI.



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David Togut - *Evercore ISI - Analyst*

Thank you very much. Two questions. Could you update us Charles and Stephanie on where you are with onboarding Mercury's merchant processing volume onto your platforms and what the associated economic impact is?

Charles Drucker - *Vantiv Inc - President & CEO*

We have completed in the last quarter or second quarter. We completed everything's on our -- converted to our -- the piece that's converted to our platform last quarter.

Stephanie Ferris - *Vantiv Inc - CFO*

Yes. So we finished the integration of Mercury in the second quarter of this year. You can see the strong growth in the merchant business in the second quarter, 15%. You can obviously -- you know the high-growth channels Mercury specifically continues to benefit from really strong growth rates here in the third quarter.

Part of the reason for that is as Nate mentioned earlier, OptBlue. So we have been able once we got them onto our platform in the second quarter and we have started deploying OptBlue as an opportunity throughout that portfolio and that certainly help drive integrated payments in the high growth channels as well as the overall merchant growth rate in third quarter.

So we are complete. We are seeing the benefits of them on our platform. And it continues to give us confidence for the remainder of the year.

Charles Drucker - *Vantiv Inc - President & CEO*

There's always odds and ends. A couple here and there but substantially everything.

David Togut - *Evercore ISI - Analyst*

Understood and Charles curious to your thoughts about Visa and MasterCard's new agreements with PayPal, particularly given your own strong position in the e-commerce channels with Litle & Company. Longer term do you see any impact from this? Does it change the way you work with Visa and MasterCard at all?

Charles Drucker - *Vantiv Inc - President & CEO*

No. You know we have a strong relationship with Visa and MasterCard. We have known for a while that some form of deal was going to happen with the PayPal because there has been questions around that.

We don't think it changes our position. From our retailers we will still be a gateway to help some of our retailers if they want the PayPal wallets. But you know obviously we look at all our competitors and see where they want to go.

Right now I don't see this as having any change except there is more economics that it appears that PayPal will have to pay for the same type of pieces. So right now nothing. But we watch all our competitors.

We have a lot of respect for these companies that are growing fast like ours. We have working scale and our connections to clients and the products we bring and complexity, they're really our friend. We're going to take advantage of that.



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David Togut - *Evercore ISI - Analyst*

Understood. Congratulations on the strong results.

Charles Drucker - *Vantiv Inc - President & CEO*

Thank you. With that we will conclude today's call. Thanks everyone for joining today. If you have any additional questions, please reach out to us by the contact information on our Investor Relation's website. Thanks again.

Operator

This does conclude today's conference. We thank you for your participation. You may now disconnect.

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