Global Payments Inc at Citi Financial Technology Conference

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PRESENTATION

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

For our next guest, we have Global Payments. And from Global Payments, my pleasure to welcome you Jeff. So, Jeff Sloan, CEO of GPN. And same as the last session, let's try and keep it interactive if we can. I'll go through a list of questions, about half way through, just kind of open it up.

And Jeff, I just want to start with sort of a broader question again. And this kind of goes back to all of the changes that we're seeing in the industry; demographic changes, technology shifts. And you guys have reacted as have a couple of your competitors with regards to changing your products suite, changing your service strategy, better modifying it, modifying your footprint. Just kind of give us an idea of, if you could spend three, four minutes, just your view of the future. How things are evolving? Where are you focused on? What you see as Global's advantages in the next couple of years coming up?

Jeff Sloan, Global Payments Inc. - CEO

So, it's a great question. I think that the way to think about where we have really been investing is really two-fold, Ashwin. The first I think is in expanding our integrated businesses multinationally. If you think about one of the strengths that we have at Global Payments is what you alluded to is our multinational footprint. We're physically present and doing business in 29 countries today. We expect our transaction with Erste Bank to close in the back half of this fiscal year. That will add another one or two countries that we are directly in. We think it's important for us to accelerate our rates of growth by taking our business, that's primarily in the US today in OpenEdge, and expanding into Canada, which we've done. And now as we discussed in our last couple of calls expanding into the United Kingdom.

We also bought Ezidebit in Australia just about a year ago, which is in Australia/New Zealand and is going into Singapore and Hong Kong with the same technology. So we think integrated is a very attractive business today in the United States. Of course, we're not the only ones. But I think where we're able to differentiate ourselves and where I think we can really accelerate our growth beyond our cycle guidance is to bring that into other markets. And in fact, we announced in one of last two calls that we actually had one of our larger enterprise customers in the auto area, who is a customer of ours here in the United States, expand their business with us into the United Kingdom. So our ability to service that in multiple markets we think is distinctive to Global Payments.

The second thing we're investing in heavily as it relates to technology is our omni-channel business. And for us, omni-channel means customers who do business in generally multiple geographies, across different types of interaction, generally card-not-present as well as card-present. So as we discussed in our Investor Day, we have customers like ZARA, Melia, Tiffany's, Burberry's, Apple whom we enable in multiple geographies around the globe, both online as well as offline.

So our ability to marry some of our technology, like Realex, for example in Ireland, which we acquired in March of 2015; our ability to combine that card-not-present gateway with our physical acceptance capability that we have in those 29 markets today, we think is distinctive to us and we think presents an opportunity to grow more quickly across Europe, given the regulatory changes in Europe, and ultimately around the rest of world. And those are two areas of primary focus for us.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

Okay, great. And we'll get into each of those areas in just a bit, but I want to talk also about revenue mix more broadly. And the way I kind of see it in general the push has been do more direct, do more international. It's been usually successful both from a revenue growth standpoint as well as steady margin improvement standpoint. And the question really is how much more can you push revenue mix as a lever?

Jeff Sloan, Global Payments Inc. - CEO

So I think the nice thing about where we are, Ashwin, is that the rates of growth. We have a retail business and a wholesale business. And those are both good businesses for us and I expect us to always to have a retail business and a wholesale business. The nice thing about where we are is they are just growing organically because the retail business grows more quickly, because we can control distribution. It's about 40% of our revenue today, is what we call technology enabled. That's providing 80% of our growth. So because that business is growing so much more quickly organically on the retail side, especially in the technology area, versus our wholesale business, we're able to shift that mix continually.

So I expect that mix shift, even absent additional transactions, to continue to improve over time as that 80% continues to drive the additional revenue growth. Concurrently, we will augment that with additional partnerships and acquisitions in a number of geographies. As you've seen us do with Bank of the Philippines in the Philippine Islands and as you've seen us do in a number of markets with Erste Bank. So that would just accelerate that trend further. So we'll always have that mix. As most companies do, we have a variety of businesses, but there is no reason why that trending won't accelerate.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

Okay. So, by the way, I love words like accelerate, just so you know. In terms of integrated solutions, which you mentioned as one of your two big focus areas, if you could talk broadly about just growth potential. It is well recognized as a growth area. You guys do a good job. Vantiv, which just hosted, does a good job, obviously single geography for them. There are others. How do you differentiate? I understand it's -- a lot of it is verticalized, and you could certainly differentiate on specific vertical expertise, but can you get deeper into areas? For example, you guys are fairly deep in the dentist area with (multiple speakers) Dental. Can you do things around, surrounded with non-payment solutions, grow it that way?

Jeff Sloan, Global Payments Inc. - CEO

I think the answer is absolutely. And in fact what we've have been able to do in OpenEdge concurrent with Apple Pay, Android Pay and Samsung Pay is really bundle EMV solutions with tokenization, encryption and NFC. And take PCI and that kind of data out of scope. So to answer your question, we've able to gain share I believe in our integrated businesses by offering a package that makes it easier for our ISVs and our merchant partners to conduct business in a way that's more secure and more compliant.

So the ability to take value-added technologies like the ones I just mentioned and go-to-market with those solutions and charge differentially for those things, reduce risk. I think, while we're not the only ones doing it, is certainly enhancing our ability to compete. Primarily when you step back. I really do think it is about what markets are you attacking. And for us it's a balance of new markets like auto, which we went into about a year ago. We also went into municipal billing for utilities and the like about six months ago. And you balance that against penetration of the existing markets that we're in.

So I think what we said was even in our most penetrated vertical, dental, we're only about 20% to 25% penetrated. Meaning, we are only at that number of dentists, three quarters of whom don't use us today, who are available in that vertical to us through our software provider. So overall we're less than 10% penetrated in existing verticals and we balance adding new vertical markets like auto and like municipal billing. We balance entering those markets against better penetration of existing markets. So we think there is a long way to go in the integrated business here in the United States. And certainly we are in the very early first or second inning globally in the integrated business.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

So when you decide to go in autos or municipal billing, what sort of incremental investment does it take? How do you decide municipal billing, and not something else?

Jeff Sloan, Global Payments Inc. - CEO

So I think it's a function of targeting those markets that we think grow more quickly than the overall rate of market growth, with better margin opportunities. Invariably what that means, Ashwin, is that we have an ability to develop product specific applications. We have the ability to deliver better sales expertise. We have the ability to call on ISVs, who we really think are underpenetrated with our sales people. Our technology is better than the market rate of growth and that's essentially where we've invested in the United States. If you told me that there is a vertical market that's large but that we couldn't capture share in that doesn't grow as quickly as the market overall where the margin is not good, that would be very hard to take people off of our direct operating business and move into that environment. I think you see that reflected in the last year and a quarter's worth of operating results as a revenue amount in the United States.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

And integrated, is that mean different outside the US than in the US? As you take OpenEdge, I mean, is it basically the same solution?

Jeff Sloan, Global Payments Inc. - CEO

I think it's the same concept, but not the same solution. So for example, when we into Canada, some of our peers in the US market also provide integrated into Canada. But I really view that as integrated in Canada for non-Canadians. Meaning, cross-border integrated from a US or other company going into Canada. That's very different than what we've done in Canada and what we are working in the United Kingdom, where we've really nativized our applications for that market. So for example, our integrated applications in Canada are certified on Interac.

They are sold by our Canadian sales force to companies that are just in Canada. It's not to say that it isn't a very good business to have cross-border commerce; in integrated, we do that too. But most dentists, that's self-storage providers are largely in one market. And it's important that we have our Canadian sales team understand how to sell those technologies into that marketplace. So I think if you're only focused on capturing cross-border commerce for US companies doing business in Canada vice versa, you're going to miss that piece of the market, which is the Canadian integrated market for Canadians. And that's how we think about the business. The same thing will be true in the United Kingdom and the same thing is already true with Ezidebit in Australia.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

A bunch of questions about international and Europe in particular. And I want to start with the concept of Europe as one market and what opportunity that gives you. Let me just start with that and I'll kind of lead into other questions. Because I have, kind of feel, it's been a long time coming. But now that you have -- between the regulation as well as your own better footprint and your own better product suite, between Realex and everything, you guys can do a lot more?

Jeff Sloan, Global Payments Inc. - CEO

So when I took MasterCard public in 2005 or 2006, SEPA was right on the horizon. So you are certainly right in saying that it's a long time in coming, but it is upon us. And in fact December 9 is the date in most of the EU; Spain of course, has really adopted some of the interchange changes. But December 9 is the date where you see a more fulsome rollout of SEPA and the interchange rules across most of Europe.

So you're right when you said it's finally upon us. What's most exciting about the interchange changes and SEPA is not just the changes to the cost of acceptance for the merchant group. But when you think about the common European shopping environment and market experience, it's really tending to make it more like the other markets that we're in today, which is opening up the possibility of a common series of products, sales and technology across all those environments.

So for example, our ability to bring Realex, which is based in Ireland as a card-not-present gateway, into those environments with our acquiring into Continental Europe is a huge opportunity for us that doesn't exist today. So if you think about where our businesses are -- and is not dependent on interchange being reduced. So if you think about where businesses are, once we look forward to the Erste joint venture, those four markets closing -- those four markets that Erste Bank is in today that will be added as part of the joint venture, my sense is, there's very low penetration of products like Realex on a card-not-present gateway basis to come into those markets as a bundle acquiring offering.

So the ability of a common European payments area to enhance our go-to-market strategy where we can then do true omni-channel, entering Realex with our acquiring, in those markets is a fantastic opportunity. In a market environment -- in the Czech Republic and other markets in Continental Europe, they are already growing at double digits without an environment. So I look at what we're able to do in those markets by way of product distribution, technology, services, and sales, it's only accelerated by all the changes going on coming through SEPA.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

Can we look at what you guys did with, like, Caixa as a proxy for what you can do with Erste? That was pretty darn amazing what you guys did, considering how the economy was in Spain.

Jeff Sloan, Global Payments Inc. - CEO

Well, Caixa is a fantastic partner, I would say. And all the credit to those guys for as fantastic business as they run. In Spain, we're up to about 300,000 merchants in that country of Spain. And now of course, the economy in Spain is continuing to grow and we are very fortunate to be in the position we're in with them. So Caixa is actually one of our partners in the Erste transaction and they have a relationship with Erste, too. So I think that it somewhat answers your question, which is absolutely, is the answer to what you asked.

I think they at Caixa and we share a common view, even advance of SEPA implementation, of a common European marketplace. So for example, we work with ZARA and Melia, two Spanish based firms across a number of markets in Europe, and now we've brought ZARA into a number of markets in Asia.

So we share a common vision of what might be across Europe and the changes going on across Europe will help accelerate that growth. So we certainly look forward to adding many more geographies and businesses with Caixa. And I think the changes going on as a regulatory matter, will accelerate our ability to do that.

We've also invested with them in Latin America. So they are our partners in the Brazilian business. Ironically, Brazil is one the countries in Latin America that doesn't speak Spanish, it's Portuguese, so we have a little bit of a quasi language barrier. But what I would say is we share the same vision not just in Europe that we can bring also to Latin America. We're starting with Brazil and they've been a great partner there, and we're pleased with our business there. And we'd also like to bring that to other markets in Latin America.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

I am going to take a little break here and see if there's any questions. Just put your hand up, there's a mic going around if you -- any questions. Going once, going twice? Why don't I just keep going?

Jeff Sloan, Global Payments Inc. - CEO

Sure.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

So with regards to Europe, I just want to ask almost a cultural type of question. Because one of the things I work on on the side has to do with the Digital Money Symposium I run. And we've written reports about how different, the different parts of Europe are in terms of things like card usage and what they think about it and so and so forth, and how they use cards versus other means of payment. What's your view on -- do you want to approach specific countries, first? Go for the Nordics, where it's really more penetrated? Go for Germany, where you can be part of the penetration to come? Does it matter?

Jeff Sloan, Global Payments Inc. - CEO

So I think it's a very good question. What I would say is, we have a proactive view of each one of the markets that we're in and that we're not in really globally, not just in Europe. We start first by looking -- we generally chase GDP in what we do; we're really a GDP derivative. So we start by looking at the size of GDP, the rate of growth of GDP, which usually influences our rate of growth. We look at card penetration, demographics of those markets, the competitive landscape and pricing in those markets.

Those things are really what drive our view in which markets we want to be in. Then we layer on top of that, well, what might be available and under what set of terms? And we really do that globally, led by our folks in market but also by corporate as a development matter. I think if you think about what countries in Europe that we are not in today that we would clearly like to be in using those criteria, we are not directly in France and Germany today. We are not directly in Switzerland, Italy or Poland today. We'd like to be in those markets given their size and other criteria that I just mentioned.

In fact, if you look at Asia, by way of proxy, part of the reason we were so excited about going into Australia and New Zealand was on those same metrics I just gave. The fourth largest economy in Asia Pacific; very good at the time. On a relative basis, GDP growth and stable for when we entered that market. And that's all been true. So if you look at the countries I mentioned in Europe, they are all attractive, but you have to find the right entry vehicle. We haven't found those yet in those markets, otherwise we would be in them if we thought it was the right thing to do.

Conversely, we did find the right partner for the Czech Republic, for Slovakia, Romania, Serbia and potentially also Austria. So when you look at those businesses and those markets, those things did line up, when we looked at those. If we look at where we would like to be, you should focus on some of the other countries I mentioned -- Italy, Poland, et cetera -- as being the next leg up for growth.

And as the EU continues to move towards SEPA, hopefully it'll be easier for us to enter those markets with a combined service platform, combined regulatory platform and everything else. We are a direct acquirer in almost all those markets that I just mentioned. So our ability to get in those markets, we can be fairly efficient about doing it.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

Visa combining with Visa Europe, any impact you see from that? Obviously, rebates might go away, might change their pricing; that can always be beneficial for you guys. Is that ongoing benefit?

Jeff Sloan, Global Payments Inc. - CEO

It's nothing but good news for us, really. If you think about how our business operates, we work and have a lot of respect for the networks globally. I think Visa, as does MasterCard and other networks, do a very good job globally at managing their businesses. Our ability to innovate and deliver new product and ultimately to grow is related to the degree of value-added services that we can provide. I think -- and I'm not privy with Visa's plans are as an operator now over Visa Europe -- but one would surmise that it will look over time a little bit more like Visa Inc. than it might otherwise be, if they had not moved forward with them.

I think, if you look at our businesses where we interact with Visa Inc. around the world, I would expect us to have an ability to innovate, deliver more products that may not exist today in those markets. I gave you the card-not-present example. Of course, Visa has CyberSource. We work and partner with Realex, but we also partner with CyberSource around the world. That should provide additional opportunity as the card-not-present environment is relatively small in some of the markets that Visa Europe is in today.

So I think the complexity, the ability to provide more innovation, more value-added products is very good news for our business, and really look forward to seeing what changes they make across Europe. It also speaks to our global operating environment, in our footprint, our technologies that we can leverage the innovations that we've brought to other markets. We've been able to bring Apple Pay from the US to the UK and soon to other markets. There's no reason why, as Visa Europe looks more like Visa Inc., that we're not able to do more things like that in conjunction with Visa.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

E-commerce, M-commerce: obviously faster growing parts of commerce overall. Have been for a while; should continue to be for a while. What's your footprint, your presence, your product offering there? Would you like to do more? I mean, obviously, you guys acquired Realex. But if you could bring that to a more global context.

Jeff Sloan, Global Payments Inc. - CEO

Sure. So today, we do about $250 million of revenue annually in what we call our omni-channel environments. I would say only about 20% of that is probably directly card-not-present, meaning card-not-present only, with no intention to be card-present in some point. So $50 million outside the United States in card-not-present; $200 million primarily outside the United States in omni-channel. We've got a really long way to go.

Part of the Realex investment, Ashwin, in March was the premise that we only account for a very small percentage of the e-commerce acquiring market across Europe. As we said at the time, Realex is a $20 million US revenue business. And we thought the acquiring market is, in terms of acquiring revenue, a couple billion dollars a year growing at 15%.

So the good news is we are growing at 15% to 20% too in Realex. But at $20 million of a $2 billion annual market, it's really small. And we have the ability to capture a lot of share. We've already been able to combine their gateway with our acquiring business in the United Kingdom. We'll soon do the same in Ireland and throughout Continental Europe. And my expectation there is we'll only capture a bigger share of the market going forward than we have today.

So if we only grow at 15% in that business, that would be disappointing. Our goal is to gain share as it to relates to that size of opportunity. As we size what we think e-commerce and omni-channel is around the world, we think it's tens of billions of dollars of potential market for us. And today we've got [$250 million] of it. So we've got a very long way to go to gain share.

We've been able to bring customers like ZARA from our European market and introduce them into Hong Kong and into Asia. We need to do more of that to capture more share across market, both in card-not-present as well as in card-presents. There is plenty of blue sky to go in our card-not-present omni-channel environments globally. We've only really scratched the surface, I think of what we're to do.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

Any questions? I'll keep asking, until one of you asks --.

Jeff Sloan, Global Payments Inc. - CEO

It's a shy audience.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

And so let's go talk about digital wallet. This is a very crowded space. So obviously, you've got Apple Pay, Google -- Android Pay, Samsung Pay, all of these things. And you guys were part of some of those launches directly, indirectly. Chase Pay comes up. What are your thoughts? What impact can they have on acquirer pricing? Can you talk about wallets in general?

Jeff Sloan, Global Payments Inc. - CEO

Sure. So I think it's another example of value-added service, whether it's Chase Pay or Apple Pay, et cetera, or PayPal is a very good partner of ours globally. So I think the proliferation of consumer choice, our ability to solve for merchants, what they ought to enable and accept in the United States and globally, is really good news for how we go to market. I think that the idea that there's going to be one winner in terms of wallet or one winner in a closed loop form, which is a bit of what's going on with Chase Pay with MCX, is kind of hard to say.

I think nonetheless, our perspective is it's good for us and good for the industry that people innovate, that people are spending money on consumer adoption of faster, quicker, more efficient payment schemes. That's only going to make the consumer and merchant experience more wholesome than it is today. So from our perspective, these things are really good news at the end of the day. Now, in the United States market, we don't compete with any of those people I just mentioned.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

You don't skew towards the MCX partners.

Jeff Sloan, Global Payments Inc. - CEO

Right. That's exactly right. So we're really an SME-focused in niches in the US market. But I think it's good news for the industry that Chase has made a decision to invest in consumer fronting encouragement of additional mobile usage. We have probably more NFC deployment worldwide as a company than almost anybody else. I think we've got a quarter million NFC deployments globally.

And obviously part of EdgeShield and GlobalShield here in the United States. So anything that spurs that adoption, whether it's from PayPal or Chase or Apple -- every time I see the Apple commercials on TV, I just smile. That's good news. I see the same thing with Google and Samsung. So we really encourage all that stuff, although we are in a slightly different focus point here in the US as to how we go to market.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

So we've talked a lot about demand, revenues. Want to shift gears to talking about margins. And the last couple of years have been great. Our viewpoint is this is going to continue, there's no reason it shouldn't. You guys, in addition to the growth which brings leverage and scale, announced specific cost optimization plans. Can you talk a little bit about those? Why now? What's involved? When you talk about going from a holding company structure to operating, what does that mean?

Jeff Sloan, Global Payments Inc. - CEO

So we're just coming off of a quarter where we announced a 150 basis point expansion in margin year-over-year to 30.5% versus the prior year. We raised our expectations for margin expansion this year, so you are exactly right, Ashwin, in what you said. So when I first came to the Company, not surprisingly, we've grown a lot through acquisition. So when you grow a lot through acquisition, especially geographically, you tend to have businesses that you leave as islands unto themselves when you're first buying them, because it's a fairly complicated matter to convert these businesses over to common front and a common back and a common operating environment.

We've done that in almost all of our markets in Asia. It's not easy to move nine or 10 markets in Asia to a common front and a common back, which we've done, especially where you are doing EVM, here in the United States. We've done that in Europe, too, with our UK business. Of course we've done it Canada.

So we're largely on one common back end except where by rule it's prohibited, like in China, Mainland China. And where it's owned by utility, for example like in Spain. But generally where it has been possible to do it, we are really on one back end globally and we are on one or two really front ends worldwide. And that's been a really competitive advantage for us in our businesses.

We had not historically matched that -- first was the technology. We had not really matched that as an operating matter, going back to your question about unified operating structure. So what we've been doing in the last couple of years is managerially moving all of our reporting units over to common management. Meaning, the operating environment in Prague also reports into our COO in Atlanta. It is managed that way. It also means that our technology environments in other markets also report to our CTO in Atlanta.

And now, as we talked about in our Investor Day, we are investing about another $20 million of capital over the next three years in ensuring that our operating environments themselves as a technology matter are on common platforms around the world. What that means is, not only would they be state-of-the-art as it relates to electronic communication, elimination of paper in the next generation of management, but it also means that, no matter where you go around the world, we can take an employee from Prague and put that in play in Hong Kong and the screens are the same in both environments.

It also means that the languages are customized for that specific employee, no matter where you are. So it's really the next generation of management and it means commonality of goals, measures across all our markets. But we also did -- heading into the spring of fiscal 2015 and carrying it to fiscal 2016 -- is we eliminated about $10 million of annualized operating expense in our environments by rationalizing the number of service centers that we have, changing the reporting and operating environments as I described. And our investments in this new project will ultimately pay for themselves.

So as we look about repositioning the business, rather than where we started, which was a bunch of independent fiefdoms, we started with a technology. Then we changed the management, and now are changing operating environment. So I think what you're left with is really will be called the unified operating environments, instead of just being a holding company. We'd rather operate as one business globally; it allows us to sleep at night, comfortably that we all are doing the right thing globally. But it also means that we manage the business as one company, one culture, and we get the right efficiencies that we need to reposition the business into the future.

So when we're making these tough decisions about which service centers to keep open, we also were concurrently investing in businesses like Realex, realizing that our environment and our businesses were shifting from traditional legacy distribution into the next generation environment. So it's not so much -- it's a bit of doing the right thing as an efficiency matter, but it's also taking that capital and moving it to businesses that are growing more quickly than the markets and will provide for the next half decade's worth of growth.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

So we just have couple of minutes, so I'll to try to squeeze in a question about capital allocation. All the growth and the margin improvement obviously flows into good cash flow. So talk a bit about use of cash. Obviously, it's a tiny dividend, but a good buyback and M&A. Is that basically where you are headed in terms of use of cash?

Jeff Sloan, Global Payments Inc. - CEO

So you can look at the last two or three years; that's been a pretty good template for what we expect to continue. We've spent about $2.75 billion in the last two or three years in our business, about a $1.75 billion of it actually went in M&A and about $1 billion of it buying back 20% of our float over the last few years.

So it's about 60% in investing in the business and about 40% buying back our stock. So, what we've said is each year, we expect this year to generate a little bit over $400 million of free cash flow. Our expectation heading into every year is that we're going to repurchase stock with that amount. Of course, we balance that with M&A. We've got plenty of leverage capacity. We've got $200 million of free cash and about a $3 billion facility. So in the aggregate we have about $850 billion of available capital to invest under the current facilities in our current cash position.

So we balance those acquisitions relative to the IRR and the earnings accretion from share buybacks. And you can see that split over time. So as we enter each year, we think about $400 million plus going back into repurchasing stock. We'll balance that versus M&A, so that could be higher or lower. In some years it's been lower, in some years it's going to be higher, based on the deals that we do and we expect that to continue.

Ashwin Shirvaikar, Citigroup Incorporated - Analyst

Okay, great. On that happy note, I just want to say thank you, Jeff, and thank you all for being here.

Jeff Sloan, Global Payments Inc. - CEO

Thanks for having us.