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Global Payments, Inc. (GPN)

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CORPORATE PARTICIPANTS

Jane M. Elliott
Chief-Staff & Executive Vice President

OTHER PARTICIPANTS

Jason Alan Kupferberg
Jefferies LLC

MANAGEMENT DISCUSSION SECTION

Jason Alan Kupferberg
Jefferies LLC

Okay, everybody. We're going to go ahead and get started here. I'm Jason Kupferberg, the Computer Services and IT Consulting Analyst at Jefferies and here with us is Jane Elliott from Global Payments. We're going to do a fire-side chat format, would save some time for questions. And, Jane, thanks for joining us. I appreciate it.

Jane M. Elliott
Chief-Staff & Executive Vice President

Well, thanks, Jason for having me here today. I appreciate it.

QUESTION AND ANSWER SECTION

Jason Alan Kupferberg
Jefferies LLC

Q

So, I know that next quarter when you guys report, you'll be giving your initial guidance for fiscal 2016 in July. Can you just talk us through the general pipes, tailwinds and headwinds that you should be thinking about for the business as you head into next fiscal year?

Jane M. Elliott
Chief-Staff & Executive Vice President

A

Sure. So, I think from a tailwind perspective, we've experienced growth this fiscal year in 2015, which ends the end of this month, through our growth in our integrated channels in the U.S., in particular, through our business called OpenEdge. So, we've had a lot of success with that and you've seen that in our numbers. Our total direct book in the U.S. accelerated last quarter growing 15% organically, and we've got a ISO channel book of business in the U.S. that has slowed and has been slowing last two years. So, on the headwind side, that the ISO channel continues to slow, but you're finally seeing the direct business, the mix of business shifting in our favor, driving our overall organic growth has been running at the 7%, 8% total company constant currency. And so, that tailwind will continue into 2016.

We've also had positive growth internationally from our Spanish business, both organic growth from a shift in the market share gains. The penetration rates in Spain for card usage isn't as developed as some of our other markets. We've also had the benefit of regulation change in Spain that occurred September 1 of 2014 and that change will occur again this fiscal year, probably the second half of our fiscal 2016. The EU has promulgated that the credit and debit card interchange rates will move to 30 basis points and 20 basis points. And while that has been somewhat ratified by the EU Commission, there are a few other things that have to occur over there before the clock starts ticking, and it'll be a six-month implementation, so that kind of puts it towards December-January timeframe, as December of 2015, January of 2016. And that is a benefit or will be likely a benefit in our UK business similar to Spain, so that's a nice tailwind for us.

We've got a number of product launches that we've experienced benefit from this fiscal that we'll continue. OptBlue is one of those products that we launched back in June of 2014 in the U.S., and that is an American Express program for small and medium-sized merchant. And what is – effectively, it allows merchants to be able to accept American Express at a cost effective basis and make it more similar to Visa and MasterCard cost from a merchant's points of view, and we have not rolled that out in all of our lines of business in the U.S., so we're probably in our fifth inning or sixth inning in the U.S.

And last week, we just announced that we will be launching that in Canada. Again, American Express is American Express. So, Canada is a little bit smaller pool, but it's still a positive helpful thing for us. And later on in the year, we will do the same type of thing in the UK. So, those are some of the examples of positive tailwinds. One thing on the headwind side, Jason, is FX which isn't in our control but, certainly, we should be mindful of it.

Jason Alan Kupferberg
Jefferies LLC

Q

Right.

Jane M. Elliott
Chief-Staff & Executive Vice President
A

Because of how we report our numbers, we obviously are translating all of our regions into the U.S. currency, and you've seen some of that impact in our numbers this past quarter, and we will continue to report constant currency. So, you can see what the business is really doing.

Jason Alan Kupferberg
Jefferies LLC
Q

Right. Year-over-year, as we think ahead to fiscal 2016, I mean unless some of the major non-U.S. currencies take a major step back again, you probably start to flip into positive territory...

Jane M. Elliott
Chief-Staff & Executive Vice President
A

That's right.

Jason Alan Kupferberg
Jefferies LLC
Q

...in the second half of your next fiscal year?

Jane M. Elliott
Chief-Staff & Executive Vice President
A

Yeah, that's exactly right.

Jason Alan Kupferberg
Jefferies LLC
Q

Can we see it like that?

Jane M. Elliott
Chief-Staff & Executive Vice President
A

Yeah, yeah.

Jason Alan Kupferberg
Jefferies LLC
Q

Okay. So, maybe it's bit of a headwind early in the year and...

Jane M. Elliott
Chief-Staff & Executive Vice President
A

And then good news later.

Jason Alan Kupferberg
Jefferies LLC
Q

Yeah, yeah. Exactly, exactly. So, let's come back to the ISO business for a second, I know you touched on that. And the fact that it's been swelling not just for you guys but the whole industry, I think, and in fact in your numbers, I think it was about zero growth this past quarter, it's been very positive for the North American margin story, right? But can you just touch on what has really driven that ISO slowdown? And do you see it actually reversing at some point, or do you think that for the foreseeable future, we're sort of stuck at like a 0% to 2% growth rate in that channel?

Jane M. Elliott
Chief-Staff & Executive Vice President **A**

I'm going to – I assume it's going to be we're on the same trend. So, you probably see that in the – unless there is some market shift in pricing, that's either regulated for some reason or something...

Jason Alan Kupferberg
Jefferies LLC **Q**

Right.

Jane M. Elliott
Chief-Staff & Executive Vice President **A**

...that Visa or MasterCard do that's different. But from a sheer organic growth in the market, it's pretty saturated in the U.S. market for that small and medium-sized merchant. And so, I think you'll see that trend continue.

Jason Alan Kupferberg
Jefferies LLC **Q**

Okay. And what do you attribute the real slowdown to, I mean anything else besides the market saturation, is it just a shift to the newer channels early?

Jane M. Elliott
Chief-Staff & Executive Vice President **A**

Yeah. I think what we've been seeing is the integrated solution channel which is, just to remind you, this is essentially utilizing what we call the ISV. An integrated software vendor has the distribution point to integrate our payment technology directly into an ERP solution that is being sold to a certain type of business. So whether it's a dentist office or a veterinarian or self-storage system, they are utilizing software to help manage a variety of business tasks on a daily basis. And our technology essentially remove any complexity from the merchant's standpoint making that a very easy seamless transaction.

And I know it sounds like a large number, but we have over 2,000 of these software vendors today as a partner in over 60 different verticals. Some of these are very large companies, and some of them are very small companies. And what you're seeing is a lot of basic software packages out there for small businesses that has become very affordable to these businesses, and they realize that they can actually have some functionality around their business model that includes payment as opposed to the ISO model largely was successful in its day because it offered a very plain vanilla terminal and very effective price for that merchant, but there wasn't a lot of functionality for the merchant around that. And I think you're also seeing that shift there.

Jason Alan Kupferberg
Jefferies LLC **Q**

So, let's talk a little bit more about that channel because a lot of the competitors in the space have also been expanding more in that channel. So, it's becoming a bit more crowded. Do you worry at all about the impact of an increased competition, in other words, the VARs or the ISVs are going to start asking for bigger residuals, for example? Any signs of that or any type of concern?

Jane M. Elliott
Chief-Staff & Executive Vice President

A

I mean, obviously, it's always a concern. Today, that's a revenue share model with the ISV partner. And will they want more of a share? Everybody wants more because to some extent. And our job is to really offer as much value as we can to that partner so that it's not only when he's selling to the next new customer that he's selling his package to but the value that we bring to make that even a more thoughtful product, it is helpful to try to mitigate any of that risk. You're always going to have the outliers that will want to try to do it themselves.

But it's not easy obviously because the technology required at the back office and really the secret sauce is the back end, what we refer to as backend which is settlement. Statementing the funding piece is difficult. So, I think there's always going to be pressure, but our goal is to really offer value that it is commensurate with that pressure, so that we kind of keep that at bay.

Jason Alan Kupferberg
Jefferies LLC

Q

Okay, okay. Understood. And if we think about the international side of the equation here, clearly over time, Global Payments has checked more and more boxes in terms of expanding into newer geographies, newer countries. So, given all the deals that you've done today, which country should we be thinking about is still remaining on your target list that you would like to get into, whether it's organic expansion or via a JV or an outright acquisition?

Jane M. Elliott
Chief-Staff & Executive Vice President

A

That's a good question. We are, today, very focused on Europe. Today, we are in the UK, Spain, Czech Republic, and Russia. We would like to be bigger in Western Europe, in particular, but even some of the East European markets are interesting to us. And I think the regulation that's out there today that's lowering the interchange rate has created a catalyst where banks are asking themselves what are they going to do with their business, do they need to partner, what should they do, which is good for us. We're very happy to have these conversations and hope that some of them will come to fruition in the future.

But banks do move very slowly from a decision making. But we're hopeful over time that we'll win some additional geographies in Europe. We'd love to be bigger in Latin America. We have a very small presence in Brazil today that was in start-up essentially which is different for Global Payments because we normally actually go acquire or partner with a bank in a geography in order to get our footprint, and there really wasn't anything for sale there. So, today, we're at about 10,000 merchants in Brazil. We partner in Brazil with Caixa, and we'd like to obviously have a bigger role there. So if something came for sale, we'd like that market.

Mexico is a market we'd love to be in in a much bigger way. We've spent a lot of time in Mexico over the years trying to break into that, and it's just a closed market. Asia, we're always happy to look at some of the bigger GDP markets that we're not in today which would be South Korea, Japan to name the big ones that we are not in, although we have added Ezidebit in Australia in this past October that gave us Australia and New Zealand.

And then we've announced the JV with a Bank of the Philippine Islands which doubles our business in Philippines. That has not closed yet but it'll likely close at the very end of this month, so it would be a fiscal 2016 add to us. And so, all of that is really distribution assets that I'm commenting on so through either bank partners or some other company like an Ezi that would give us integrated distribution.

We also would like to look at technology assets that fill a niche or a gap, if you will...

Jason Alan Kupferberg
Jefferies LLC

Q

Okay.

Jane M. Elliott
Chief-Staff & Executive Vice President

A

...and how we think about our omni-channel offering. And we recently completed Realex, let's see, about four weeks ago which is a gateway business in Ireland. And that business, we had a lot of personal knowledge of that business because we were actually white labeling our solution in the UK, and we feel that longer term, we'll have the opportunity to actually bundle the gateway and merchant acquiring in a pan-European type of focus, but also it fills the gap for us in terms of our omni-channel future experience with multinational merchants. We feel that's a longer opportunity for us. So, we're happy about that business.

Jason Alan Kupferberg
Jefferies LLC

Q

Okay. Let's switch gears a little bit and talk about margins. I know you guys have reiterated on multiple occasions that over the longer term, mid-20s cash operating margin is a target of yours. You were 19% last quarter. Just talk about some of the levers you think that will be pulled to kind of get you to that mid-20s over time. So, if I'm not mistaken, that's excluding the kind of accounting benefit you will get, if you will, from Mercury once the de-conversion takes place there. Maybe you can talk a little bit about that there.

Jane M. Elliott
Chief-Staff & Executive Vice President

A

Okay. So, yeah, to actually talk about the latter first...

Jason Alan Kupferberg
Jefferies LLC

Q

Okay.

Jane M. Elliott
Chief-Staff & Executive Vice President

A

...so, Mercury was acquired by Vantiv, I don't know when, I can't remember.

Jason Alan Kupferberg
Jefferies LLC

Q

A year ago.

Jane M. Elliott
Chief-Staff & Executive Vice President

A

A year ago, maybe.

Jason Alan Kupferberg
Jefferies LLC

Q

Yeah.

Jane M. Elliott
Chief-Staff & Executive Vice President
A

So, that conversion will happen. We're still processing for them on our systems, and that will occur in early 2016. So, that puts us at our second half of our fiscal 2016 year. And today, our GAAP accounting accounts for that has all the revenue if it's our customer, and then the residual or the commission payment actually fits in our SG&A line. So, when those accounts move, which happen over a little period of time, it's not a switch to clip. The accounting will follow the movement of those accounts. So, the GAAP revenue as we report today, you will see a impact from the movement of those accounts, and you will not see an impact on operating income for Global Payments or for cash EPS because it's just not material.

And before I talk about Jason's margin question, I'll remind you that two quarters ago, we had 90 ISOs in the U. S., and 90 ISOs is about 8% of operating income, total company. And North America was about 14% or 15%. So, it's not as large as it was once ago. So, back to Mercury, so Mercury's revenue, because that will be coming off, our margins will just mathematically obviously go up.

Jason Alan Kupferberg
Jefferies LLC
Q

How much roughly?

Jane M. Elliott
Chief-Staff & Executive Vice President
A

We haven't said, but you can all do the math. It's pretty steep. So, that aspirational 25% that our CEO has said over the last year-and-a-half, well, obviously, that was not factoring in Mercury.

Jason Alan Kupferberg
Jefferies LLC
Q

Right.

Jane M. Elliott
Chief-Staff & Executive Vice President
A

And so, obviously, at some point, we'll have to adjust that aspiration for that. We've talked pretty regularly that our ongoing annual organic margin expansion is 30 basis points to 50 basis points. That's just organic. It doesn't factor in this accounting movement in terms of where things lie on the P&L. So, that continues.

In this fiscal year, we'll close out at 60 basis points of expansion. The levers of that margin expansion – so put Mercury aside because that's just kind of the math, that's how things roll out. But the levers for the margin are really the direct business in the U.S. becoming more and more meaningful, and you've seen that already. We expanded 40 basis points in North America last quarter. At constant currency, it would have been 90 basis points. That's literally just from that shift. So, that lever will continue.

And you can also look at our international segment margins which are probably about 35%, 37% and that's higher than North America because it's all direct. There is a nice book of business. So, the other lever for margin expansion is really just – we have an internal strategy of just becoming more and more efficient, leveraging our infrastructure to either promote and produce more products quickly around the company. And OptBlue on the American Express is a good demonstration of that because we did the work for the U.S. a year-plus ago, and we're able to launch it in Canada and then it will be launched in the UK very rapidly because we've already done the work, and it's one single infrastructure.

The other initiative we have is from a company perspective, we're continuing to focus on operating as a single unified company under our management team. And in the past, we've always been a bit siloed in terms of like a holding company. So from a merchant back office operation, some of it has been consolidated over time. We've got a great call center and back office support center in Manila.

Jason Alan Kupferberg Q
Jefferies LLC

Right.

Jane M. Elliott A
Chief-Staff & Executive Vice President

But not all the functions were...

Jason Alan Kupferberg Q
Jefferies LLC

Yeah.

Jane M. Elliott A
Chief-Staff & Executive Vice President

...moved. And so, we're in the process of looking at those functions. And I think over time, that'll also help drive that. That will be one of the levers driving that organic expansion.

Jason Alan Kupferberg Q
Jefferies LLC

Okay. Any questions from the audience? Let me ask you a question about Canada because performance there, after struggling for a period of time, has been much better the last 18 months or so. And really, it seems like it's been a bit of a self-help story which has been good to see. But just talk about the competitive environment right now in Canada, what changed, what remains the same?

Jane M. Elliott A
Chief-Staff & Executive Vice President

Yeah. Canada is a GDP-grower. There is no real secular shift left there from cash to card, and it is very price competitive. The main competitors there are Moneris and Paymentech – are the three major ones. So, our market for our merchants are low-single digit kind of revenue growth.

Jason Alan Kupferberg Q
Jefferies LLC

Yeah.

Jane M. Elliott A
Chief-Staff & Executive Vice President

Spreads have been fairly steady. So, we don't foresee anything that's going to change there in terms of something in the market that's changing. There is something called the code of conduct there, and there is a new proposed additional, I guess, enhancements, you would say, to the code of conduct that came out a month or two ago. Most of those changes are really, for us, we've already been doing it. Our focus is on transparency. So, to circle around that, Visa, MasterCard lowered their interchange rate, let's see, I guess, last month so in April.

Jason Alan Kupferberg
Jefferies LLC
Q

April, okay.

Jane M. Elliott
Chief-Staff & Executive Vice President
A

Those changes, according to their code of conduct and the Canadian regulatory folks, need to go all the way back to the business. And so, that's already in the works and that's all part of the code of conduct transparency. We will be able to – at any given time because it's such a competitive market, we do try to roll out new services that we can add value and charge for. So, optically it was one of those...

Jason Alan Kupferberg
Jefferies LLC
Q

Yeah.

Jane M. Elliott
Chief-Staff & Executive Vice President
A

...creating additional revenue opportunity there. The other opportunity that we have is to continue to penetrate in the integrated phase. We rolled out OpenEdge a year ago in Canada and have added over 20 partners in Canada. It is a slower pitch because it doesn't really exist in Canada. So, you're really kind of educating the market at the same time as you're selling. But longer term, it's another helpful lever that we can – any kind of pressure there in the market has its – it is a competitive area. So, we feel pretty good of where we stand in Canada.

Jason Alan Kupferberg
Jefferies LLC
Q

Okay. And then just one last one on margin thoughts for next year, I know you're going to be integrating the Pay Pros and APT...

Jane M. Elliott
Chief-Staff & Executive Vice President
A

Yeah.

Jason Alan Kupferberg
Jefferies LLC
Q

...platforms. So, just an update there on timing of when you think that will be done and what order of magnitude in terms of its contribution to margins.

Jane M. Elliott
Chief-Staff & Executive Vice President
A

So, you're seeing some of that benefit hit in Q3...

Jason Alan Kupferberg
Jefferies LLC Q

Okay.

Jane M. Elliott
Chief-Staff & Executive Vice President A

...to North America. We have combined the businesses selling going to market as OpenEdge. Obviously, the sell side is a little easier to do than some of the tech side.

Jason Alan Kupferberg
Jefferies LLC Q

Right.

Jane M. Elliott
Chief-Staff & Executive Vice President A

The actual technology side should be completed by the end of May in terms of the application technology. We actually still have account on a competitor business that we bought that was processing for PayPros, and we will move that. That will be done some time in 2016.

Jason Alan Kupferberg
Jefferies LLC Q

Okay.

Jane M. Elliott
Chief-Staff & Executive Vice President A

Because we've been putting all the new accounts on our own system, that's not as big as you might think. So, it'll be helpful, but it's not a major driver. Most of the work has been done, so you'll see that in the numbers so it's profitable. We haven't given an exact margin, but OpenEdge is a very profitable business, much higher than the corporate average which is driving that overall margin expansion.

Jason Alan Kupferberg
Jefferies LLC

Excellent. Okay. Well, I think, we're out of time. Thank you very much.

Jane M. Elliott
Chief-Staff & Executive Vice President

Thank you.

Jason Alan Kupferberg
Jefferies LLC

Okay.