Verifone

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Operator: Good afternoon, my name is Brent and I will be your conference operator today. At this time, I would like to welcome everyone to the Barclays Emerging Payments Forum Fireside Chat with Verifone. (Operator Instructions) Thank you. Mr. Peller, you may begin your conference.

Darrin Peller: All right, thanks operator. Thanks again to everyone joining us on this day. As you guys are aware, the weather made it a little more challenging to do it as we would have liked in person but we're happy to have, obviously, the management teams, many of them or most of them actually with us on the line for these presentations today.

So in terms of logistics, keep in mind that the agenda should continue to be updated. You should have incremental color on the dial-ins for the new sessions, but mostly the schedule is pretty much the same, just a lot of it through either dial-in and them tomorrow, some it will be on site, some of it will be dial-in.

And so with that in mind, let me just start off this process with first of all, thanking Verifone and Paul and Mark both for being with us, the CEO and the CFO of Verifone, on this call. So thank you both for joining us today, guys.

Paul Galant: It's our pleasure, Darrin. Thank you for having us.

Darrin Peller: Okay, all right, guys, I mean I think best way to start off, maybe Paul at your investor day a few weeks ago, you recently provided a longer term outlook, including growth targets to 2020. Can we just start off again by reviewing some of those objectives and maybe some of the drivers behind them? And then we'll go a little more granular from there.

Paul Galant: Absolutely. Look, to position Verifone for success, we absolutely needed to get in front of the demand curve for our core business and so the outlook that we provided to 2020 is driven 100% by that. Our core business is the payment acceptance business. We help merchants accept payments from consumers and there are some pretty big trends happening in that core business. I think mainly three trends. One is that you're seeing a real acceleration of the move from cash to electronic payments. That is happening everywhere in the world. It's being driven by fiscalization. It's being driven by demonetization. It's being driven by terminalization, lots, and lots of buzzwords. But really, it's just that cash is going to become a lower and lower percentage of the number of payments that consumers make to businesses.

All right, and that's also spurring, by the way, mobile. Mobile is a big component of that. The second major trend is that there is no doubt a convergence of payments and commerce. Payments was a monolith always. You did that separate from everything else and security was the main reason for that. And I think where we are today is that there is way to make payments a part of commerce in a very seamless fashion. In fact, it's becoming more and more of a product, if you will, payments and commerce converging and we're able to do that luckily with the same if not higher levels of security.

The third is the convergence of the physical store or some people call it offline with the online payment and commerce sphere and that's creating this thing called omni channel. So those are the three main drivers for our core business, and Verifone, our DNA was always to be ahead of these things and we lost our way a bit. We are absolutely back and so what we're doing is we're rolling out our next generation devices, which are all built to capture the maximum impact of those trends. We're rolling out next generation services, which are really focused on the experience and the total cost of ownership in delivering that experience.

And so when you take the next generation devices and you combine them with the next generation services, you get these solutions and these solutions are the ones that are driving the growth targets. And one of the important things for you all to know is we're not Pollyanna-ish. We know technology takes time, but these trends are real and our position globally with distribution is real. And so we think that there's a real opportunity for us to achieve these goals and then some.

Darrin Peller: All right, that's great. And then I guess even putting a little more granularity behind this, within that same guidance your service growth was called out to be -- expected to be 78% CAGR and really outpacing systems. Similarly, I mean I know some of those drivers were overlap with what you just said, but can you give us a little bit more specifics on that?

Paul Galant: Well, I think the most important thing to understand is the -- our core business forever and ever was really facilitated by hardware. Hardware could get you everything you wanted -- very, very basic software, if you will. The only thing that was advanced was encryption, but now I think what you're seeing -- our services business is going to be driven almost entirely by software, not hardware. We just need our devices -- next generation devices -- to be network end points that can run all of this new software.

And the other thing that that's I think going to be doing for people is that it's going to really cause them to think very hard about their total cost of ownership. Whereas in the past, an acquirer, or a bank, or even a large merchant would be able to buy a device and make it do what it needed to do and be good enough in terms of a consumer facing experience. It's very, very hard to do that today given the trends I've just talked about. You need to have seriously strong talent in payments, in commerce, in security, in the whole GUI interface, the online/offline.

And so there are people that are scratching their heads today and say, well, this is going to cost us a lot more to stay competitive if we're doing it all internally and we need to get to more of a solutions provider that we can trust that has the security, but could do all this software for us. So that's what's going to drive the services business on top of our devices.

Darrin Peller: Okay, I mean that's really it, right? The trustworthiness of the Verifone brand versus a lot of the newer smaller companies trying to offer something where some of the other names in the ecosystem offering and crossing lines is really what I think differentiates -- has always differentiated Verifone. And now, coupling that with differentiated products that you could layer on top of your secure systems is got to be the pitch that wins, right?

Paul Galant: It is the pitch that wins. People will experiment with lots of things but when it comes to saying, okay, we want to do something different here. We want to be able to succeed with all these trends. We want to be able to grow our revenues with our consumer businesses then it starts to evolve into not just what's the shiny object but how do we make it work 24 by 7 for the next seven years and make it be a learning and growing engine. We're real good at that and we'd lost our way for a little bit there, but everything that we've talked about in terms of call it Verifone 2.0 is getting back to the roots of being able to do that in a no excuses, high volume, global way where we're as excited in seven years' time as we are today about these new next generation systems.

We're not looking to just spend most of our time capital raising. We're looking to spend all of our time developing solutions that work.

Darrin Peller: Well, you've definitely announced a lot of incremental new types of offerings and products recently, and we'll come back to some of those in a moment, because for now, I actually -- if you don't mind -- I want to hone in on some of the key areas in North America in the way you've typically reported them. And let's start off for some of the growth trends we're seeing in multi-lane or some of the opportunities there amongst multi-lane retailers. I guess can you just talk what stage we're in for in the adoption amongst these larger merchants, and what kind of traction you continue to see, which you've always stood out in terms of market share.

Paul Galant: I think multi-lane retail in North America is done with EMV and if it's not done, it's 95% done. It's pretty much there. I think what we're seeing now is some of the folks that adopted our MX series multi-lane devices, the earlier ones like the MX800 series are now refreshing those. They're doing it because, although those devices are -- still work beautifully, they don't have a lot of processing speed. They don't have a lot of memory and so if you're trying to do more of what I just talked about, those are not the right network end points.

And so what we're seeing is those retailers, they're not refreshing because the devices aren't taking EMV cards. They're refreshing because in addition to EMV cards, they want to be able to do a lot more. And so we had 50,000 upgrades -- 50,000 devices upgraded in Q1, which was really exciting for us and a lot of conversations about engage now as the replacement for some of those MX 800 series devices.

Darrin Peller: All right, that's helpful. I guess beyond just multi-lane, QSRs are now becoming an increasingly important opportunity just given, I mean, posting in View World, right? How much growth do you expect out of that area now?

Paul Galant: We think there's a significant growth area there, not just in devices but really in a whole lot of services attached to them. The QSR space in terms of hospitality in general, we always knew that to be the biggest piece of the hospitality pie. That's why we kind of focused in on that and we've done quite well in it. I think we've won nine of the last nine big tenders in that and it was really not a function of price. It was a function of the fact that these clients really liked our technology.

And what's going to happen there -- it's about 500,000 lanes give or take. And what's going to happen there is that those folks not only want to take EMV, but they want to have the cash register do less of the heavy lifting, all right. In the past, all QSRs, it was really the cash register. They took your card. They swiped it against the magnetic stripe reader that was attached to the cash register. They want to get all of that consumer information out of their environment and so they're moving with something called semi-integrated. And so they take Verifone devices, they take our secured commerce architecture solution that takes the cash register out of PCI scope and then they connect that system directly to either our gateway or direct to the acquirer, and we're encrypting everything and tokenizing everything.

And that's really a wonderful service for us. I think the next big thing there is that many of these folks want to take Apple Pay, and Samsung Pay, and while that's all fine and good for payments, the exciting part is when it's going to drive into loyalty. And that's where we have yet another set of services that we will avail.

Darrin Peller: Okay, all right. So it still sounds like there's a lot more to go there. Similarly, on the SMB side, I think there's a lot more to go. I mean if we shift there for a moment, beyond just -- maybe start off with EMV. Just give us an update on what you think will incentivize some of those SMBs to actually do it? Or is it just going to come on at the typical, normal rate of terminal replacement? And then maybe any update on the visibility around demand from these merchants for other services as well, if you don't mind.

Paul Galant: Two things going on with SMBs. One is that they got a reprieve because BMV deadline was extended for them. They also got a reprieve on low-ticket items, $25 and under. So the bills that they were starting to see from their acquirers and others have stopped and so they're less incented right now, but they will restart again because I think that EMV is here to stay and it will, over time, become 100% of the U.S. market. But today, there are five million devices that still need to be upgraded. Primarily, they are in the SMB space. There's also another million devices in gas dispensers. A lot of that five million is also grain field. All of that is going to have to get replaced, probably more normalized up until, say, a quarter or two before the EMV deadline gets enacted again, in which case I think it'll speed up.

But the bigger thing going on in the SMB space is that increasingly, it's not about the terminal. Increasingly, it's about the total end-to-end solution for that business, not just to accept the payment but also to help them run their business. Square has done a really good job in that, creating that sort of capability. You've seen a nice job done from Frank Bisignano at First Data on Clover, where that's starting to do more than just provide a basic terminal.

And for us that is a massive opportunity. It's why we got well ahead of the curve. We created carbon. Carbon is an entire family of devices and they help these merchants to run their business. And so if you're an enquirer or a bank that serves these merchants, right, you're looking at carbon as a way to get yourself sticky beyond just paying -- processing the payment and it's a way that these acquirers and banks can compete against what Square has and what First Data has, and some others. And so we think that will be a good, important space for us.

Darrin Peller: I was going to touch on new products. Might as well shift there now. So carbon, I mean there's also -- you mentioned obviously Engage earlier, E-series value. I mean can you give us a little more color on what some of these opportunities may be and how big can carbon really be for you guys as part of not just SMB but more broadly speaking?

Paul Galant: Well, again, I think that let's take it from the top. Engage is a replacement of VX and MX series. They do payments real well but they also connect to a marketplace of applications. They come with a lot of capability, tons of processing speed, even higher levels of security, more color, vibrancy, more memory, right. So it's not just a payment thing. It's a way for any merchant to engage much more closely to the consumer, something consumers are expecting more and more, right. So that's what that's about. It's a good thing for us because it provides us with hopefully better margin and attached services, not just the box that we ship.

The second thing is in mobile, as I said, mobile is really being driven by this cash electronic payment. In the U.S., we understand that there are -- we're all as consumers used to the retailer, the smaller retailers, big retailers. In the big retailers, the entire thing now is to get closer to consumers and you do that with a mobile device attached to a tablet. So we have this thing called the E-355. It's done extraordinarily well. That is the core thing for multi-lane and for large retailers to get closer to their consumers and you see us with deals in Canada, with Moneris and others. This thing has really taken off nicely.

On the other end of the spectrum are all of those merchants that are no taking huge numbers of transactions, but because the rules in their country have changed and they now need to be able to take a debit or credit card, it's the least expensive way to do that is with a mobile device like our new E285, which we're rolling out. And even our more economic solutions, a little less functionality but we call them value. And those are also starting to take off nicely because of those mandates in government.

And then finally, you've got carbon, which is an entire different segment for us. It's helping our merchants, our acquirers, and banks to go beyond payments and to help their merchants with an end-to-end solution.

Darrin Peller: Yes, okay. Well, it certainly sounds like a lot of innovation in a pretty short period, but it's clearly meeting the demand that's needed. I guess if we shift gears for a moment, at the pump, when we look at the pump deadlines around EMV, they were pushed but if you could just walk us through, I guess, maybe some updated thoughts around that opportunity overall, fuel pumps longer term. I know you can touch on the JV, perhaps. You could touch on Gilbarco, maybe give us a little more color and when you couple that with media, what this really could mean now.

Paul Galant: The petroleum business has been one of our biggest verticals. It is something we're real good at. We have a very high market share in North America and we're starting to grow market share globally. You mentioned Gilbarco, very good partner of Verifone. We have really a seamless relationship with that group and they're the largest pump dispenser. So we're starting to come at petroleum from all sides. We know there's going to be a regulatory change. We're not happy that it got moved out by three years. I think nobody expected that in North America. Most of had modeled a year extension. I don't think anybody modeled three years.

So we're sort of adjusting to that, but the core thesis, the core fundamental thesis is build out, which is you're going to have a change and like with the terminals and carbon, our clients expect more from the payment module. Media is one of the things that they're expecting and so we looked at our ability to deliver media as a core business and it's not our core business. It's just something that we can facilitate but we needed the world's best media team for pump. So we combined our very talented folks, a small group, with GSDV's much larger group and we put those two teams together in a joint venture. And now, we're going to have over 100,000 screens on launch day. And so between the EMV upgrade, when we upgrade those pumps it's going to come with a screen that could show media to having a core team that really understands media end-to-end. They built it from scratch. I think that puts us in a very strong position and we're looking forward to maybe taking that show globally. But right now, it solves the North America opportunity very nicely for us.

Darrin Peller: And what kind of timing would you expect investors to look for seeing further traction on that media opportunity being something bigger than it's been in the best?

Paul Galant: Well, we're going to close the JV probably this quarter, I'd say in the next couple weeks. The team is going to obviously spend a lot of time in front of their advertiser clients and agencies. We're going to be helping them to upgrade the platform so it's a single platform that allows for targeting, that allows for a certain type of media performance, a picture in picture in the loop. And I would say that a year to 18 months from now, we should start to see a significant improvement in the economics. But from Verifone's vantage point, it was just the right thing to do for the clients and I think it's going to be financially beneficial to us even in the short-term.

Darrin Peller: Okay, all right. That's helpful. I mean I guess when we put it all together on North America, we just talked about a lot but obviously, given some of the revenue move into the JV, the numbers were a little lower in this year than previous. But again, just moving things around, I guess when we think of the overall opportunity for North America. Nothing else has changed from that standpoint. I mean there's good trends in some of the new products, the services as well.

That should still reaccelerate to the growth rate that you talked about long-term in your investor day, in terms of just a quick update.

Paul Galant: Yes, look, I think what you're hearing from us is focusing on the core, understanding that we're going to move from hardware to services to solutions and understanding that there are certain things that we're doing today that we probably ought not to be doing on our own. So it's a function of focusing on the areas where our resources are going to get the best return.

Right, and so we have businesses, which were purchased over many years that I think have some strong things in them, but we're probably not the best owners of them. And that's what's going to drive our guiding principles. You're going to see us continue to focus. You're going to see us continue to upgrade in areas where we can get global scale. And in every element of what we do, if we're not improving the company's chances of getting annuity revenue then we're doing the wrong thing.

Darrin Peller: Okay, all right. That's a good way to look at it. Paul, in Latin America, it's been a fairly competitive environment for a while and we saw some evidence of that last year. But like I said on the conference call, I think, or earnings call last week, it seemed to me like it was showing some pretty good signs at least for Verifone. Just a quick update again on what's happening there versus your competitors in particular. It seems like you did pretty well this past quarter I know in Brazil and Argentina. If you can give us a little more color.

Paul Galant: Well, it starts with having the right people. We have a very strong team led by a really terrific guy, Carlos Lima, who runs our Latin American business and he's really continued to make great strides. We've got a seasoned team there that really knows the clients extraordinarily well.

They're really good listeners and they've been doing a fabulous job of translating what clients need today as well as understanding what those individual markets are going to look like a year, two years from now. And that's allowing us to deliver the right product at the right price point.

Now, having said that, it's a really tough market to have visibility into. It's very volatile. A lot of it is driven by political uncertainty. Brazil was the poster child last year for that. Bad recession, lots of turmoil, people changing their plans because the market was changing so rapidly. A lot of businesses were going under. So it's hard to predict, although the fundamentals are there. When you have the right team and you have a market that is certainly moving away from cash, and you've got innovative clients, which Brazil has very innovative clients. Some of the best digital banking in the world is found in Brazil with players like [Itau], all of that is going to stay.

And so we just are going to continue doing the thing that has worked for us in the past. Mexico, where we have a very strong relationship base. We've got a terrific guy in Fernando Lopez, who's been running our Mexico business for a long time. He's got a very good sense of what we need. The problem with Mexico today is that the foreign exchange market is just crucifying him and it's just a very tough thing, but we are faring extremely well competitively irrespective of the market.

And lastly, you've got Argentina. They've got the devaluation thing, lots of issue. But the market is wanting more electronic payment and I think all of these emerging markets in general are realizing that with political turmoil, it's even more important than ever to collect taxes. They need revenue. Oil isn't going to do it for them and in order to be able to collect revenue, you've got to go electronic. So we think the trends are still strong.

Darrin Peller: All right, that's good to hear. All right, Paul, I guess if we shift away now from Latin America, a quick tour around the world. Europe is continuing to look like a market that you've gained back some traction and see -- I mean maybe you want to comment on sustainability and growth going forward.

And then I want to touch on India before we go to some financial questions to wrap it up.

Paul Galant: Yes, I think that India is a good market for us. Unfortunately, a lot of goodness is masked by a tough foreign exchange environment for us. It's been a hell of a headwind since I've been here. I don't see it letting up anytime soon unfortunately, but again, we're getting back to the core business, which is understanding what the larger acquirers and banks need throughout Europe and being able to deliver it. Being able to Pan-European things. InterCard is helping us do that, that acquisition. We just didn't have any capabilities and now we do.

And you're seeing the strength that we have in the Nordics. We're taking that strength and the wonderful team that we have there and we're leveraging in other parts of Europe. We're leveraging it in North America as well and that's continued to be a good driver for us.

Being so entrenched in the Nordics where 90% of all transactions are done away from cash taught us a lot and we're bringing that know how through the other parts of the world. PCI 1.3, the expiration of that is creating some good momentum for us in the Nordics, and France, and Germany and we finally got our act together and were able to deliver with certified product at a good price point. And lastly, you got Turkey. Gosh, I love the market but you just never know on any given day where you stand.

Their fiscalization effort, I think, is going to come to fruition even though it's been delayed by a year and we're in a really strong position there. Just hoping to get that thing moving. Also, by the way, Greece is probably seeing some of that as well. They're going to fiscalization. It's all the same thing. They've got to collect taxes. They've got to be able to fund their government.

Darrin Peller: On that note, India is a good example of that, which obviously, we already saw pop up in your quarter last quarter. So I mean, a little more color on what's happening there now that we have you on this line. Maybe beyond what was even said on the call, is this an area that can show sustainable trends or is it really just sort of a little -- a bit of a peak and a trough thing that will seal the next year?

Paul Galant: I don't think it's a peak and a trough thing. I do think that it is fundamentally a change. The monetization is the most aggressive way to move to electronic payments. Very few places have actually done it. India has 1.3 billion people and it has one device per thousand. Okay, so you're starting off a very low base. China has 17 devices per thousand people, okay. The USA has 44 devices but India has one. So I think it's here to stay. It's likely to go in waves. The first wave is going to be all the major cities, the major banks cover those cities, especially the merchant acquiring banks. They're going to get their terminals installed and they're going to start to go the same curve that you're seeing in any developed market.

You go to a store in Mumbai, it looks a hell of a lot like a store in New York. It's not like this outdoor market thing. And so that's the first wave. That's what I think we're starting to benefit from. That will run its course and then the second wave, we're going to be the smaller cities and rural areas. And for that to happen, you need the mid-market -- the middle banks, right, bank number 11 through 50 in India to start developing a merchant acquiring business. They don't have one today.

As those people develop those businesses, you're going to see that second wave of terminal demand. While that's happening, the first wave is going to go from just devices through [sub-cards] to now some of the services that we're seeing in other parts. But I think it is going to be a robust market. I view it as much of a services opportunity as a device opportunity.

Darrin Peller: Okay. What about the biometrics theme that we're seeing there? Is that still going to allow you enough room and opportunity? Or is that something you can work with? Just give a little more thoughts on that.

Paul Galant: Well, it's been around for some period of time. A lot of devices that we deploy there have biometric readers. It's, again, a government mandate. To us, it doesn't get in the way of anything we're doing there. It's just another feature function that we build in. It's got its limitations. Biometrics are very good except they have, unfortunately, a lot of limitations too.

Darrin Peller: Okay. All right, maybe we can shift gears just in the interest of time. And Marc, on the margin side, obviously, the 2020 outlook calls for about 300 basis points of gross margin expansion. If you want to just update us quickly on the key drivers of that and then more recently, what we would expect or I should say more to your (inaudible) be able to expect for that as well.

Marc Rothman: So the 300 basis point improvement is what I discussed about a month and a half ago when we did our first panelist meeting and the primary driver of the improvement is really around new product introduction. And I think there's still opportunities across Verifone on the supply chain side, both on the systems and services business. I think there's still some fruit to pick on the services platform and globalizing that. Although we made progress, is still think that what we can still do is accretive to our long-term projections.

So I really would probably bucketize it into two or three categories. One, clearly, new product introduction. We know that there's a material improvement in the bill of materials of the new products that were launching across all four new families engaged -- carbon, value, and [empas], and we can look at that relative to where our competitors are shipping today and it's at parity or if not better and you can see some of the margins that our competitors are producing. And they're several hundred basis points better than us.

If I can wave that magic wand today, there would be an improvement in excess of the 300 basis points but I think for longer term planning, it makes sense to assume that there will be some dynamic in the marketplace relative to the pricing or there will be some mix issue as the emerging markets expand. So I think new product introduction, sourcing in general, and then continuing to optimize the supply chain related footprint will be the three drivers.

In the meantime, when we look at 2017, we've di 38.9% in Q1. We think it will be slightly higher in Q2. The majority of our new product introductions, when Paul and I spoke about the new products contributing about 5% to 10%, it's probably right in the middle, by the way, of that range related to our services, our systems, excuse me, our systems business. We think that that will be accretive to the second half margins and that's why we see a little bit more of an uplift in the second half.

Darrin Peller: All right, that's helpful. And then just lastly, and I'll open it up for about one or two minutes of questions the operator can take if there's any in the audience after this, but just a couple of -- one last question. I guess the bridging between the revenue growth rates and the EPS growth targets through 2020, obviously, is above and beyond -- I mean it's revenue growth and then there's gross margin expansion. Is there other variables you want to just help us bridge just to keep in mind before we wrap up the call?

Marc Rothman: It's a leverage play. We think our guidance is very balanced, that the 5%, 6% revenue side, like I've said a month and a half ago, it's balanced. Obviously, we have higher aspirations around the new products and the attached services, and there's places where we haven't contributed as much as we can, like in China.

But I think that the revenue leverage is going to be a big driver to the 3X EPS accretion and we said approximately 15% over that period. The CAGR is about 15%. So it's a function of the revenue and the margin accretion and we're going to be very thoughtful and responsible about the amount of funds that we invest in the business around overhead.

Darrin Peller: All right. Thanks, Marc. Listen, operator, I think we have time for about one minute of questions if there are. I know there's often -- a lot of times people will just want to email me and I can follow-up with management as well. But if there's any questions, I think we'll be happy to take them for a minute or two.

Operator: We'll pause for just a moment to compile the Q&A roster.

Darrin Peller: Guys, while we're waiting, just in case, I just want to first of all say thank you very much. It was I know alto of adjustment. Hopefully, you still have your calls and your meetings going well all day with your one-on-ones, but having you on the line with us to allow for the content to be delivered to what's almost 100 clients on this line is also really helpful.

So thank you both very much. Operator, I think that -- I don't see any questions in the queue. Is that fair?

Operator: No, sir, we have no questions.

Darrin Peller: Okay, all right, well, I'm sure we'll be having more. We'll follow-up with you guys, but Paul and Marc, thank you again. I really appreciate the time today.

Paul Galant: Thanks, Darrin. We really appreciate it and we're having terrific calls, and we love the forum and thanks very much for including us.

Darrin Peller: Thanks, Paul. Thanks, guys. All right, have a great day.

Operator: Thank you. This concludes today's conference call. You may now disconnect.