Priority Technology Holdings Inc.

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Moderator: Thank you everyone for joining our fireside chat with Priority Technology Holdings. Priority is a payments technology company that leverages a purpose-built platform to enable clients to collect, store, and send money, operating at scale. Priority helps its customers take and make payments while managing business-and-consumer operating accounts to monetize payment networks.

Today I am pleased to introduce Tom Priore, Executive Chairman and CEO of Priority, and Tim O'Leary, CFO of Priority.

Tom Priore: Thanks for having us.

Moderator: Tom, thanks for being with us today. Priority had an impressive Q1 with 21 percent year-over-year revenue growth and reaffirmed its full-year guidance. Can you talk a little bit about the demand environment across your businesses?

Tom: Sure. We've been fortunate to see strong demand really across our three operating segments. Unlike some of our peers in SMB payments, we've seen close to 20-percent volume growth. That's really coming on the heels of winning market share.

Consistency in our products being adopted by the small merchant community in the US, we're consistently boarding north of 5,100 merchants a month. That's up from last year as well. That segment's just winning on the strength of its products. On the B2B segment, it's pretty early innings in that industry we think generally. We are seeing continued margin expansion in that segment.

Volume is growing on our existing logos. We're winning new contracts across the middle market and institutional space for automated payables. Then lastly, our enterprise business has really seen the greatest adoption. We have a deep platform in consumer finance payments. In the environment that's been challenging for the consumer finance sector generally, we tend to do well.

We're doing well as a result. Then we've also seen, just in the beginning of the year alone, 18 new partners join the platform and start to move their volume through. Tim can go into a little bit more of the granular financial tail in each segment. We've been fortunate that it's been broad-based.

Moderator: Great. Diving into your segments, let's maybe start with the big one, SMB payments. That business grew 19 percent year over year in Q1, which is very impressive. Can you talk a little bit about what are the top drivers of growth in SMB payments and do you see any near-term headwinds just given the macroeconomic environment?

Tim O'**Leary:** Yeah, I think the growth has been really broad-based. I think Tom's already mentioned some of the boarding trends we're seeing, and we do continue to see our distribution channels operate very effectively. Adding an average of over 5,000 merchants a month so that continues to grow the total merchant base.

We're up over 260,000 merchants today across the SMB portfolio, and that's driving the volume growth. We had volume growth, we had transaction count growth, and all that contributes to what we're seeing on the revenue side where the business continues to grow at a very nice, strong organic pace.

As far as some of the headwinds, I think the broader macro market is certainly starting to show its impact across the sector. All the rate increases from the Fed has started to impact some of the consumer spending. The benefit for us, though, is our portfolio is very diversified, very broad.

There's really no concentrations, as you think about industries. In some ways, we've got nice defensive areas in there where we're probably less concentrated to restaurants than the broader payments industry might be, which we haven't seen the impact through there yet. Then we've got legal services and other areas that have been very defensive for us and growing nicely.

Tom: Maybe to put some fine-tuning on that, on the current environment, Tim noted our book is 17 percent in the hospitality space, which small restaurants probably make up a third of all small businesses. The underrepresentation there is, by the way, it's intentional.

The other thing I would just note, if you look across our SMB book, close to 80 percent of our volume is either what you'd consider integrated or semi-integrated. We're not supporting a distribution network that is out pushing terminal solutions. These are software solutions. They leverage our MX Merchant and MX Merchant POS platform to really to manage their business.

That enables us two advantages. One, it's very sticky. Our attrition is historically below 10 percent, which is less than half the industry average. We're not chasing money that's leaking out of the bottom of the bucket every year.

The other thing that is significant is we're selling software solutions to larger businesses. Our average customer's doing probably thirty to thirty-five thousand of bank-card volume a month. That's large within the SMB segment. These are businesses. They need technology solutions.

We've cultivated a distribution network that understands that, is a value-added group of resellers. They do an outstanding job being consultative. That makes a difference in difficult markets.

Moderator: Very helpful. Maybe turning to the B2B payments business, on your last earnings call you spoke about the evolution of the business mix, the wind-down of a large managed-services contract. Can you talk about B2B in general? Where do you see the growth opportunities in the industry and also in your business going forward?

Tom: Look, we've always had the view of B2B that we're still in early innings, number one. We've been very measured about how we've invested. As a result, we have one of the few B2B divisions that is profitable. We're driving that income to the bottom line while most of our peers are still burning capital. We're picking our spots. One of those spots was announced today.

We are the stalking-horse bidder in a restructuring of plastic, which is a really exciting B2B technology but maybe was underoptimized for the environment. We can now bring resources to help optimize that within our vision for B2B, which needs to be one that is not network oriented. We think that's a mistake. We think the market's proving that out.

What I mean by that is not every supplier's going to sign up to accept payment just to automate their receipt of their invoice. It's very situational. The reason is because buyers have different deals in procurement with their suppliers. Not every network's identical. We take more of a bespoke approach. We curate those merchant networks between the buyer and their suppliers.

We now are doing that not just with a supplier-driven automated payable solution, as we add plastic to the mix, which is a buyer-driven solution. It'll all be housed in one place. We think that's an important part of the successful strategy in B2B. Be very bespoke-oriented, curated for big buyer and supplier networks. You'll also have to have a full suite.

We're not just a virtual card issuer. We're not just a card player. You mentioned the opening. We're a collect-store-and-send engine. We have money transmission licenses nationwide. We handle lock boxes. Any form of payment that we want to make to automate or a buyer wants to make to automate their payables we can handle in one place.

That's a differentiator we think drives our profitability and our margin, which is now approaching 70 percent in that business.

Moderator: It's great to see the announcement earlier today with plastic. Can you talk a little bit more about plastic and the strategic rationale of doing that deal? It seems to be a lot of overlap between your S&B customers and plastics customers.

Tom: Without question. Their core constituent is small businesses that are looking to utilize their credit to improve their cash flow. We're already an existing service provider to plastics. This is really a layup for us. We're excited to start bringing those tools out to our S&B universe. We think it's a great cross-sell opportunity for our base.

They've built really impressive technology to help small businesses manage their payables, which complements our more enterprise-oriented solution really beautifully.

Moderator: Great. Maybe we could pivot to the enterprise payment segment. Enterprise payments grew an impressive 57 percent in Q1, which is incredible. Can you talk about the solutions you provide in enterprise payments and some of the market tailwinds that you're seeing?

Tom: Sure. I'll let Tim dig into a little bit of the particulars on performance here as well. The growth has been driven by a couple of conditions. We have been touting this business as a counter-cyclical one that we felt would do well as the economy started to turn downward. It was very intentional in us getting into the business.

We've been talking about the probability, I'll call it, of a recessionary, or, certainly, economic pressure evolving for the better part of 18 months to two years. We endeavored to set up for it with a business that helps consumers resolve outstanding debts. In an environment like that, like we have today, you might imagine that that's top of mind for a lot of consumers.

We've seen tremendous enrollment in that segment. Then, as we've rolled out a full set of APIs for integrated partners -- so these are everything from real estate software to construction software, to other bill payment and payables platforms -- they're now leveraging our engine to collect, store, and send money.

We're getting the benefit of that growth. We have 18 new partners that have come on board since channel one. It's been driven by that new partner adoption, and the macroeconomic environment.

We're going to naturally see a lot more consumer enrollment through the integrated partners we have, which is now well north of 50, well north of 50.

Tim: The other tailwind there is that business, it drives deposit balances. We have over $600 million of deposit balances that we've managed through a network of 13 or 14 partner banks where we have those deposits in FDIC-insured accounts. We capture interest income and the float.

Obviously, with the tailwinds behind rates, that's been a benefit for us. We'll continue to see that for the benefit of this year. Then, the continued growth in new enrollments. We continue to add to the overall customer base there. We haven't seen any signs of slowing. If anything, it's accelerating.

Moderator: That's exciting. We could switch gears, and talk about the competitive environment a little bit. Overall, in terms of competition, how do you think about competition in the verticals that you're in, or in the segments you're in? Can you talk a little bit of any changes you've seen in the last year or so?

Tom: Look, and I hate to be cute in this remark, but we don't think about our competitors. That's not to be dismissive towards them. It's just that they don't drive our decision-making. We've had a vision that we felt payments in banking would converge. A lot of people call that embedded payment, or better payments. We think it's much more than that.

Modern networks are not just about card payments any longer. They're commercial networks. Banking, banks do this great. They store that money for a period of time, and allow companies to then decide how they want to manage their money. We felt it's only natural to add that to our breadth of offerings in the market.

I'd say that that's what we've focused on from, I'll call it, the competitive landscape. It's, what's the evolution of how commercial networks should operate? Do we have the tools to deliver?

It's starting to become very clear that that modern delivery of payment solutions -- and I would call them cash acceleration solutions, which is what we should be endeavoring to do as payment companies -- requires a banking capability, requires a banking expertise.

We brought that all together with nationwide money transmission licenses. A banking-as-a-service capability. That's where our competitive mindset is.

Making that a differentiated platform or engine to move money. Then, plugging that in across our channels, so that our customers can go to one place to have all their money flow through their business. When it needs to stop for a minute, it stops with us. They can redisposition however they want.

We're there now. We can handle. We have managed checks. We have our own ACH-Fed connection. It's why we're driving the kind of deposit growth that we're benefiting from as well that Tim noted.

Moderator: You've talked a little bit about the convergence of payments and banking, and embedded finance. You've mentioned on your earnings calls that Priority is a unified commerce platform. Can you give us some use cases or examples of how your customers use all these capabilities and tools in the tool kit to collect money, store money, and send money?

Tom: That's great. I'll typically go into SMB to...Let's reverse it, make it a little interesting. You mentioned Plastic, right? We just acquired it. I told you they're a customer. Well, they're paying bills on behalf of small businesses.

The benefit they provide that small business is utilizing their credit to pay the bills. Use Plastic to process the card transaction for all of their payables. That money needs to sit for a moment while it's determining, "How does that supplier want that money? Do they want it via ACH? Do they want it via wire? Do they want it via check?"

Our engine does all of that in one place. Brings the money in on the card, holds it for a moment safely in FDIC-insured accounts, then can send out checks, send out wires, ACH. Even virtual cards to the extent that that becomes a future thing within that platform. All of that's handled in one area for an ISV, like Plastic.

We have a host of other ISVs signing up to say, "Hey, I want to use that engine to do that. That's what I really want. Right now, I've got to connect to three different places to try and make that happen. I got to send files to my bank. I don't want to do that anymore." It becomes a much more simplified approach to moving money.

If I'm in the construction industry, and I need to resolve payment to a host of contractors, or I'm in the real estate payments business. Not only do I need to collect from renters. I've got a lot of things I need to do at the property to manage that property. It becomes a compelling solution in that environment. That's one way.

In B2B, just straight up supplier demand, imagine instead of having to go and reach out to every single supplier to understand how they might want to accept payment because we have money transmission licenses and we can qualify all that information to the buyer, we can give them a payment wallet literally within minutes -- thousands, tens of thousands, a hundred thousand of them.

I've got to close the network. It's done. It's already built. Now it's just a matter of, "Hey. How do I, as part of procurement, get my supplier to accept funds in one form or another? How are we going to manage that?" It starts to enable buyers to look at their supplier networks differently to monetize them differently.

In the SMB space, I'd say it's a pedestrian approach, really. We're already handling 90 percent of our customers' AR. We'll just give them a bank account that's FDIC-insured. It sits on our passport platform. They can write checks from it. They have a debit card linked from it to make payments.

It's done the moment they sign up their merchant account with Priority. That is now in beta. That will be the future. It should be. It just makes it a lot easier for SMBs to operate. Look. It's one of the reasons why we think there's going to be a lot more competition in payments -- you mention it -- from banks.

They're starting to realize these are great potential deposit generators. A lot of them got out of payments in the past. We think they're going to get back in. Your bank, for one, has...

Moderator: [laughs]

Tom: touted it very thoughtfully, if I may.

Moderator: It's a great segue to the next question. Given the current banking environment, what's going on in regional community financial institutions, how do you think that's going to affect the payments industry going forward? What do you see in terms of you're going to benefit from that or competition in the future?

Tom: I'll offer my thoughts and invite Tim because he's very close to many of our banking relationships, particularly as we manage deposits. Look. We think the banking sector generally is going to start to chase payments as a business line in ways they hadn't in the past. We're already seeing that just with the management of our deposits.

We control half a million deposit accounts. That's pretty attractive relationship for most banks to have. There's competition to...If you think about what we're building in Priority, it's, in many regards, a virtual bank branch. It generates a lot of deposits that stick around for a while.

We're looking to certainly maximize the opportunities in the current environment that are going to continue to play out over the next couple of years. Banks are going to be challenged to generate deposits and fee income. Those are two things we do really well, really well. What are your thoughts on that, Tim?

Tim: I was thinking of approaching it from the other side. The customer side, or the SMB side, or the B2B enterprise customer.

Where your money is set at a bank was probably a little bit of an afterthought before. You weren't too worried about the deposit balances over there. Obviously, people woke up with what happened here in the last couple of months, and now pay more attention to that.

If you have a different provider, an alternative provider, like we have with Passport and our product offering. The ability to have your deposits be syndicated across a group of larger banks where you can get FDIC insurance through the ledgering technology.

That's an attractive alternative for a customer versus having to manage those relationships themselves, and reach out to 5, 6, 10 banks to disburse their deposits. Now, you can go to one point, and have that technology -- the Passport technology we have -- manage that process for you. We're seeing a lot of uplift in that.

The 18 new program managers will come aboard this year. A lot of that's because of that type of technology, and the desire to have a different service provider on the banking-as-a-service side.

Tom: I'm going to give you a future view of that, too. Let's say we've now created that relationship. They've got their operating account. They're utilizing Passport. These are all small business owners. You will be coming out with a product that allows them to connect to a money market account. The ability to invest in Treasury bills for short-term investments.

Things that large companies have access to that we can very easily aggregate. We've abstracted all the complexity of setting up a bank account, and virtualized all of it in a technology framework that makes it simple for the customer, "Hey, I want another passport account. That's my savings account. And yes, I want it to do this."

Money just sweeps in. It gets aggregated with everybody else doing it and off it goes to JP Morgan Investment Management to put it to work overnight for us. That's modern commerce. We see that as the evolving future and we're today built to facilitate that.

Moderator: Maybe, Tim, this is a question for you. As we think about the capital structure and priority, how do you prioritize future cash flow generation of a lot of EBITDA, a lot of cash flow, you pay down debt, you do M&A, you announced an agreement today. How do you think about capital allocation priorities?

Tim: I think it's a continual process and we're always evaluating the best return on our capital, whether that's looking at M&A. Obviously, we made a decision today to invest some of our dollars in an acquisition opportunity we think is extremely attractive for our business and growing the B2B franchise.

We'll also look at whether we invest those dollars internally in development. We have a large development team to build new technology and new products, so we think about is it best to allocate those dollars to new products with internal development or pay down debt.

Obviously, in this environment, the cost of capital is higher, given the underlying interest rates. That's an attractive opportunity as well. We continually balance that. If you think about last quarter, we ultimately paid down our net debt with the balance of our free cash flow versus looking at M&A.

I've been in this seat now for eight months and we've looked at a lot of different M&A opportunities and have been pretty selective. There's a high bar in this environment to think about M&A and does it really drive the strategy of the business, how does it fit. We're seeing more and more opportunities now in this environment too as companies get stressed.

We'll have more opportunities to look at deploying capital in M&A, but we're going to continue to be diligent about managing the balance sheet effectively to make sure we've got the flexibility to capitalize on those opportunities when they're there.

Moderator: Maybe this next question, I'd like to ask some of these questions. Tom, if you think about the next five, in five years, what does priority look like to you? What's the vision for the business going forward?

Tom: I appreciate the question, candidly. Look, hopefully it's becoming clear, we built this platform as one that's built to last. It's a tremendous top line grower, bottom line grower, kicks off free cash flow. We don't spend a lot of CapEx to maintain our technology, so it's very efficient.

We want to continue to utilize the engine that we call Passport, collect, store, and send money, into verticals where that functionality is a really important part of the value chain. I brought up a couple of them already. We've started to spread investments out in construction. We think that's a complex problem that needs solving, and we're well-situated to do it. We're going to put some attention towards that.

Another one on our mind, which is probably the quagmire of all quagmires, healthcare. We haven't quite decided how we want to go about it, but starting to drive what I'll call vertical software and payment monetization strategies across our business, leveraging the scale of the single engine that we've built.

I think what we have proven out is that, and we've taken our time to do it, we've been very measured about building a single technology stack so that we don't have duplicative expense across our businesses, and we're able to operate very efficiently across business channels. We have the fourth largest non-bank acquiring business in the US.

We have one of the few B2B businesses that are profitable in automated payables. We've got a large and growing enterprise, ISB-oriented payments business. All that's happening in one place. A lot of our peers who, I'll say, appear diversified, have duplicated backend technology, tremendous overlap in systems that we don't have.

We want to continue that journey. It may be a deep one in construction or a deep one in healthcare, in other areas that interest us like social impact and nicher segments, but it'll become more and more verticalized.

Moderator: Fantastic. What keeps you up at night as it relates to priority? What are you most concerned about, business or macro?

Tom: I don't know if I would characterize anything as keeping me "up at night" at this point. That wasn't probably 1 a couple of years ago, frankly. The things that continually motivate us are is our tech up to the standard it needs to be to win?

Those are the things that we're constantly driving for as an organization to ensure that we're delivering a value-added solution, not something that's commoditized.

We feel really good about the macro environment and just being able to maintain a balanced business even in a challenging macroeconomic environment. The things that are out of our control, call it geopolitical unrest, another pandemic. Those are the things that I'll say we try and just make sure we're prepared and have looked around the corners, if you will, so that we'll be able to react to them.

That occupies, I'll say, our strategic thought process at a thousand-foot level. Instances like that that we just want to make sure the business is insulated from.

Moderator: I have a few more questions, but if anybody in the audience wants to ask any questions, let us know. If you think about the stock price and valuation, what aspect of priority do you think investors are not fully appreciating in the company?

Tom: You want to offer your thoughts first, Tim?

[crosstalk]

Tim: Yeah. I think the business is probably still viewed externally as just a traditional merchant acquirer, when obviously, it has a lot more than that from a technology standpoint. The question we get asked a lot is what makes Priority different?

It's the technology, and it's the fact that we're not burdened by 20, 30-year-old technology in mainframes and other older systems, so it's more nimble. It's something that leads to the higher retention rates. Tom talked about some of our attrition rates being half the industry norms.

A lot of that is driven by the technology platforms we have and what our agents are using, what the merchants are using. It's differentiating. I don't think that's fully appreciated by the market.

Then I don't think they're appreciating the balance we have in the business. When we think about your question, what keeps you up at night, I think a lot of people in our seat that have just a focused business on just the payments side of it, they're going to be a little more stressed if the economy starts to turn down in a meaningful way.

We've got the counterbalance with certain parts of our business that are countercyclical. Our enterprise business does very well in tough environments, and we're seeing that balance now. Those are the things that probably aren't fully appreciated and being reflected in the stock price.

Obviously, the performance is what it is, and you can see the numbers in our quarterly results with strong growth in both the top line and the bottom line, but I don't think the investors have fully appreciated the diversity of the business and the ability to survive and strive in multiple different types of environments.

Moderator: Maybe one last question. This has been a topic of conversation at our conference this year. As you think about AI or artificial intelligence, how do you think that's going to affect payments and payment technology or your business particularly? Maybe we're very early, but it could have an impact down the line. Have you given any of that some thought?

Tom: It's having an impact now. We use AI today for predictive analytics on risk management. It's an extremely efficient tool, because people are emotional. It's interesting. This is a hard example of the benefit of AI. 50 percent of the merchants who will leave us will do so because we held money. Over 50 percent of the time, the reason we did is a positive.

We could eliminate a lot of merchant angst by deploying better AI tools that guide human behavior. We're doing that. That'll become a big part of the future.

I think AI has a bigger impact on the expense side of technology businesses. Look at ChatGPT. I've actually tested this with some folks at Priority. Just went into ChatGPT and asked it to write an integration to Amex Merchant, and it started coding and got 85 percent of the way there.

Think about the impact of that when you're building tools and what library of code you can create. Probably the most expensive thing in the technology business is engineers. This provides an avenue to start to more efficiently use your engineering staff, which is pretty exciting.

I do think it'll be transformative over time. We're looking at, again, risk and how do we better utilize our resources from an expense standpoint.

Moderator: We have a question in the audience.

Audience Member: Yeah. Can you just give us a little color on the economics? Obviously, it's a hundred million flow [inaudible] spreads are there [inaudible] .

Tom: Right now, it's being invested at fed funds. We're getting the lion share of that differential from fed funds to, call it, fractional expense. It's going to be impacted by the overall direction of rates. The benefit we have, however, is that balance continues to accumulate.

Most of our relationships in that segment have a long average life, close to three years. They're sticky and steady. The volatility that we could see in earnings is more related to just where the overall rates are, but it's muted because the balance is very consistent.

Moderator: We're out of time. Tom and Tim, thank you so much for taking the time. We really appreciate coming to the conference. Thank you.

Tom: Absolutely. Thank you.

Tim: Thanks for the opportunity. Thank you.