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Deluxe Corp. (DLX)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. And welcome to the Deluxe Quarterly Earnings Conference Call. All participants are currently in a listen-only mode. And today's call is being recorded.

At this time, I'd like to turn the conference over to your host, Vice President of Strategy and Investor Relations, Brian Anderson. Please go ahead.

Brian Anderson

Vice President, Strategy & Investor Relations, Deluxe Corp.

Thank you, operator. And welcome to the Deluxe third quarter 2024 earnings call. Joining me on today's call are Barry McCarthy, our President and Chief executive Officer; and Chip Zint, our Chief Financial Officer. At the end of today's prepared remarks, we will take questions.

Before we begin, and as seen on the current slide, I'd like to remind everyone that comments made today regarding management's intentions, projections, financial estimates and expectations of the company's future performance or strategy are forward-looking in nature, as defined in the Private Securities Litigation Reform Act of 1995. Additional information about factors that may cause actual results to differ from projections is set forth in the release we furnished this afternoon in our Form 10-K for the year ended December 31, 2023, and in other company SEC filings.

On the call today, we will discuss non-GAAP financial measures, including comparable adjusted revenue, adjusted and comparable adjusted EBITDA and EBITDA margin, adjusted and comparable adjusted EPS, and free cash flow. In our release, today's presentation and our filings with the SEC, you'll find additional disclosures regarding the non-GAAP measures, including reconciliations of these measures to the most comparable measures under U.S. GAAP. Within the materials, we are also providing reconciliations of GAAP EPS to comparable adjusted EPS, which may assist with your modeling.

And with that, I'll turn it over to Barry.

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

Thanks, Brian, and good evening, everyone. I'm pleased to report our strong third quarter results, including sustained growth across our core comparable adjusted earnings metrics, continued expansion of free cash flows, and a reduced level of net debt for the enterprise. During the quarter, we drove nearly 7% year-over-year growth in comparable adjusted EBITDA, accompanying a margin expansion of 140 basis points.

Our free cash flow also grew 9.5% for the period. As we outlined at our Investor Day last December, the North Star program was designed systematically to accelerate these key profitability metrics. And our third quarter results further demonstrate our ability to consistently expand earnings faster than revenue. During the quarter, we also continued to deliver healthy top line results across our payments operating units.

We saw sustained mid-single-digit growth of more than 6% within Merchant Services. The B2B Payments segment also returned to modest year-over-year growth profile during the period, consistent with our guidance last quarter. The Data segment also drove strong sequential improvement. The business succeeded \$60 million of revenue during the quarter for the first time this year, first as a strong prior-year comparable.

On a year-to-date basis through the three quarters, the Merchant and Data segments have seen growth of just over 7% and 6% respectively. I'll cover additional segment revenue highlights in a bit more detail in a few moments. Accompanying this ongoing top line progress, the continued expansion of our earnings and cash flow results are testament to strong execution across the enterprise on our core capital allocation priorities. We reduced our net debt balance sequentially by \$45 million for the second quarter, further demonstrating our commitment to debt reduction as a top priority for the company.

Building from the strong through third quarter and year-to-date results, tonight we're confirming our existing full-year guidance within a narrower range. Chip will share more detail during his comments. Now, prior to providing more insight into the quarter, I'd like to highlight progress on our North Star for our execution plan.

As a reminder, our North Star program was designed across 12 workstreams to identify \$130 million of improvements to our baseline 2023 comparable adjusted EBITDA results over a multi-year horizon. On a net basis, after factoring for impacts from secular decline trends across the Print portfolio, these improvements are expected to unlock the targeted \$80 million of incremental adjusted EBITDA, and \$100 million of annualized incremental free cash flow, both by 2026.

During the third quarter, we reached a notable North Star milestone. I'm pleased to share the enterprise is now fully scoped out and is in the execution or completion stage of projects comprising more than \$100 million of the \$130 million targeted annualized EBITDA improvements. We're proud of our progress as we mark the first anniversary of the multi-year initiative. This success further increases our confidence in achieving our goals.

Importantly, full benefit realization will be reflected over the coming quarters throughout 2025 as our phased execution progresses. As I noted last quarter, one of the clearest ways to see our North Star progress is via the continued improvement of our SG&A expense, particularly within corporate. During the third quarter, overall corporate expenses improved by more than 11% from the prior-year period.

Additionally, cash restructuring and integration expenses related to North Star have trended favorably versus our full-year estimates. This contributed to our improved year-to-date free cash flow results through the third quarter. Now, to provide some additional details about our third quarter performance. As a reminder and consistent with prior calls, my comments will reflect comparable adjusted results for the quarter and year-to-date periods, which we believe best represent our ongoing business performance.

Chip will review both our reported consolidated and comparable adjusted results to provide additional context. For the third quarter, net of exited businesses, revenue was \$527 million, which reflects to the decline of just under 1% year-over-year. Total adjusted EBITDA reached \$104.5 million, increasing roughly 7% from the third quarter of 2023.

This strong EBITDA growth rate matched that of the first quarter of this year and reflected our third consecutive quarter demonstrating robust operating leverage at the enterprise level. As I noted in my opening comments. Adjusted EBITDA margins finished the quarter at just under 20%, reflecting the continuation of our year-to-date sequential expansion trend, and growing by 140 basis points versus the prior year.

On a year-to-date basis, comparable adjusted EBITDA margins have expanded by a full 100 basis points, while free cash flow has improved by more than \$30 million from the year-to-date 2023 figures. We remain particularly pleased with these adjusted EBITDA and cash flow results, further enabling our progress toward our focused capital allocation priorities under North Star.

Moving now to our third quarter segment revenue highlights beginning with Merchant Services. For the quarter, segment revenue grew just over 6%. While this reflected moderation from our nearly 8% second quarter trajectory, as we signaled on our last call, we remain very pleased with the overall year-to-date trajectory of the Merchant business. Total processing volumes remain solid and we continue to benefit from new wins.

As always, we continue to monitor material macroeconomic trends surrounding consumer discretionary spending and sentiment. We leverage recent insights on the card brands, the Fed and other economic forecast providers, as well as our internal proprietary data sources. While some overall economic uncertainty remains, some trends appear to have largely stabilized during the third quarter.

Impacts from recent weather events might pressure growth a bit, but we believe that our diversified portfolio will enable us to continue to deliver healthy growth even as we lap the major win that went live last November.

Shifting to results within the B2B Payments segment. As we anticipated during the third quarter the B2B segment recovered from the year-over-year decline rates experienced across the first half of 2024. We reported revenue growth of about 1% for the period. This improvement was in line with the commentary we provided during our last call.

Consistent with our expectations, we anticipate the B2B revenue growth trajectory will improve sequentially in the fourth quarter. We remain confident in our longer-term growth outlook for these lines of business given our strong existing pipeline of SaaS opportunities, and near-term onboarding of new incremental remittance volumes.

Moving now to Data Solutions, which continue to deliver strong revenue results, expanding sequentially by more than 6% versus the second quarter to just over \$61 million. As we signaled during our last call, the core data-driven marketing or DDM business once again lapped a challenge in prior-year compare during the third quarter, driven by client campaign timing, resulting in a 4.5% revenue decline for this business period.

As we've noted previously, we believe that the best view of Data's growth trajectory remains through a multi-quarter launch. On a year-to-date basis, through three quarters, revenue growth for Data remains strong at more than 6%, reflective of continued demand for customer acquisition marketing activities across both our core FI clients and expanding growth verticals.

Shifting finally to our Print segment. This business returned to its expected low-single-digit revenue decline profile during the quarter. Third quarter revenue finished just over \$297 million, declining roughly 2% versus the prior year. Importantly, legacy check revenues have experienced overall declines just under 2% on a year-to-date basis. This rate is aligned to our guidance and better than long-term Fed estimates.

To summarize, our overall third quarter results, particularly our continued expansion of earnings, free cash flow, and our management of operating costs, demonstrate our ongoing transformation and North Star progress. The enterprise remains diligently focused on execution of our deleveraging path, demonstrated within our Q3 net debt reduction, and continuing to deliver robust operating leverage.

Finally, before passing this to Chip, I want to take a moment to once again thank my fellow Deluxers. Your consistent commitment to exceeding the needs of our customers and driving continuous improvement is recognized and appreciated every day. You are the Deluxe difference.

With that, I'll turn it over to Chip.

Chip Zint

Chief Financial Officer & Senior Vice President, Deluxe Corp.

Thank you, Barry. And good evening, everyone. As Barry noted in his opening, we were pleased with our continued progress during the third quarter, particularly our strong margin expansion, free cash flow generation, and year-over-year growth of comparable adjusted EBITDA and EPS during the period. As in past quarters, I'll begin today providing a bit of additional context around our consolidated highlights for the period before moving on to the segment results, our balance sheet and cash flow progress, and our 2024 guidance.

For the quarter, on a reported basis, we posted total revenue of \$528.4 million, down 1.7% inclusive of the impact of our prior-year exits while declining 0.7% year-over-year on a comparable adjusted basis. As of the end of the second quarter of this year, we have fully lapped the divestiture of our web hosting businesses. As such, our exited business impacts are lowered and remaining quarters will reflect only the ongoing conversion of the payroll business.

We reported GAAP net income of \$8.9 million or \$0.20 per share for the period, improving from the loss of \$8 million or negative \$0.18 per share in the third quarter of 2023. This improvement was driven by both lower restructuring and integration-related spend, and improved SG&A expense as well as a gain related to our payroll exit.

Comparable adjusted EBITDA was \$104.5 million, up 6.9% versus the third quarter of last year. Comparable adjusted EBITDA margins were 19.8%, improving 140 basis points versus the third quarter of 2023, as Barry noted. Q3 comparable adjusted EPS came in at \$0.84, improving from \$0.75 in 2023, primarily driven by the net income drivers previously noted, net of increases to the tax provision for the period.

Now turning to our Operating segment details beginning with the Merchant Services business. The Merchant segment grew third quarter revenue by 6.3% year-over-year to \$93.5 million, bringing year-to-date growth to 7.4% through the first nine months of the year as Barry noted in his opening comments.

Segment adjusted EBITDA finished at \$17.8 million, improving 2.3% versus the prior year, while margins finished at 19%, down slightly from the 19.8% prior-year rate, driven primarily by year-to-year channel mix dynamics, while maintaining the margin-dollar growth trend we've seen consistently throughout the year-to-date period.

As we noted during our prior quarter comments, we would anticipate some continued moderation of Merchant revenue growth from the year-to-date levels during the fourth quarter period as we begin to lap the prior-year mid-market FI implementation activity that began in November of last year.

Our outlook for both the full-year 2024 and longer-term horizon remains consistent with the mid-to-high single-digit growth rates included in our prior guidance in Investor Day communications. Third quarter year-to-date adjusted EBITDA margins for the Merchant segment of 20.2% also remain consistent with our outlook for this segment.

Moving to B2B Payments. For the third quarter B2B segment revenues finished at \$75.1 million, sequentially improving \$4.9 million from the prior quarter, and growing 0.7% versus 2023. While multiple factors contributed to the overall improved trajectory during the third quarter, primary drivers included those we anticipated on our prior quarterly call. We've previously mentioned material new customer wins in the lockbox remittance business, and we saw initial implementation activity and volume additions from the onboarding of these deals.

Additionally, we saw a moderation of prior-year comps of legacy on-premise hardware, software license, and other one-time revenue across the balance of treasury management business, as we continue to execute our migration towards our more recurring revenue business model. Adjusted EBITDA within B2B finished at \$15.3 million, declining 5% while maintaining a rate of 20.4%, which reflected a sequential improvement of 50 basis points from the second quarter margin level.

This overall adjusted EBITDA result included impacts from initial onboarding activity for the lockbox share gain implemented during the period and overall receivables mix shifts from prior-year non-recurring business as noted previously. Based on these year-to-date results, including the third quarter trajectory improvement, we continue to anticipate a full-year low-single-digit revenue decline rate for the segment, included in our updated revenue guidance as we noted last quarter. We remain confident that adjusted EBITDA margins should also stabilize around the low-to-mid 20% range.

Moving on to Data Solutions. This segment continued its strong performance inclusive of another challenging prior-year revenue comp during the third quarter. Data revenues finished at \$61.1 million for the quarter, reflecting a year-over-year decline of 4.5% versus the same period of 2023, lapping very strong prior-year deposit seeking campaign activity among core FI partners, which we discussed during both the second and third quarters of 2023. Segment revenues improved sequentially from the second quarter by 6.4%.

Overall, third quarter revenue results performed favorably against the average of the three to four trailing quarter barometer we had previously noted for comparison. Adjusted EBITDA finished at \$17.5 million, reflecting a very strong 14.4% growth versus Q3 of the prior year, while adjusted EBITDA margins expanded 470 basis points to 28.6%, on continued management of core operating expense in this segment and a favorable overall mix of DDM campaign activity during the period.

We anticipate the Data segment returning to a year-over-year growth profile during the fourth quarter consistent with our full-year mid-to-high single-digit growth guidance for 2024, and in line with our anticipated longer-term

trajectory expectations for this segment shared during Investor Day. We also maintained strong confidence in the longer-term low-to-mid 20% adjusted EBITDA rate outlook for this segment.

Turning now to our Print businesses. Print segment third quarter revenue was \$297.3 million, declining 2.3% on a year-over-year basis. Legacy check revenues continue to perform in line with our expectations declining 1.8% during the quarter. The balance of the promotional solutions offerings declined just over 3%, reflecting both the short cycle discretionary spending dynamics discussed last quarter, as well as our continued focus on higher margin printed offerings, which leverage our broad print manufacturing platforms.

Overall adjusted EBITDA margins for the Print segment improved 32.8%, expanding 60 basis points versus the prior-year quarter as we continue to proactively manage the Print portfolio to drive supply chain efficiency and capacity utilization, while leveraging our print-on-demand investment to deliver the highest quality products while maximizing ongoing cash flow generation.

Adjusted EBITDA for Print finished at \$97.4 million, which reflected a very modest 0.7% decline from the prior year. Consistent with our longer-term outlook shared at Investor Day, we continue to expect to see the low-to-mid single-digit revenue declines across the Print segment, with adjusted EBITDA margins remaining in the low 30s within our full-year 2024 outlook.

Turning to our balance sheet and cash flow results for the third quarter. We ended the period with a net debt level of \$1.49 billion, improving \$30.7 million from our 2023 year-end level of \$1.52 billion, while sequentially improved by \$44.7 million from the \$1.53 billion mark at the end of Q2, on our strong free cash flow results as Barry noted. Our net debt to adjusted EBITDA ratio finished at 3.6 times at the end of the quarter, improving from 3.7 times on a sequential basis while remaining flat versus the ratio reported at year-end.

Free cash flow defined as cash provided by operating activities less capital expenditures finished at \$46.7 million for the third quarter, improving to \$64.3 million for the nine-month year-to-date period, and reflecting a \$30.2 million improvement from the results reported through the nine months of 2023, driven by improved year-to-date net income results, inclusive of lower restructuring spend, continuing working capital efficiency and lower capital expenditures versus the prior year. We continue to be pleased with our year-to-date operating cash flow generation and our ability to sustain our third quarter de-leveraging trajectory consistent with our clear capital allocation priorities.

Moving to our overall capital structure. As we shared last quarter, we continue to actively monitor the broader interest rate environment, and remain consistently engaged with our current lending group and other advisors surrounding exploration of available optionality regarding our longer-term debt capital stack. As shown here, our interest profile remains roughly 75% fixed rate in our existing revolving credit and term loan facilities carry June of 2026 maturities, while our 8% bonds mature in 2029.

We also remain comfortable with our available liquidity levels, and we'll provide additional updates on any capital structure or other financing developments going forward as applicable. Before turning to guidance, consistent with prior quarters, our Board approved a regular quarterly dividend of \$0.30 per share on all outstanding shares. The dividend will be payable on December 2, 2024 to all shareholders of record as of market closing on November 19, 2024.

As Barry detailed previously, we continue to make strong progress against our key North Star initiatives. Forecasted realization of the implemented workstream impacts noted in Barry's comments reflected fully within our 2024 guidance outlook. Tonight, we are narrowing our estimates for full-year guidance metrics from within the

existing ranges. Full-year guidance ranges are shown on the current slide, keeping in mind all figures are approximate, and reflect the impact of business exits over the prior 12 months.

Revenue of \$2.12 billion to \$2.14 billion, reflecting a decline of 1% to flat comparable adjusted growth versus 2023, adjusted EBITDA of \$405 million to \$415 million, reflecting between 4% and 6% comparable adjusted growth. Adjusted EPS of \$3.20 to \$3.35, reflecting 6% to 11% comparable adjusted growth and free cash flow of \$90 million to \$100 million. These forecasts reflect continuation of the robust operating leverage we have delivered across comparable adjusted results through the first three quarters.

Finally, to further assist with your modeling, our guidance assumes the following. Interest expense of \$120 million and adjusted tax rate of 26%, depreciation and amortization of \$165 million, of which acquisition amortization is approximately \$75 million, and average outstanding share count of 45 million shares, and capital expenditures of approximately \$100 million. This guidance remains, subject to among other things, prevailing macroeconomic conditions, as noted previously, including interest rates, labor supply issues, inflation, and the impact of divestitures.

In summary, we were pleased with our continued focus on North Star execution during the third quarter and our overall year-to-date results. Before we open the mic for questions, I'd like to leave you all with a clear statement that we're simply executing well against our objectives. Through the first nine months of the year, we've continued to grow EBITDA, expand margins, improve free cash flow, and pay down debt the way we intended, and told you we would.

We remain confident that our execution and focus will continue to be reflected in our fourth quarter performance and look forward to sharing our progress on our fourth quarter call. Operator, we are now ready to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from Lance Vitanza with TD Cowen.

Lance Vitanza

Analyst, TD Cowen

Q

Thanks, guys. Can you hear me?

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

We hear you fine. Hey, Lance.

Lance Vitanza

Analyst, TD Cowen

Q

Great. Great. Great. Thanks. So, first off, nice job on the EBITDA and cash flow. And I appreciate the improving tone in Merchant Services and Data Solutions. All the same. I was a little disappointed to see total revenue down on a like-for-like basis, I know it was just down a smidge, but it wasn't up. So, my question, I've got kind of a two part here, Barry, as we think about 2025 and obviously I'm not expecting guidance here, but how confident are you that you can see consolidated revenue growth the full-year?

Obviously, I appreciate you've got some businesses that are growing nicely. You've also got some businesses that, you know, that are facing some secular headwinds. So, I just wanted to get your -- your temperature there. And then maybe for Chip, you mentioned the Investor Day a couple of times, if you could perhaps go back and remind us when we lay out the long-term growth expectations for each of your four sectors, and then, factoring in the size of those businesses as we exit 2024, what should we expect for consolidated growth in 2025 if it turns out to be a normal year?

And I just -- I don't have the math at my fingertips. Is it 2%? Is it 4%? Is it more? Is it less? Any color there would be very helpful. Thank you.

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

So, Lance, let me start with the first question. First of all, we're very pleased with the progress against our North Star initiative. And you'll recall that North Star is more than just cost. It's also improving product development, launching more products and helping to grow our revenue. And so, you're starting to see the sort of the first fruits of that. I think I would point you to look at what's happening in the B2B business.

We said it would be a tough start to the year, and we have got that business now to just slightly positive growth. And we've guided for the rest of this year that we think there'll be sequential growth in Q4 from Q3. And we think that's a trajectory without providing guidance for 2025 for how that business ultimately gets to its goal that we have shared is a mid-single-digit or better growth rate. If you look at the Merchant business, we're very proud of that as well. And we think that that business continues to be on very solid footing as well as what we see in data-driven marketing.

Now, in this particular quarter, Data had a really super tough comp versus last year, which I think made the grow over for this year particularly difficult in Q3. But as we said in our prepared remarks, we expect that to recover in Q4 and that we think that is a very healthy mid-single or better growth business over a multi-quarter horizon.

So, put all of those things together, we think the businesses with great growth prospects, data-driven marketing, Merchant Services, B2B, are on their path to delivering what we said would be their long-term growth horizons, while at the same time, we are holding on to our Print business with really flat margins that helps fuel the growth across the enterprise.

Chip Zint

Chief Financial Officer & Senior Vice President, Deluxe Corp.

A

Yeah, Lance. And that was well said by Barry. I'll take the second part of your question. So, if you think about what we laid out in Investor Day and I'll simplify a few things, we showed you guys ranges, CAGR ranges across the horizon, but directionally speaking, B2B business, we're expecting it to grow in the mid-single-digit range over the next two-year horizon. The Merchant business we're expecting to grow in the upper-single-digit range, as well as Data growing in the upper-single-digit range.

And then, on top of that, you have the Print business declining in the low-to-mid single-digit range. So, those are the near-term next few year trajectory. When you put it all in the vacuum, we have not guided 2025, right, we guided CAGRs over the horizon. But if you put it all based off where we're going to end this year, where we think it will be, I think it will put us to the lower end of our growth value algorithm, right.

The value algorithm is to grow 2% to 4% over the long-term with profit expanding faster than revenue. I would think initially you should expect based off the scale of what's going on that we would be somewhere in the lower

end of that in the kind of the 1% to 2%. But again, we haven't guided fully 2025. That's just along the journey how I think it will play together.

And I think Barry said it well. I think, with the third quarter, with the tough comp that Data had and B2B starting to turn the corner, I think we were close to putting those points on the Board to be able to show that low-single-digit growth, again, if the comp wouldn't have been there for Data. So, I think we feel good about how the businesses are shaping up and the ability to exit the year with the right trajectory and set us up for that 2025 year, which we'll guide on the next call.

Lance Vitanza

Analyst, TD Cowen

Q

That's super helpful, guys. Thanks and great execution. Take care.

Operator: And the next question will come from Charlie Strauzer with CJS.

Charles Strauzer

Analyst, CJS Securities, Inc.

Q

Hi, good evening.

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

Hey, Charlie.

Charles Strauzer

Analyst, CJS Securities, Inc.

Q

Hey. EBTIDA margin was pretty strong actually in the quarter despite kind of revenue being in line, nearly 20% there in the quarter, can you shed a little bit more light on the drivers behind that? I know you said mix, and you know, expense reductions, but maybe a little bit more color on that as well. And then moreover, EBITDA margins were very strong, you know, maybe in your commentary, that's all my question is, you know, shed some more color on that too.

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

Yeah, just at the very high level, Charlie, you know, we've been pretty focused on improving the operating efficiency of the company. And you can see the overall margin profile being improved because, the best place to see this, of course, on what we're doing on our efficiency is in the corporate line where you see we have had very significant reduction year-on-year, quarter-on-quarter, in our efficiency, in our corporate line spending.

But, it's also just broader execution across each of the businesses that had healthy periods. I think that the Data business, and Chip can have more here had you know, honestly had -- had a pretty darn good quarter. It was, say, over \$60 million quarter, which is a good milestone for that business. And it grew sequentially. It just was up against a gigantic comp of Q3 last year, and I think they're doing a great job there selling additional features and functions as well as just great execution of all. But, do you want to add on that?

Chip Zint

Chief Financial Officer & Senior Vice President, Deluxe Corp.

A

Yeah, I think starting with the Enterprise, Charlie, I mean, part of this is the North Star vision, and what we needed to do for a period of time to drive the operating leverage, expand the margins and grow the EBITDA faster than revenue. And so, even with noise in the numbers and tough comps, and a slightly down top line, we would expect that as we execute the program, we roll out, we realize the savings into the P&L, whether it's through the corporate cost center or across the P&L.

We're seeing really good progress inside of North Star, whether you're talking about the procurement track of work, the tech and app, all of the things we're doing to run the business more efficiently or grow the business via our revenue initiatives. It's all leading towards what you're noticing, right. The margin expansion, the accelerated growth of EBITDA relative to revenue. So, I think we feel really good about that.

And as Barry said, you know, relative to Data, you know, this business continues to really perform well in terms of the campaign mix of deals we're taking, how we're driving efficiency inside the business, realizing some North Star value inside that segment, and obviously, setting us up to maybe be on the higher end of what we thought our long-term margin rates would be there. So, I think we continue to maintain that kind of low-20s to mid-20s range for the Data business, but obviously, it continues to perform like it is. That's an area for optimism for us over the long-term, and we feel really good about how that team is executing.

Charles Strauzer

Analyst, CJS Securities, Inc.

Q

That's very helpful. Thank you. And Chip, just to switch gears a little bit to the balance sheet, you made the commentary about the debt, and you know, some of your term maturities with rates lower -- going lower and heading in the right direction, your thoughts more to kind of tackle that sooner rather than later?

Chip Zint

Chief Financial Officer & Senior Vice President, Deluxe Corp.

A

Yeah. I mean, we're still working through those strategies and thoughts with our bank group. I think we all know it's the bank side of the equation will mature in of next year, and obviously, we don't want to let those -- those maturities go current. So, as we look at it, we have a window of opportunities that we're nearing or walking into here very soon where we would want to get that done, whether this quarter or next.

And so, I think for us, it's, you know, looking at the market, seeing what's going on with interest rates, hearing how credit spreads have progressed broadly speaking, and trying to find the right timing. So, nothing to announce yet, nothing to really talk about. But, it's definitely something we'll make sure to address in short order before we get anywhere near the debt going into next year.

Charles Strauzer

Analyst, CJS Securities, Inc.

Q

Appreciate it. Thank you very much.

Operator: And our next question will come from Will Brunemann with Northcoast Research.

Will Brunemann

Analyst, Northcoast Research

Q

Hey, guys, how's it going?

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

Hey.

Will Brunemann

Analyst, Northcoast Research

Q

I was going to ask -- hey, I was going to ask, are you guys seeing any changes in the competitive environment or any pricing pressure in the Merchant business? And then, if you're able to, could you possibly provide us any color on how transaction growth has looked within the business as well?

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

So I'm going to answer those sort of separately. So, on the first one, on price pressure and competitive pressure, but of course, there's always competitive pressure in the marketplace. But one of the really great things about where we compete and where our foothold is strongest in areas like state and local government, not-for-profit, auto repair, among a number of others, including integrated software vendors, et cetera, and bank channel leads.

These are areas that are very sturdy and durable and less subject to the ongoing pressure of -- and on constant flipping that is present in other parts of our business. And we think that has allowed us to really focus more on our service level, which is how we win in the space, of course, you have to be price competitively, but if sometime you were to come and see our facility in Fort Worth, it's in a cabinet full of awards that show that we are the best-in-class in the Merchant category around service, and that's helping us win business.

You'll recall last November, we announced and implemented a very significant win for us on a mid-sized regional bank, and moving their entire portfolio to our platform. And while we were competitively priced, it wasn't about price, it was about service and value, and we were able to win. So, that's helping us win additional business across our footprint.

And as far as processing volume, we don't specifically release processing volume trends, but we said in our prepared remarks that we think processing volume is solid. Of course, we shared plenty earlier in the year about what we thought was happening with consumer. We think that is largely, at this point, stabilized with the mix move towards less discretionary categories now stabilizing. So, we're optimistic about the fourth quarter and looking forward into 2025.

Will Brunemann

Analyst, Northcoast Research

Q

Okay. Thank you. And then, just one more. So, we were curious, if there was an increase in bank M&A with the new administration in office, what kind of impact would that have on the check business?

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

So [Technical Difficulty] (00:38:26) and I will tell you that bank consolidation is almost always a very important positive for Deluxe. In a scenario when we don't have both sides of a merged bank, we have a very high success rates of winning both sides when the banks come together. The most notable one that we were very public about a couple of years ago was the formation of Truist, when BB&T and SunTrust came together, and it ended up being one of the largest single sale in the company's history.

And it's because in those environments, we can show that our product is better, we can show that our service is better, we can show that we help a bank sell more to their existing customer. Our balance sheet is better, and as a result, we win, and we win a very, very disproportionate share, when that happens, of course, we're not perfect, but a very disproportionate share there.

And that is not only in bank consolidations but even in many contracts up for renewal. And that's, in part, how we are able to keep our check business decline to a rate much less than what's happening in the industry overall, as has been much -- as information shared by the Fed regularly. So, the product -- the faster we have a better product, we have a better balance sheet, we deliver on service for customers, better help us win really in any environment, whether it's a bank consolidation environment or on a renewal basis.

Chip Zint

Chief Financial Officer & Senior Vice President, Deluxe Corp.

Q

And I think we'll just this is Chip, I'll chime in, I think Barry nailed that aspect of it. But just to qualm and any follow-up concerns or where the next question may come from, additionally, when banks merge and consolidate, you know, they're important partners to us. They're important sell-through vehicles to us, but ultimately, the volumes, the end consumers, the end businesses, they're still there.

So, if we have less banks to partner with, we'll still partner and deliver service, we'll still drive whether it's checks, lockbox equipment, all the aspects of our portfolio to the end markets, regardless of the number of banks. So, there's no negative there from consolidation. Barry is right, it's more about the opportunity it creates for us, to maybe gain more wallet share or gain a new customer that we didn't have before.

Will Brunemann

Analyst, Northcoast Research

Q

All right. Thank you guys much. I appreciate it.

Operator: And the next question will come from Marc Riddick with Sidoti.

Marc Riddick

Analyst, Sidoti & Co. LLC

Q

Good evening, guys.

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

Hey, Marc.

Marc Riddick

Analyst, Sidoti & Co. LLC

Q

I wanted to touch a little bit on -- I wanted to touch a little bit on, I guess, check was ahead on both revenue and margin relative to where I was, sort of curious as to what you're seeing as far as, was there any pick-up in discretionary spend or a revenue mix that might have been helpful? I know that certainly the expense management and productivity was, was key, but I was wondering from a -- from a client behavior standpoint, if you're seeing much change relative to where we were early in the year there?

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

I think on the check business, it's just steady as we go. And I think we are seeing some of the fruits of the investments, Marc, that, you know, we made to in our printing capabilities so that we have made most of the expense in producing checks variable, sort of having a significant inventory as an example, and other fixed expenses. The variable cost we can manage really effectively. And then, as we win business, that helps, you know, helps gives us volume. And so, I think, it's a strong executional all around along with, you know, the smart investments we made in that, and how we manage and produce, and print product.

Marc Riddick

Analyst, Sidoti & Co. LLC

Q

Great. And then, it's been about a year now since North Star was -- was introduced initially on the call, and then -- and then, more broadly in the -- at the Investor event. I was just wondering that sort of, you know, we're a year-in, and probably Slide 7 is probably my favorite slide in the deck, as far as all the pieces involved.

I was wondering if there are any areas that you sort of look at among those -- those opportunities and sort of, you know, sort of see maybe a different level of optimism upside things of that nature where you are now versus maybe six months ago or so, seeing that there's so many different pieces that are part of the plan.

Barry C. McCarthy

President, Chief Executive Officer & Director, Deluxe Corp.

A

Yeah, I guess, the first thing I would say, is that Marc, we're really proud of our progress. We said that we were going to go and increase cash flow for the company by the time we get to 2026 by an incremental \$100 million and \$80 million of EBITDA. And we said, we would get there by following, as you saw on Page 7, a series of initiatives. And we are on track or ahead of track on those initiatives and we are booking the savings.

Now, of course, you understand how this works. Just because you've completed the work that you have implemented, it takes you sometimes a year plus to actually get the full value from that because you got to earn that value over multiple quarters. But, we're very pleased with the progress and we said in our prepared remarks that we've hit a big milestone of getting \$100 million of the \$130 million goal in process and in the implementation phase or beyond. I'm not sure, Chip, if you want to add anything on that.

Chip Zint

Chief Financial Officer & Senior Vice President, Deluxe Corp.

A

Yeah. I mean, just to clarify, in process, we think of that is identified, executed, but not yet realized. So, depending on the nature of the program, certain things realize value quicker like or designed in the late last half of last year, other things take time, whether it's pricing fully lapping a year or getting to the decommission of tech -- technology application, and then, realizing the savings.

So, they're all sequences. So, we're going to build all that into our guidance for next year and how we get from where we're going to end this year to where we'll be in 2026. But I think we're executing very well. I think we've been pleased with the way things have played out, the way we've stayed on target, stay together as a team.

I think the last piece I'll leave you with, I think Barry mentioned it a little bit in the script, but I'll kind of hit it home for you guys here. I think one important thing we delivered when we launched North Star as well as when we talked about it at Investor Day, as we mentioned, we thought we would spend roughly \$115 million to \$135 million of restructuring dollars to enable the program, and that it would be roughly IRR of north of 50%.

I think the great news is, as I said, we're on path, we're executing well. We still see the full value that we promise there, but we're being very disciplined stewards of the restructuring spend. And as Barry said in his script, we're actually spending less than we anticipated. So now, we've spent about \$80 million to-date to the program. And we see about another just north of \$30 million. So, if you do the math, I would say we've drifted down to the lower end of that range, which makes the returns on the program even better.

So, I think we're very pleased with the way it's playing out, the returns we're going to deliver, and then ultimately how that's going to lead to improving free cash flow this year, which obviously, you can see as we've tightened free cash flow up to the high-end, which is well above where we started the year at.

We've raised guidance along the year, and then, we also -- gives us maybe some ability to have lower restructuring spend as we finish the spring next year, and again, haven't guided yet, but again, look for a material step forward on free cash flow next year. So, I think overall, Marc, just very pleased and very proud of the way the team has partnered and stacked hands on the delivery here.

Marc Riddick

Analyst, Sidoti & Co. LLC



Excellent. Thank you very much.

Operator: [Operator Instructions] At this time, there are no further questions. I'll now turn the conference back over to Brian Anderson for any closing or additional remarks.

Brian Anderson

Vice President, Strategy & Investor Relations, Deluxe Corp.

Thanks, Justin. Before we conclude, I'd like to share that management will be attending the 2024 Stephens Annual Investment Conference in Nashville on November 20, as well as the UBS Global Technology Conference and the BoFA Securities Leveraged Finance Conference on December 2 and 3 respectively during the quarter, for which any applicable webcast information will be posted to our Investor Relations website.

Thank you again for joining us this evening. We look forward to speaking with you all again in early 2025 as we share our fourth quarter and full-year 2024 results.

Operator: Thank you. And that does conclude today's conference. We do thank you for participation. Have an excellent day.

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