Heartland Payment Systems
Fourth Quarter and Year End 2012 Earnings Conference Call Transcript

Moderator: Maria Rueda
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Operator: Please standby. We're about to begin. Good day and welcome to the Heartland Payment Systems fourth quarter and year end 2012 earnings conference call. Today's conference is being recorded. At this time I'd like to turn the conference over to Ms. Maria Rueda chief financial officer. Please go ahead.

Maria Rueda: Thank you (Audra) and good morning everyone. I'd like to welcome you to our fourth quarter and fiscal year end 2012 earnings call. Joining me this morning are Bob Carr chairman and chief executive officer and Bob Baldwin vice chairman.

Before we begin I want to remind you that some of our discussions may contain statements of a forward-looking nature which represent management's beliefs and assumptions concerning future events.

Forward-looking statements involve risk, uncertainties, and assumptions that are based on information currently available to us. Actual results may differ materially from those expressed in the forward-looking statements due to many factors.

Information concerning these factors is contained in the report of our financial results we released earlier this morning and that accompanies SEC filing. We undertake no obligation to update any forward-looking statements made during this call to reflect events or circumstances that may arise after this call. Now I'd like to turn the call over to our chairman and chief executive officer, Bob Carr.

Bob Carr: Thank you Maria and good morning everyone. I'd like to thank you all for joining us today and for your interest in Heartland. The fourth quarter was another strong quarter as we put the finishing touches on the most profitable year in Heartland's 15 year history.

For the quarter we reported adjusted net income of $17.2 million or $0.44 per share. Increases of 22% and 26% respectively over the comparable year ago quarter and for the full year we reported adjusted net income of 75 million or $1.87 per share, bBoth up 48% from full year 2011 results.

These results reflect outstanding performance across the board. Total processing volume continues to increase as we grow our new business and improve merchant retention. Our SME card growth strategy focuses on providing our merchants with outstanding service and a full complement of the products and services that simplify and improve the business operations they most highly value.

New margin installed was up 11% for the year to the highest level in four years as we continue to set new relationship manager productivity records. Similar productivity improvements were achieved throughout our operations.

As a result, this year we far exceeded our operating margin improvement objectives with a full year operating margin of 20.8% and improvement of 4.6% over the full year 2011 operating margin of 16.2%.

This surpassed our 20% intermediate term operating margin target. Our success reflects our ability to help merchants improve their business operations through a comprehensive suite of valuable business services.

While payment processing remains the focal point of our strategy, our non-card businesses such as payroll, school solutions, campus, prepaid card, and equipment sales now comprise almost 20% of our total net revenue up from 16% a year ago and are likely to reach as much as 30% over the next year or two.

In the fourth quarter we strengthened our ability to compete across these various markets with two strategic acquisitions. The acquisition of ECSI strengthens Heartland Campus Solutions by adding a number of complimentary cost effective customized payments processing solutions to our existing portfolio of financial aid disbursement, campus card, and payment processing solutions.

Heartland is now in the unique position of offering colleges and universities one stop shopping that will streamline processes and increase operational efficiencies while providing enhanced convenience and value to students.

Adding ECSIs client portfolio has boosted our roster of college and university relationships to over 2000 where the relationships with the finance office provides access to the key decision maker for most of our campus products. The combined organization can better leverage our operational capabilities to achieve scale economics and more efficiently support our growing client base. ECSI also adds experienced leadership with John Lynch president and CEO of ECSI joining our Campus Management Team. Finally, this combination will lift campuses aggregate annual revenue to more than 5% of our total net revenue.

Our Ovation Payroll acquisition is truly transformational in nature from a number of perspectives. Ovation offers payroll, tax preparation and administration, internet payroll reporting, direct deposit, and serves over 10,000 clients in 48 states.

Our consolidated payroll business will now serve more than 22,000 clients enabling us to more quickly leverage our proprietary payroll platform and reduce operating costs. In addition to being an important element in our strategic growth plan, the acquisition immediately brings aboard additional veteran payroll industry leaders.

Tony Tortorella president and CEO of Ovation Payroll will be leading the combined payroll services operation reporting to David Gilbert. Ovation also represents another opportunity to tweak our innovative sales strategy.

With Ovation's dedicated experts, our relationships managers will now have product specialists to assist them in their payroll sales efforts. Product specialists will continue to sell the payroll solution directly while also providing critical product expertise to the SME sales organization.

In addition, Ovation has an established affinity partner network which consistently generates high quality sales leads that can be effectively captured with our national sales organization. This is a model we believe will strengthen our entire sales organization.

Like Campus, with Ovation our own payroll services will now represent well above 5% of our aggregate net revenue and sets the stage for payroll to become an increasingly important business line for Heartland.

These acquisitions represent strategic actions we've taken to achieve our broader vision that an accelerating convergence of payments and operational systems is creating opportunities for solutions that help merchants simplify and improve their business operations.

As both a successful technology integrator and owner of the last mile to the merchant, we believe we have proprietary competitive advantages that place us in a powerful position to capitalize on this market dynamic.

Over the past six months we have been building a senior team that will enable us to separate what is real from what will never get out of the headlines and into the marketplace. We've been engaged with many of the names making these headlines including LevelUp, Google, PayPal, and Dwolla.

They all have one thing in common, the lack of an effective channel through which to distribute their products. We've heard many interesting suggestions on how we could benefit by providing potential partners access to the multitude of merchants who rate Heartland as one of the most trusted names in the payment industry.

But we're going to stick to the philosophy that has built our franchise and that is to keep the best interests of our merchants in mind. You only need to look at how the industry reacted to Durbin to understand the real fundamental difference between Heartland and the competition.

Heartland is the only processor to give every dollar back, every Durbin dollar back, to every merchant no questions asked. And that now exceeds over $350 million. So we're going to continue to pursue these opportunities that we believe provide enduring value to our merchants and create value for our shareholders. And now Maria let me turn the call back to you.

Maria Rueda: Thanks Bob. For the fourth quarter we recorded gap net income of $15 million or $0.38 per share. Adjusted net income for the quarter was 17.2 million or $0.44 per share up 22% and 26% respectively from 14.2 million or $0.35 per share for the fourth quarter of last year.

Fourth quarter net revenue increased 8.4% driven by growth in SME card volumes and continued strong growth in non-card revenues led by Heartland School Solutions. As Bob briefly mentioned, non-card revenue has shown robust growth over the past year increasing to almost 20% of total fiscal 2012 net revenue and likely to reach as much as 30% of net revenue over the next year or two.

Primarily as the result of rapid non card business growth and the recent Ovation Payroll and ECSI acquisitions. SME card revenue growth reflects a 5% increase in transaction processing volumes as we continue to increase new margin installed, experience positive same store sales, and keep volume attrition in check.

For the year, same store sales grew 2.2% which was better than our 1% to 2% guidance for the year. We’re expecting 1% to 2% same store sales growth again this year. Due to lower than projected processing volumes and some fluctuation in K through 12 revenues, total net revenue for the quarter was a bit short of our expectations.

Productivity and efficiency initiatives continue to limit the increase in expenses. For the quarter processing and servicing costs were up just 1% while general and administrative expenses were also contained up just 6.7% from a year ago.

As a result, operating income increased to 29.6% from a year ago as the operating margin expanded to 19.3% up from 16.1% a year ago. For the full year the operating margin came in at 20.8% which exceeded our 20% intermediate term objective.

Cash flow was also up with management's measure of operating cash flow at 27.1 million or $0.70 per share for the quarter up almost 15% from the last year. And our free cash generation amounted to 17.6 million up 8% from last year's fourth quarter.

CAPEX in the fourth quarter was 9.5 million up roughly $2 million from the same quarter a year ago. Our substantial cash flow and strong balance sheet are being used to create value and reward our shareholders through dividends, shared purchases, and strategic acquisitions.

In the quarter we utilized $54 million to repurchase nearly 2 million shares at an average cost of $27.63 per share. Also we drew down $82 million of our revolving credit facility to fund the Ovation and ECSI acquisitions.

As it now stands, we have $58 million of borrowing capacity remaining on our existing facilities. As we have previously articulated, we intend to use our free cash flow primarily for dividends and share repurchases going forward.

Also on January 31 we sold Collective POS a Canadian company we purchased in 2008. We received $18 million of cash and recorded a gain of almost $8 million that will appear in our first quarter results.

Let me wrap up with our guidance for 2013. For the full year of 2013 we expect net revenue growth of 10% to 12% to approximately $600 to $610 million. Our fiscal 2013 gap earnings per share are expected to be between $1.92 and $1.96 net of after tax stock compensation expense of $0.22 per share for the year.

Implicit in this guidance is a modest reduction in our operating margin for 2012 strong levels. This is the result of a number of factors including the acquisitions of ECSI and Ovation which will result in near doubling in our acquired intangibles amortization to $0.15 per share in 2013.

Further, the pro forma operating margin of ECSI and in particular Ovation, where the operating margin is currently single digit dilute our operating margins while the sale of CPOS eliminates an operation that was above our corporate average.

And finally, operating margins in fiscal 2013 will also be impacted by the increased investment and the growth initiatives we have been highlighted. On the net basis we believe the benefits to both long term revenue and earnings growth resulting from our new businesses and strategic investment spending far outweigh any incremental short term margin concession.

And in fact, will hasten our achievement of a 25% operating margin over the medium term. Now I'd like to return the call to Bob for some concluding remarks.

Bob Carr: Thank you Maria, 2012 was the year of remarkable progress at Heartland. In addition to our record financial performance, we reached new heights in productivity, deepened our management team and made significant investments that have added new and existing resources and capabilities.

In this rapidly changing payments industry we are confident that we are building a strong foundation of technology, people, and relationships that will be the key ingredients to long term market success. Before closing today's call and opening it up to questions, I am pleased to announce that the board of directors has increased the quarterly dividend by 17% to $0.07 per share.

The new dividend is payable March 15 to holders of record as of March 4. And finally I would like to thank all the great Heartland team members for making these powerful results positive. (Audra) we are now ready to open the call for questions.

Operator: Thank you. If you would like to ask a question please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone please make sure mute function is turned off to allow your signal to reach our equipment. Once again, that is star 1 for questions. Now we'll go first to Dave Koning at Baird.

Dave Koning: Yes, hey guys another great quarter. Yes, yes, and I guess first of all just, you know, competitive threats obviously being kind of front and center the last several months now. It seems pretty clear that by your attrition numbers you're really not seeing much of an impact there.

But gross margin install was a little weaker this quarter than it's been over the last few quarters and maybe you could just comment a little bit on the trends there and maybe on the sales reps up just slightly this quarter and kind of how you see the sales reps ramping over the year.

Male: Right. We actually slowed down our recruiting processes in the fourth quarter to gain a little bit of traction. We restructured the way we're going to market with some, you know, some strategies that we think are going to be very helpful over the next couple of years.

We felt like it was important to get that structure right. I think we've got it there and so our margin install was only up - was up less than the rest of the quarters. But we've already seen that picked up in the first quarter. We're going to have a, I think, a nice model going forward with our sales - the sales, the senior product advisors we call them.

This arrangement where we have experts in the field with some of our nonpayment products helping people to get educated on selling the different products. So we expect to have a lot more multi product sales going forward as a result and think that's going to really pay off for us.

Dave Koning: Okay. Okay so we shouldn't be surprised to see a return to 10% plus GMI going forward?

Male: Correct.

Dave Koning: Okay. And then secondly, just a couple things just on the acquisition impacts. I guess first of all, how much acquisition related revenue do you expect in 2013? And I know it's complicated, but maybe net of the CPOS. So I guess, what in total is kind of your net incremental revenue from all the acquisitions and divestitures and then what is kind of core organic growth in 2013?

Male: Right. Dave you do have some cross currents with the two acquisitions, but netting out through an unknowable number for what CPOS would have represented for the year. But it's really - it's going to be $30 million plus net in terms of growth in net revenue. So that really somewhere a little under half of our - of the guided growth is coming from acquisitions and the remainder is organic.

Dave Koning: Okay. Good. And then the final question, just with the acquisitions obviously diluting the margins a bit and so, you know, looks like from what you said that if margins are flaccid down in 2013 that EBIT growth next year will be reasonably similar to net income, or I'm sorry, to revenue growth.

So if revenue and EBIT are both in that 10% to 12% range, how do you get to the EPS? I mean, is it just pretty material buybacks or what's happening below the operating line to really drive the big EPS expansion?

Male: Well EPS is absolutely a driver. If you look, the 54 million I think we spent on - in the fourth quarter, 2 million shares repurchased. So we're going into the year with a good reduction in our shares outstanding.

And then, you know, are anticipating completing the 50 million. We did about - out of the 50 million authorization that the board made in November, we used about 20 and we expect to use the remaining 30 during the course of the year.

Dave Koning: Okay. Great and then just a final quick one. Interest expense for 2013?

Male: It's around 3 million probably.

Dave Koning: Okay. Great thank you. Good job.

Male: Depends on acquisitions and interest rates and only another half dozen unquantifiable things. But on a one rate basis right now would be about 3 million.

Dave Koning: All right. Thanks.

Operator: Now we'll go next to Tim Willi at Wells Fargo.

Tim Willi: Thank you and good morning. I had two questions. First, going back to the margin, Maria would you expect that EBITA margins would be up relative to your comments about the acquisition intangible. I know you don't specifically talk about that margin. It hasn't been a part of the discussion with Heartland, but given the acquisition intangible you called out what'd we think about the EBITA margin being flat to up slightly?

Maria Rueda: Well we're thinking that it will be up but we will continue to call out now that we have a significant portion of our intangible related to our purchases, we'll certainly be talking about what that may be.

Tim Willi: Okay that's great. And the second was around sort of the partnerships you guys have, the investment spending that you called out, which I think you've alluded to now for a couple of quarters.

I guess, you know, Bob or Bob or Maria, as you look at the landscape, are the dollars that you're spending or think you will spend on investments - is that pie getting bigger or do you think you've sort of narrowed it down to the best models and the best horses to place a bet on?

Just trying to get a feel for, you know, what that ((inaudible)) might look like over time and just sort of your thoughts about the quality of the opportunities that are out there that are being brought to you.

Bob Carr: Right. Well let me comment first. You know, bringing in the three group presidents we have to, you know, give them resources to build out the areas of the business that we want to focus on and, I'll use ecommerce as an opportunity. We have never had the personnel here at Heartland to focus on ecommerce in an effective way.

And Ian Drysdale came over and he's built a fantastic ecommerce team. We are already seeing the benefits of that in terms of new installations and we expect that to be a major part of the business.

Grocery's another area we were never in. We have some expertise now there. That probably isn't going to yield a lot of results in 2013 but we expect that to yield results in 2014 and beyond.

So we're investing in some, you know, core businesses that our competition has been cleaning our clock on forever and we're moving into those markets in a significant way. And on top of that, we're doing some things in mobile that are less, you know, you can't really point to the revenue but we want to be there in that space and we want to be ahead of the game so that our merchants can benefit from things that are working.

We are investing in relationships with folks like Level Up and some other mobile technology providers. We don't know where they're going to wind up neither does the industry but we're making the investments. So we have a combination of investments of, you know, pretty predictable outcomes in some that are not so predictable.

We think it would be a really big mistake to not be making these investments because we do want to be one of the top providers and we want to be a full service provider in payments, and also take advantage of all these adjacent technologies that now are becoming part of the payments chain.

The idea that we can take a transaction - the value of a transaction and increase its revenue to us by as much as 50% by adding couponing and adding loyalty services for our merchants is extremely attractive. That's the way the industry is headed and I think we're in a very nice position to benefit from those investments later this year and into 2014 and beyond.

Male: And just add briefly, you know, right now and in the first part of this year you're in that sort of worst part of the investment cycle where you really can't point too much in the way of incremental revenue but you've got to spend not - the spending won't all the sudden stop.

It'll probably grow in the future, but as you look out toward the back part of 2013 and certainly 14, our plans and intentions would be to have revenue growth that would be absorbing that. So it's really that temporary mismatch between what we're spending now and the benefits that'll be achieved later down the road.

Male: So if we think even though you guys don't give quarterly guidance to sort of conceptually think about the impact throughout the course of the year, and you just said, "Bob, it's, you know, probably a little bit more pressure around the margin, you know, on the front half and a little bit of, I guess you'd say a need for lift in the back half relative to the first.

Bob Carr: Yes probably. And of course, we always have our seasonally weakest first quarter that - and don't forget last year was a very good first quarter. We had, you know, an extra day in the leap year. We had the benign weather that as we sit here today with the snow apocalypse coming our way or something silly, people are getting crazy again.

But the winter is not being nearly as benign so it's going to be a tougher first quarter for that reason typically and I think there's some of that, Tim. We're not going crazy on the spending it's really just that we aren't getting the revenue benefit that we're expecting later.

Tim Willi: Great, thanks very much.

Operator: We'll go next to Roman Leal of Goldman Sachs.

Roman Leal: Thank you, good morning.

Male: Good morning.

Roman Leal: Hi, how's it going guys? So first off on the acquisitions you closed in the commentary, Maria provided on relative margins relative to kind of the consolidated average, what's the - how do you want those margins to look, you know, maybe one and three years out?

Help us think the process getting those closer to the, kind of consolidated average and are some of these models, I mean if you look at some of the payroll models that we cover, obviously well above 20% of the operating, can you get that in your payroll business?

Bob Carr: Absolutely. I don't want to leave you with the wrong impression about (Ovation Payroll). They have been historically very, very focused on growth and have been achieving substantial growth. This year we have challenges in terms of achieving consolidation costs saving because they have their platform, we have ours in an agreement.

It was a great experience because their view of the two platforms was that we ought to combine onto the Heartland platform which is a great validation of what we've been building on our own. And, you know, as you may know, its acquisitions when in essence their management team is taking over and they're saying they like Heartland's platform better. So that was a validation of what we have.

As we look toward the end of the year, we'll be starting to put new merchants all on the Heartland platform. We can't do that now, in part because there's some front end pieces that interact with those lead generation sources that we talked about that Ovation has.

And we need to bolt some front end pieces onto our platform but then in the first half of 2014 is when we expect to do the consolidation. We see that driving substantial cost savings. We have a great platform that has only the disadvantage that right now there's only about 12 thousand merchants on it.

When we get the 22 thousand plus the growth we're anticipating in the next year that really drives a lot of cost savings. So payroll business absolutely in the - whether, you know, it's in 2014 or maybe 2015, certainly we'll have a two handle on its operating margins and we're well aware of the operating margins that our larger competitors have and we'll aspire to get to those higher levels.

But we think this can be a very much contributor to our getting the 25%. And we see SI in a very similar way, you know, they're very close to overall corporate average now. And there are some consolidation costs savings, and there are also some revenue opportunities we see with cross selling the different products.

But we think that business - the campus business overall can also be a mid-twenties kind of operating margin business in the not very distant future.

Roman Leal: Thanks. And as a follow up to the commentary on your new partnerships and the potential to increase your revenue per transaction if you're going to start adding some value added services there, have you - first of all how would that work?

Would it be the partner that would charge the merchant for the value added services or would it be Heartland, you know, charging the merchant directly? And secondly, have you actually approached some of your merchants maybe in your current pilots and, you know, received any feedback or push back on potentially increased net revenue per transaction?

Male: Yes, the answer to your last question is yes we have. And merchants are happy to pay a little bit more money if we're helping to drive their revenue, which is what we're doing. The (CPG) companies are happy to deliver coupons that are redeemed and that's the direction, you know, that a lot of us are headed in this industry is the driving new revenue opportunities to the merchants where the costs of getting that revenue are paid for by their vendors.

That's been the grocery store magic with gasoline over the years and that concept is coming to the retail market and we're leading, you know, one of the leaders in that effort I believe.

Roman Leal: Okay, and the last one is just on the acquisition pipeline, our strategy going forward. You have payroll and campus and also K-12 all kind of lead to nicely contributing now is the goal to expand in those three verticals, or is there another vertical that perhaps you want to get bigger in? Thanks.

Male: Yes, we want to not have to invent the whole mobile world, ourselves. We need to take advantage of the technology that's out there and there's a ton of it being developed. We don't have a pipeline of acquisitions, but we want to build up our capabilities to help our merchants benefit from the change in the POS environment and in all the different adjacent environmental technologies around that.

Such as communications and, you know, just all the different services now that are cloud-based we want to enable those services for our customers. So we are looking for acquisitions in those areas, and if we have an opportunity to find other acquisitions that would fit into our payroll or campus business or school solutions business, we would take advantage of those.

We're looking for the right opportunities, I think we've done a really good job the last few years of buying properties that were integrated easily into the company. I think that's what we just did with these other two acquisitions.

And we'll be looking for those, you know, more of those but our plan for 2013 is pretty solid and doesn't include a lot of new acquisitions at all in this existing model. If something comes up, we'll take advantage of it but it's not in the pipeline.

Operator: We'll go next to Steven Kwok at KBW.

Steven Kwok: Hi, good morning, thanks for taking my question. Just had a quick follow-up on the network services business. Seems like there was a little bit of a decline quarter over quarter with regards to revenues and for the processing volume and transactions.

So I was wondering if you could just provide a quick update on that? Is that, is a seasonal move or, and how should we expect things going forward? Thanks.

Male: You know, it was, I think that you're really talking about, I mean on a quarter, linked quarter basis it was down and that's not unexpected in the business. You know, summer is the peak driving season and things like that.

And, year-over-year the business is about, you know, the net revenue is down but it has been tracking toward the year as well. So nothing particular out of line with the network services net revenue.

We are very focused this year on turning that direction, turning that around. It's been a challenging area, but it's one that we've had some major investments in technology to have a better solution and that's being realized actually a substantial rollout of new technology that really completes our product sets for those midmarket merchants that we're really targeting.

So we're pretty excited about turning this trend around. And then the last thing I mentioned is, you know, you will be impacted still by fluctuations in gas prices and generally in the fourth quarter the gas prices were lower.

Steven Kwok: And I was just wondering around the Heartland Summit, are you guys planning to have one in 2013?

Male: We are - we had one scheduled for middle of October.

Male: We're on an 18-month cycle there, is where our heads are at. So there is a likelihood, I'm not guaranteeing it, but that 2014 we may well not have a summit in 2014. May still have expense because if the 18 months, we would maybe do it in the first quarter of 2015, and you'd have some pre-you know, some expenses prior to the summit. But that's keeping to the 18-month schedule.

Steven Kwok: Got it, and in terms of, from expense- wise, it is around like $2million?

Male: In aggregate those run north of three.

Steven Kwok: Three okay great thank you.

Operator: We'll move next to Chris Shutler at William Blair.

Chris Shutler: Hey guys, good morning. I might have missed this, but ECS accretion from the two acquisitions that you're embedding in the guidance for '13?

Maria Rueda: That's in the 13 to 15 cents range.

Chris Shutler: Okay great. And a couple of questions on ECS, first the I guess, I'm wondering if the decision-maker at the college for some of their loan management products, is it the same decision-maker that decides on the campus card sales? Is it, you know, typically the Bursar or CFO?

Male: There are multiple decision-makers on that product. But I guess it's, you know, certainly the Bursar, or the business officer is involved in that decision. So the answer is partially yes.

Chris Shutler: Okay, okay fair enough. And then I guess secondly, on ECS, I think not 100% sure about this, but I think that they had a refund product themselves for the students I was just curious...

Male: Yes, and as a matter of fact that...

Chris Shutler: Had that gotten, you know, much traction at all or what's going to change now that Heartland's the owner?

Male: Yes, actually they had a very strong tuition payment plan which is what we were looking for and we developed a relationship with (John Lynch), with that product and he liked our refund product better.

So that's how the conversation got started between our two companies and we have a stronger platform for the tuition, the reimbursement card product but they have such strong tuition payment plans and of course the loan payment processing, that they were just a really great match, also with our sales organization.

So I think together we have a really competitive product to the other ones that are out there, and we're winning some nice accounts as a result of that.

Chris Shutler: Okay great, just a couple more quick ones. You sold CPOS, I think he said it's about an $8 million gain that's going to appear in Q1. I just want to confirm that that is included in your guidance?

Bob Carr: That is not, we've left that out of the guidance. Because there's no - and let me address (CPOS) more broadly. You know, that was a really attractive acquisition we felt back in 2008.

The intention was to take, they were essentially a sales only ISO that was relying on others for underwriting, risk-taking, sponsorship, processing. And our intention when we bought 70% was to help them move up the food chain as if we're in the acquiring world providing, you know, get them sponsorship, provide processing take on the underwriting function.

Two things happened in later 2008 into 2009. First, we bought Network Services which changed the profile of what we could and wanted to invest in from a technology standpoint. And the second thing of course was the unfortunate breach.

The combination really set our plans back dramatically in terms of what we could do to work with this collective POS team. And so then we got to the point where a year plus ago, we had either to really invest a lot in terms of platform and probably acquisitions, if we wanted to really grow that business.

They'd been growing nicely, but it was still very, very small relative to our overall net revenue. So I think we've been pretty consistent in articulating what we decided internally that we want our business lines to either be or have a near-term prospect of becoming at least 5% of our net revenue and, you know, on their own they have no reasonable prospects for doing it.

And the cost of getting them there in terms of getting, making acquisitions in a market that there aren't a lot of, plus the platform investments when we have other, lots of other exciting alternatives.

The decision was made okay it's going to be very tough to devote those kind of resources into Collective POS. Then we turn to the other side, well okay let's sell it and obviously the gain indicates that we had invested in a really good operation.

Elavon was a natural buyer, they've been the processor for a lot of what the CPOS was producing, I think named CPOS their ISO of the year last year. And so really it was a transaction that in many ways we regret.

We regret giving up the profitability and the growth but it was the result of a good disciplined process and, you know, we wish them the best while we focus on other, you know, bigger opportunities for Heartland.

Chris Shutler: Okay, thanks for the color Bob. And then just last question on the innovation deal. Just curious to get the, kind of the early reaction amongst your RMs. In terms of, you know, just what they think of the deal and then, you know, what kind of early educational efforts or efforts are you undertaking to ensure that that revenue ramps as you expect over the next, let's call it 12 to 18 months?

Male: Well, we closed at the very last minute of December 31, so we didn't have a lot of chance to do a lot of work until after the Holidays. The answer is that most of our RMs are pretty thrilled about the acquisition because they're going to have expertise available for them that they've never had available before in terms of calling on bigger payroll prospects and just learning the different systems.

Also Ovation brings us Affinity network. We had never really been able to break into the CPA firms and the insurance companies and so on and the Ovation folks are experts at doing that. That's their model.

And so not every, we have a, you know, a couple of our salespeople would prefer to not have a new player in the market place, but that's definitely just a few. In terms of our rolling it out, you know, we are in the middle of doing that right now.

We just announced our new SPA program that I mentioned earlier that, you know, just really was released this week. We're implementing it now. So we have high expectations for it. But it's too early in the game to really say that we have any results yet.

Chris Shutler: Sure, okay, thanks a lot guys.

Operator: And I would like to remind everyone to please limit yourself to one question and one follow-up to allow everyone an opportunity to ask a question. And we'll go next to Greg Smith at Stern Agee.

Greg Smith: Hi, guys good morning. First question, just what are your thoughts on surcharging, what we may ultimately see within your merchant base?

(John): Good question, we're going to go, we're sort of caught in between frankly. The settlement and the merchants where the platforms are not ready for surcharging. We're working hard to make them ready.

We're getting very modest incoming commentary from merchants who want to do it. And the strictures and restrictions on it are I think going to make it a very modest uptake in most of our everyday kind of merchants. Restaurants and retailers et cetera.

You probably will see it in environments where the customer is more captive to using a card, one that comes to mind immediately it'll be fascinating to see what the airlines do. We don't process for airlines. So right now modest demand, lots of confusion out there but we're working hard to prepare ourselves so that we can take care of a merchant who wants to undertake surcharging.

Male: (John), I'll just add, that in 2003 if you recall, merchants were given this opportunity, you know, they were screaming they didn't want to have to take all kinds of cards. So merchants were given the right to accept debit or credit and not the other if they so chose.

We didn't have one single merchant select that as far as I know. At this point I'm not aware of more than just like under five merchants that have even brought up the topic of doing surcharges.

Like Bob, I think there are niches such as, you know, government units are going to now be able to take cards with a surcharge. We don't expect a lot of volume to come from that. There will be, you know, some.

There's actually a move on, for surcharging debit, which is different from the settlement but there's more of a move to do that on the backend and there's some products that are in the market in that area that we're looking at trying to match that functionality.

So it's to be seen, but my view is that we're not going to have much of an impact on the surcharging on credit, with our current base.

Greg Smith: Okay, and then just thinking about your EPS guidance for this year, over the past year and a half your guidance actually proven to be very conservative. So I guess the first, the question is just, where could your guidance for this year be conservative and where does the risk lie in potentially missing it? That'd be helpful thanks.

Male: Well, that, you know, we're trying to be reasonable in our expectations and cover for unexpected spending requirements and things like that. I think that we feel good about the revenue side of things.

And, you know, so the risk could be on some, either if you had an unexpected deterioration in the margins is always the risk in the business. It's a very competitive business and has been for years and will remain.

And so there's always a risk there. But we're not, you know, if you look at weakened trends, the margin deterioration has been very modest to virtually nonexistent. So we're not expecting that, but you do want to be prepared in case something turns for the negative and you know, try to condition our guidance accordingly.

Maria Rueda: And I would just add that I think we run a very well-organized ship here. But sometimes there are macro-economic factors that can come into play. For instance, in the fourth quarter I think a lot of institutions were feeling the aftermath of Hurricane Sandy.

And also, there was also a lot of uncertainty regarding the looming Fiscal Cliff, and that's the sort of thing that's very difficult to incorporate into any sort of forward-looking guidance.

Male: And you have all the normal risks, including merchant losses, you know, and those kinds of things so.

Male: And the final thing I'd throw out, I would throw out, you know, there is some chance we don't see it right now but if, you know, we’re working on a lot of really interesting initiatives. And we do have plans for rolling those out.

If you saw, if we saw an opportunity to roll something out much more aggressively to push an initiative much more aggressively, you get into that situation which always exists in our business which is you have to spend the money up front in order to drive the revenue in the future. Don't see, I mean we’re planning on some aggressive rollouts this year, so it's not like we’re not incorporating those into our planning, but if something came up where we saw a substantial opportunity to take market share, to really drive the traction of a particular solution or product, that might argue for increasing spending in the near-term in order to make that succeed over the, you know, in the near, you know, soon but not quite as quickly.

Operator: And we move next Tom McCrohan at Janney.

Tom McCrohan: Hi, thanks for squeezing me in. How much of your dollar volume is generated in the say tri-state area, or the area that was adversely impacted by Hurricane Sandy?

Male: Probably, it's under 10% it depends on what you have defined as, because if you look, I think New York is under 5% of our total volume. And, you know, because one of our four biggest states, the other three being California is the largest, Texas, and Florida.

So, you know, New Jersey would be smaller than that so probably, and much of New York was not that heavily impacted. So overall, frankly we didn't see a substantial impact in terms of our sales and revenues in, from Sandy.

October same-store sales were the strongest of the quarter, and so, you know, it's hard to see an impact there.

Male: A technology comment, 200 of our merchants in New Jersey now have our mobile product which is, you know, the square competitor where you have a card swipe on your cell phone. And when Sandy took out the power and a lot of our merchants were able to go to their mobile devices to continue to process transactions even though we couldn't get to them physically. So, that's - now that's something that wasn't available during Katrina for example.

So, not all merchants were out of business because their credit card machine was not workable. I just think that's an interesting thing.

Tom McCrohan: Yes, that is interesting. And, as just a follow-up on same store sales, your guidance is reasonable, I would say strong relative to your comments in the past about saw tooth patterns and same store sales growth and 4 of the 11 sub-merchant categories that you break down for same store sales.

Was it in negative territory in the fourth quarter? So I am wondering if that was Sandy related or if you're seeing trends in January that - or give you confidence that, you know, same store sales on a aggregate basis. You know, are going to, you know, be in line with what you report in the fourth quarter or better.

Bob Carr: We don't, you know, try to speculate on where that's going. We do not - it's hard - we do not feel that the environment is getting worse. We don’t have our same store sales results for January at this point.

But, our overall volumes in January were the growth rate for both debit and credit was - or for combined rather was higher, well higher than the growth rate in the fourth quarter. Interestingly more credit growth in January than debit growth which has not been typical.

But, so January was a pretty decent start and we don't see much as we didn't see last year the strong part strength in the - the strength in the early part of the year. We didn't anticipate that and it came back to things. We don't anticipate any further weakening from the current kind of levels.

Male: Great, thanks.

Operator: Well then next to Mike Grondahl with Piper Jaffray.

Mike Grondahl: Yes, first question, could you just repeat what you said about the amortization expense into 2013.

Maria Rueda: Well, we are going to have - because we've just done these very strong strategic acquisitions so in December of 2012. We will have amortization expense, additional amortization expense related to those purchases. And, that will probably be in the, you know, 10% to 15% range.

Male: Well 15 cents.

Maria Rueda: Yes, it'll be 15.

Mike Grondahl: Okay.

Male: That's up about double from the intangible amortization expense we had in 2012.

Mike Grondahl: Yes, okay. That's what I thought I'd heard double. And then, secondly, I think in the earlier prepared remarks there was a reference made to some outside entities approaching Heartland basically trying to, you know, leverage Heartland sales force or access to small retailers.

Can you give us an example or two of what some of those entities are and what they want to offer and use you for?

Male: Well, this is - this is been try for Heartland for a long, long time, because we have a large, you know, single branded employee only sales organization. You know, we don't have control of our people, but we certainly can direct them and put requirements, you know, out there.

So, virtually anyone that wants to sell a product to a merchant comes to us. We literally got people coming to us every month wanting us to distribute their product, and we have to obviously select products that our sales people can sell and earn a good, reasonable amount of commissions from and that the company can still make a viable profit margin.

So virtually, anyone that wants to have a face to face relationship with the merchant, you know, comes to us. So, we are working with just about everybody you can think of in the payments world out there that isn't a direct competitor would like us to distribute their product.

And, we named four companies in the prepared remarks and we'll leave it there. But, there are others that, you know, we don't want to name them because we don't want to give the wrong impression. But, we talk to just about everybody and we're in the unique position, and

I think the enviable position of being able to pick and choose what it is that we want to distribute and you know, it's hard to find the right product because many of these companies, as brilliant as their boards and management teams are, they don't realize that it costs some serious money to go visit merchants and sign them up.

And their business models don't really allow for enough sales expense to make a financial arrangement that makes sense for us and our sales team. I'm not sure if that answers your question, but.

Operator: And we'll move next to Reggie Smith at J.P. Morgan.

Reggie Smith: Hey guys. Thanks for squeezing me in. I just, I guess I have a few questions. I guess when you gave your long-term outlook at your annual state last fall, you kind of talked about 12% to 15% of net revenue growth and you said that would, you know, include acquisitions.

I guess, thinking about your 2013 guidance in the mix of inorganic and, kind of, organic growth, is that a fair approximation for, you know, what you think the growth mix will look like in coming years or is there something going on this year in particular that may be depressing organic growth.

Male: Reggie, we are very focused on improving our organic growth and, you know, that's what we're spending these resources on, trying to get a new vertical, expanding what we can do in payroll.

As an example, we think the footprint in the school solutions is great as well as K12. So, I would say that we are looking for an improved and improving rate of organic growth and a heavier percentage of our growth going forward to be from that.

Reggie Smith: Thanks. And, I guess that kind of leads to my next questions with the kind of K through 12 opportunity. I know you guys talked about having, you know, 30% kind of market share amongst the schools.

But, it sounded like your wallet share, relative to total spend was pretty low. Can you kind of give us a sense of what your penetration is, you know, within the K through 12 segment to kind of you know, help us understand, you know, what the opportunity really is there?

Male: Right, good question actually. It's low. The competition is, you know, checks and cash. The companies that we acquired were primarily focused on the point of sale business and they didn't really push payments the way that we are.

So, we have two major opportunities. One is to grow the number of parents who want to use the site to make the payments and also to view what their children are eating in school or at least what they're buying.

And then, the other opportunity is to expand the payments opportunity within each school to take payments for uniforms, for dues, for club memberships, for tickets, all of the student activities. So, we have two growth opportunities that are both extremely significant and so, we think there's a tremendous opportunity to grow that with the 30% market share of schools that we have.

Reggie Smith: And if I could sneak one last quick one in. I guess on SME volume and if I think about, kind of, revenues there. Obviously excluding the education opportunities and some of the other things you guys are doing, I mean, is it fair to think about that business as kind of a mid-single digit grower.

Or, do you think the SME specifically can kinda re-accelerate over time and that'll be my last question. Thanks.

Male: SME card is right now in driven by the volumes and - and we are very focused on growing that. Our productivity of our sales people in our card installing new merchants has never been higher. We need more sales people and we're working - we are very focused on that.

Overall, SME will include payroll of course as well. And give the loyalty solutions those are growing faster and have greater growth. Getting back to overall SME is a tanker. It's going along at a certain speed and getting it to speed up is hard.

It's slower to happen but we're very focused on moving that up toward the double digit growth, but you know, that's going to take awhile.

Operator: We will go now to Chris Brendler at Stifel Nicolaus.

Chris Brendler: All right, thanks. Good morning. Another question on SME, if you could, Bob I think you eluded to some changes I think in your strategy when it comes to the sales force.

And, I was wondering if you could give us a little more detail on what you're planning on doing to re-energize the sales force growth effort. I think if we go back to a year ago when Durban was the hot topic.

It sounds like that you planning on adding a lot of sales people this year to take advantage of that opportunity. It doesn't seem to have materialized. I'm just wondering if there's something structurally you're planning on doing to help energize that sales force growth and is there anything you see that, obviously, productivity is a key focus right now.

But can you balance productivity with also helping grow that sales force in having a final follow-up as well?

Male: I think we you know, we can grow the sales organization and productivity. Our major focus is on multi-product sales with our specialist program and we are as I said slowed down recruiting at the end of last year deliberately.

And, I think we, you know, we have a really good momentum and a nice pipeline right now. We expect a yield result in doing - in getting that growth now.

Chris Brendler: Okay. A follow-up, just and I can't help but asking one question on square. I know you focus on generally focus on a larger merchant. And in talking to some of the merchants and the ISOs out there, it, I get a wide range of answers.

Some people say that they're not seeing any impact. Some people say that, you know, every small merchant that they talk to square is now part of the conversation. Any increase in the number of conversations you're having on educating your sales force on how to sell against square in some of these cheaper alternatives.

I think obviously a real merchant account from Heartland is going to be a better solution for most larger merchants. But at the smaller end are you hearing that complaint from your sales force. Or, is it still just at the fringes at this point? Thanks.

Male: There's a couple merchant categories where this square deal is, you know, attractive financially where they actually lose money. It'll be interesting to see how long they continue to do that, but you know, the market place for square is a different market place than ours. And, we don't - the answer is we don't hear a lot about square from our core merchant base.

Male: Anything with a low average ticket is at the - that's a very difficult price money...

Male: Square is losing. Square is losing big dollars on small ticket merchants and we'll see how they're willing to do that.

Operator: And we'll take our final question today from Brett Huff at Stevens Incorporated.

Brett Huff: Good afternoon or good morning. One quick question, I'm trying to suss out the impact from the acquisitions, both the acquisitions and disposals on rev and profit. So, I just want to make sure. I'm going to reiterate kind of what I heard and if you could correct me that would be great.

I think you said, Maria, that the net revenue impact would be a positive 30, both the buy and the sell. Is that right?

Maria Rueda: That's correct.

Brett Huff: And then CPAS last year was about 10 million, so should we assume about 10 million for that as a negative and about 40 million positive for the new deals?

Maria Rueda: That's reasonable to assume.

Brett Huff: Okay. And then I think, you or Bob, I'm not sure who said that the new businesses coming on were single digit EBIT margins. Is that - did I hear that right?

Maria Rueda: Well, yes and in our commentary, we did talk about the payroll being in the single digits at this point because we haven't had the opportunity yet to obtain the integration synergies that we anticipate over the long term. But, the ECSI margins are creative. They are not individual.

Brett Huff: Okay. And then I guess you kind of answered my last question which is we're not getting any really getting any real cost synergies this year and Bob, I think you said maybe the first half of '14 is when we are expecting that because there's - and can you explain why we can't get them. Is it the platform can't be moved or something?

Bob Carr: Yes. Because the platforms, well our platform is not ready for all of their originations until late in this year. Then, you get into the January affect for next year. What you never - you don't mess around with platform conversions while doing W2's.

So, as a practical matter we can't convert their portfolio until the first half of next year of '14. And, that's going to be a significant cost saving, but right now, we have to run two parallel platforms and so we'll achieve some other, obviously some other synergies.

But, you know, have to have the different servicing centers to handle the two Ds. There's a redundancy. So, you just need to maintain until you can consolidate the platforms.

Brett Huff: Okay. And then one last questions. On the processing and servicing cost, that was better than we expected. Structurally, how do we - how should we think about that going forward into next year. I mean it was meaningfully lower than we had modeled. How does that look relative to the run rate in fourth quarter when you think about '13? On a percentage basis, I guess.

Maria Rueda: We said previously that we've been undergoing a long term program to streamline our processing and servicing costs. And, we really think that we've achieved the low hanging fruit at this point.

But we will continue. We've got the right band width here. We've got very talented people. We're going to continue to refine those costs and keep our focus on these costs. So I would say don't anticipate any, you know, foul weather changes. However we will continue to keep those costs as efficient as possible.

Brett Huff: Okay. That's what I need. Thanks for your time.

Operator: And that does conclude today's question and answer session at this time. I'll turn it back over to management for any closing remarks.

Maria Rueda: Thank you very much, (Audra). I would like to thank all of you for joining us this morning and all of you have a great day.

Operator: And that does conclude today's conference again. Thank you for your participation.

Maria Rueda: Thank you.

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