

Edgar Filing: DELUXE CORP - Form 10-Q

DELUXE CORP

Form 10-Q

July 31, 2017

false--12-31Q220170000027996Large Accelerated FilerDELUXE

CORP3492490003530350002828000311700000228000298000217620002342300021534000there are no maximum amounts of contingent payments

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us-gaap:RetainedEarningsMember 2016-12-31 0000027996 us-gaap:AdditionalPaidInCapitalMember 2017-01-01

2017-06-30 0000027996 us-gaap:CommonStockMember 2017-01-01 2017-06-30 0000027996

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iso4217:USD iso4217:USD xbrli:shares xbrli:pure dlx:Employees

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

## **FORM 10-Q**

(Mark One)

- Quarterly Report Pursuant to Section 13 or  
15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2017  
Transition Report Pursuant to Section 13 or  
15(d) of the Securities Exchange Act of 1934**
- For the transition period from**

\_\_\_\_\_ to  
\_\_\_\_\_

**Commission file number: 1-7945**

## **DELUXE CORPORATION**

**(Exact name of registrant as specified in its charter)**

**Minnesota**

(State or other jurisdiction of incorporation or organization)

**3680 Victoria St. N., Shoreview, Minnesota**

(Address of principal executive offices)

**41-0216800**

(I.R.S. Employer Identification No.)

**55126-2966**

(Zip Code)

**(651) 483-7111**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

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Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of registrant's common stock, par value \$1.00 per share, at July 19, 2017 was 48,354,273.

**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements.****DELUXE CORPORATION****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share par value)

(Unaudited)

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$34,780	\$ 76,574
Trade accounts receivable (net of allowances for uncollectible accounts of \$3,117 and \$2,828, respectively)	139,332	152,649
Inventories and supplies	41,434	40,182
Funds held for customers	86,824	87,823
Other current assets	51,909	41,002
Total current assets	354,279	398,230
Deferred income taxes	2,718	1,605
Long-term investments (including \$1,694 and \$1,877 of investments at fair value, respectively)	41,851	42,240
Property, plant and equipment (net of accumulated depreciation of \$353,035 and \$349,249, respectively)	84,279	86,896
Assets held for sale	1,089	14,568
Intangibles (net of accumulated amortization of \$481,703 and \$435,756, respectively)	405,964	409,781
Goodwill	1,134,712	1,105,956
Other non-current assets	143,863	125,062
Total assets	\$2,168,755	\$ 2,184,338
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$97,248	\$ 106,793
Accrued liabilities	272,167	273,049
Long-term debt due within one year	39,801	35,842
Total current liabilities	409,216	415,684
Long-term debt	680,652	722,806
Deferred income taxes	78,665	85,172
Other non-current liabilities	51,233	79,706
Commitments and contingencies (Notes 10 and 11)		
Shareholders' equity:		
Common shares \$1 par value (authorized: 500,000 shares; outstanding: June 30, 2017 – 48,351; December 31, 2016 – 48,546)	48,351	48,546
Retained earnings	948,216	882,795
Accumulated other comprehensive loss	(47,578)	(50,371)
Total shareholders' equity	948,989	880,970
Total liabilities and shareholders' equity	\$2,168,755	\$ 2,184,338

See Condensed Notes to Unaudited Consolidated Financial Statements



**DELUXE CORPORATION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands, except per share amounts)

(Unaudited)

	<b>Quarter Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Product revenue	\$363,641	\$359,821	\$735,815	\$726,006
Service revenue	121,591	90,821	237,183	183,934
Total revenue	485,232	450,642	972,998	909,940
Cost of products	(130,591 )	(126,939 )	(262,986 )	(257,533 )
Cost of services	(48,623 )	(32,893 )	(95,388 )	(66,604 )
Total cost of revenue	(179,214 )	(159,832 )	(358,374 )	(324,137 )
Gross profit	306,018	290,810	614,624	585,803
Selling, general and administrative expense	(208,306 )	(198,726 )	(425,100 )	(400,198 )
Net restructuring charges	(1,427 )	(1,135 )	(2,441 )	(2,014 )
Asset impairment charges	(2,954 )	—	(8,250 )	—
Operating income	93,331	90,949	178,833	183,591
Interest expense	(5,258 )	(5,183 )	(10,087 )	(10,426 )
Other income	746	442	1,304	593
Income before income taxes	88,819	86,208	170,050	173,758
Income tax provision	(29,240 )	(27,819 )	(53,405 )	(57,267 )
Net income	\$59,579	\$58,389	\$116,645	\$116,491
Comprehensive income	\$61,190	\$59,282	\$119,438	\$122,474
Basic earnings per share	1.23	1.19	2.40	2.37
Diluted earnings per share	1.22	1.18	2.38	2.36
Cash dividends per share	0.30	0.30	0.60	0.60

See Condensed Notes to Unaudited Consolidated Financial Statements

**DELUXE CORPORATION**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

(in thousands)

(Unaudited)

	<b>Common shares</b>	<b>Common shares par value</b>	<b>Additional paid-in capital</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive loss</b>	<b>Total</b>
Balance, December 31, 2016	48,546	\$48,546	\$ —	\$882,795	\$ (50,371 )	\$880,970
Net income	—	—	—	116,645	—	116,645
Cash dividends	—	—	—	(29,156 )	—	(29,156 )
Common shares issued	316	316	7,627	—	—	7,943
Common shares repurchased	(419 )	(419 )	(7,581 )	(22,068 )	—	(30,068 )
Other common shares retired	(92 )	(92 )	(6,870 )	—	—	(6,962 )
Fair value of share-based compensation	—	—	6,824	—	—	6,824
Other comprehensive income	—	—	—	—	2,793	2,793
Balance, June 30, 2017	48,351	\$48,351	\$ —	\$948,216	\$ (47,578 )	\$948,989

See Condensed Notes to Unaudited Consolidated Financial Statements

**DELUXE CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(Unaudited)

**Six Months Ended**

**June 30,**

**2017            2016**

Cash		
flows		
from		
operating		
activities:		
Net		
income	\$116,645	\$116,491
Adjustments		
to		
reconcile		
net		
income		
to		
net		
cash		
provided		
by		
operating		
activities:		
Depreciation	7,561	
Amortization		
of	1,828	37,091
intangibles		
Asset		
impairment	—	
charges		
Amortization		
of		
costs	9,485	
acquisition		
costs		
Deferred		
income taxes	(6,042)	(1,032)
Employee		
share-based		
compensation	7,309	6,865
expense		
Other		
non-cash		
items,	(2,983)	2,829
net		

Changes  
 in  
 assets  
 and  
 liabilities,  
 net  
 of  
 effect  
 of  
 acquisitions:  
 Trade  
 receivable  
 14,038  
 Inventories  
 supplies  
 3,924  
 Other  
 assets  
 (1,776 ) (1,723 )  
 Non-current  
 assets  
 Accounts  
 payable  
 (12,063 ) (4,487 )  
 Contract  
 payments  
 (14,341 )  
 Other  
 accrued  
 non-current  
 liabilities  
 (49,703 )  
 Net  
 cash  
 provided  
 by  
 operating  
 activities  
 128,266  
 Cash  
 flows  
 from  
 investing  
 activities:  
 Purchases  
 of  
 capital  
 assets  
 (22,184 )  
 Payment  
 for  
 acquisitions,  
 net  
 of  
 (28,497 )

cash		
acquired		
Proceeds		
from		
sales	1,635	
of		
marketable		
securities		
Proceeds		
from		
company-owned	3,053	
life		
insurance		
policies		
Other	452	
Net		
cash		
used	(96,102 )	(45,541 )
by		
investing		
activities		
Cash		
flows		
from		
financing		
activities:		
Proceeds		
from		
issuance	107,000	
of		
long-term		
debt		
Payments		
on	(207,052 )	(128,584 )
long-term		
debt		
Proceeds		
from		
issuing	4,193	
shares		
under		
employee		
plans		
Employee		
taxes		
paid	(5,572 )	(2,260 )
for		
shares		
withheld		
Repayments	(29,981 )	
for		
common		

shares  
 repurchased  
 Cash  
 dividends  
 paid, 156 ) (29,446 )  
 to  
 shareholders  
 Other ) (417 )  
 Net  
 cash  
 used  
 (98,445 ) (79,495 )  
 by  
 financing  
 activities  
 Effect  
 of  
 exchange  
 rate  
 change  
 on  
 cash  
 Net  
 change  
 in  
 cash, 794 ) 7,165  
 and  
 cash  
 equivalents  
 Cash  
 and  
 cash  
 equivalents, 62,427  
 beginning  
 of  
 year  
 Cash  
 and  
 cash  
 equivalents, \$69,592  
 end  
 of  
 period

See Condensed Notes to Unaudited Consolidated Financial Statements

**DELUXE CORPORATION**  
**CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands, except per share amounts)

**Note 1: Consolidated financial statements**

The consolidated balance sheet as of June 30, 2017, the consolidated statements of comprehensive income for the quarters and six months ended June 30, 2017 and 2016, the consolidated statement of shareholders' equity for the six months ended June 30, 2017, and the consolidated statements of cash flows for the six months ended June 30, 2017 and 2016 are unaudited. The consolidated balance sheet as of December 31, 2016 was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles (GAAP) in the United States of America. In the opinion of management, all adjustments necessary for a fair statement of the consolidated financial statements are included. Adjustments consist only of normal recurring items, except for any discussed in the notes below. Interim results are not necessarily indicative of results for a full year. The consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q and do not contain certain information included in our annual consolidated financial statements and notes. The consolidated financial statements and notes appearing in this report should be read in conjunction with the consolidated audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2016 (the "2016 Form 10-K").

Amounts within the cash flows from investing activities section of the consolidated statement of cash flows for the six months ended June 30, 2016 have been modified to conform to the current year presentation. This change presents proceeds from sales of marketable securities separately. In the previous year, this item was included within the other caption.

**Note 2: New accounting pronouncements**

*Recently adopted accounting pronouncements* – In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-04, *Simplifying the Test for Goodwill Impairment*. The standard removes Step 2 of the goodwill impairment test, which requires a company to perform procedures to determine the fair value of a reporting unit's assets and liabilities following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, a goodwill impairment charge will now be measured as the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. We elected to early adopt this standard on January 1, 2017. As we have not been required to complete Step 2 of the goodwill impairment test for several years, we do not anticipate that this standard will have an impact on our consolidated financial statements.

*Accounting pronouncements not yet adopted* – In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The standard provides revenue recognition guidance for any entity that enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets, unless those contracts are within the scope of other accounting standards. The standard also expands the required financial statement disclosures regarding revenue recognition. In addition, in March 2016, the FASB issued ASU No. 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, in April 2016, the FASB issued ASU No. 2016-10, *Identifying Performance Obligations and Licensing*, and in May 2016, the FASB issued ASU No. 2016-12, *Narrow-Scope Improvements and Practical Expedients*. These standards are intended to clarify aspects of ASU No. 2014-09 and are effective for us upon adoption of ASU No. 2014-09. The new guidance is effective for us on January 1, 2018. We are currently in the process of analyzing each of our revenue streams in accordance with the new guidance. We have completed the evaluation of our Direct Checks revenue streams and we do not expect the application of these standards to those revenue streams to have a material impact on our results of operations or financial position. We continue to make progress in our evaluation of the impact of the new standards on

our Small Business Services and Financial Services revenue streams. We currently anticipate that we will adopt the standards using the modified retrospective method. This method requires the standard to be applied to existing and future contracts as of the effective date, with an adjustment to opening retained earnings in the year of adoption for the cumulative effect of the change. In addition, we will disclose the amount by which each financial statement line item is affected in the current reporting period by the application of the new guidance as compared with the guidance that was in effect before the change.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The standard is intended to improve the recognition, measurement, presentation and disclosure of financial instruments. The guidance is effective for us on January 1, 2018. We do not expect the application of this standard to have a significant impact on our results of operations or financial position.



**DELUXE CORPORATION**  
**CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands, except per share amounts)

In February 2016, the FASB issued ASU No. 2016-02, *Leasing*. The standard is intended to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities for virtually all leases and by requiring the disclosure of key information about leasing arrangements. The guidance is effective for us on January 1, 2019, and requires adoption using a modified retrospective approach. We are currently assessing the impact of this standard on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. The standard introduces new guidance for the accounting for credit losses on instruments within its scope, including trade and loans receivable and available-for-sale debt securities. The guidance is effective for us on January 1, 2020 and requires adoption using a modified retrospective approach. We do not expect the application of this standard to have a significant impact on our results of operations or financial position.

In October 2016, the FASB issued ASU No. 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*. The standard requires recognition of the tax effects resulting from the intercompany sale of an asset when the transfer occurs. Previously, the tax effects were deferred until the transferred asset was sold to a third party. The guidance is effective for us on January 1, 2018 and requires adoption using a modified retrospective approach. We do not expect the application of this standard to have a significant impact on our results of operations or financial position.

In January 2017, the FASB issued ASU No. 2017-01, *Clarifying the Definition of a Business*. The standard revises the definition of a business, which affects many areas of accounting such as business combinations and disposals and goodwill impairment. The revised definition of a business will likely result in more acquisitions being accounted for as asset acquisitions, as opposed to business combinations. The guidance is effective for us on January 1, 2018 and is required to be applied prospectively to transactions occurring on or after the effective date.

In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The standard requires that the service cost component of net periodic benefit expense be recognized in the same statement of comprehensive income caption(s) as other compensation costs, and requires that the other components of net periodic benefit expense be recognized in the non-operating section of the statement of comprehensive income. In addition, only the service cost component of net periodic benefit expense is eligible for capitalization when applicable. The guidance is effective for us on January 1, 2018. The reclassification of the other components of net periodic benefit expense will be applied on a retrospective basis. As we will use the practical expedient for adoption outlined in the standard, annual net periodic benefit income of \$2,016 for 2017, \$1,841 for 2016 and \$2,697 for 2015 will be reclassified from total cost of revenue and selling, general and administrative (SG&A) expense to other income in our consolidated statements of comprehensive income. This represents the entire amount of our net periodic benefit income as there is no service cost associated with our plans. The guidance allowing only the service cost component of net periodic benefit expense to be capitalized will be adopted on a prospective basis, and we do not expect this change to have a significant impact on our results of operations or financial position.

In May 2017, the FASB issued ASU No. 2017-09, *Scope of Modification Accounting*. The standard provides guidance about which changes to the terms or conditions of a share-based payment award require modification accounting, which may result in a different fair value for the award. The guidance is effective for us on January 1, 2018 and is required to be applied prospectively to awards modified on or after the effective date. Historically, modifications to our share-based payment awards have been rare. As such, we do not expect the application of this standard to have a significant impact on our results of operations or financial position.



**DELUXE CORPORATION**  
**CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands, except per share amounts)

**Note 3: Supplemental balance sheet information**

*Inventories and supplies* – Inventories and supplies were comprised of the following:

(in thousands)	<b>June 30, December 31,</b>	
	<b>2017</b>	<b>2016</b>
Raw materials	\$ 8,090	\$ 5,861
Semi-finished goods	8,166	7,990
Finished goods	22,077	23,235
Supplies	3,101	3,096
Inventories and supplies	\$ 41,434	\$ 40,182

*Available-for-sale securities* – Available-for-sale securities included within funds held for customers were comprised of the following:

(in thousands)	<b>June 30, 2017</b>			
	<b>Cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Fair value</b>
Funds held for customers: <sup>(1)</sup>				
Domestic money market fund	\$ 7,000	\$ —	—\$ —	\$ 7,000
Canadian and provincial government securities	8,709	—	(298 )	8,411
Canadian guaranteed investment certificates	7,714	—	—	7,714
Available-for-sale securities	\$ 23,423	\$ —	—\$ (298 )	\$ 23,125

<sup>(1)</sup> Funds held for customers, as reported on the consolidated balance sheet as of June 30, 2017, also included cash of \$63,699.

(in thousands)	<b>December 31, 2016</b>			
	<b>Cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Fair value</b>
Funds held for customers: <sup>(1)</sup>				
Domestic money market fund	\$ 6,002	\$ —	—\$ —	\$ 6,002
Canadian and provincial government securities	8,320	—	(228 )	8,092
Canadian guaranteed investment certificates	7,440	—	—	7,440
Available-for-sale securities	\$ 21,762	\$ —	—\$ (228 )	\$ 21,534

<sup>(1)</sup> Funds held for customers, as reported on the consolidated balance sheet as of December 31, 2016, also included cash of \$66,289.

Expected maturities of available-for-sale securities as of June 30, 2017 were as follows:

(in thousands)	<b>Fair value</b>
Due in one year or less	\$ 14,722
Due in two to five years	4,954
Due in six to ten years	3,449
Available-for-sale securities	\$ 23,125

Further information regarding the fair value of available-for-sale securities can be found in Note 7.

*Assets held for sale* – Assets held for sale as of June 30, 2017 included the operations of a small business distributor, as well as assets associated with certain custom printing activities. Assets held for sale as of December 31, 2016 included the operations of a small business distributor that was sold during the second quarter of 2017 and a provider of printed and

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**DELUXE CORPORATION**  
**CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands, except per share amounts)

promotional products that was sold during the first quarter of 2017. Also during the first quarter of 2017, we sold the operations of an additional small business distributor that previously did not meet the requirements to be reported as assets held for sale in the consolidated balance sheets. We determined that these businesses would be better positioned for long-term growth if they were managed independently. Subsequent to the sales, these businesses are owned by independent distributors that are part of our Safeguard® distributor network. As such, our revenue is not impacted by these sales and the impact to our costs is not significant. We entered into aggregate notes receivable of \$20,435 in conjunction with these sales (non-cash investing activity) and we recognized an aggregate net gain of \$6,779, which is included in SG&A expense in the consolidated statement of comprehensive income for the six months ended June 30, 2017.

The businesses sold during the first half of 2017, as well as those held for sale as of June 30, 2017, were included in our Small Business Services segment and their net assets consisted primarily of intangible assets. During the first quarter of 2017, we recorded a pre-tax asset impairment charge of \$5,296 related to one of the sold small business distributors. This impairment charge reduced the carrying value of the business to its estimated fair value less costs to sell, based on on-going negotiations for the sale of the business, including multiple offers. During the second quarter of 2017, we recorded an additional pre-tax asset impairment charge of \$2,954 as we finalized the sale of this business.

We are actively marketing the remaining assets held for sale and we expect the selling prices will equal or exceed their current carrying values. Net assets held for sale consisted of the following:

(in thousands)	<b>June 30, December 31,</b>		<b>Balance sheet caption</b>
	<b>2017</b>	<b>2016</b>	
Current assets	\$	—\$ 3	Other current assets
Intangibles	808	14,135	Assets held for sale
Goodwill	281	—	Assets held for sale
Other non-current assets	—	433	Assets held for sale
Accrued liabilities	—	(146 )	Accrued liabilities