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PMTS - Q3 2015 CPI Card Group Inc Earnings Call

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CORPORATE PARTICIPANTS

Diane Jackson *CPI Card Group Inc. - VP, Strategic Marketing*

Steve Montross *CPI Card Group Inc. - President and CEO*

David Brush *CPI Card Group Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

S.K.Prasad Borra *Goldman Sachs - Analyst*

Chris Kennedy *William Blair & Company - Analyst*

Stephanie Price *CIBC World Markets - Analyst*

Paulo Ribeiro *BMO Capital Markets - Analyst*

David Koning *Robert W. Baird & Company, Inc. - Analyst*

William Johnson *Raymond James & Associates, Inc. - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the CPI Card Group's third-quarter earnings conference call. (Operator Instructions). As a reminder, this call is being recorded.

I would now like to introduce your host for today's conference, Diane Jackson. Please go ahead, ma'am.

Diane Jackson - *CPI Card Group Inc. - VP, Strategic Marketing*

Good morning, ladies and gentlemen, and welcome to the CPI Card Group Inc. third-quarter 2015 earnings conference call. Participating on today's call from CPI Card Group are Steve Montross, President and Chief Executive Officer; and David Brush, Chief Financial Officer. At this time, all conference call lines are in a listen-only mode. And later we will conduct a question-and-answer session for conference call participants, and instructions will be given at that time. As a reminder, this call is being recorded.

Before we begin, I would like to point all of you to the disclosure at the end of the Company's earnings press release for information about forward-looking statements that may be made or discussed on this call. The earnings press release is posted on CPI's website. Please review the information, along with the filings with the SEC, for a disclosure of the factors that may impact subjects discussed on this morning's call.

The Company will be discussing one or more non-GAAP financial measures, including adjusted EBITDA, adjusted EBITDA margin, and adjusted net income. Please look at the earnings release on the CPI website for all the disclosures required by the SEC, including reconciliations to the most comparable GAAP numbers.

On this call, we will also be referencing certain industry and market data included in our initial public offering prospectus, which was derived from a report prepared by First Annapolis Consulting. For additional information, we see our prospectus, filed with the SEC on October 9, 2015.

And now I would like to turn the call over to Steve Montross, President and Chief Executive Officer.

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Steve Montross - *CPI Card Group Inc. - President and CEO*

Thank you, Diane. I'd like to welcome everyone to our third-quarter 2015 earnings conference call, and our first earnings call as a public company. We went public on October 9, 2015. And I'd like to thank all of you who supported us through the IPO: our new shareholders, our bankers, our Directors and the employees of CPI. We are very excited to take this important step in our development.

Let me start by saying that we are very pleased with our strong third-quarter results. We have a solid level of business activity, and we believe that we continue to be well positioned to execute on our internal plans through the end of the year and into 2016.

The format for our earnings calls in the future will be very straightforward. We will provide you with an overview of the business, review the numbers, and dedicate the majority of our time together to questions and answers. Today, on our first call, I thought it would be useful to provide a brief overview of CPI, the fundamentals that drive our industry and our business, the business highlights, and our growth strategy. Following this overview, I will discuss our third-quarter highlights and then turn the call over to Dave Brush, our Chief Financial Officer, who will provide a more detailed review of our financial performance.

We are the North American leader in the financial payment card market, with the number-one overall market position. We have a leading position in each of the financial payment card market segments: number one in the US prepaid debit market; number one in the highly attractive US small issuer market; and the leading position in the US large issuer market, serving 19 of the 20 large issuers.

Our leadership position is supported by the following key strengths. We are a mere producer of debit, credit, and prepaid debit cards. We are a leading provider of card services, which is putting the data on the financial cards to enable the cards to function. We have a well-established and diversified customer base, with over 4,000 customers. And we have the largest network of certified, high-security facilities in North America.

We believe that we have an attractive financial profile with business diversification and long-term growth that has accelerated with the beginning of the conversion in the US from magnetic stripe financial payment cards to chip, or EMV, financial payment cards. From 2012 through the third quarter of 2015, we have realized the 29% compound annual growth rate in our revenues, and a 51% compound annual growth rate in adjusted EBITDA, which highlights our growth trend.

We also generate high levels of free cash flow. Our free cash flow, defined as EBITDA less CapEx, was $49.6 million for the 12 months ended September 30, 2015, providing CPI excellent financial flexibility to pursue corporate and strategic initiatives and return capital to our shareholders.

We believe that the financial payments industry in general, and the financial payment card industry in particular, are great markets to be in for four key reasons.

First, there is consistent and strong secular growth in consumer payments and also a long-term shift from paper-based payments -- which is cash and checks -- to card-based payments, with card-based payments anticipated to increase from approximately one-third of consumer payments in 2005 to over two-thirds of consumer payments by 2018.

Second, those long-term trends have fueled the long-term 4% per year unit growth of the financial payment card market, which is projected to reach 1.4 billion payment card units by 2018. And annual industry demand is predictable and recurring, given that almost 90% of annual demand is replacement in nature.

Third, the EMV conversion -- the conversion from magnetic stripe financial payment cards to the higher-value EMV chip cards -- is forecast to more than triple the dollar value of the financial payment card market, rising from approximately $400 million in 2014 to $1.3 billion by 2019. As we will discuss in more detail, this trend is incredibly impactful to our business.

Fourth, the strong demand for the value-added services that go with financial payment cards -- the personalization services that put encrypted data on the cards -- is growing at approximately 8% per year, which is anticipated to provide an additional strong boost to industry growth.

As the leader in financial payment cards in the US, we believe we are well positioned to benefit from these four powerful trends in the market.

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We have a comprehensive offering of products and services, which is a strong competitive differentiator and competitive advantage.

Our end-to-end offering of products and services includes the following: EMV financial payment cards -- these cards are your debit and credit bank cards that have a chip on them and consist of contact EMV cards, which operate when they are fed into a reader; and dual interface EMV cards, a more advanced technology which operates on both a contact and a contactless, or tap-and-go basis.

Non-EMV payment cards -- these cards are the debit, credit, and prepaid payment cards that utilize the magnetic stripe, versus a chip, to initiate a payment transaction.

Card data personalization -- this service encodes the payment card, including the chip, in the case of an EMV card, with the information necessary to enable a card payment transaction. Due to the high level of data security required, this service is very sticky with our customers.

Instant issuance systems and services -- this web-based, software-as-a-service solution enables the financial institution to issue, in its branch, on the spot, fully personalized payment cards, which speeds new account openings or issuance of replacement cards. This service is an extension of our central issuance card data personalization services.

And tamper-evident packaging solutions -- this is a bundled solution of a personalized prepaid debit payment card enclosed in tamper-evident security packaging for retail sale by the prepaid program managers. You will find this product in a grocery store or a pharmacy. Our product engineering and design, our production capability, and our intellectual property portfolio for our core packaging products are unmatched in the industry.

The size of the financial payment card market is expected to triple, from $400 million in 2014 to $1.2 billion by 2019, driven by the growth in card volumes and the conversion to higher-priced EMV cards from magnetic stripe cards. The financial payment card services market is expected to continue its strong growth of greater than 8% per year to $600 million by 2019, reflecting volume growth of higher-value units. In total, our served market -- payment cards and payment card services -- is anticipated to grow from $800 million in 2014 to $1.8 billion by 2019.

It's also important to highlight what we expect will be three key drivers to strong market growth beyond 2019: first, continued unit growth, consistent with the long-term industry growth trend; second, continued conversion to EMV of market segments beyond debit and credit cards, such as private label and prepaid cards; and, third, a product mix shift to the more advanced dual interface EMV cards, which would have a dramatic impact on industry revenues, given the higher selling price of this product.

This strong growth in our served market provides a great tailwind for our business.

We have built an industry leader, distinguished by the following key investment highlights. We have the leading market position, with a 35% market share in the US financial payment card market. We have an exceptional customer base distinguished by long-term, trusted relationships with the leading players in the market. And as the leading provider of EMV cards to the market, we are extremely well positioned to continue to take advantage of the very positive industry conversion to EMV. We have a powerful offering of products and services for the market. Also we have achieved strong growth through our use of multiple growth drivers, which I will describe in a moment. And our business has an extremely attractive financial profile with strong growth, high margins, and significant free cash flow generation.

As mentioned earlier, the Company has achieved strong growth, especially in the past several years. This growth has been achieved through five key drivers that will continue to propel our business: first, grow as our customers and markets grow; second, grow by increasing our share of our customers' wallets through cross-selling on our entire suite of products and services; third, grow through focused innovation and development of products and services; fourth, grow by broadening our market reach into new, attractive market verticals; and, fifth, grow through selective strategic acquisitions. We will continue to utilize a growth strategy that we have shown to be successful.

Before I turn the call over to Dave, I will provide a brief review of our third-quarter results, including a discussion on what we are seeing in each of our reporting segments.

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For the third quarter, our net sales were $107.7 million, which was a 39.2% increase over the prior-year period. Adjusted EBITDA was $32.5 million, which was a 66.5% increase over the prior-year period. And adjusted net income was $17.3 million. Our sales growth and strong increase in profitability was driven primarily by our US debit and credit segment, with the US prepaid debit and UK Limited segments also contributing to our earnings increase.

The US debit and credit segment net sales were $72.8 million for the quarter, a 69% increase over the prior-year period. And income from operations for the segment was $21.6 million, a 108% increase. The substantial increases in revenue and earnings were driven largely by a 120% increase in EMV, or chip, card shipments to 41.2 million cards in the quarter as the conversion of the US market from magnetic stripe financial payment cards to EMV cards continued to build.

The EMV demand from our large issuers was slightly higher than we expected and, we believe, represented a modest pull forward of business into the quarter. With the resolution of industry-wide technical issues associated with EMV debit routing, we began to see increased EMV debit implementations by the banks. The level of EMV debit implementations has been lagging behind that of credit.

As we move into 2016, we anticipate strong growth in EMV debit implementations and, accordingly, strong growth in EMV demand from our core small issuer market, which is heavily weighted to debit. For the quarter, we also realized strong growth in card services and our instant issuance, or Card@Once activities, which contributed meaningfully to our revenue and earnings increases, reflecting in large part the addition of EFT Source. We are realizing substantial benefit from our broad, robust product and service offering, which has been enhanced through the September 2014 acquisition of EFT. Our earnings margins in the quarter were higher than what we expected. We expect our margins to moderate to our long-term trend as we manage the dynamic between profitability and accelerating growth.

For the quarter, US prepaid debit segment net sales were $23.7 million, which was essentially flat over the prior-year period. And income from operations was $9.5 million, a 10% increase over the prior-year period. Our business volumes in this segment do readily shift throughout the year, reflecting the timing by prepaid program managers of product introductions and refreshes, and management of their own distribution channels. And we've seen that again this year, with a strong first half and a moderate third quarter.

For the nine months ended September 30, the segment was tracking to our expectations. Net sales and income from operations were $53.5 million and $18 million, respectively, which represented increases of 13.7% and 36.7%, respectively, over the prior-year period. For the quarter, UK Limited segment net sales were $9.7 million, a 23.8% increase from the prior-year period. And income from operations was $1 million, up from $300,000, as business activity in the UK retail sector strengthened and the segment experienced a higher-value product mix and improved operating efficiencies.

I will now turn the call over to Dave to discuss the IPO and the results of the third quarter in greater detail.

David Brush - *CPI Card Group Inc. - CFO*

Thanks, Steve, and good morning, everyone. Our third-quarter 2015 net sales increased $30.3 million or 39.2% to $107.7 million compared to $77.4 million in the third quarter of 2014. Our third-quarter 2015 net sales, as Steve mentioned, benefited from the ongoing conversion in the US financial payment cards space, going from magstripe cards to EMV chip cards. Additionally, the third-quarter 2015 net sales benefited from the EFT Source acquisition we completed in September of 2014. The EFT sales that we picked up in the third quarter were $15.8 million. For the nine months ended September 30, 2015, net sales were $280.5 million, and increased by $107.4 million or 62% over the prior-year period.

We reported net income from continuing operations of $14.8 million or $0.19 per share in the third quarter of 2015 compared to $6.8 million and a loss of $0.10 per share in the third quarter of 2014. The earnings per share reflected a deduction for the preferred stock dividends that accrue in the related quarter. For the nine months ended September 30, 2015, net income from continuing operations was $32.9 million and increased by $22.6 million over the prior-year period.

I'll spend a few minutes discussing two non-GAAP financial measures that we believe provide a better basis for comparing our operating performance. First, our adjusted EBITDA for the third quarter of 2015 was $32.5 million, representing a 66.5% increase over the $19.5 million in the third quarter

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of 2014. A reconciliation of reported net income loss to adjusted EBITDA is also provided in our earnings release. Adjusted EBITDA as a percentage of net sales -- or what we refer to as adjusted EBITDA margin -- was 30.2% in the third quarter, reflecting a 500-basis-point improvement over the prior-year third-quarter adjusted EBITDA margins of 25.2%.

The second non-GAAP measure that I would like to point your attention to is adjusted net income. Our adjusted net income was $17.3 million for the third quarter of 2015, representing an $8.2 million or 89.8% increase compared to $9.1 million in the prior-year period.

Adjusted net income from continuing operations per diluted share in the third quarter of 2015 was $0.42 compared to $0.21 in the prior-year period. These diluted per-share amounts do not reflect the impact of the preferred stock dividend, which is recorded as a deduction from net income from continuing ops in computing earnings per share in our financial statements.

Importantly, with the redemption of the Series A preferred stock in the third and fourth quarters of 2015, the Series A preferred stock will no longer have an effect on the Company's financial statements, beginning with the first quarter of 2016.

A final note on the income statement related to taxes: our effective tax rate in the third quarter was 30.8% compared to an effective tax rate of 41.3% in the 2014 third quarter. Our tax rate in the third quarter of 2015 was reduced by one-time discrete adjustments related to foreign taxes and state taxes. The year-to-date September 30 effective tax rate was 33.5%.

Going forward, we would expect our tax rate to be in the range of 34% to 35% for the fourth quarter of 2015, and a similar range for the full-year 2016 before discrete items.

Cash flow from operations for the first nine months of 2015 was $44.4 million. Capital expenditures in the first half of the year were $13.9 million. Free cash flow, defined as cash flow from operations less capital expenditures, was $30.5 million compared to a use of cash of $10.4 million in the nine months ended September 30, 2014. The free cash flow for the 12-month period ended September 30, 2015, was $49.6 million.

Moving on to the balance sheet, we ended the quarter with a cash balance of $15.9 million, while debt outstanding was $444 million. On August 17, 2015, the Company entered into a first lien credit agreement with a syndicate of lenders providing for a $435 million first lien loan facility and a $40 million revolving credit facility. The proceeds of the first lien loan were used to repay existing debt of $142 million and redeem $276.3 million of Series A preferred stock.

The interest rate on the new first loan facility is either at a base rate plus a margin of 350 basis points, or the Eurodollar rate plus 450 basis points. The interest rate under the first term loan facility was 6.75% during the third quarter of 2015. We will shift to the Eurodollar rate during the fourth quarter, which will lower the rate to 5.5%.

On October 15 we completed the IPO, issuing 15 million shares of common stock. The proceeds of the offering were used to repay debt of $112.5 million, redeem the remaining Series A preferred stock outstanding, and repay our liability under the phantom stock plan.

Following the IPO, our net debt is approximately $315 million.

Giving effect to the 15 million common share issuance, pro forma adjusted diluted earnings per share from continuing operations would have been $0.30 per share for the three months ended September 30, 2015, compared to the $0.42 reported. Similarly, the pro forma adjusted diluted earnings per share from continuing operations for the nine months ended September 30, 2015, would have been $0.68 per share compared with the $0.92 reported. The total diluted common shares outstanding today are 56,956,449, which includes 480,333 shares exercisable under stock option grants.

Finally, I wanted to reiterate the Company's position on guidance. Going forward, we plan to issue annual earnings guidance. As such, we will not be issuing 2016 guidance until the fourth-quarter earnings announcement in early 2016. Further, we are not giving guidance today relative to the fourth quarter of 2015.

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With that, I would like to ask the operator to open up the lines so that we can take any questions that you may have. In order for everybody on the lines to get a chance with their questions, we just ask you to limit them to one at a time; and, if you have more, jump back into the queue.

With that, I will turn it over to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) S.K.Prasad Borra, Goldman Sachs.

S.K.Prasad Borra - *Goldman Sachs - Analyst*

Just on the fourth quarter, given what we have seen in terms of the prepaid business for third quarter, are you expecting a significant rebound? And could you provide any guidance or any revenues, really, what you have for fourth quarter?

Steve Montross - *CPI Card Group Inc. - President and CEO*

What we saw in the third quarter is a couple things. First, in the third quarter of 2014, we had a -- one of our customers rolled out a number of new product introductions. So we had a relatively strong quarter in the third quarter of last year that we were comparing against this year.

Also, with a couple of our large prepaid customers, what they have been doing is they have been purchasing themselves their collateral materials, and supplying those collateral materials to us so that our -- that has an impact in terms of our total revenues that we would have, but also a very positive impact in terms of the margins. So you saw the margins in our prepaid business are higher than what we were expecting. And we expect that trend to continue where they will be purchasing from those two customers, they will be purchasing collateral materials, supplying those to us.

We were getting a relatively low markup on that. And so our value add for the business with those customers is going up. And so we see that increase in the margins. And overall, what we are seeing is the business for prepaid does move around. It gets a little bit lumpy. And it really is driven by the timing that the customers have in terms of their new product introductions and then also just the management of their own distribution channels. The business moves around from quarter to quarter.

Overall, we feel good about where we are with the business. The business has performed as we would expect, and we feel very good about the prepaid business we have.

S.K.Prasad Borra - *Goldman Sachs - Analyst*

Okay, just one follow-up -- with regards to margins, obviously they were significantly better than expected. Apart from the comments you made on prepaid, is there something from a mix perspective between the larger shares and smaller shares, which helped you out in the third quarter? And again, if you could provide any visibility into fourth quarter, that would be great. Thank you.

Steve Montross - *CPI Card Group Inc. - President and CEO*

We saw the demand for EMV cards in the third quarter primarily from the large issuers. And the issuance in the small issuer segment, which is our core segment for us, is starting to increase. But it's still lagging behind the large issuer segment. So the majority of the demand was coming from

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large issuers. And the pricing did exceed our expectations. And we expect that the margins for EMV will moderate to our long-term trend as we continue to manage the trade-off between profitability and accelerating growth.

Operator

Bob Napoli, William Blair.

Chris Kennedy - *William Blair & Company - Analyst*

It's Chris Kennedy filling in for Bob. Steve, you mentioned some business was pulled ahead from the fourth quarter. Is there any way to quantify that?

Steve Montross - *CPI Card Group Inc. - President and CEO*

We haven't quantified it, Chris. We just noticed that -- we think that there was a modest, very modest pull forward. It was not material, but a modest pull forward from the fourth quarter into the third quarter. Again, it really just reflects what the customers -- the timing of their own operations. So we just -- it was more what we had expected as we got into the second half of the year. And it was a little bit higher than we expected, and it seemed to represent a slight pull forward of that business into the third quarter.

Chris Kennedy - *William Blair & Company - Analyst*

Okay, great. And then just one on capital allocation going forward, and talk about your M&A pipeline, if you could.

Steve Montross - *CPI Card Group Inc. - President and CEO*

Sure. In terms of our M&A activity, you know that we have been very successful in growing the business through acquisitions. And that's an important part of our growth strategy going forward. And we will continue to be looking for opportunities that are strategic for the business, that really complement what we are doing, and build out our value proposition to our customers. And so we will continue that, and we believe that there are going to be good opportunities for us.

There's nothing that's imminent at this stage, but we believe that there are going to be good opportunities for us. And we want to make sure that we are allocating capital for that activity, because we have been very successful in growing the business through acquisition.

Chris Kennedy - *William Blair & Company - Analyst*

Great, thank you.

Operator

Stephanie Price, CIBC.

Stephanie Price - *CIBC World Markets - Analyst*

Steve, you mentioned that pricing on EMV cards exceeded expectations this quarter. Could you talk a little bit more about that and give us a bit more color there?

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Steve Montross - *CPI Card Group Inc. - President and CEO*

I'd say that the pricing was fairly in line with what our expectations were. It was just the margins were a little bit higher than what we expected. It was a little bit higher than what we see as our long-term margins. And it just -- I think it was a matter of generating the sales that we had; and then, at the end of the quarter, looking at what those margins were; or, as we were going through the quarter, looking at those margins. The pricing was in line. It was just the margins were slightly higher than what we expect for our long-term trend.

Stephanie Price - *CIBC World Markets - Analyst*

Okay. And then in terms of the prepaid, the Q3, I thought, was a seasonally strong quarter. Can you just walk us through that again? And I know there was a year-over-year -- potentially a tough compare there. But is it typically a seasonally strong quarter? And how should we think about seasonality in the business?

Steve Montross - *CPI Card Group Inc. - President and CEO*

Yes. The third quarter this year was stronger than the other quarters. And so we saw a definite strength in the business. And so, when you look at the third quarter in the prepaid business, the results are up from the other quarters, so that -- you are correct. There is seasonality to that business, and the third quarter is the strongest quarter.

In terms of the year-over-year comparison, in the third quarter of 2014, one of our principal customers in the prepaid segment rolled out a number of new products. And these were also high-value GPR products that they were rolling out. And that reduced strong results for us in the third quarter of 2014. So we are comparing ourselves in 2015 against those strong results. And so that's one impact.

And then another factor was that we've got a couple prepaid customers that are now acquiring the collateral materials and supplying those collateral materials for us. And so that reduces our revenues because we are not, in essence, charging back for those collateral materials. But it also increases our margin, because our value add from that business is higher than it had previously been because the revenues are little bit lower. So that also was a factor when you look at the revenue side.

I would point you to looking at the income side, because we feel really good about the income, and it's in line with expectations. And we saw the impact of the strong business in the third quarter; also the strong value add that we had, with that work in our margins that we had for the third quarter.

David Brush - *CPI Card Group Inc. - CFO*

And just to make the point on the seasonality, I think if you go back and look at first-quarter revenues in that business -- at $17 million this year, at $12 million in the second quarter, and then jumping up to $23.7 million -- and I think you'd see that same trend as you go back and look at the 2014 quarterly results, as well, where 2014 -- first quarter $10 million, second quarter $13 million, and then the $23 million.

So when we refer to the seasonality, we clearly are still seeing the big lift that we expect in the third quarter this year, consistent with prior years; then the growth that Steve described that underlies it was maybe just a little different this year.

Stephanie Price - *CIBC World Markets - Analyst*

Okay. Okay, great. Thanks for the color.

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Operator

Paulo Ribeiro, BMO Capital Markets.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

My first question is on the tax rate. Could you just give us some color -- I know you are not going to give guidance for 2016. But we've seen this year, and also last year if you do quarter-by-quarter, it swings around a little bit. And you gave guidance for this quarter. But is there a sense that, going forward, 35% is a normal cruising altitude rate? Or does this year seem to be exceptional in that front?

David Brush - *CPI Card Group Inc. - CFO*

No, I think -- if I missed it in my notes, 34% to 35% seems to be the right normalized tax rate, going forward.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

Okay.

David Brush - *CPI Card Group Inc. - CFO*

So I think, as we've gone through and just moved away from a lot of the unusual transactions that were hitting the tax rate -- whether it was the discontinued op in Nevada, and cleaning up a number of the equity structure-related items -- we have seen a bit higher rate historically this quarter, at 30% a bit lower, given a couple of discrete true-ups or discrete items related to foreign taxes and state taxes. But as we look at the fourth quarter and then into 2016, that 34% to 35% rate should become much more of a stable predictor on taxes.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

Perfect. And drilling down a little bit, if I may, on something else, two points here -- in terms of the seller's note, you paid that already? Because it doesn't show on, the $9 million, the balance sheet. And second, also talking about numbers, the restructuring costs -- are you done with restructuring? You have a charge, I think, of $1.1 million or so this quarter. Are those done?

David Brush - *CPI Card Group Inc. - CFO*

Yes. So the first one, on the seller's note for $9 million -- that moved from long-term liabilities up into current. So it sits in the $13 million of current maturities. The note is due in September of 2016. That's where that one went.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

Okay.

David Brush - *CPI Card Group Inc. - CFO*

On -- tell me what your other question was.

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Paulo Ribeiro - *BMO Capital Markets - Analyst*

The restructuring. If you --.

David Brush - *CPI Card Group Inc. - CFO*

Yes, I got it. So all related to the Petersfield UK closure. And what you see in terms of the charge, $1.1 million is it. We've closed out of the business or the operation there. And the charges principally just related to the runoff of our lease liability on the facility. But everything else got captured, and either paid or -- in the third quarter, and is included in the charge. So all done.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

Perfect. I have more questions, but I'll get back in line. Thank you.

Operator

David Koning, R. W. Baird.

David Koning - *Robert W. Baird & Company, Inc. - Analyst*

Great job on the margins. My first question: you mentioned the smaller banks, and the debit portfolio is getting sent out now at a more rapid pace. Is it fair to say, as we look into next year -- without, obviously, giving any sort of granular guidance -- but if we just look into next year, and we think about all these small banks, you get higher economics on cards from small banks. And then on top of that, you get more personalization, so you get a higher yield on personalization services, too.

Could it set up that even if EMV growth decelerates a little bit, your revenue yields are enough to drive very, very strong revenue growth into next year as the mix shift goes to those smaller, higher-yielding banks?

Steve Montross - *CPI Card Group Inc. - President and CEO*

Yes. As you know, the core market for us is that small issuer market. That small issuer market, for the reasons you just mentioned -- they are heavily concentrated in debit. Debit, industry-wide -- we have the technical issues with working out the debit routing. Now that that has been done, we are seeing the debit implementations really pick up. And also we are seeing the small issuers now lining up for implementations of EMV.

So we think that next year is going to be a very, very strong year for implementations with that core small issuer market. And as you also mentioned, we see really good results. We have higher margins in that market. And so we expect that it's going to be a very robust year in the industry for that small issuer segment.

David Koning - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And I guess my one follow-up -- just looking at the commentary where the core US debit and credit was higher than you expected, prepaid was about in line, margins way better than expected, and yet the stock is down about 10% this morning. And I think consensus revenue was you missed that by 1%. I'm just trying to balance out between a very positive message here and what seems like, in your mind, really crushed expectations; but in the minds of investors, maybe missed by a little bit, and maybe where that disconnect is in the message a little bit.

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Steve Montross - *CPI Card Group Inc. - President and CEO*

Well, I honestly can't tell you exactly what the investors -- what they are looking for. I can just tell you what we are really trying to do with the business, which is we are making sure that we are achieving the growth objectives we have in the business, but then also making sure that we are continuing to really drive the profitability of our business. And I think that we were successful in doing that.

We were successful in driving the growth, maintaining the position we have in our markets, and then really driving the profitability of the business. And that has been, always, our focus is -- how do we continue to really drive the profitability of the business? And so we feel very good about that, and very good about the results that we showed for the third quarter.

David Koning - *Robert W. Baird & Company, Inc. - Analyst*

Yes, it looks great to me. Nice job. Thank you.

David Brush - *CPI Card Group Inc. - CFO*

Thanks. I saw your piece early this morning. I just wanted to make sure you got what you needed on the EMV volumes, which we would expect to have in our 10-Q when we file it. And I think we've articulated them here this morning, but happy to help you with that. if you didn't get it, before you hop off the line.

David Koning - *Robert W. Baird & Company, Inc. - Analyst*

Yes. No, that's great. I appreciate it.

Operator

William Johnson, Raymond James.

William Johnson - *Raymond James & Associates, Inc. - Analyst*

So just to backtrack a little bit here -- so on the prepaid side, so obviously positive impact on margins by the customers taking some of the raw materials. So just on terms of top-line trajectory, from a core business basis, on a revenue outlook basis, just remind me again here -- how does that look? How should we be thinking about it?

And then kind of a similar question on the UK. And I know you touched on that a little bit. But if we could just circle back to those two topics, I'd appreciate it.

Steve Montross - *CPI Card Group Inc. - President and CEO*

In terms of how we are thinking about the revenue trajectory, I would look at what we've done year-to-date for the nine months. Business, [William], as you know, moves around during the year. So I would really look at it over the period of time. And the revenue trajectory that we are seeing in that business is in line with what our expectations would be for that business; and so is the profitability, the profitability trajectory that we are seeing in that business as we look at the nine months is in line with what we were expecting from that segment.

And in terms of the UK, we have a similar dynamic in the UK prepaid business, in the respect that that business also shifts around, depending on when the retailers want to be rolling out their card programs and refreshing the product that they have that's out in their distribution channels --

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that timing does move around. And last year, for instance, it was very late in the year that we saw some of those managers or merchants bringing product in. This year, we are seeing it in the third quarter of this year. And so that business does move around a bit, as they very their timing.

And overall in that business, that business, we believe, is -- we're on a good trajectory. We look at where we have been, where we are going with the business. And we believe that is going to meet the expectations. It is meeting our expectations, and we believe it's going to meet our expectations, both from a revenue and also from an earnings standpoint.

William Johnson - *Raymond James & Associates, Inc. - Analyst*

Right. And just one quick follow-up here, if I may. I apologize if I missed this. But with one quarter to go, and you guys only provide annual guidance, could you reiterate the 2015 guidance here?

David Brush - *CPI Card Group Inc. - CFO*

So, we didn't put out any guidance for 2015. I think you guys have all issued your research reports based on dialogues, pre-IPO, with us. And so it's a hard question for me to answer, in terms of what you're looking for.

Steve Montross - *CPI Card Group Inc. - President and CEO*

Yes. And given the proximity to the IPO, we are not going to comment on what we see for the fourth quarter.

David Brush - *CPI Card Group Inc. - CFO*

I think what Steve suggested in his dialogue, though, is that we clearly -- when we look at our numbers we are at for the third quarter, versus generally where the consensus was at, we exceeded those. And we saw a little bit of pull forward into the third quarter. And so I think, take that as you like it, in terms of how you put that back at your model. But the fundamentals of the business for the full year still remain the same as what we talked to you, pre-IPO.

William Johnson - *Raymond James & Associates, Inc. - Analyst*

Okay, I'll jump back in the queue. Okay, thanks.

Operator

(Operator Instructions). Paulo Ribeiro, BMO Capital Markets.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

In terms of -- I know you, again, guidance for fourth quarter, you are not talking about. But can you just remind us, and help us think through what are some of the non-recurring costs that we could see that quarter that will muddy the waters a little bit? Specifically, you had the IPO. Or just set up expectations for that. There was expectation also of some non-cash compensation and expense in the quarter. Can you just -- if not the numbers, at least walk us through what do you expect to see this quarter that is costs associated with non-recurring events.

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David Brush - *CPI Card Group Inc. - CFO*

So the biggest item that we will see in the fourth quarter, Paulo, as a non-recurring item is the expense related to the payoff of the phantom stock plan. So the charge or the total buyout of that phantom stock plan in October was roughly $13.3 million, if my memory serves me correct. We've recorded expense up through the third quarter of roughly $6 million, so there's about a $6.5 million charge that will be taken in the fourth quarter as we pay that out. So that one -- that will be the largest. Then we will have the ongoing just non-cash comp add-back, relative to equity-based compensation.

In terms of the -- we still have that ongoing $250,000 a quarter performance payout relative to the EFT Source acquisition, which, given the performance of that business, we fully expect to have that, as well, in the fourth quarter. And then, when we look at -- we talked to you already about the restructuring. But that should be behind us. And that should be about it.

Paulo Ribeiro - *BMO Capital Markets - Analyst*

Okay, great. Thank you.

Operator

At this time, I'm showing no further questions.

I would like to turn the call back to Steve Montross for any further remarks.

Steve Montross - *CPI Card Group Inc. - President and CEO*

Okay, thank you. And I want to thank everyone for participating in our earnings call. We look forward to communicating with you next quarter, if not sooner. And to all our new shareholders, we greatly appreciate your support, and the trust and confidence that you've placed in us. We look forward to working with all of you and to speaking with you again soon. Thank you, everyone. Have a good day.

Operator

Ladies and gentlemen, thank you for participating in today's program. This does conclude the program, and you may all disconnect. Everyone have a great day.

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