

Company Name: Priority Technology Holdings, Inc. (PRTH)
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<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Well, thanks, everyone, for being here. We have Tim O’Leary from Priority Technology Holdings here with us. We’ve got 25 minutes for a conversation here, so we’ll run through some Q&A. And then if there are any questions from the audience, we can take those too.

Tim, do you want to start with just maybe a quick intro to yourself and Priority before we kick off?

<<Tim O’Leary, Chief Financial Officer>>

Sure. I’ll start with myself. So Tim O’Leary, I joined Priority about three years ago after a long career in banking. I made the move into the CFO seat here about three years ago. It’s been a fun time transitioning into the public company CFO seat, and a lot of good things happening in the business. I’ll talk more about that today.

But Priority was founded in 2005, and we’re a leading provider of payments and banking solutions that help our customers accelerate cash flow and optimize working capital. We do all of that on a single technology stack that we call the Commerce Engine. And we help our clients collect, store, lend and send money. We do that with capabilities in merchant services, payables and banking and treasury solutions. And happy to talk more about any of those segments today.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Yeah. And maybe just a sense of scale of the business?

<<Tim O’Leary, Chief Financial Officer>>

Sure. So this year, if you take the midpoint of our guidance, it’s \$980 million of revenue, \$375-ish million gross profit and \$225 million of EBITDA. So a scaled business running with \$1.4 billion of accounts under administration or deposits under administration, 1.6 million accounts on our platform and doing about \$140 billion of total payments volume.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay, great. Why don’t you take us through the operating thesis for Priority? I think it’s a bit unique just from the scope of payment – the payments ecosystem. So let’s start there and then we’ll dig in a little bit.

<<Tim O’Leary, Chief Financial Officer>>

Sure. If you go back to the origins when the business was founded in 2005, it was really built on the thesis that there was going to be a convergence of payments and software. And I think it's pretty safe to say that that has certainly played out in reality over the last decade or two. And then over time, that thesis though changed to there's going to be a convergence of payments and banking.

And you're going to want to have a single provider be able to service you both on the payment side as well as for banking and treasury solutions. And we've continued to expand the suite of products we have and solutions we offer, whether it's through acquisitions or organically, to build that solution set and offer what we call the Commerce Engine today to really provide that full suite of solutions to our customers, whether it's an SMB business, in our SMB segment where you're a small merchant, whether you're a restaurant or some other type of Main Street business or if you're a larger enterprise customer, really offering all those solutions to our customers on a single technology stack.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Maybe just to take each operating segment on a standalone basis for a minute. For the SMB acquiring piece, just give us a sense of who Priority is competing with on that front. And then where you think that piece of the business is differentiated? And then just any sort of commentary you could add on vertical mix.

<<Tim O'Leary, Chief Financial Officer>>

Sure. So we compete with all the other large acquirers you think about, right? When you think about pro forma for the merger of Global Payments and Worldpay, we're the fifth largest U.S. based non-bank acquirer in the country. So scaled operator, we're competing against all those other providers, whether it's Fiserv, Global Payments, Paysafe, Shift4, that's the universe we're competing in, as well as ISOs or resellers servicing local markets, right, we compete in those arenas as well.

We really think we're differentiated on two fronts. One, it's really leading with modern technology and leading with a modern technology platform that not only services the end merchant and gives them a technology tool set that they can use every day to run their business more efficiently, but also working to provide the same types of tool sets to our resellers so that they can run their business more efficiently, manage their portfolio more effectively. And then we combine that with what we believe is really white glove level customer service, right? So when you have an issue either as a merchant or as a reseller, you're getting a person on the phone to help you answer that, that problem or resolve that in typically the first call.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay. And we'll do sort of a lightning round for the rest. So on the B2B payments side, I think like from my seat, there's a good understanding of just the TAM of B2B payments, often described as underpenetrated and from some perspective under monetized.

<<Tim O'Leary, Chief Financial Officer>>

Sure.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Let's maybe just talk about how you think about the size of the B2B opportunity and some of the peers that you see in market to start?

<<Tim O'Leary, Chief Financial Officer>>

Sure. I think if you just look at payments volumes for B2B, it's 2x the consumer payments you're seeing in the typical acquiring segment. It's \$25 trillion of payments volume. And you're still relatively underpenetrated compared to traditional checks, right? Check is still a large component of B2B payments. So you're earlier in that evolution of that transition towards electronic payments, whether that's virtual card, ACH or some other type of electronic payment.

So it's still early stages. Our business continues to grow at very healthy rates. We grew 14% plus last quarter in B2B. And we really bring together both a buyer funded and supplier funded model to really service the entire ecosystem from an automated payable solution set. So we think we're early stages in capturing that market share. Again, its \$25 trillion of payments volume and...

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Yeah.

<<Tim O'Leary, Chief Financial Officer>>

You're still seeing a lot of that convert from check to electronic payments, so there's a rising tide overall.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

And just to go a bit further on the B2B payments conversation, monetization is a thing that investors have focused on a lot. It's been a tailwind for some and a headwind for others. Maybe just describe payment modality mix that you see and some of the levers there and how that ties back to monetization of volume on the B2B side.

<<Tim O'Leary, Chief Financial Officer>>

Sure. Yeah. I think overall, if you look at our supplier funded model, right, where it's your kind of more traditional automated payable solution with combination of virtual card, ACH, some checks as part of that. We continue to see increasing electronic payments. So virtual card is probably a third of the payments modality. ACH is probably closer to 40%, 50% and then the balance is still checks.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay.

<<Tim O’Leary, Chief Financial Officer>>

So that conversion is happening. I think if you look at the broader market, you’re probably closer to 50% checks. So we’ve been very successful in enabling more of our buyers to pay their suppliers electronically compared to the broader marketplace. So we’ll continue to monetize it that way.

If you think of our buyer funded model, which we gained those capabilities through the acquisition of Plastiq in August of 2023, and that gives you the ability to pay any supplier by credit card, even if that supplier doesn’t accept a card. And we do that as the merchant of record where we’ll run the transaction, we’ll take the funds, and then we’ll disperse those funds to the supplier by whatever payment method they wanted.

If they want a check, wire or ACH, we’ll disperse the funds that way. But it gives the buyer the ability to use existing credit card capacity they have, whether that’s a small business or a larger enterprise company, using existing capacity they have, so they can extend their working capital. They capture cash back rewards on those cards or if you’re a small business, you might get points on your card that you use in your business every day. So there’s economic benefits to doing it on card plus you’re automating that payable stream and getting it through electronically to your end supplier.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

We had SMB acquiring, we hit B2B payments. Can you help us sort of fold in the banking treasury component? Maybe just – what’s being accomplished on behalf of customers and then just from a competitive standpoint, how you think Priority sort of fits in, what seems like a less defined landscape versus B2B payments and SMB acquiring?

<<Tim O’Leary, Chief Financial Officer>>

Sure. So our Enterprise segment of banking and treasury is really providing a fully scaled banking as a service offering to our customers and embedding banking capabilities into either their day to day work streams directly or embedding it into a software platform that then is being sold to the end customer. And we do both. We go direct to customers and work with them through API connections to offer the embedded finance solutions that they use in their business. And we also partner with software providers where we’re embedding our banking and treasury capabilities into their applications.

A good example of that is we’ve talked on our earnings calls about some of the examples in the athletic space. And think about college athletics and NIL has become very prevalent, billions of dollars of funds flowing to athletes through the NIL. One of our partners is a software provider in the college athletics space and they offer an application to the university that does more for the

athletic department than just what we're doing. It does everything from budgeting to other different applications. But there's an application that the athlete has on their phone, right? And it's everything from workout plan, nutrition plan, class schedule, coach communication. It now has a digital wallet embedded in it that we power.

So we've empowered this digital wallet inside that software application. As the athlete gets NIL funds, it flows into that digital wallet. There's a debit card or virtual card attached to it that they can upload into their Apple Pay or Google Pay Wallet and really use that as a fully functional bank account. We're then capturing interchange on the debit card usage. There's float income generated on some of the deposits and it really just provides an additional capability in that provider's software system that they didn't have before we embedded that.

And you can take that same type of application and apply it to other verticals, whether it's construction and you're embedding that same capability into a construction management software application or rent payments. And the ability to not only manage the rent payments, but now you can manage the deposits, right? The tenant deposits on that system as well and have all those subledger down to the individual account level and get daily reconciliation down to the penny on those in accounts that are FDIC pass through eligible, because we're a money transmitter and have those funds syndicated to large banks on the back end.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Switching gears a little bit just to product distribution and again maybe split it by operating segment. But just talk about how you go to market with each of the three products or suites of products.

<<Tim O'Leary, Chief Financial Officer>>

Sure. So in the SMB segment, it is close to 80% through resellers and that's a combination of more traditional ISOs as well as ISVs. Although, I would argue that the lines between some of your more sophisticated ISOs and ISVs is definitely blurring if not already merged. A lot of them are already value added resellers and offering other solutions. But let's call it, 80% or so is through resellers. So a variable cost model for us, a lot of capabilities in the marketplace and people out there selling on our behalf. Within B2B, it's mostly direct. We do have channel partners and resellers including white labeling our solution with bank partners into their customer base. And then enterprise is largely direct sales, where we're going into the software provider, embedding our payments and banking capabilities into their applications. And then they're ultimately working with the end consumer as the interface and the sales agents.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

And how much – when you think about the commerce engine, maybe put it in, I don't know, whatever terms make sense to you, when customers are interacting with Priority solutions, mix of interacting via them being embedded with partners, whether software partners or other versus more direct interaction.

<<Tim O’Leary, Chief Financial Officer>>

It’s a good mix. But I’d say over time, our business is definitely shifting towards from a profitability standpoint, the B2B and Enterprise segments. If you look at our business today, roughly two-thirds of our revenue is from the SMB channel. But almost two-thirds of our gross profit is from the B2B and Enterprise segments. So that value proposition has really shifted over the years towards a much higher growth, higher margin, more recurring revenue-oriented model where it is more direct sales to the B2B and Enterprise segments.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay. Maybe just to move on to the model, when you think about respective growth rates for the three operating segments, I mean, I sense some excitement around a couple of them. Not to say, there’s not enthusiasm for the other, but just when you think about the three operating segments, give us a sense of like relative growth rates and how – what you’re excited about?

<<Tim O’Leary, Chief Financial Officer>>

Sure, yeah. I think we’re excited about the combination of all of them coming together. When we think about the commerce engine and we’ve had some recent wins where it’s the diversity of those solutions and the ability to deliver the full suite of payments and banking solutions that’s really driving those wins. But if you broke apart the segments and think about the growth rates, what we’d said coming into the year was SMB was going to be high single digits, B2B was going to be low double digits growth rates, and then Enterprise was going to be in the low 20% growth rate.

And that’s played out so far. If you look at the first half of the year, SMB is a little over 5% but there’s been some headwinds there. If you look at the core portfolio and the growth we’re seeing in the business, it’s closer to 10% in the first half of the year. There were a couple defined headwinds that will start to moderate in the back half of the year. That should give us some uplift there.

And then B2B we were just over 12% in Q1, it was 14.4% in Q2, so we’ve seen a nice acceleration there. And then Enterprise is running right around 20%, just over 20% growth rate. So kind of in line with what we expected. But it’s really some – it’s the combination of those three solution sets between acquiring, payables and banking and treasury that’s really allowed us to go into some of these larger customers and win some very significant opportunities in the recent months that we’ll see the benefit of in the second half of the year.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

And when you think beyond 2025 and just sort of take the midterm view, I mean do those growth rates that you mentioned, the high single, low double and 20, like is that, does that feel comfortable as you think about the opportunity at hand for each of those segments and sort of where you fit into the ecosystem?

<<Tim O’Leary, Chief Financial Officer>>

It does. I think you could see Enterprise maybe moderate a little bit on a percentage basis just given the law of large numbers and growing off of a larger base, but continue to see pretty consistent dollar growth in that segment. We’re also still relatively early stages in some of our Priority Tech Ventures entities starting to get to scale and starting to become a more meaningful piece of enterprise. So that could be an acceleration on the upside there. And then within SMB, I think once some of these headwinds we’ve talked about in the last couple earnings calls dissipate, you’ll see us get back up into that high single digits versus the 5% we’ve had so far this year.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay. On the sort of revenue type conversation, there are SaaS fees, as I understand. Maybe just sort of walk us through the mix of more transactional or volume-oriented revenue versus SaaS?

<<Tim O’Leary, Chief Financial Officer>>

Sure. I’ll maybe talk about gross profit because I think...

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Sure. Yeah.

<<Tim O’Leary, Chief Financial Officer>>

...a lot of times, especially in the payments industry, revenue gets a lot of the attention. But it can be a little bit of a head fake.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Everybody, right.

<<Tim O’Leary, Chief Financial Officer>>

Because a lot of that revenue gets passed right through as residuals or commissions. So if you think about gross profit, our business today, two thirds of our gross profit comes from B2B and Enterprise segments. If you looked at the level of gross profit coming from recurring revenue where it truly does repeat itself every month and it’s not dependent on transaction count or bank card volumes, that’s also running at about two-thirds of our gross profit, or about 62% to be exact.

So that mix shift has really been evolving in the business and we’ve got great visibility into our profitability now because of that level of whether it’s a monthly subscription fee or an account fee, it might be a fixed monthly fee for either the merchant or the reseller. It could be float income on the accounts that we administer. So there’s a number of different factors that drive a

very high level of recurring profitability. The recurring revenue is lower, but those revenue streams flow through at a much higher margin. So it equates to about 62% of our gross profit. And that mix shift is going to continue as B2B and Enterprise grow faster than the SMB business.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

And with that sort of that type of gross profit, I mean, is there an NRR type metric that you all share or think about just in thinking about the growth formula for any given year and it may differ across the operating segments, but just anything on NRR?

<<Tim O'Leary, Chief Financial Officer>>

No, we don't focus as much on NRR as we do on the gross profit and just the level of visibility we have there. We'll certainly look at churn and how much of the revenue we keep every year, every month in the SMB segment and feel like we do a better job than most on managing our attrition there, given the stickiness and some of the tools we provide not only to the merchant but to the reseller. Our what I'll call controllable churn, where it's merchants that leave the platform in the year that's been running high single digit percentage rates, which we think is leading in the industry. The piece we can't control sometimes is same-store sales.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Sure.

<<Tim O'Leary, Chief Financial Officer>>

And that has some volatility to it and that provides some additional volume attrition. But we do manage that overall attrition pretty closely. B2B retention rates are high and then in the Enterprise segment retention rates are extremely high.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay. Maybe just to sort of work our way down the model. How do you think about the operating margin profile of the business considering some of the mix shift that's ongoing?

<<Tim O'Leary, Chief Financial Officer>>

Yeah. So if you look at our gross margins in aggregate, we expanded 135 basis points in Q2 over last year. Q1 was up a little bit higher than that. We had some one time things in Q1 that gave it a little bit of a bump up to 150 basis points year-over-year. I think we'll continue to see good margin expansion especially given Enterprise is growing at a 20% rate and that business operates at Enterprise software level gross margins. That business today is at a 93%, 94% gross margin. So that will continue to have a benefit for us on the consolidated platform.

We've also seen some stabilization in the gross margins at SMB. So those are in the 22%-ish range right now and that's been stable the last couple quarters as we've gone through some of the mix shift there with larger resellers growing faster. So I think we'll continue to see nice margin expansion in the business over the next several quarters and that leads us into some of the acceleration we think we're going to have in the back half of the year.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Yeah. And that's on, I mean a lot of that sounds like mix shift and some other sort of gross margin factors when you think about leverage and things that you can sort of be actionable around at the OpEx line. What would you speak to there?

<<Tim O'Leary, Chief Financial Officer>>

Yeah. I think we've been pretty efficient on the OpEx side, especially with managing salary and benefits. SG&A, we do have some - I won't call them one time because they'll repeat - but it's a one time kind of having to lap those costs. But we are going through a migration moving more towards the public cloud domain versus running kind of private hybrid clouds. So we're converting some CapEx to OpEx. So that's a little bit of an SG&A headwind for us this year. But once we get through this year, we'll have a little bit less headwind from anniversarying that standpoint. We continue to manage our expenses well.

It doesn't show up on the P&L, but one of the big benefits we have is with a single technology stack, our CapEx spend is extremely low. And so if you think of what we're spending on CapEx, we're in the \$20 million to \$22-ish million range a year on a business of our size. Almost all of that or most of it is capitalized software development. So it's building new product. It's building new revenue streams. There's very little maintenance CapEx in our platform. A lot of our competitors who have legacy technology platforms have to spend a lot more on CapEx to maintain those systems. So we're very efficient from a cash flow conversion standpoint.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay. Yeah. I mean, just from a free cash flow potential standpoint, how do you think about this business over a five, 10-year period?

<<Tim O'Leary, Chief Financial Officer>>

Yeah. I think, we're going to continue to grow cash flow. We've done a number of things in the balance sheet to improve cash flow. We took out \$270 million of preferred equity last year. That was a cash flow drag for us in addition to an EPS drag as that flowed down through the P&L. We just lowered our interest expense on our debt by 100 basis points. So, that's got some meaningful cash flow savings for us. So, we did over \$20 million of cash flow this past quarter. If you do a walk down from EBITDA, similar in Q1, so, we expect to do north of \$80 million of free cash flow this year on \$225 million of EBITDA. So pretty high cash flow conversion, and that will continue to expand as we continue to delever the balance sheet.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Yeah. Maybe just there's been actually quite a bit of M&A in the payments space. Some companies that were supposed to be here were taken out. I'd be curious to get your perspective on just the state of the sector from an M&A standpoint, and then which as a former banker, might be insightful. And then from the Priority perspective, opportunities?

<<Tim O'Leary, Chief Financial Officer>>

Sure. Look, I think payments and banking and fintech has always been an active sector. And the last couple of months have been no different, right? Whether it's a couple of recent B2B transactions, they have pretty healthy valuations, the Melio transaction going to Xero and AvidXchange. There's been a handful in the B2B space. And I think that goes back to the earlier comments on just the size of that market opportunity and where it stands in its evolution, where you've got a rising tide in a lot of ways that can benefit a lot of companies. We feel like we've got a very well positioned B2B platform today that is highly automated, it's very profitable and growing at a nice rate.

So, I feel like we've got a very, very high-quality asset there. We continue to look at opportunistic M&A opportunities. We've been pretty diligent on how we go after deals and the structure. Obviously, we've been focused on deleveraging our own balance sheet. So, we haven't done a lot of transformative M&A in the last couple of years.

But, we are seeing some pretty unique opportunities out there right now to take advantage of, some dislocation in the market. But, look, I think it's an attractive time. I think there is a bid ask gap out there right now given where some of these valuation multiples are. Obviously, we're not happy with where we're trading from a multiple standpoint. I'm sure many of our peers aren't either. So, that presents a little bit of a challenge from a valuation gap.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Sure. Any questions from the audience before I keep going? Okay. Well, this wouldn't be a payments conversation in August of 2025 if I didn't ask about stablecoins. I think the combination of the enterprise business and the B2B payments business in particular, it seems like there's a conversation to be had around the sort of value that stablecoins can deliver to those ecosystems. I'd be curious to get your perspective on that?

<<Tim O'Leary, Chief Financial Officer>>

Yeah. I think where I see the initial value for stablecoin, and there's probably others who are much closer to it, is really the cross-border payments, right? And probably a good percentage of that could move to a stablecoin environment to stay in lower cost of conversion and moving those funds cross border.

I think, where we have some unique opportunities to potentially play a valuable role in that chain is there still has to be an on-ramp and an off-ramp. And some of the banking and treasury

technologies we have and the ledgering technology and the ability to administer funds in a virtualized account is going to be somewhat useful in that environment because you're going to have to back that stablecoin with actual dollars.

And you've got to have those in an account. So, I think having that on-ramp and off-ramp capability is something we're looking at, it's early stages. I think some of the others may be first movers as you think about the actual cross border payments. But I think it's a unique opportunity for a lot of companies out there.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay. In the 30 seconds that we have left, maybe just from your perspective, your conversations with investors, what is being sort of missed or misunderstood about the priority story?

<<Tim O'Leary, Chief Financial Officer>>

I think there's still a, maybe a lack of appreciation of the breadth of our business and how that mix shift has changed over the last couple of years to where two-thirds of our profitability is now from B2B and enterprise. I think there's still a view from people who haven't looked at us in a while that we're a mono-line merchant acquirer. But, the business has really transformed and is a single commerce engine technology stack that delivers a much different solution set than many of our peers in the market. And I don't know if that's being fully appreciated or valued in today's market.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Okay, great. Thank you, Tim. Thanks for being here with us.

<<Tim O'Leary, Chief Financial Officer>>

Thank you.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets>>

Thanks, everyone, for listening.