FISERV INC
Form 10-Q
October 27, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended September 30, 2016
OR
¨ 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 0-14948

FISERV, INC.
(Exact Name of Registrant as Specified in Its Charter)

WISCONSIN	39-1506125
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer Identification No.)
255 FISERV DRIVE, BROOKFIELD, WI	53045
(Address of Principal Executive Offices)	(Zip Code)

(262) 879-5000
(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 ý 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer ý Accelerated filer ¨
Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of October 21, 2016, there were 217,057,326 shares of common stock, $.01 par value, of the registrant outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Fiserv, Inc.
Consolidated Statements of Income
(In millions, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Processing and services	$1,160	$1,125	$3,441	$3,301
Product	220	188	633	585
Total revenue	1,380	1,313	4,074	3,886
Expenses:				
Cost of processing and services	551	541	1,651	1,625
Cost of product	186	172	547	521
Selling, general and administrative	274	258	806	758
Total expenses	1,011	971	3,004	2,904
Operating income	369	342	1,070	982
Interest expense	(41)	(41)	(121)	(131)
Interest and investment (loss) income, net	—	—	(7)	1
Loss on early debt extinguishment	—	—	—	(85)
Income before income taxes and income from investment in unconsolidated affiliate	328	301	942	767
Income tax provision	(114)	(117)	(373)	(279)
Income from investment in unconsolidated affiliate	—	34	146	35
Net income	$214	$218	$715	$523
Net income per share – basic	$0.98	$0.94	$3.23	$2.22
Net income per share – diluted	$0.96	$0.92	$3.18	$2.18
Shares used in computing net income per share:				
Basic	219.2	232.9	221.6	236.0
Diluted	222.7	237.0	225.2	240.1

See accompanying notes to consolidated financial statements.

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Fiserv, Inc.
Consolidated Statements of Comprehensive Income
(In millions)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$214	$218	$715	$523
Other comprehensive income (loss):				
Fair market value adjustment on cash flow hedges, net of income tax benefit of $1 million	—	(1)	—	(1)
Reclassification adjustment for net realized losses on cash flow hedges included in interest expense, net of income tax provision of $1 million, $1 million, $3 million and $6 million	2	2	5	9
Foreign currency translation	3	(10)	—	(20)
Total other comprehensive income (loss)	5	(9)	5	(12)
Comprehensive income	$219	$209	$720	$511

See accompanying notes to consolidated financial statements.

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Fiserv, Inc.
Consolidated Balance Sheets
(In millions)
(Unaudited)

	September 30, 2016	December 31, 2015
Assets		
Cash and cash equivalents	$ 303	$ 275
Trade accounts receivable, net	830	802
Prepaid expenses and other current assets	467	429
Total current assets	1,600	1,506
Property and equipment, net	403	396
Intangible assets, net	1,868	1,872
Goodwill	5,375	5,200
Other long-term assets	391	366
Total assets	$ 9,637	$ 9,340
Liabilities and Shareholders' Equity		
Accounts payable and accrued expenses	$ 1,129	$ 1,024
Current maturities of long-term debt	6	5
Deferred revenue	413	473
Total current liabilities	1,548	1,502
Long-term debt	4,624	4,288
Deferred income taxes	742	726
Other long-term liabilities	154	164
Total liabilities	7,068	6,680
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value: 25.0 million shares authorized; none issued	—	—
Common stock, $0.01 par value: 900.0 million shares authorized; 395.7 million shares issued	4	4
Additional paid-in capital	1,001	952
Accumulated other comprehensive loss	(69)	(74)
Retained earnings	8,779	8,064
Treasury stock, at cost, 177.9 million and 170.4 million shares	(7,146)	(6,286)
Total shareholders' equity	2,569	2,660
Total liabilities and shareholders' equity	$ 9,637	$ 9,340

See accompanying notes to consolidated financial statements.

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Fiserv, Inc.
Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	$715	$523
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and other amortization	187	163
Amortization of acquisition-related intangible assets	119	149
Share-based compensation	54	51
Excess tax benefits from share-based awards	(46)	(34)
Deferred income taxes	7	(2)
Income from investment in unconsolidated affiliate	(146)	(35)
Dividends from unconsolidated affiliate	140	36
Non-cash impairment charges	17	4
Loss on early debt extinguishment	—	85
Other operating activities	(2)	3
Changes in assets and liabilities, net of effects from acquisitions:		
Trade accounts receivable	(15)	16
Prepaid expenses and other assets	(40)	(64)
Accounts payable and other liabilities	111	135
Deferred revenue	(59)	(75)
Net cash provided by operating activities	1,042	955
Cash flows from investing activities:		
Capital expenditures, including capitalization of software costs	(223)	(292)
Payments for acquisitions of businesses	(265)	—
Other investing activities	2	(4)
Net cash used in investing activities	(486)	(296)
Cash flows from financing activities:		
Debt proceeds	1,711	2,392
Debt repayments, including redemption and other costs	(1,380)	(2,058)
Proceeds from issuance of treasury stock	65	60
Purchases of treasury stock, including employee shares withheld for tax obligations	(970)	(1,066)
Excess tax benefits from share-based awards	46	34
Other financing activities	—	(6)
Net cash used in financing activities	(528)	(644)
Net change in cash and cash equivalents	28	15
Cash and cash equivalents, beginning balance	275	294
Cash and cash equivalents, ending balance	$303	$309

See accompanying notes to consolidated financial statements.

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Fiserv, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The consolidated financial statements for the three-month and nine-month periods ended September 30, 2016 and 2015 are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the consolidated financial statements have been included. Such adjustments consisted of normal recurring items. Interim results are not necessarily indicative of results for a full year. The consolidated financial statements and accompanying notes are presented as permitted by Form 10-Q and do not contain certain information included in the annual consolidated financial statements and accompanying notes of Fiserv, Inc. (the “Company”). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

Principles of Consolidation

The consolidated financial statements include the accounts of Fiserv, Inc. and all 100% owned subsidiaries. Investments in less than 50% owned affiliates in which the Company has significant influence but not control are accounted for using the equity method of accounting. All intercompany transactions and balances have been eliminated in consolidation.

2. Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”), which adds or clarifies guidance on the presentation and classification of eight specific types of cash receipts and cash payments in the statement of cash flows, with the intent of reducing diversity in practice. For public entities, ASU 2016-15 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. Entities must apply the guidance retrospectively to all periods presented; however, entities may apply prospectively if retrospective application is impracticable. The Company is currently assessing the impact that the adoption of ASU 2016-15 will have on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326) (“ASU 2016-13”), which prescribes an impairment model for most financial assets based on expected losses rather than incurred losses. Under this model, an estimate of expected credit losses over the contractual life of the instrument is to be recorded as of the end of a reporting period as an allowance to offset the amortized cost basis, resulting in a net presentation of the amount expected to be collected on the financial asset. For public entities, ASU 2016-13 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For most instruments, entities must apply the standard using a cumulative-effect adjustment to beginning retained earnings as of the beginning of the fiscal year of adoption. The Company is currently assessing the impact that the adoption of ASU 2016-13 will have on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which simplifies several aspects of the accounting for share-based payment awards, including the accounting for income taxes and forfeitures, as well as classification in the statement of cash flows. The standard requires that all tax effects related to share-based payments be recorded as income tax expense or benefit in the income statement at settlement or expiration and, accordingly, excess tax benefits and tax deficiencies be presented as operating activities in the statement of cash flows. For public entities, ASU 2016-09 is effective for annual periods beginning after December 15, 2016, including interim periods within those annual periods, with early adoption permitted in any interim or annual period for which financial statements have not yet been issued. The recognition of all excess tax benefits and tax deficiencies in the income statement, as well as related changes to the computation of diluted earnings per share, is to be applied prospectively. Entities may elect to apply the change in presentation in the statement of cash flows either prospectively or retrospectively to all periods presented. The impact of adopting this standard on the Company’s consolidated financial statements is dependent upon the intrinsic value of share-based compensation awards at the time of exercise or vesting and may result in more

variability in effective tax rates and net earnings and may also impact the dilution of common stock equivalents. During the three and nine months ended September 30, 2016 and 2015, the Company recorded $5 million and $4 million, and $42 million and $38 million, respectively, to consolidated equity as excess tax benefits from share-based compensation awards. The Company expects to adopt ASU 2016-09 in January 2017.

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In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which requires lessees to recognize a lease liability and a right-of-use asset for each lease with a term longer than twelve months. The recognized liability is measured at the present value of lease payments not yet paid, and the corresponding asset represents the lessee's right to use the underlying asset over the lease term and is based on the liability, subject to certain adjustments. For income statement purposes, the standard retains the dual model with leases classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. For public entities, ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. The standard requires a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently assessing the impact that the adoption of ASU 2016-02 will have on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), which primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements of financial instruments. For public entities, ASU 2016-01 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted for certain provisions of the standard. Entities must apply the standard, with certain exceptions, using a cumulative-effect adjustment to beginning retained earnings as of the beginning of the fiscal year of adoption. The Company is currently assessing the impact that the adoption of ASU 2016-01 will have on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), to clarify the principles of recognizing revenue and to create common revenue recognition guidance between U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This model involves a five-step process for achieving that core principle, along with comprehensive disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In July 2015, the FASB deferred the effective date of the new revenue standard for one year and will permit early adoption as of the original effective date in ASU 2014-09. For public entities, the standard is effective for annual and interim periods beginning after December 15, 2017. Entities have the option of using either a full retrospective or a modified approach to adopt this new guidance. The Company is currently assessing the impact that the adoption of ASU 2014-09 will have on its consolidated financial statements.

3. Fair Value Measurements

The Company applies fair value accounting for all assets and liabilities that are recognized or disclosed at fair value in its consolidated financial statements on a recurring basis. Fair value represents the amount that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability.

The fair values of cash equivalents, trade accounts receivable, settlement assets and obligations, and accounts payable approximate their respective carrying values due to the short period of time to maturity. The estimated fair value of total debt was $4.9 billion at September 30, 2016 and $4.3 billion at December 31, 2015, and was based on quoted prices in inactive markets for the Company's senior notes (level 2 of the fair value hierarchy) and discounted cash flows based on the Company's current incremental borrowing rate for its term loan (level 3 of the fair value hierarchy). The fair value of the Company's revolving credit facility borrowings approximates carrying value as the underlying interest rate is variable based on LIBOR.

4. Acquisitions

On January 15, 2016, the Company acquired Hewlett Packard Enterprise's Convenience Pay Services business, which enables providers to accept electronic payments from their consumers through multiple channels, thereby expanding the Company's biller solution offerings. On March 3, 2016, the Company completed its purchase of certain assets of ACI Worldwide, Inc.'s Community Financial Services business, further enhancing the Company's suite of digital banking and payments solutions.

The Company acquired these businesses for an aggregate purchase price of $265 million. During the third quarter of 2016, the Company finalized the purchase price allocations based upon final valuations of intangible assets. The final purchase price allocations for these acquisitions did not materially change from the preliminary allocations and resulted in technology and customer intangible assets totaling approximately $80 million, goodwill of approximately $175 million, and other identifiable net assets of approximately $10 million. The goodwill, recognized within the Payments and Industry Products ("Payments")

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segment, from these transactions is deductible for tax purposes and is primarily attributed to synergies and anticipated revenue and earnings growth associated with the products and services that these businesses provide.

The results of operations for these acquired businesses have been included in the accompanying consolidated statements of income from the dates of acquisition. As a result of these acquisitions, the Company has incurred merger and integration costs, including a $10 million non-cash impairment charge in the first quarter of 2016 related to the Company's decision to replace existing software with an acquired solution. The related impairment charge was recorded in cost of processing and services within Corporate and Other as such amount is excluded from the Company's measure of the Payments segment's operating performance. Pro forma information for these acquisitions is not provided because they did not have a material effect on the Company's consolidated results of operations.

5. Investment in Unconsolidated Affiliate

The Company owns a 49% interest in StoneRiver Group, L.P. ("StoneRiver"), which is accounted for as an equity method investment, and reports its share of StoneRiver's net income as income from investment in unconsolidated affiliate. During the first quarter of 2016, StoneRiver recognized a gain on the sale of a business interest in which the Company's pre-tax share of this gain was $190 million. During the first quarter of 2016, the Company also received cash dividends of $140 million from StoneRiver, which were funded from the sale transaction and recorded as reductions in the Company's investment in StoneRiver. In conjunction with this activity, the Company evaluated its equity method investment in StoneRiver for its ability to recover the remaining carrying amount of such investment. Utilizing a discounted cash flow analysis (level 3 of the fair value hierarchy) to arrive at a measure of the investment's fair value, the Company recognized an impairment loss of $44 million. The Company's $146 million pre-tax share of the gain, net of the impairment loss was recorded within income from investment in unconsolidated affiliate, with the related tax expense of $54 million recorded through the income tax provision, in the consolidated statements of income.

During the three months ended September 30, 2015, StoneRiver recognized a gain on the sale of a subsidiary business. The Company's $32 million pre-tax share of the gain and related expenses was recorded within income from investment in unconsolidated affiliate, with the related tax expense of $14 million recorded through the income tax provision, in the consolidated statements of income. During the three months ended September 30, 2015, the Company received cash dividends of $36 million from StoneRiver, which were funded from the sale transaction and recorded as reductions in the Company's investment in StoneRiver.

The Company's investment in StoneRiver was $22 million and $17 million at September 30, 2016 and December 31, 2015, respectively, and is reported within other long-term assets in the consolidated balance sheets. The dividends, in their entirety, represented returns on the Company's investment and are reported in cash flows from operating activities.

6. Share-Based Compensation

The Company recognized $15 million and $54 million of share-based compensation expense during the three and nine months ended September 30, 2016, respectively, and $15 million and $51 million of share-based compensation expense during the three and nine months ended September 30, 2015, respectively. The Company's annual grant of share-based awards generally occurs in the first quarter. During the nine months ended September 30, 2016, the Company granted 0.9 million stock options and 0.5 million restricted and performance-based stock units at weighted-average estimated fair values of $31.43 and $98.24, respectively. During the nine months ended September 30, 2015, the Company granted 1.1 million stock options and 0.3 million restricted stock units at weighted-average estimated fair values of $25.50 and $79.20, respectively. During the nine months ended September 30, 2016 and 2015, stock options to purchase 1.6 million and 1.9 million shares, respectively, were exercised.

7. Shares Used in Computing Net Income Per Share

The computation of shares used in calculating basic and diluted net income per common share is as follows:

	Three Months Ended September	Nine Months Ended September

(In millions)	30, 2016	2015	30, 2016	2015
Weighted-average common shares outstanding used for the calculation of net income per share – basic	219.2	232.9	221.6	236.0
Common stock equivalents	3.5	4.1	3.6	4.1
Weighted-average common shares outstanding used for the calculation of net income per share – diluted	222.7	237.0	225.2	240.1

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For the three months ended September 30, 2016 and 2015, stock options for 0.9 million and 1.0 million shares, respectively, were excluded from the calculation of diluted weighted-average outstanding shares because their impact was anti-dilutive. For the nine months ended September 30, 2016 and 2015, stock options for 0.8 million and 0.9 million shares, respectively, were excluded from the calculation of diluted weighted-average outstanding shares because their impact was anti-dilutive.

8. Intangible Assets

Intangible assets consisted of the following:

(In millions) September 30, 2016	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Customer related intangible assets	$ 2,201	$ 1,012	$ 1,189
Acquired software and technology	508	427	81
Trade names	117	56	61
Capitalized software development costs	631	227	404
Purchased software	226	93	133
Total	$ 3,683	$ 1,815	$ 1,868

(In millions) December 31, 2015	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Customer related intangible assets	$ 2,155	$ 922	$ 1,233
Acquired software and technology	488	413	75
Trade names	120	53	67
Capitalized software development costs	575	199	376
Purchased software	256	135	121
Total	$ 3,594	$ 1,722	$ 1,872

The Company estimates that annual amortization expense with respect to acquired intangible assets, which include customer related intangible assets, acquired software and technology, and trade names, will be approximately $160 million in 2016, $150 million in 2017, $140 million in each of 2018 and 2019, and $120 million in 2020. Annual amortization expense in 2016 with respect to capitalized and purchased software is estimated to approximate $130 million.

9. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of the following:

(In millions)	September 30, 2016	December 31, 2015
Trade accounts payable	$ 73	$ 74
Client deposits	387	330
Settlement obligations	247	224
Accrued compensation and benefits	149	196
Other accrued expenses	273	200
Total	$ 1,129	$ 1,024

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10. Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component, net of income taxes, consisted of the following:

(In millions)	Cash Flow Hedges	Foreign Currency Translation	Other	Total
Balance at December 31, 2015	$ (31)	$ (41)	$ (2)	$ (74)
Amounts reclassified from accumulated other comprehensive loss	5	—	—	5
Net current-period other comprehensive income	5	—	—	5
Balance at September 30, 2016	$ (26)	$ (41)	$ (2)	$ (69)

(In millions)	Cash Flow Hedges	Foreign Currency Translation	Other	Total
Balance at December 31, 2014	$ (41)	$ (20)	$ (2)	$ (63)
Other comprehensive loss before reclassifications	(1)	(20)	—	(21)
Amounts reclassified from accumulated other comprehensive loss	9	—	—	9
Net current-period other comprehensive (loss) income	8	(20)	—	(12)
Balance at September 30, 2015	$ (33)	$ (40)	$ (2)	$ (75)

Based on the amounts recorded in accumulated other comprehensive loss at September 30, 2016, the Company estimates that it will recognize approximately $12 million in interest expense during the next twelve months related to settled interest rate hedge contracts.

The Company has entered into foreign currency forward exchange contracts, which have been designated as cash flow hedges, to hedge foreign currency exposure to the Indian Rupee. As of September 30, 2016, the notional amount of these derivatives was approximately $84 million, and the fair value totaling approximately $2 million is reported in prepaid expenses and other current assets in the consolidated balance sheet. As of December 31, 2015, the notional amount of these derivatives was approximately $85 million, and the fair value totaling approximately $1 million is reported in accounts payable and accrued expenses in the consolidated balance sheet.

11. Cash Flow Information

Supplemental cash flow information was as follows:

	Nine Months Ended September 30,	
(In millions)	2016	2015
Interest paid	$ 79	$ 78
Income taxes paid	306	222
Treasury stock purchases settled after the balance sheet date	18	38

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12. Business Segment Information

The Company's operations are comprised of the Payments segment and the Financial Institution Services ("Financial") segment. The Payments segment primarily provides debit and credit card processing and services, electronic bill payment and presentment services, internet and mobile banking software and services, person-to-person payment services, and other electronic payments software and services. The businesses in this segment also provide card and print personalization services, investment account processing services for separately managed accounts, and fraud and risk management products and services. The Financial segment provides banks, thrifts, credit unions, and leasing and finance companies with account processing services, item processing and source capture services, loan origination and servicing products, cash management and consulting services, and other products and services that support numerous types of financial transactions. Corporate and Other primarily consists of unallocated corporate expenses including share-based compensation, amortization of acquisition-related intangible assets, intercompany eliminations and other costs that are not considered when management evaluates segment performance.

(In millions)	Payments	Financial	Corporate and Other	Total
Three Months Ended September 30, 2016				
Processing and services revenue	$ 589	$ 570	$ 1	$1,160
Product revenue	183	53	(16)	220
Total revenue	$ 772	$ 623	$ (15)	$1,380
Operating income	$ 241	$ 209	$ (81)	$369
Three Months Ended September 30, 2015				
Processing and services revenue	$ 554	$ 572	$ (1)	$1,125
Product revenue	160			