

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Carreker Corporation



J.D. (DENNY) CARREKER, JR. is Chairman and Chief Executive Officer of Carreker Corporation. The company advises financial institutions around the world on revenue enhancement, consolidation, e-commerce, IT strategy, payment systems, fraud mitigation, and customer relationship management (CRM). Mr. Carreker was named "Entrepreneur of the Year" in the 2001 Ernst & Young competition in the e-commerce category. *American Banker* named him to its list of the "Top 25 Technology Consultants." He serves as an expert witness to the U.S. Congress on banking and payment system matters. Working with the largest US banks, he has founded influential industry organizations, including ECCHO (Electronic Check Clearinghouse Organization), The Payment Solutions Network (now SVPCo), and Cash Services Australia. These shared-services entities have improved the payments system landscape while providing considerable financial value and vital thought leadership to their members through Carreker. Carreker Corporation was named to *Fortune's* list of the Top 100 Fastest Growing Companies, number 50 on *Forbes' Best Small Companies of 2000* and number 75 on *BusinessWeek's Hot Growth Companies of 2000*. Mr. Carreker holds BS and MS degrees in Industrial Engineering/Management from Oklahoma State University.

igation, and customer relationship management (CRM). Mr. Carreker was named "Entrepreneur of the Year" in the 2001 Ernst & Young competition in the e-commerce category. *American Banker* named him to its list of the "Top 25 Technology Consultants." He serves as an expert witness to the U.S. Congress on banking and payment system matters. Working with the largest US banks, he has founded influential industry organizations, including ECCHO (Electronic Check Clearinghouse Organization), The Payment Solutions Network (now SVPCo), and Cash Services Australia. These shared-services entities have improved the payments system landscape while providing considerable financial value and vital thought leadership to their members through Carreker. Carreker Corporation was named to *Fortune's* list of the Top 100 Fastest Growing Companies, number 50 on *Forbes' Best Small Companies of 2000* and number 75 on *BusinessWeek's Hot Growth Companies of 2000*. Mr. Carreker holds BS and MS degrees in Industrial Engineering/Management from Oklahoma State University.



SECTOR – BUSINESS SERVICES

(PAZ611) TWST: Would you give us an overview of Carreker Corporation?

Mr. Carreker: Carreker Corporation is a company that provides technology and services to the largest banks in the United States and many banks outside the United States, primarily in English-speaking countries. We provide technology to banks primarily in the check processing or the payments processing space. We also provide revenue-enhancing, best-practices consulting to the top 200 banks in the United States and a number of large banks internationally, and we provide consulting services to help banks consolidate or to integrate new, large technology infrastructure.

The company is 24 years old and has headquarters in Dallas; we have about 650 employees. In addition to me, the management of the company includes Mike Hansen as President and COO and Terry Gage as CFO. We have other people in charge of our Global Solutions Group, our Revenue Enhancement Group and our Enterprise Solutions Group, which is the consulting arm. Then we have administrative and sales management.

TWST: What are you hearing from your customer base as far as what they're trying to do with their own pocketbooks and how that might impact your relationships with them at Carreker?

Mr. Carreker: To grow at double-digit numbers puts a lot of pressure on our customers, both from a revenue standpoint and an expense-saved standpoint. The larger clients that we serve are very much under that pressure.

So when we go in with our value-priced, or contingency-based, revenue-enhancing consulting practice, we find a high level of receptivity there because it's basically a no-lose situation for them. We bring them new ideas that allow them to increase their revenues and we only get paid to the extent that they approve and implement those ideas. It's been a successful offering on our part, and it's been very profitable for our company because of the value of the ideas we can bring to the customer.

The next thing that they're really focused on is driving expenses down. In this area, we help with operations design, consulting

and integration where we compete with accounting firms and other IT integration companies. We also provide significant support with our technology applications in the payments-processing space. So we have rich business-case driven technologies that help them with fraud mitigation, cash management, management of their relationship with the Federal Reserve and other customers, as well as imaging — or converting paper to electronics — where we have a number of different applications.

TWST: Do you find that your customers are receptive at this point to the products and services that Carreker is offering?

Mr. Carreker: Yes. Banks over the last year have gone through a lot of questioning of themselves relative to their IT spending results, and so in that case they're much more cautious and deliberate than they used to be. The good news is that our revenue enhancement business, as I said, is contingent driven and the banks are very aggressively searching for revenue. So that is a very good business model for us to market to that high demand area.

“We’ve been especially aggressive about positioning ourselves internationally. We’ve had great success there in terms of year-over-year growth rates. We’re also going to Tier 3 banks, where our footprint is still small, but we’re doubling revenue year over year in those markets.”

Likewise, on the technology side, banks basically are in the payments infrastructure business. About 40% of the top 25 bank holding companies' operating income is payment related. It's about a \$200 billion business in the United States, for example. Banks have to continue to invest in high ROI technologies if they're going to remain competitive.

TWST: What are you seeing as the competitive landscape?

Mr. Carreker: Our view is that as the banks we serve have increasingly come under cost-reduction pressures, they have basically thinned down in terms of their internal bandwidth, so it's important for us to bring in new technologies or bring in new revenue-enhancing ideas, and to be able to wrap that technology with whatever level of service is required to implement them successfully in the bank. We very seldom sell technology without installation support and, increasingly, consulting support.

Likewise, on the revenue-enhancing side, we ask our clients what they believe are the things they have to do to reap value from these revenue-enhancing ideas. Oftentimes, they benefit from our bringing in either technology or consulting to help them reap value more quickly.

So it is really a very complementary model, and I think that's evidenced by other larger companies that are embracing the same model.

TWST: How does consolidation within the banking industry impact what you're doing?

Mr. Carreker: It has good and bad impact. When a bank goes into a major merger, they basically go into a several-month period of defining who's going to be in charge and what their priorities will be. So it creates confusion around our sales activities.

Conversely, when a bank acquires another bank, they have an opportunity to take a one-time cost charge and so it creates a rich environment where they can migrate to best-of-class technology infrastructure. They want to embrace things that will allow them to hit a real cost-effective burn rate from an operating standpoint, very quickly and with minimal risk of failure. So it's a very rich climate to sell into. We have typically, with our larger clients, had rich experiences with them once they did an acquisition. That's kind of the good and the bad of the large bank acquisitions.

By and large, for our market, there are more banks aggregating into our economic space, which is about \$1 billion and above

in assets, than there are banks consolidating within that segment. Our market's actually getting larger because smaller banks below our economic space are aggregating into that market.

TWST: I was reading about your fraud detection products. I would think that at this point, the banking industry and the financial services industry are pretty well focused on preventing fraud or identifying fraud. It strikes me as interesting that there's still a lot of opportunity for a company to grow within that space.

Mr. Carreker: It's actually big and getting bigger, both within banks and certainly with their customers. Going forward, there is a major opportunity for us because we dominate the protective technology used to mitigate fraud on demand-deposit accounts. We dominate that market. What we're attempting to do is to enrich that offering even more by promoting data sharing among our customers, and pulling in other information that's available in the industry to improve the ability of a bank to mitigate additional fraud. It's a very rich, very high ROI kind of an area to be working in.

If you look at retailers or any customers of banks, banks have pretty much left this market historically to other companies that do check guarantee or check authorization, for example. The dollars spent there make it an enormous business.

What we are attempting to do is to enrich our bank clients with information that will in turn position them to incorporate fraud

mitigation or check payment guarantee with their payment offerings as they attempt to redefine their relationships with their customers. Of course, what we're trying to do there is become the company inside the solution offering that they make available to their customers, which gets us into all new vertical industries in addition to banking, but through the banks themselves as opposed to around the banks or selling directly to the other verticals.

TWST: What have been the barriers to getting your top line growth to flow to the bottom line, and what are you doing actively to increase the positive aspects of the bottom line at this point?

Mr. Carreker: Last year was a very difficult year for most businesses. It was also a difficult time for us. We had some management changes at the very top. We had some market disruption issues that we had to deal with. We had legal issues that we had to deal with. We had right-sizing issues around IT spending that we had to deal with. So we had a number of things in FY 2001 Q2 and Q3 and then getting them into alignment in Q4 that we dealt with successfully. Coming into this year, we actually entered the year at about a \$16 million annualized cost run rate below where we were last year during the third quarter.

In that process we have assimilated and integrated Check Solutions, which was a very important and large acquisition for us. It was about a \$110 million acquisition, with about \$50 million to \$60 million of revenue. The reason that acquisition was so important is that it increased our management strength, our technology capabilities and made us the largest technology player in our space, so it gave us some market advantages as well. We fully integrated Check Solutions into Carreker's operations in 2001.

“Banks are a priority and a very fortuitous market for us to be focused on. We believe as e-commerce and electronification of payments occur, the banking industry will be favored by regulation, favored by investment, favored by the number of customers it deals with.”

Rolling into 2002, we are well positioned to grow our margin back to the historical rates that we had before 2001. Now what we're doing is focusing on the strategic initiatives necessary to accelerate top-line growth.

TWST: Where are those investments focused?

Mr. Carreker: As you can imagine, when we brought in Check Solutions, we doubled our technology footprint, and their solutions and ours were not integrated. What we're attempting to do right now is to integrate those solutions, identify where we have gaps, build those out, and leverage the fact that a bank will probably have to deal with five or 10 different vendors if it chooses not to partner with us.

What we're trying to do is to make it increasingly valuable for a bank to partner with us because we can increase our

wins, increase our business case to make decisions, and move forward with image-processing technology. Very much now, it's about product improvement, product fill-out, taking the larger business case, causing more to be spent and increasing the win rate on the spend that banks have. To that end, we're expanding our consulting practice to include more strategic consulting where we're able to help banks rationalize their vision for the next three to five years and incorporate an understanding and appreciation for what we have to bring them as a partner, so that those things are integrated.

The other thing we're doing to grow revenues is going into new markets. We've been especially aggressive about positioning ourselves internationally. We've had great success there in terms of year-over-year growth rates. We're also going to Tier 3 banks, where our footprint is still small, but we're doubling revenue year over year in those markets.

TWST: Have there been any “for cause” customer defections? Any reasons to anticipate that you lose some as you win some?

Mr. Carreker: We hardly ever would be in a position to lose a customer. Probably 90% of our revenue this year will come from customers that we did business with last year, so a very small percentage of our revenue actually comes from new customers. We basically hold on to old customers and continue to cross-sell the relationships that we have.

If we were to lose something with a customer — and we do, obviously — we might lose a consulting project, but continue the other eight things we're doing. We'd lose a particular software sale, but con-

tinue the other four sales that we have in maintenance revenue streams we enjoy, and so on. So we don't lose customers. We have a relationship management infrastructure in place that is focused on broadening and enriching the value proposition we bring to our customers.

TWST: Is this a good environment for Carreker to participate in M&A activities?

Mr. Carreker: Yes, it really is, and in a couple of different directions. One is for us to broaden our value proposition. Again, since we basically grow by increasing the value and scope of what we bring to our existing customer base, we're an excellent channel for new products, new ideas. So we become an outstanding partner for companies that grow and develop new, important value propositions but don't have the market presence, don't have the go-to-mar-

ket strength that we do. We're viewed well by a number of companies in that regard.

The other thing we're really excited about is a concept called "strategic sourcing," where banks will increasingly outsource functions where they can create scale or added value by forming new entities that they own a piece of as opposed to 100% of the functionality. We are well positioned to become a design technology partner/facilitator for the creation of these new companies. So that's a form of acquisition because typically we'll end up with a percent ownership.

Conversely, as banks start to break down the walls that separate them from their customers electronically, we want to be the company inside that they take to their markets as they attempt to in-source and redefine functional relationships with customers. Again, that's another form of acquisition or alliance.

TWST: Are your accounting practices and balance sheet pretty straightforward or plain vanilla as far as any of the questions that have been leveled at public companies recently by analysts and investors?

Mr. Carreker: We're somewhat complicated for our investors to understand because we have different revenue models. We have contingent revenue models. We have time and materials. We have license fees. We have recurring maintenance-related revenue streams, which are growing, by the way. While we have that complexity, as far as GAAP practices and quality of numbers, we're straightforward there, on purpose, and also just the nature of our business lends itself to clarity and transparency.

TWST: Have there been any criticisms from analysts and investors on the business model or the strategies that you've had to address?

Mr. Carreker: The primary concern that they've brought up, in this uncertain economic climate and with so many companies having visibility issues and disappointing guidance, has been our predictability, say two to four quarters in the future. What we're working on aggressively there is metrics around our pipeline — how big a pipeline do we have, where are the deals in the sales cycle, are they maturing through the sales cycles. So we can increase our confidence level and our ability to communicate to the analysts about what we believe will be happening at Carreker and its impact on financial results in the near future.

The other thing we're doing is that we are growing our recurring revenues. Maintenance revenues, as I mentioned earlier, have gone up from about \$10 million to \$12 million in FY 2000 to \$40 million projected this year. The numbers are growing significantly there.

TWST: Is there any new technology that you'd like to highlight?

Mr. Carreker: The huge thing that is really gaining exponential momentum for us and that we're very proud of is the technology that we call imaging technology. This is basically the ability

to scan or read paper, or checks, and convert it to digital form. We dominate that space.

Just recently, in the last two quarters, several major banks have made multi-million-dollar investments in imaging technology, which is a \$100-million-to-\$200-million-a-bank kind of infrastructure build out. That momentum and our uniqueness there, in terms of the scope of our position and the quality of our clients and how we're regarded, positions us well to ride that technology curve.

TWST: What would be the three or four key summary points that would compel an investor to buy in today?

Mr. Carreker: I think there would be several things. First I'd say that our company is 24 years old, and we've gone through multiple stages of growth as a company. Coming into last year, we had six years of consistent quarter-over-quarter, year-over-year top-line growth, with an expanding bottom-line margin. We have a real history of excellence in performing for the investor.

Last year we had some tough times, some tough issues to deal with. We believe we've recaptured our historical capability and are applying the same disciplines we applied before to improve our business predictability going forward. That would be one thing — the solid management and accounting practices, business management practices.

From a strategic positioning standpoint, a second thing would be that banks are a priority and a very fortuitous market for us to be focused on. We believe as e-commerce and electronification of payments occur, the banking industry will be favored by regulation, favored by investment, favored by the number of customers it deals with. And as a company that serves those banks from inside, we think we're well positioned to play out that advantage. We believe we have a great growth position for future years.

The third point would be how we're positioned functionally to perform against that. The Check Solutions acquisition improved our management and technology capabilities and gave us a really unique technology footprint. That, combined with our revenue-enhancement solution, positions us well, we believe, to go forward.

TWST: Thank you. (DWA)

J.D. (DENNY) CARREKER, JR.

Chairman & CEO

Carreker Corporation

4055 Valley View Lane

Suite 1000

Dallas, TX 75244

(972) 458-1981

(972) 701-0758 - FAX

www.carreker.com