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DELUXE CORP

Form 10-Q

July 27, 2018

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or  
15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2018  
Transition Report Pursuant to Section 13 or  
15(d) of the Securities Exchange Act of 1934**

**For the transition period from  
\_\_\_\_\_ to  
\_\_\_\_\_**

**Commission file number: 1-7945**

**DELUXE CORPORATION**

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

**Minnesota**

**(State or other jurisdiction of incorporation or organization)**

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

**(Address of principal executive offices)**

**41-0216800**

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

**55126-2966**

**(Zip Code)**

**(651) 483-7111**

(Registrant's telephone number, including area code)

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

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

Yes  No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

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

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

Yes  No

The number of shares outstanding of registrant's common stock, par value \$1.00 per share, as of July 18, 2018 was 47,622,187.

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

(in thousands, except share par value)

(Unaudited)

	<b>June 30, 2018</b>	<b>December 31, 2017</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$68,594	\$ 59,240
Trade accounts receivable, net of allowances for uncollectible accounts	131,132	149,844
Inventories and supplies	43,233	42,249
Funds held for customers	92,606	86,192
Other current assets	73,839	55,441
Total current assets	409,404	392,966
Deferred income taxes	1,778	1,428
Long-term investments	43,172	42,607
Property, plant and equipment (net of accumulated depreciation of \$363,143 and \$358,020, respectively)	81,751	84,638
Assets held for sale	3,822	12,232
Intangibles (net of accumulated amortization of \$497,117 and \$444,933, respectively)	386,143	384,266
Goodwill	1,173,475	1,130,934
Other non-current assets	193,699	159,756
Total assets	\$2,293,244	\$ 2,208,827
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$105,281	\$ 104,477
Accrued liabilities	245,719	277,253
Long-term debt due within one year	765	44,040
Total current liabilities	351,765	425,770
Long-term debt	766,039	665,260
Deferred income taxes	55,828	50,543
Other non-current liabilities	44,476	52,241
Commitments and contingencies (Notes 11 and 12)		
Shareholders' equity:		
Common shares \$1 par value (authorized: 500,000 shares; outstanding: June 30, 2018 – 47,623; December 31, 2017 – 47,953)	47,623	47,953
Retained earnings	1,076,683	1,004,657
Accumulated other comprehensive loss	(49,170	) (37,597
Total shareholders' equity	1,075,136	1,015,013
Total liabilities and shareholders' equity	\$2,293,244	\$ 2,208,827

See Condensed Notes to Unaudited Consolidated Financial Statements

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

(in thousands, except per share amounts)

(Unaudited)

	<b>Quarter Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Product revenue	\$359,935	\$363,641	\$723,342	\$735,815
Service revenue	128,309	121,591	256,816	237,183
Total revenue	488,244	485,232	980,158	972,998
Cost of products	(134,332 )	(130,728 )	(267,703 )	(263,260 )
Cost of services	(55,869 )	(48,640 )	(111,256 )	(95,422 )
Total cost of revenue	(190,201 )	(179,368 )	(378,959 )	(358,682 )
Gross profit	298,043	305,864	601,199	614,316
Selling, general and administrative expense	(209,585 )	(208,656 )	(420,739 )	(425,800 )
Net restructuring charges	(5,635 )	(1,427 )	(7,780 )	(2,441 )
Asset impairment charges	—	(2,954 )	(2,149 )	(8,250 )
Operating income	82,823	92,827	170,531	177,825
Interest expense	(6,130 )	(5,258 )	(11,708 )	(10,087 )
Other income	2,436	1,250	3,724	2,312
Income before income taxes	79,129	88,819	162,547	170,050
Income tax provision	(18,922 )	(29,240 )	(39,003 )	(53,405 )
Net income	\$60,207	\$59,579	\$123,544	\$116,645
Comprehensive income	\$57,272	\$61,190	\$118,838	\$119,438
Basic earnings per share	1.26	1.23	2.58	2.40
Diluted earnings per share	1.25	1.22	2.56	2.38
Cash dividends per share	0.30	0.30	0.60	0.60

See Condensed Notes to Unaudited Consolidated Financial Statements

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

(in thousands)

(Unaudited)

	Common shares	Common shares par value	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total
Balance, December 31, 2017	47,953	\$47,953	\$ —	\$1,004,657	\$ (37,597 )	\$1,015,013
Net income	—	—	—	123,544	—	123,544
Cash dividends	—	—	—	(28,804 )	—	(28,804 )
Common shares issued	490	490	16,677	—	—	17,167
Common shares repurchased	(573 )	(573 )	(4,876 )	(34,547 )	—	(39,996 )
Other common shares retired	(247 )	(247 )	(17,579 )	—	—	(17,826 )
Employee share-based compensation	—	—	5,778	—	—	5,778
Adoption of Accounting Standards Update No. 2014-09 (Note 2)	—	—	—	4,966	—	4,966
Adoption of Accounting Standards Update No. 2018-02 (Note 2)	—	—	—	6,867	(6,867 )	—
Other comprehensive loss	—	—	—	—	(4,706 )	(4,706 )
Balance, June 30, 2018	47,623	\$47,623	\$ —	\$1,076,683	\$ (49,170 )	\$1,075,136

See Condensed Notes to Unaudited Consolidated Financial Statements

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

(in thousands)

(Unaudited)

**Six Months Ended**

**June 30,**

**2018            2017**

Cash		
flows		
from		
operating		
activities:		
Net	\$123,544	\$116,645
income		
Adjustments		
to		
reconcile		
net		
income		
to		
net		
cash		
provided		
by		
operating		
activities:		
Depreciation	8,223	
Amortization		
of	5,694	51,828
intangibles		
Asset		
impairment	8,250	
charges		
Amortization		
of		
product	1,124	9,588
discounts		
Deferred		
income	(2,747)	(6,942)
taxes		
Employee		
share-based	5,757	7,309
compensation		
expense		
Other		
non-cash	(7,543)	(2,983)
items,		
net		

Changes  
in  
assets  
and  
liabilities,  
net  
of  
effect  
of  
acquisitions:  
Trade  
receivable  
15,401  
Inventories  
and  
supplies  
637  
Other  
current  
assets  
(2,779 )  
Non-current  
assets  
(1,776 )  
Accounts  
payable  
(12,063 )  
Prepaid  
product  
discount  
payments  
(10,937 )  
Other  
accrued  
non-current  
liabilities  
(28,823 )  
Net  
cash  
provided  
by  
operating  
activities  
151,578  
Cash  
flows  
from  
investing  
activities:  
Purchases  
of  
capital  
assets  
(22,788 )  
Payments  
for  
acquisitions,  
net



of  
cash  
acquired  
Proceeds  
from  
sales  
of 3,500  
of  
marketable  
securities  
Other 739  
Net  
cash  
used  
(117,563 ) (96,102 )  
by  
investing  
activities  
Cash  
flows  
from  
financing  
activities:  
Proceeds  
from  
issuance  
of 168,000  
long-term  
debt  
Payments  
on  
(851,410 ) (207,052 )  
long-term  
debt  
Proceeds  
from  
issuing  
5,763 5,914  
under  
employee  
plans  
Employee  
taxes  
paid  
(7,947 ) (5,572 )  
for  
shares  
withheld  
Payments  
for  
(30,068 ) (30,068 )  
shares  
repurchased  
(28,762 ) (29,156 )  
Cash  
dividends  
paid

to  
shareholders  
(1,021 ) (511 )  
Net  
cash  
used  
(18,269 ) (98,445 )  
by  
financing  
activities  
Effect  
of  
exchange  
rate  
(1,750 ) 1,175  
change  
on  
cash  
Net  
change  
in  
cash  
and  
cash  
equivalents  
Cash  
and  
cash  
equivalents, 76,574  
beginning  
of  
year  
Cash  
and  
cash  
equivalents, \$34,780  
end  
of  
period

See Condensed Notes to Unaudited Consolidated Financial Statements

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

**Note 1: Consolidated financial statements**

The consolidated balance sheet as of June 30, 2018, the consolidated statements of comprehensive income for the quarters and six months ended June 30, 2018 and 2017, the consolidated statement of shareholders' equity for the six months ended June 30, 2018, and the consolidated statements of cash flows for the six months ended June 30, 2018 and 2017 are unaudited. The consolidated balance sheet as of December 31, 2017 was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles (GAAP) in the United States of America. In the opinion of management, all adjustments necessary for a fair statement of the consolidated financial statements are included. Adjustments consist only of normal recurring items, except for any discussed in the notes below. Interim results are not necessarily indicative of results for a full year. The consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q and do not contain certain information included in our annual consolidated financial statements and notes. The consolidated financial statements and notes appearing in this report should be read in conjunction with the consolidated audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K").

**Note 2: New accounting pronouncements**

The following discusses the impact of each accounting standards update (ASU) adopted on January 1, 2018:

*ASU No. 2014-09* – In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The standard provides revenue recognition guidance for any entity that enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets, unless those contracts are within the scope of other accounting standards. In addition, the FASB subsequently issued several amendments to the standard. We adopted the standard and all the related amendments on January 1, 2018 using the modified retrospective method. We applied the new guidance to uncompleted contracts as of January 1, 2018 and recorded the cumulative effect of initially applying the standard as an adjustment to retained earnings, with the offset to other current assets, other non-current assets and deferred income tax liabilities. We have elected the practical expedient for contract modifications, allowing us to consider the impact of all contract modifications completed prior to January 1, 2018. We have also elected the practical expedient that allows us to disregard the effects of a financing component if the period between payment and performance will be 1 year or less. Election of these practical expedients did not have a significant impact on our results of operations or financial position. Prior periods have not been restated and continue to be reported under the accounting standards in effect for those periods. We do not expect the adoption of this guidance to have a material impact on our results of operations, financial position or cash flows on an ongoing basis. The new guidance also expands the required financial statement disclosures regarding revenue recognition. Those disclosures appear below, while information regarding the disaggregation of revenue can be found in Note 14.

Our product revenue is recognized when control of the goods is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods. In most cases, control is transferred when products are shipped. We recognize the vast majority of our service revenue as the services are provided. Many of our check supply contracts with financial institutions provide for rebates on certain products. We record these rebates as reductions of revenue and as accrued liabilities on our consolidated balance sheets when the related revenue is recognized. Many of our financial institution contracts also require prepaid product discounts in the form of upfront cash payments we make to our financial institution clients. These prepaid product discounts are included in other non-current assets in our consolidated balance sheets and are amortized as reductions of revenue, generally on the

straight-line basis, over the contract term. Sales tax collected concurrent with revenue-producing activities is excluded from revenue. Amounts billed to customers for shipping and handling are included in revenue, while the related shipping and handling costs are reflected in cost of products. We have elected the practical expedient that allows us to account for shipping and handling activities that occur after the customer has obtained control of a good as a fulfillment cost, and we accrue costs of shipping and handling when the related revenue is recognized. As part of our Financial Services rewards, incentive and loyalty programs, we receive payments from consumers or our clients for the products and services provided, including hotel stays, gift cards and merchandise, such as apparel, electronics and clothing. This revenue is recorded net of the related fulfillment costs.

Certain of our contracts for data-driven marketing solutions and treasury management outsourcing services within Financial Services have variable consideration that is contingent on either the success of the marketing campaign ("pay-for-performance") or the volume of outsourcing services provided. We recognize revenue for estimated variable consideration as

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

services are provided based on the most likely amount to be realized. Revenue is recognized to the extent that it is probable that a significant reversal of revenue will not occur when the contingency is resolved. Estimates regarding the recognition of variable consideration are updated each quarter. Typically, the amount of consideration for these contracts is finalized within 3 months, although pricing under certain of our outsourcing contracts may be based on annual volume commitments. Revenue recognized from these contracts was approximately \$100,000 in 2017. Under the new standard, we have accelerated the recognition of a portion of this variable consideration.

Certain of our contracts for treasury management solutions result from the sale of bundled arrangements that may include hardware, software and professional services, as well as customization and modification of software, and specify the timing of customer billings over the course of the contract. Revenue for these contracts is recognized using a cost-based input method that depicts the transfer of services to the customer. The transaction price is allocated to each performance obligation based on its relative standalone selling price. We generally determine standalone selling prices based on the prices charged to customers or using expected cost plus margin. When the revenue recognized for uncompleted contracts exceeds the amount of customer billings, a contract asset is reflected in our consolidated balance sheets within other current assets. The amount included in other current assets was \$31,955 as of June 30, 2018 and \$16,379 as of December 31, 2017. When the amount of customer billings for uncompleted contracts exceeds the revenue recognized, a contract liability is reflected in our consolidated balance sheets within accrued liabilities. The amount included in accrued liabilities was \$1,509 as of June 30, 2018 and \$2,233 as of December 31, 2017.

At times, a financial institution client may terminate its check supply contract with us prior to the end of the contract term. In many cases, the financial institution is contractually required to remit a contract termination payment. Such payments are recorded as revenue when the termination agreement is executed, provided that we have no further performance obligations and collection of the funds is assured. If we have further performance obligations following the execution of a contract termination agreement, we record the related revenue over the remaining service period.

Our payment terms vary by type of customer and the products or services offered. The time period between invoicing and when payment is due is not significant. For certain products or services and customer types, we require payment before the products or services are delivered to the customer. When a customer pays in advance for services, primarily for treasury management solutions and web hosting services, we defer the revenue and recognize it as the services are performed, generally over a period of less than 1 year. Deferred revenue is included in accrued liabilities and other non-current liabilities in our consolidated balance sheets. The decrease of \$4,308 in deferred revenue for the six months ended June 30, 2018 was primarily driven by the recognition of \$32,221 of revenue that was included in deferred revenue as of December 31, 2017, partially offset by cash payments received in advance of satisfying our performance obligations. In addition to the amounts included in deferred revenue, we will recognize revenue in future periods related to remaining performance obligations for certain of our data-driven marketing and treasury management solutions. Generally, these contracts have terms of 1 year or less and many have terms of 3 months or less. The amount of revenue related to these unsatisfied performance obligations is not significant to our annual consolidated revenue.

The new guidance requires that certain costs incurred to obtain contracts be recognized as assets and amortized consistent with the transfer of goods or services to the customer. As such, we are now deferring sales commissions related to obtaining check supply and treasury management solution contracts within Financial Services. These amounts are included in other non-current assets and are amortized as selling, general and administrative (SG&A) expense. Amortization of these amounts on the straight-line basis approximates the timing of the transfer of goods or services to the customer. Generally, these amounts are being amortized over periods of 3 to 6 years. We elected the practical expedient allowing us to expense sales commissions as incurred when the amortization period would have been 1 year or less.



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

The cumulative effect of the changes made to our unaudited consolidated balance sheet as of January 1, 2018 for the adoption of the new revenue guidance was as follows:

(in thousands)	<b>Balance as of December 31, 2017</b>	<b>Adjustments due to ASU No. 2014-09</b>	<b>Balance as of January 1, 2018</b>
Other current assets	\$55,441	\$ 960	\$56,401
Total current assets	392,966	960	393,926
Other non-current assets	159,756	5,733	165,489
Total assets	\$2,208,827	\$ 6,693	\$2,215,520
Deferred income taxes	\$50,543	\$ 1,727	\$52,270
Retained earnings	1,004,657	4,966	1,009,623
Total liabilities and shareholders' equity	\$2,208,827	\$ 6,693	\$2,215,520

The impact of adoption of the new revenue guidance on our unaudited consolidated statements of comprehensive income for the quarter and six months ended June 30, 2018 and on our unaudited consolidated balance sheet as of June 30, 2018 was as follows:

(in thousands)	<b>As reported</b>	<b>Effect of adoption</b>	<b>Balance without adoption of ASU No. 2014-09</b>
	<b>Quarter Ended June 30, 2018</b>		
Service revenue	\$128,309	\$(33 )	\$128,276
Total revenue	488,244	(33 )	488,211
Cost of services	(55,869 )	129	(55,740 )
Total cost of revenue	(190,201 )	129	(190,072 )
Gross profit	298,043	96	298,139
Selling, general and administrative expense	(209,585 )	(1,567 )	(211,152 )
Operating income	82,823	(1,471 )	81,352
Income before income taxes	79,129	(1,471 )	77,658
Income tax provision	(18,922 )	380	(18,542 )
Net income	\$60,207	\$(1,091 )	\$59,116
	<b>Six Months Ended June 30, 2018</b>		
Service revenue	\$256,816	\$(568 )	\$256,248
Total revenue	980,158	(568 )	979,590
Cost of services	(111,256 )	384	(110,872 )
Total cost of revenue	(378,959 )	384	(378,575 )
Gross profit	601,199	(184 )	601,015
Selling, general and administrative expense	(420,739 )	(1,051 )	(421,790 )
Operating income	170,531	(1,235 )	169,296
Income before income taxes	162,547	(1,235 )	161,312
Income tax provision	(39,003 )	319	(38,684 )

Net income

\$123,544 \$ (916 ) \$122,628

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

(in thousands)	<b>As reported</b>	<b>Effect of adoption</b>	<b>Balance without adoption of ASU No. 2014-09</b>
	<b>June 30, 2018</b>		
Other current assets	\$73,839	\$(1,146 )	\$72,693
Total current assets	409,404	(1,146 )	408,258
Other non-current assets	193,699	(6,783 )	186,916
Total assets	\$2,293,244	\$(7,929 )	\$2,285,315
Accrued liabilities	245,719	(319 )	245,400
Total current liabilities	351,765	(319 )	351,446
Deferred income taxes	55,828	(1,727 )	54,101
Retained earnings	1,076,683	(5,883 )	1,070,800
Total liabilities and shareholders' equity	\$2,293,244	\$(7,929 )	\$2,285,315

*ASU No. 2016-01* – In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The standard is intended to improve the recognition, measurement, presentation and disclosure of financial instruments. We adopted this standard on January 1, 2018. This standard had no impact on our results of operations or financial position. Our financial statement disclosures in Note 7 related to financial instruments have been modified to comply with the new standard.

*ASU No. 2016-16* – In October 2016, the FASB issued ASU No. 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*. The standard requires recognition of the tax effects resulting from the intercompany sale of an asset when the transfer occurs. Previously, the tax effects were deferred until the transferred asset was sold to a third party. We adopted this standard on January 1, 2018. No adjustment was required to opening retained earnings, and we do not expect the application of this standard to have a significant impact on our results of operations or financial position going forward.

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

*ASU No. 2017-07* – In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The standard requires that the service cost component of net periodic benefit expense be recognized in the same statement of comprehensive income caption(s) as other compensation costs, and requires that the other components of net periodic benefit expense be recognized in the non-operating section of the statement of comprehensive income. In addition, only the service cost component of net periodic benefit expense is eligible for capitalization when applicable. We adopted this standard on January 1, 2018. The reclassification of the other components of our net periodic benefit income was applied on a retrospective basis. As such, we have revised our results of operations for previous periods. We utilized the practical expedient for adoption allowing us to use the amount previously disclosed in our postretirement benefits footnote as the basis for revising prior periods. As there is no service cost associated with our plans, we reclassified the entire amount of our net periodic benefit income from cost of revenue and SG&A expense to other income in our consolidated statements

of comprehensive income. In addition, we no longer include any portion of net periodic benefit income in amounts capitalized for inventory or internal-use software, as only the service cost component is eligible for capitalization. This change did not have a significant impact on our results of operations or financial position.

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

The impact of the revision on our unaudited consolidated statements of comprehensive income for the quarter and six months ended June 30, 2017 was as follows:

(in thousands)	<b>As previously reported</b>	<b>Effect of adoption</b>	<b>As revised</b>
	<b>Quarter Ended June 30, 2017</b>		
Cost of products	\$(130,591 )	\$ (137 )	\$(130,728 )
Cost of services	(48,623 )	(17 )	(48,640 )
Total cost of revenue	(179,214 )	(154 )	(179,368 )
Selling, general and administrative expense	(208,306 )	(350 )	(208,656 )
Operating income	93,331	(504 )	92,827
Other income	746	504	1,250
Net income	\$59,579	\$ —	\$59,579
	<b>Six Months Ended June 30, 2017</b>		
Cost of products	\$(262,986 )	\$ (274 )	\$(263,260 )
Cost of services	(95,388 )	(34 )	(95,422 )
Total cost of revenue	(358,374 )	(308 )	(358,682 )
Selling, general and administrative expense	(425,100 )	(700 )	(425,800 )
Operating income	178,833	(1,008 )	177,825
Other income	1,304	1,008	2,312
Net income	\$116,645	\$ —	\$116,645

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

*ASU No. 2018-02* – In February 2018, the FASB issued ASU No. 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The standard allows companies to make an election to reclassify from accumulated other comprehensive income to retained earnings the stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the "2017 Act"). We elected to early adopt this standard on January 1, 2018, applying it in the period of adoption. As such, a reclassification from accumulated other comprehensive loss to retained earnings of \$6,867 was recorded during the quarter ended March 31, 2018. This represents the effect of the change in the United States federal corporate income tax rate on the gross deferred tax amount at the date of enactment of the 2017 Act related to items remaining in accumulated other comprehensive loss. Our policy is to release stranded income tax effects from accumulated other comprehensive loss when the circumstances upon which they are premised cease to exist.

In March 2018, the FASB issued ASU No. 2018-05, *Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 118*. The standard added to the FASB Codification the guidance provided by the SEC in December 2017 regarding the accounting for the 2017 Act. We complied with SAB No. 118 when preparing our annual consolidated financial statements for the year ended December 31, 2017. Reasonable estimates were used in determining several of the components of the impact of the 2017 Act, including our 2017 deferred income tax activity

and the amount of post-1986 foreign deferred earnings subject to the repatriation toll charge. We are still analyzing certain aspects of the 2017 Act and refining our calculations, which could potentially affect the measurement of our deferred tax balances and the amount of the repatriation toll charge liability, and ultimately cause us to revise our initial estimates in future periods. In addition, changes in interpretations, assumptions and guidance regarding the 2017 Act, as well as the potential for technical corrections, could have a material impact on our effective tax rate in future periods. During the quarter ended June 30, 2018, we recorded an increase in income tax expense of \$441 as we refined our accounting for the 2017 Act, and during the six months ended June 30, 2018, we recorded an increase in income tax expense of \$131.

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

In order to complete our accounting for the 2017 Act, which we expect to finalize by the fourth quarter of 2018, the following specific items need to be completed or addressed:

- issuance of state-by-state guidance regarding conformity with or decoupling from the 2017 Act;
- finalize the calculation of post-1986 foreign deferred earnings, which are subject to the repatriation toll charge, and determine our ability to beneficially claim a foreign tax credit resulting from the income inclusion; and
- where pertinent, adjust to clarifications and guidance regarding other aspects of the 2017 Act, including those related to the deductibility of executive compensation.

*Accounting pronouncements not yet adopted* – In February 2016, the FASB issued ASU No. 2016-02, *Leasing*. The standard is intended to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities for virtually all leases and by requiring the disclosure of key information about leasing arrangements. In July 2018, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, which amends narrow aspects of the guidance in ASU No. 2016-02. Both standards are effective for us on January 1, 2019 and require adoption using a modified retrospective approach. We have established an implementation team to evaluate and identify the impact of the standard on our financial position, results of operations and cash flows. We are currently assessing our leasing arrangements, evaluating the impact of practical expedients and accounting policy elections, and implementing software to meet the reporting requirements of the standard. We are not able to quantify the impact of the standard at this time.

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

**Note 3: Supplemental balance sheet information**

*Allowance for uncollectible accounts* – Changes in the allowance for uncollectible accounts for the six months ended June 30, 2018 and 2017 was as follows:

	<b>Six Months</b>	
	<b>Ended</b>	
	<b>June 30,</b>	
(in thousands)	<b>2018</b>	<b>2017</b>
Balance, beginning of year	\$2,884	\$2,828
Bad debt expense	1,470	1,635
Write-offs, net of recoveries	(1,383 )	(1,346 )
Balance, end of period	\$2,971	\$3,117

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

	<b>June 30, December 31,</b>	
(in thousands)	<b>2018</b>	<b>2017</b>
Raw materials	\$7,131	\$ 7,357
Semi-finished goods	7,787	7,635
Finished goods	25,348	24,146

Supplies	2,967	3,111
Inventories and supplies	\$43,233	\$ 42,249

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

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

(in thousands)	<b>June 30, 2018</b>			
	<b>Cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Fair value</b>
Funds held for customers: <sup>(1)</sup>				
Domestic money market fund	\$10,000	\$ —	—\$ —	\$10,000
Canadian and provincial government securities	8,747	—	(464 )	8,283
Canadian guaranteed investment certificates	7,614	—	—	7,614
Available-for-sale debt securities	\$26,361	\$ —	—\$ (464 )	\$25,897

<sup>(1)</sup> Funds held for customers, as reported on the consolidated balance sheet as of June 30, 2018, also included cash of \$66,709.

(in thousands)	<b>December 31, 2017</b>			
	<b>Cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Fair value</b>
Funds held for customers: <sup>(1)</sup>				
Domestic money market fund	\$17,300	\$ —	—\$ —	\$17,300
Canadian and provincial government securities	9,051	—	(393 )	8,658
Canadian guaranteed investment certificates	7,955	—	—	7,955
Available-for-sale debt securities	\$34,306	\$ —	—\$ (393 )	\$33,913

<sup>(1)</sup> Funds held for customers, as reported on the consolidated balance sheet as of December 31, 2017, also included cash of \$52,279.

Expected maturities of available-for-sale debt securities as of June 30, 2018 were as follows:

(in thousands)	<b>Fair value</b>
Due in one year or less	\$20,588
Due in two to five years	3,578
Due in six to ten years	1,731
Available-for-sale debt securities	\$25,897

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

*Assets held for sale* – Assets held for sale as of June 30, 2018 included a provider of printed and promotional products, a small business distributor and a small business customer list. Assets held for sale as of December 31, 2017 included 2 providers of printed and promotional products, 1 of which was sold during the second quarter of 2018, and 2 small business distributors, 1 of which was sold during the first quarter of 2018. Also during the six months ended June 30, 2018, we sold certain small business customer lists that previously did not meet the requirements to be reported as assets held for sale in the consolidated balance sheets. We determined that the assets sold would be better positioned for long-term growth if they were managed by independent distributors. Subsequent to the sales, the businesses and customer lists are owned by distributors that are part of our Safeguard® distributor network. As such, our revenue is not impacted by these sales, and the impact to our costs is not significant. We entered into aggregate notes receivable of \$22,715 in conjunction with these sales (non-cash investing activity), and we recognized aggregate net gains within SG&A expense of \$3,862 during the quarter ended June 30, 2018 and \$11,089 during the