PARTICIPANTS

Corporate Participants

Veronica Rosa – Vice President-Communication & Investor Relations, USA Technologies, Inc.
Stephen P. Herbert – Chairman & Chief Executive Officer, USA Technologies, Inc.
David M. DeMedio – Chief Financial Officer, USA Technologies, Inc.

Other Participants

Gary F. Prestopino – Analyst, Barrington Research Associates, Inc.
Mike Latimore – Analyst, Northland Securities, Inc.
Alexander Renker – Analyst, Sidoti & Co. LLC
Gregg Hillman – Analyst, First Wilshire Securities Management, Inc.
William L. Florida – Analyst, Advisory Research, Inc.
Jim E. Gentrup – CFA, Founder, Senior Analyst, Discovery Investment Research

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen and welcome to USA Technologies First Quarter and Fiscal 2014 Earnings Conference Call. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] As a reminder, this call will be recorded.

I would now like to introduce your host for today's conference, Vice President of Investor Relations, Ms. Veronica Rosa. You may begin.

Veronica Rosa, Vice President-Communication & Investor Relations

Thank you, and good morning. Before beginning today's call, I would like to remind our listeners that all statements other than statements of historical facts included in this call are forward-looking statements. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including but not limited to, business, financial market and economic condition. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in our filings with the Securities and Exchange Commission including our most recent Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

Listeners are cautioned not to place undue reliance on any such forward-looking statements, which reflect management's view only as of the date they are made. USA Technologies undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

This call will also include a discussion of certain non-GAAP financial measures that we believe are useful for ongoing – understanding our ongoing operations. These non-GAAP financial measures are supplemental to and not a substitute for GAAP financial measures such as net income or loss. Details of these items and a reconciliation of these non-GAAP financial measures to GAAP financial measures can be found in our press release issued this morning and on the Investor Relations section of our website, usatech.com.

On our call this morning are Stephen Herbert, Chairman and Chief Executive Officer; and Dave DeMedio, Chief Financial Officer. We'll begin this morning with a first quarter business review by Steve, followed by a more detailed analysis of first quarter fiscal 2014 financial results by Dave. Steve will return for some brief closing remarks before we open the call up for questions.

At this point, I'm going to turn the call over to Steve. Please go ahead, Steve.

Stephen P. Herbert, Chairman & Chief Executive Officer

Thank you, and good morning, everyone. On our fourth quarter conference call held just six weeks ago, we talked about the multiple ways we're continuing to open up cashless adoption in a self-serve retail market, a market we estimate generates more than $120 billion in largely cash-based transactions today. We also talked about how steady progress in each of these areas might transfer to fiscal 2014 financial targets for the business, including a 25% to 30% growth in service revenues, a 20% to 25% growth in total revenues, 40% to 50% increase in adjusted EBITDA and a doubling of non-GAAP net income for fiscal 2014.

We also believe that as market dynamics continue to unfold, as we maintain our leadership position and given the size of the market relative to current penetration levels, that achieving a 0.5 million connections to our service is not unreasonable over the next three to four years. Under today's model, that would equate to about $100 million in revenues, double-digit operating margins, and given the fact that over 80% of our revenues are based upon our recurring revenue service base model, that would produce cash flows, which we believe would be of high value.

Our first quarter results reflect steady progress towards these strategic opportunities and financial targets. Our service revenues driven by connections to our ePort Connect service base increased by 23%, and total revenues were up 21% from the same period last year. Adjusted EBITDA of $1.5 million doubled from the same period last year.

We also continue to deliver a solid number of new connections to our service in the first quarter. 14,000 connections from a mix of vending, kiosk, amusement, commercial laundry and taxi and transportation customers, highlighting the versatility of our ePort Connect service platforms across multiple segments of the self-serve retail market. Compared to first quarter new connection activity in past years, we view that as a solid start.

Service fees grew year-to-year and sequentially despite the 11,000 deactivations to our service as noted on last quarter's call. So, while we don't like to lose connections to our service, I think the fact that we were able to post solid top line progress towards our fiscal 2014 growth targets, while also maintaining non-GAAP net income, really speaks to the resiliency of our service base business and how far that has developed in the past few quarters.

To capture the substantial industry and financial opportunities we see for USAT, our growth platforms are aligned around three major areas for fiscal 2014 and are essentially designed to drive an increasing number of connections to our service over the next several years. Those areas are: continued penetration of our existing customer base; strengthening our reach to adjacent self-serve retail markets such as commercial laundry, kiosk, amusement and taxi and transportation; and leveraging our ePort Connect service via QuickConnect with other industry developers and manufacturers in the self-serve retail market.

In addition, to benefit customers in all these areas, we continue to develop and bring to market value-added offerings that drive more value into every connection to our service. In fiscal 2013, we lay a lot of ground work in these areas. So our efforts in the first quarter of fiscal 2014 were focused on beginning to operationalize some of these opportunities while also adding more firepower to this effort primarily in terms of sales and marketing.

Total connections to our ePort service grew to 217,000 connections as of September 30, reflecting a 35% three-year compound annual growth rate. We also added 550 new customers to the ePort Connect service for a total of 5,600 as of September 30, a 65% three-year CAGR.

We're attracting customers from a broader range of industries and size now as opposed to prior years, particularly as we continue to develop our Inside Sales or [ph] SMB group (0:07:46). The growing interest by small to medium-sized customers sends another strong signal regarding adoption in the industry in my view as the smaller players begin to join in these market's cashless transition.

We achieved these important industry milestones we believe by making cashless easy, scalable, reliable and beneficial for our customers in self-serve retail. In vending for example, the value generated by our turnkey and comprehensive cashless and telemetry offerings has earned us what we understand to be the majority share of existing cashless connections. In vending alone, our customers range from global food service organizations such as Campus Canteen, ARAMARK, and Sodexo, a host of Pepsi and Coca-Cola bottlers as well as large and small self-serve retail business operators throughout the US.

We believe that these existing customers together constitute over $2 million potential connections to our service. So, there are more significant opportunity for near-term growth and connections. In the first quarter accordingly, these customers accounted for the majority of our new connections. Our goal therefore is to be assertive, to do all that we can to drive cashless penetration within these existing accounts.

Customers' specific performance data, for example, we believe is critical to this effort. With 200,000-plus self-serve retail locations and 5,600 customers, we're tracking cashless sales and cash sales, facilitating data feeds to logistics and fulfillment systems that today amounts to over 2 terabytes of information. We believe this information is a strategic – is a significant strategic advantage for USAT and one that will continue to leverage on behalf of our customers to make them more informed and successful as they transition to cashless.

In the first quarter, we continue to accelerate the rate at which we present customers' specific performance data on multiple levels from tailored emails to an enhanced online dashboard on our customer web portal USA Live to face-to-face consultation with customers. Consistent with our own knowledge based report issued in the spring, as we continue to consult with our customers to better understand their existing cashless platforms and the potential naturally for continued expansion of cashless, they're beginning to see and talk about the real benefits on their own.

Many are seeing a 20% to 30% uplift in revenues, sales volume and/or average spend as a result of cashless as they re-engage with currency-constrained consumers more successfully implement price increases and carry more targeted product. Ultimately, we anticipate that it will be about the power of Big Data in accelerating this emerging market, especially as loyalty program as loyalty offerings begin to collect new – even more valuable information about purchasing demographics and preferences from consumers.

During the first quarter, we officially kicked off our loyalty program called MORE as a value-added feature to our ePort Connect service. Customers were quick to sign up for MORE and many see it as a way – as a strategic tool to attract new accounts and/or retain existing accounts. For example, one customer is helping a business client reward employees for their use of company vending locations with discounts based on volume, et cetera. When you're disentrenched in your client's business, it's much harder to lose an account. We expect consumer engagement services like MORE to become increasingly valuable as both the facilitator too and benefactor from market adoption.

A great example of how we continue to leverage our market leadership and customer base is reflected I believe, in our recent announcement with USConnect. This commitment for 50,000 ePorts and corresponding connections to our ePort Connect service over the next five years is our largest customer commitment ever. USConnect is a consortium of roughly 25 independent vending operating companies and growing throughout the US, many of which are already on our service.

Perhaps more important, this group has indicated that they want to be 85% cashless in five years. So I think this is another great signal for others in the industry that could accelerate the mindset toward accelerated cashless adoption.

While our early wins and progress have largely been in vending, we believe there's considerable room for growth in adjacent self-serve retail market such as amusement, commercial laundry and kiosk. In addition to existing customers like AMI Entertainment or Starbucks, are other customers in these markets are in their early stages of cashless adoption and therefore well suited for USAT's market leading ePort Connect service.

To expand our sales reach in these areas, we've established a variety of new distribution relationships over the last several quarters. For example, last quarter, we launched a partnership with Setomatic Systems to further penetrate the $5 billion plus commercial laundry space. As part of this relationship, USAT exclusively provides the cashless payment services for Setomatic's SpyderWash cashless acceptance offering.

Last quarter, we transitioned their existing base of 5,000 cashless connections converting over 100 independent commercial laundry operators to our service in the process. In fiscal 2014, we're hoping to add several thousand more connections as a result of this relationship. And based on our first quarter performance, it looks like we're on track to do that.

In addition, our work with Betson Enterprises, a nationwide distributor to the amusement industry continues to lead to new connections in this $5 billion largely coin-op industry. Next week in fact, USAT will join Betson at this industry's more important trade event where our technology will be visible across the show floor with almost a dozen different customers.

In our first quarter, we extended our industry reach to the $11 billion taxi and transportation industry with our new ePort GO product. This industry is a mixture of cash and credit users with the latter using expensive and aging technology and expensive complex payment services that we believe can benefit from a mobile-based upgrade cycle.

ePort GO is a cost-effective mobile-based solution that handles all aspects of an operator's business processes, dispatching, trip management, record keeping, navigation, and payment.

It's easy to implement scalable and more cost effective than current solutions. In addition to several new customers already, ePort was the featured product in the Verizon Wireless booth at a major taxi and transportation show held in Boston. Verizon intends to make ePort GO available to its customers under our existing strategic partnership agreement.

In the first quarter, our work with ePort GO has also led to a major win in this segment using our web service QuickConnect, which leads us to our third growth plan. Our third growth plan is really about making the ePort Connect service the platform of choice among developers and manufacturers who need a self-serve retail payment solution that's easy to implement, scale and maintain.

Through our web service, QuickConnect, we made that easy on us and easy on them. QuickConnect is essentially a three-step process. The customer or developer downloads the API calls from the QuickConnect website, they incorporate the QuickConnect API calls and software into their self-serve retail application or device, and then we help them get the device or app certified on our ePort Connect service.

This area not only leverages our existing service infrastructure but also demonstrates our agility across industries and platforms. In addition, QuickConnect connections are very rarely require JumpStart funding as their primarily software base, thereby optimizing cash flow.

We have a host of other QuickConnect engagements going on that we believe hold promise for fiscal 2014. That said, during the first quarter, approximately 2,800 connections came from a mobile payment application we integrated for a new customer in the taxi and transportation industry, when they saw – what they saw with ePort GO and what they've learned about our turnkey comprehensive service platform ePort Connect.

In summary, we're driving growth, achieving important milestones with customers and strategic partners and we're using our increasing scale to strengthen our competitive edge and achieve more cost savings and added benefits for our customers.

With that, I'm going to turn the call over to our CFO, Dave DeMedio for some additional details relative to first quarter financials as well as the financial trends anticipated for the remainder of fiscal 2014. Dave?

David M. DeMedio, Chief Financial Officer

Thank you, Steve. First quarter results were essentially on track with our expectations with revenues coming in slightly higher than expected. License and transaction fees grew by 23% for the first quarter of fiscal 2014 and represented 84% of the total revenue mix for the quarter.

Equipment sales grew 9%, reflecting growth in both direct sales of ePorts and EnergyMiser products. Total revenues came in at $10.1 million, up 21% from the first quarter of fiscal 2013. Non-GAAP net income was approximately $75,000 for the first quarter, up from a non-GAAP net loss of approximately $96,000 in Q1 of last fiscal year. After dividends on our preferred shares which accrue twice a year, non-GAAP net loss applicable to common shareholders for the first quarter was approximately $258,000 or $0.01 per share.

As a reminder, an Excel file with these non-GAAP reconciliations is also posted on the IR page of our website www.usatech.com under Financial Information. GAAP net income which includes the fair value of warrant adjustment was approximately $300,000 for the first quarter of fiscal 2014, compared to net income of $39,000 for the comparable quarter in fiscal year 2013. After dividends on our preferred shares, GAAP net loss of applicable to common share holders for our fiscal 2014 first quarter was approximately $39,000 or zero cents per share.

As indicated last quarter, while we expect to achieve operating expansion over the course of fiscal 2014, we also said that the first quarter was going to pull back a bit before starting to work its way back up. There are several reasons for this, namely, the deactivation of devices we absorbed this quarter, timing of newly negotiated cost to services, reductions versus new pricing provided to key customers as well as our need to invest in sales, marketing and several other areas that form the basis of our fiscal year 2014 growth objectives.

Key drivers of our performance in the quarter included a strong fourth quarter of fiscal 2013 which produced 18,000 new connections to our service. There is a typical lag in terms of when new connections transfer to top line revenue with respect to license and transaction fees, and thereafter, as transaction volumes build on these devices. And second, the benefit of 14,000 gross connections in the first quarter. Of the 14,000 gross connections, we began to see diversity among industries and product lines consistent with our strategies to expand our reach into those areas.

Vending accounted for about 60%, commercial laundry 10%, transportation 20%, and all other including amusement and kiosk 10%. In addition, the mix of JumpStart to total gross connections of 14,000 was a low 37% in the first quarter as more connections were gained through software-based connections using our web service.

We've also introduced more purchasing alternatives that would send customers to purchase versus rent our hardware and those programs help shift connections away from JumpStart in the quarter. We also handled $67.9 million in small ticket transactions in the first quarter, a 35% increase over the prior year's quarter. Against those 14,000 new connections in the first quarter, we absorbed 11,000 deactivations from one customer as noted on last quarter's conference call for a net of 3,000 connections for the quarter.

This customer has been moving to a do-it-yourself solution, but still has connections with USAT. The most conservative approach to any risk assessment here would be that as of September 30, these connections represented approximately $1.6 million and license and transaction fee revenues for the remaining nine months of our fiscal year 2014 were approximately 3.5% of our fiscal 2014 revenue expectations of $43 million to $45 million.

That risk aside, we are still comfortable with our revenue expectations which target 25% to 30% growth in license and transaction fees, and 20% to 25% growth in total revenues for the fiscal year. And that's based on 50,000 net connections. Gross profit of $3.6 million for the first quarter increased 14% from $3.1 million for Q1 of fiscal 2013. Gross revenues came in at 35.4%, down from 37.5% for the same period last year due to the margins on license and transaction fees in the quarter which represents the bulk of our gross profit dollars.

Gross margins on license and transaction fees for Q1 came in at 36%, as we indicated on last quarter's call, reflecting deactivation of units and the lag time between certain pricing incentives and the cost benefits achieved with the supplier that didn't take effect until the quarter's – towards the end of the quarter. As a result, as those cost benefits materialize, we anticipate that we'll be back at our targeted 40% GP on license and transaction fees, most likely for the second or third quarter.

Non-GAAP operating expenses were $3.5 million in the first quarter compared to $3.1 million in fiscal 2013's first quarter, as we continue to ramp up fiscal year 2014 growth initiatives. On a GAAP basis, which includes proxy costs incurred in Q1 of last year, the change was flat. With revenue per employee at over $700,000 in the quarter from $670,000 in Q1 of fiscal 2013, this is an area where we believe we have a great deal of leverage as the business grows.

Moving to cash and liquidity, our cash and cash equivalents stood at approximately $5.8 million as of September 30, down just slightly from $6.2 million at Q1 fiscal 2013. Adjusted EBITDA was approximately $1.5 million for the first quarter, up from $700,000 last year, which contributed to the 35% growth in net cash generated from operations for the first quarter of $900,000.

Use of cash for our JumpStart programs stayed relatively flat versus Q1 of fiscal 2013 even though the number of units deployed in JumpStart this quarter were fewer when compared to year-ago quarter. And this is due to the change in inventory levels of JumpStart equipment we had on hand at the end of the first quarter fiscal 2014 versus the end of the quarter of fiscal 2013's first quarter, as those units are also part of this figure.

For the remainder of the year, we continue to remain comfortable with cash on hand, continued improvement and cash generated from operation as the service model builds and our $5 million credit line with Avidbank, of which the balance drawn the on line stood at $4 million as of September 30. We also have the potential for adding an additional [ph] infusion (0:26:39) of cash as the $1.13 warrants approach their maturity date of December 31, 2013. Approximately, $2 million warrants were outstanding as of September 30.

So to recap our guidance for fiscal 2014, we expect continued expansion of our ePort Connect service base to deliver growth in license and transaction fees in the 25% to 30% range with total revenues growing approximately 20% to 25%. This revenue expectation is based on roughly 50,000 net connections.

Achievement of our revenue and connection goals coupled with efficient fees gained from cost reductions and operating leverage over the course of the year should translate into 100% improvement in non-GAAP net income to roughly $1.8 million from $900,000 for fiscal 2013. We believe this would equate to a 40% to 50% increase in adjusted EBITDA from the $5.8 million in adjusted EBITDA last fiscal year. We expect that this improvement in addition to growth from other programs, they are less reliant on CapEx requirements would begin to generate sustainable free cash flow in Q4. Free cash flow in this sense is cash from operations less capital expenditures as reported in the investing activity section of the cash flow statement.

And with that, I'd now like to turn the call back over to Steve.

Stephen P. Herbert, Chairman & Chief Executive Officer

Thank you, David, and thank you all for your attention this morning. We've been opening a lot of doors for USAT over the last 18 months and I think you began to see the benefit of those strategies in the mix of first quarter connections. We have a great deal of work underway, and we think fiscal 2014 could be another exciting year as adoption continues to accelerate and as we execute against multiple strategies that help drive connections to our service in the self-serve retail market.

At this point, we'd be happy to take your questions. So, operator, if you would, please open the call and provide instructions for our Q&A session. Thank you very much.

QUESTION AND ANSWER SECTION

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Hello?

<A – Ronnie Rosa – USA Technologies, Inc.>: Gary, are you there?

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Yeah. Can you hear me?

<A – Ronnie Rosa – USA Technologies, Inc.>: Yeah. Something happened to our operator. So go ahead.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Okay. I'm sorry. A couple of questions here. First of all, Steve, did you say that about 75% of your new connections came from your existing client base this quarter again? I missed that.

<A – Steve Herbert – USA Technologies, Inc.>: I think the mix was a little bit different. Dave, did you catch Gary say 75% from existing customer base?

<A – Dave DeMedio – USA Technologies, Inc.>: Yes. Actually, Gary, this quarter was actually lower than 75%. In the past, it's been more like 80% and then this quarter closer to 60%, as we got 20% of our connections coming from a new ePort Mobile web service customer. So that helped drive the number of new connections coming from existing customers a little lower.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: For Mobile is the taxi, right?

<A – Steve Herbert – USA Technologies, Inc.>: In this case, it was, Gary.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: And did you – all of those connections that you said you were when you first made that announcement have they been completed on that contract that you initially signed?

<A – Steve Herbert – USA Technologies, Inc.>: They were...

<A – Dave DeMedio – USA Technologies, Inc.>: I'm not sure which – Gary, which contract are you referring to?

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Well, you said you've got about 3,000 connections through an entity that has the software for doing the taxi business. Is that – am I correct with that or am I mistaken?

<A – Dave DeMedio – USA Technologies, Inc.>: Yes, Gary that is in that contract. Right.

<A – Steve Herbert – USA Technologies, Inc.>: That's exactly right.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Okay. All right. So I guess I want to get back to this whole – the taxi business in and of itself because it intrigues me. Maybe you can explain it. You guys just support the connections. You have somebody else out there doing the software, correct?

<A – Steve Herbert – USA Technologies, Inc.>: In this particular case, that is actually true. Gary, this customer had their own mobile payment application that they wanted to put into their fleet and they came to us. They certified their mobile platform via our QuickConnect service that we talked about. So they took the API calls. They went through the development and the cert process and they took their own application and put it on our service.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: And that's more or less how you're going to target this going forward? You're going to have some other applications put on your service?

<A – Steve Herbert – USA Technologies, Inc.>: It may be true in some cases but in other cases, not. For instance, we have ePort GO, which is an offering that the company has which I think you know about and we talked about it. So we have our own application and there are some customers who want to come to us with their own applications, which is the beauty really of QuickConnect. We can take connections from someone who either has their own application or their own device or they can use our device or they can use our applications, and that's really where we want to be at the end of the day with an open service that people are driving connections to in our particular market space.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Okay. Then, last question on this. I mean, in terms of the cost differential versus existing systems, how much is that cost differential benefit you in terms of what you're offering the taxi companies?

<A – Steve Herbert – USA Technologies, Inc.>: Well, the interesting thing is that, for us, the economics are a little bit different in this particular channel and are more beneficial to USA. I don't know that we're in a position to quantify that, but that's one of the other attractive things about some of the other self-serve retail verticals that the models is a little and that we can benefit from it.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Yep.

Operator: Thank you. [Operator Instructions] Our next question comes from Mike Latimore. Your line is open.

<Q – Mike Latimore – Northland Securities, Inc.>: Yeah, good morning, nice healthy quarter there.

<A – Steve Herbert – USA Technologies, Inc.>: Thank you, Mike.

<Q – Mike Latimore – Northland Securities, Inc.>: Yeah. In terms of the outlook for the year, I mean, what percent of connections do you think will come from JumpStart and maybe separately the vending vertical?

<A – Dave DeMedio – USA Technologies, Inc.>: Mike, we had been targeting 65% of connections for the fiscal year approximately coming from JumpStart. The first quarter was obviously lighter than we had expected at 37%. Although for the remainder of the year, I do think we're going to get back closer to the 65% range of connections coming from JumpStart.

<Q – Mike Latimore – Northland Securities, Inc.>: Got it. And then when we think about revenue per connection for our verticals outside of vending, I mean is there a way to narrow that down a little bit, is it better or worse than vending? I think some are better, some are a little bit lower, but how should we think about revenue connections outside of the vending industry?

<A – Dave DeMedio – USA Technologies, Inc.>: Well, and you're right a couple of the other vertical markets that we're in have a little bit from revenue mix than our traditional vending connections. For example, laundry tends to be a little less of revenue per connection than a laundry machine, and a vertical like taxi could be a little bit more per connection.

In terms of modeling in it and it's – those verticals markets influence on our results. I don't expect those – our entry into those markets to substantially change the mix of our revenue, as we anticipate still the majority of our connections are going to come from vending and our revenue metrics are going to be more closely tailored to that of vending. Now, if we do achieve more growth in those verticals and anticipate and they start to influence, we'll come back to the marketplace and on a future call with an update as to the revenue per connection.

<Q – Mike Latimore – Northland Securities, Inc.>: Okay, got it. And I think you gave us a couple – what was the transaction volume in the quarter?

<A – Dave DeMedio – USA Technologies, Inc.>: It was $67.9 million...

<Q – Mike Latimore – Northland Securities, Inc.>: Okay.

<A – Dave DeMedio – USA Technologies, Inc.>: ...across 38.5 million transactions.

<Q – Mike Latimore – Northland Securities, Inc.>: Great. And then your revenue guidance for the year, what does that assume – did you assume any additional deactivation to that revenue guidance?

<A – Dave DeMedio – USA Technologies, Inc.>: In modeling, Mike, we assume outside of the 11,000 that we talked about last quarter, we do assume some immaterial amounts of deactivations. But we're really targeting to a net deactivation number of 50,000, which means if we have any future deactivations, our growth in new connections need to outpace that in order for us to achieve our 50,000 net.

<Q – Mike Latimore – Northland Securities, Inc.>: Got it. And just last question, the – I think the G9 delays was going to come up this year. Any specific timing in terms of when that starts to ship?

<A – Steve Herbert – USA Technologies, Inc.>: Mike, it's Steve. Actually the G9 is shipping this quarter.

<Q – Mike Latimore – Northland Securities, Inc.>: Okay, great. Thanks a lot.

<A – Steve Herbert – USA Technologies, Inc.>: We're pleased about that.

<Q – Mike Latimore – Northland Securities, Inc.>: Yes, thanks.

<A – Steve Herbert – USA Technologies, Inc.>: Good?

<Q – Mike Latimore – Northland Securities, Inc.>: Great.

Operator: Thank you. Our next question comes from Alexander Renker from Sidoti & Company. Your line is open.

<Q – Alexander Renker – Sidoti & Co. LLC>: Hi, everyone. Nice quarter.

<A – Steve Herbert – USA Technologies, Inc.>: Oh, thanks, Alex, and thanks for your interest in our company.

<Q – Alexander Renker – Sidoti & Co. LLC>: Yeah, of course. So, I was just wondering how we should think about that JumpStart number for the rest of the year with a little – with the inventory build here during the quarter. Is that something that it's going to be lower year-over-year for subsequent quarters given that it was kind of the same this quarter year-over-year?

<A – Dave DeMedio – USA Technologies, Inc.>: Alex, thanks for your question. It's difficult to say from one quarter to the next, how that will translate into dollars on the investing section of the cash flow. We did have an increase in the inventory that we had on hand for JumpStart equipment at the end of Q1. Hence, the reason the dollars per JumpStart were relatively flat quarter-over-quarter from the quarter a year-ago.

I would expect that we would hold less inventory at the end of next quarter, which would mean that the dollars for JumpStart relative to how many units that we put out under JumpStart would go down. But beyond that, really that number is really dependent upon two factors, how many units we put out under JumpStart and the inventory we have on hand at the end of the quarter.

<Q – Alexander Renker – Sidoti & Co. LLC>: Okay. Thanks. That helps.

<A – Dave DeMedio – USA Technologies, Inc.>: Yeah. And just as another additional comment on that, by the end of this quarter, we expect to be holding fewer G8s as the new G9 units come in. And the G9 units, I think we've talked about a lower price per unit. That'll also help to drive down the JumpStart dollars per connection or per JumpStart connections as we go out into the second half of our fiscal year.

<Q – Alexander Renker – Sidoti & Co. LLC>: Okay. Thanks. And then on the 11,000 cancellations, were those vending? Can you just remind me?

<A – Steve Herbert – USA Technologies, Inc.>: Those were in the vending space, yes.

<Q – Alexander Renker – Sidoti & Co. LLC>: Okay, okay.

<A – Dave DeMedio – USA Technologies, Inc.>: And just – and, Alex, let me add on to what Steve had just said. They were in the vending space, and the customer owns that equipment.

<Q – Alexander Renker – Sidoti & Co. LLC>: Right.

<A – Dave DeMedio – USA Technologies, Inc.>: So those devices were not under JumpStart.

<Q – Alexander Renker – Sidoti & Co. LLC>: Okay. Okay. Great. All right. Thanks, guys.

<A – Steve Herbert – USA Technologies, Inc.>: Thank you.

Operator: Thank you. Our next question comes from Gregg Hillman from Wilshire Securities. Your line is open.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Good morning. Hey, could you comment on JumpStart going forward into fiscal 2015, 2016? Do you think it will trend to below 50% of the connections?

<A – Steve Herbert – USA Technologies, Inc.>: Yeah, actually it will, and that's really the way that we intend the business to go. The fact of the matter is that as we continue to bring on customers in these adjacent verticals, some of whom don't even require a device, we fully expect that percentage to go down over time and certainly expect it to go down below 50%.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Okay.

<A – Steve Herbert – USA Technologies, Inc.>: For multiple reasons, but I just gave you one of them.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Okay. And then the G8 versus the G9, what percentage less is that in price? The G9 versus the G8?

<A – Steve Herbert – USA Technologies, Inc.>: I think we gave a range of 20% to 30% on our previous call. It's a meaningful reduction.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: 20% to 30% less?

<A – Steve Herbert – USA Technologies, Inc.>: That's correct.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Okay. And then so – and presumably – and then does that happen once a year that you redo the units, the ePorts?

<A – Steve Herbert – USA Technologies, Inc.>: Not necessarily, we typically go through development cycles on devices a little less frequently than that. With the goal of – I think everyone familiar with buying electronics whether it's for a business or a personal use, you're always looking – you're looking to get more for less. And in the case of G9, that's exactly what we did with our customers. We brought them additional functionality and a smaller footprint for a lower price. So, it's being received very well.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: And then, David when do the preferred dividends discontinue?

<A – Dave DeMedio – USA Technologies, Inc.>: They don't. [indiscernible] (0:42:50) annual two times a year and no accrue as long as the preferred shares are outstanding. And there's no...

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Okay. Do you have the right to buy them back or can you – given option to buy the preferred shares to buy those instruments back?

<A – Dave DeMedio – USA Technologies, Inc.>: We can certainly – we can certainly – we have that flexibility to do so whether or not that the direction we're going to go is something that I know is discussed at times here. But right now, there's no strategy or no immediate strategy to do that, to buy those back.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Okay. And then finally, on the stock-based comp, that was down year-over-year for the three months. What would the – can you give me an idea of what would that be going forward or what's that based on the stock price or what's your take on that?

<A – Steve Herbert – USA Technologies, Inc.>: Well, the stock-based comp is essentially based on metrics that the company is trying to hit. And typically, if you see increased numbers in stock-based comp, then correspondingly you'll be seeing numbers that you're happy with related to the performance of the business.

<Q – Gregg Hillman – First Wilshire Securities Management, Inc.>: Okay. Okay, that's great. I'll get back in queue. Thanks.

<A – Steve Herbert – USA Technologies, Inc.>: Thank you.

Operator: Thank you. Our next question comes from William Florida from Advisory Research. Your line is open.

<Q – William Florida – Advisory Research, Inc.>: Yes, thank you. Just going back to the preferred dividends, so you – I think you said earlier in the call, you expected to be free cash flow positive by the end of the year. Is that the earliest that you guys could take out some of the preferred dividends if they're expensive or do you have [ph] such facilities (0:44:48) to do it before then?

<A – Dave DeMedio – USA Technologies, Inc.>: William, thanks for your question. When we do achieve free cash flow, I think the strategic direction of the company will be to use that cash to continue to grow the operations of the business. However, it could be decided to that point to do something with the preferred that will leave our options open. But at the moment, we intend to use cash generated by the business and any free cash flow from the business to grow the operations in the business.

<Q – William Florida – Advisory Research, Inc.>: Okay. Thanks for the answer.

<A – Steve Herbert – USA Technologies, Inc.>: Thanks, Bill.

Operator: Thank you. Our next question comes from Jim Gentrup from Discovery Investment. Your line is open.

<Q – Jim Gentrup – Discovery Investment Research>: Good morning.

<A – Steve Herbert – USA Technologies, Inc.>: Good morning.

<Q – Jim Gentrup – Discovery Investment Research>: Got it. I had a question – a couple of questions for you regarding, Dave, your comments about the gross margin kind of bounced back [ph] existing (0:45:56) about Q2 or Q3, can you help us understand is that something that's going to be gradual or won't bounce back to – I mean, what do you – can you explain a little more about that?

<A – Dave DeMedio – USA Technologies, Inc.>: I think there's – I believe we could hit – bounce back from 36% to 40% in Q2. There could be – we could miss by a few percentage points, 38%, 39%, but there is an opportunity to get back to that definitely by the end of Q2. But definitely, if not in Q2, if we missed a little bit in Q2, I think it will be back to the 40% range in our third quarter.

<Q – Jim Gentrup – Discovery Investment Research>: And what has to happen in Q2 if you get back to 40%?

<A – Dave DeMedio – USA Technologies, Inc.>: Yeah, it's normal, just business as usual. The cost incentives or the cost reductions that we received from the supplier need to take – need to be fully materialized in the quarter as well as we need to get these units that we put out in Q1, we need to get those generating service fee revenues and once that happens, it's just business as usual. It should take us back to that 40% range, and I'm anticipating hopefully in Q2 but if not Q2, there'll be an increase over the 36% in Q2 but definitely 40% by at least Q3.

<Q – Jim Gentrup – Discovery Investment Research>: So it's a function of just how quickly the new connections, kind of begin to contribute meaningfully.

<A – Dave DeMedio – USA Technologies, Inc.>: Correct.

<Q – Jim Gentrup – Discovery Investment Research>: Okay. And then could you repeat the vertical, the breakdown you gave us in the vertical, real quick, the different verticals how they've contributed?

<A – Dave DeMedio – USA Technologies, Inc.>: Yes. 60% of our connections came from vending, 10% of our connections came from commercial laundry, 20% transportation and that's the taxi connections that we talked about. And then the remainder 10% came from amusements and kiosks.

<Q – Jim Gentrup – Discovery Investment Research>: Okay. And how would you expect that to change as we go through the year?

<A – Steve Herbert – USA Technologies, Inc.>: Yeah. I believe we'll have – this is Steve by the way, Steve Herbert. I believe we'll have continued contribution from the other verticals. However, it's really – it's hard to predict. We're hoping for a healthy mix from all of the channels for various reasons including the fact that we want a diverse base of customers across self-serve retail markets. But to make a short story long, it's really as hard to predict and you also have to keep in mind that a large majority of our business is expected to come from our existing base which is largely vending. So you know that it will be skewed in that direction, but the others are really hard to predict.

<Q – Jim Gentrup – Discovery Investment Research>: Great. And just one last question surrounding the guidance, I'm assuming that you are expecting to retain the rest of the connections that you currently have from the large customer, the large 11,000 loss in the first quarter. Your guidance assumes that you're going to retain those connections for the rest of this year, this fiscal year anyway, correct?

<A – Steve Herbert – USA Technologies, Inc.>: Well, we built in, as we said on our last call, and I think we've said on this call, we built in to the guidance the activity expected from that particular customer. And specifically, I think today, and I think wisely, Dave stated we're taking the most conservative approach and laying out the risk. I think we laid out there the total risk for everyone for the rest of the year of $1.6 million for the next nine months or 3.5% of our expected revenues for the year, which essentially leads us to a comfort level to hit guidance. So, that's it. I don't think we can be any more clear than that. We're taking a very, very conservative approach.

<Q – Jim Gentrup – Discovery Investment Research>: And the 50,000 net new – that you're basing your expectations on, that's a net number, I'm sorry. That's what I meant to ask. That's a net number?

<A – Steve Herbert – USA Technologies, Inc.>: That's correct. That number that Dave gave is a net number.

<Q – Jim Gentrup – Discovery Investment Research>: Okay. Thank you, guys.

<A – Steve Herbert – USA Technologies, Inc.>: You got it.

Operator: Thank you. [Operator Instructions] Our next question comes from Gary Prestopino from Barrington Research. Your line is open.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Yeah, a couple of follow ups, please. Why was the D&A and the operating expense line down, looks like about 50% in the quarter?

<A – Ronnie Rosa – USA Technologies, Inc.>: The amortization.

<A – Dave DeMedio – USA Technologies, Inc.>: You mean, Gary, the reduction in that expense?

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Yeah, why was it down year-over-year?

<A – Dave DeMedio – USA Technologies, Inc.>: Okay. It was down because of the amortization of intangible assets. We fully amortized our intangibles, the ones that are – were being amortized. They finished their amortization in July of this year. So we just had a half month of amortization.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: That run rate were close to somewhere around, they should continue throughout the rest of the year, right?

<A – Dave DeMedio – USA Technologies, Inc.>: Correct, yes. In last fiscal year, that amortization was around $186,000 a quarter.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Right.

<A – Dave DeMedio – USA Technologies, Inc.>: Which goes – essentially goes away now.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Okay, great. And then can you – couple of other questions here, when you added 14,000 net connections, right, or new connections this quarter, right? Did all those connections pay an activation fee?

<A – Steve Herbert – USA Technologies, Inc.>: Gary, in large part, all of our customers pay some form of activation fee. You can assume that's the case. With some customers, we do make exceptions based upon the model. For instance, if we have a customer in a particular vertical, let's just pick an example, a kiosk customer who's selling through distributors and they believe that the activation fee can be a barrier to adoption with their operators. We'll sometimes waive that and build it into the backend fees, and we recoup it later on down the road. So we do flex, but by and large, we're – we typically look for an activation fee of some type.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: All right. And just more, please. The agreement with Visa, is that coming up for expiration, or has it been renewed?

<A – Steve Herbert – USA Technologies, Inc.>: Yeah. The situation with Visa is a very solid one. We're – we continue to – I would venture to guess we're adding more what they would call merchant locations or points of acceptance than just about anybody they're working with in America. They're very attractive. They're very attracted to the self-serve retail market, and we have essentially what is an evergreen in our contract. So that's not something we spend a lot of time talking to them about. We actually spend our time talking about rewing up adoption.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: As I recall, last year at this time, there was some agreement to renew the contract. This year, there's just an evergreen, and there hasn't been any discussion on renewals, rates, et cetera?

<A – Steve Herbert – USA Technologies, Inc.>: That's correct. We – I think we renewed for essentially one for two years unless somebody walked away.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Okay. Great. And then...

<A – Steve Herbert – USA Technologies, Inc.>: Yeah.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: ...in terms of this business that you got with, was it USConnect...

<A – Steve Herbert – USA Technologies, Inc.>: Yes.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: ...for over, I guess, 50,000 connections, when do you start seeing some of those roll into the mix?

<A – Steve Herbert – USA Technologies, Inc.>: Well, some of the customers who are a part of their consortium are already customers of ours. So, we have some of them on the service already and it's my understanding that we've seen a small amount of activity thus far. So it will, just like any agreement, it will start slowly. The thing that is most exciting to us about USConnect as a company and as a consortium in general, is if you go out – and I would encourage you to look at their website.

If you go out and look at their website, a part of their DNA essentially is to fully leverage technology to create vending businesses of the 21st century, and that includes an anticipated 85% penetration of cashless over the five-year period, offering healthier and better and by the way more expensive alternatives that require cashless. So they're really the perfect – they're the perfect customer for us and the people involved in running that entity are – they're veterans of the industry and they just backed away and said you know what, let's create this from the ground up. So we're very excited about that alliance.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: So this does, this would help with you other small operators that are not part of USConnect?

<A – Steve Herbert – USA Technologies, Inc.>: Well, I think what it does Gary is that it sends a message. It just sends a message loud and clear to the industry that this is where the leaders are going. They're headed in this direction and more and more we see large companies and small, making the statement, the very same statement, this is the direction we're going. We have some folks at 100%. We have some headed to 100%. So, it's good. These are all good signs of accelerated adoption and penetration which of course is what we all want.

<Q – Gary Prestopino – Barrington Research Associates, Inc.>: Okay. Thank you very much.

<A – Steve Herbert – USA Technologies, Inc.>: You got it. Thank you so much for your interest.

Operator: Thank you. I'm showing no further questions. Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone, have a great day.