

With An IPO Possible in 2010, Better Days Ahead For First Data?

BY ERIC GROVER

First Data Corp., the world's largest payment processor, was taken private by Kohlberg Kravis & Roberts Co. in 2007 at a \$26 billion valuation. The belief was value could be created, notwithstanding the whopping \$22.6 billion debt burden, if First Data was shielded from short-term earnings pressure from public investors and the company installed new management.

Market conditions permitting, Kohlberg Kravis & Roberts in 2010 will try to take First Data public again, which would testify that a two-year interregnum as a heavily leveraged private company created value.

The economic climate, however, is challenging. The Great Recession put a damper on card-payments growth. It also caused consumers to shift spending from credit to debit cards and from using premium-priced small merchants to thinly-priced Goliath retailers, hurting the processing behemoth's revenue.

On the regulatory front, U.S. Sen. Dick Durbin's proposal to cap card-acceptance fees would reduce revenue and growth prospects for First Data's U.S. acquiring business—its largest.

But the financial crisis also creates opportunities. It is unlikely a confident Bank of America Corp. would have put its merchant acquiring in a First Data joint venture. Additionally, stressed issuers may revisit outsourcing card processing. Among the largest general-purpose credit card issuers, only Capital One Financial Corp. and Wells Fargo & Co. outsource.

Long-term payment-processing trends are propitious. Electronic payments are relentlessly displacing cash; the compound annual growth rate in U.S. purchase volume from 1984 to 2007 for MasterCard and Visa cards was 15%.



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While First Data generates most of its revenue in the U.S., its most tantalizing growth prospects are abroad. A global payment-processing land grab is under way, with First Data at the front of a pack that also includes Global Payments Inc., Total Systems Services Inc. and Elavon.

Europe is the world's second-largest payments market. Since First Data's 1991 acquisition of Signet—the United Kingdom's biggest processor—bank-owned cooperatives steadily have ceded share to commercial processors. Moreover, European regulators' Single Euro Payments Area initiative to eliminate national payment borders enables increased competition, further greasing the skids for First Data.

First Data also has a presence in the largest emerging markets. In China, its joint venture with Standard Chartered PLC acquires cross-border but not domestic transactions. Acquiring in the most-promising big emerging payments market—Brazil, where First Data bought a beachhead (Check Forte) in 2007—will open up in 2010. The payments colossus is also close to establishing a joint venture with India's largest acquirer, ICICI.

But First Data's leveraged buyout had a high opportunity cost. Because of its mountain of debt, First Data has had to focus on cutting costs, foregoing growth and rationalizing redundant delivery systems, and it may have to sell off assets. It eliminated 750 positions over the past year and reined in acquisitions, abandoning a pricey but

strategically plausible purchase of prepaid-distribution network Incomm. While First Data has made headway consolidating data centers, it has made less progress rationalizing software applications.

A broader processing footprint is an advantage with multinational retailers and financial institutions, as evidenced by 2006 wins of Société Générale's retail card processing outside France and an Asian merchant-processing joint venture with Standard Chartered. But since the buyout, First Data has not meaningfully expanded its geographic footprint.

In the U.S., First Data's legacy card-processing business—battered by issuer consolidation and competition from TSYS, appears to have found its footing, winning Nordstrom's card processing and picking up Wachovia and National City through their respective acquisitions by Wells Fargo and PNC.

When First Data acquired America's largest PIN-debit network Star in 2004, there should have been synergies. For example, where First Data controls transaction data at every stage in the value chain, it could have delivered more-powerful cardholder rewards, enhancing the network's competitiveness.

That has not panned out, however, as Star ceded market share to Visa's Interlink and now looks likely to bleed issuers to MasterCard.

Nevertheless, with reduced debt, First Data's best days could be in the not-so-distant future. **CP**