TSYS' diversification moves have more upside: Intrepid's Grover

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TSYS has long been a solid payments processor that has opportunity for more growth.

Its legacy business is credit card issuer processing. Over the years, in a series of steps, it has expanded the breadth of its service and geographic reach, though the full potential of these moves has not yet been realized.

Payment processing is a fragmented global market experiencing strong secular growth as electronic payments relentlessly displace cash, which is still the primary retail payment system in most countries.

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While the U.S. is the world's largest retail-electronic-payments market, it's also the most competitive and destined for slower growth as cash and check usage continues to decline. Like all major and some tier-two U.S. payment processors, TSYS wants to participate in less competitive and higher-growth markets overseas to sustain long-term growth.

With that in mind, in 2005 TSYS purchased a minority stake in China UnionPay's issuer-processing subsidiary. In 2007 CEO Phil Tomlinson gushed to investors, “We are very excited about the long-term prospects in China.” Yet many (most) have run aground on the ballyhooed China opportunity’s shoals. The idea of a processing joint venture in the explosive-growth Chinese payments market was to bolster growth and international reach. But this joint venture using CUP software is a dead end. TSYS has a minority stake. It can’t get control. And there’s only one potential buyer, CUP.

In 2006 TSYS acquired Card Tech, a fledgling prepay third-party processor and a leading provider of card management software in emerging markets, markets that TSYS was challenged to develop.

The processor picked up 190 primarily software-licensing clients and kept the Prime brand, adding “TS.” While there’s tension between processing and licensing business models, Card Tech’s scrappy and enterprising culture could have infected the mother ship and emerging markets might have become a major contributor. But it hasn’t panned out yet.

In 2010, during the financial crisis, when many banks were looking to shed noncore assets, TSYS crossed the acquiring Rubicon, in two steps buying First National Bank of Omaha’s acquiring business.

A global payment processing land grab is underway. Banks continue to spin off payment processing assets. Given a desire to grow acquiring and international share, it’s surprising and disappointing that TSYS hasn’t scooped up acquiring businesses abroad.

In 2013 the Columbus, Ohio, processor bought the prepay specialist Netspend to boost U.S. growth. Unfortunately, it's an awkward fit. TSYS' core businesses and competencies are commercial processing. Netspend is a consumer business, albeit relying heavily on distribution partners.

In 2014 TSYS divested its issuer-processing and point of sale terminal services ventures in Japan. Like China, albeit for different reasons, Japan is a cul-de-sac. It's the Galapagos of payments markets. Whether one is successful there isn't relevant elsewhere.

Perhaps TSYS' most successful moves abroad have come in its comfort zone, through organic processing growth with large credit card issuers in mature, safe markets such as Canada, the United Kingdom, Ireland and the Netherlands. Issuer processing is a nice though not particularly sexy business, enjoying enviable operating leverage with significant fixed delivery-system costs and variable account and transaction fees, five- to seven-year contractual commitments, and high renewal rates. The principal negative is buyers are large, sophisticated, and demanding financial institutions. They have alternatives and typically extract fee concessions on renewal.

And some key executives have left quickly. Initially, First National's Diana Mehochko remained president of the business. She left after a year. Total Systems then recruited a BofA Merchant Services alum, Mark Pyke, to run acquiring. He left in 2016 when TSYS purchased the acquirer Transfirst.

At the acquisition was announced, Transfirst CEO John Schlonksy declared, "I can tell you firsthand from my interaction with TSYS and, particularly, with the executive team, it makes me feel confident that our values and how we treat each other and our clients are firmly aligned.” He became president of the processor’s acquiring business. Six months later Schlonsky resigned.

In May, 2016, the processor hired former U.S. Bank, Visa and Wells Fargo executive Pam Joseph, appointing her president and COO of Total Systems and to its board.

When Joseph joined TSYS, it was hoped she would boost its U.S. acquiring business and stalled globalization, and assumed she was in line to succeed CEO Troy Woods. But on Friday, Sept. 22, TSYS announced Joseph's resignation. The following Monday its stock price dropped 5%.

TSYS’ valuation multiples compare unfavorably with competitors such as First Data, Global Payments, Vantiv, Square and Wirecard. TSYS enterprise value/sales multiple is 3.29. Growth-challenged processing behemoth First Data’s EV/sales multiple is 4.37. Global Payments’ and Vantiv’s EV/sales multiples are 4.32 and 3.95 respectively. High-growth Square’s and Wirecard’s EV/revenue multiples are 5.49 and 7.04 respectively. At a minimum TSYS should aim to merit valuation multiples comparable to if not slightly better than First Data’s, Global Payments’ and Vantiv’s.

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