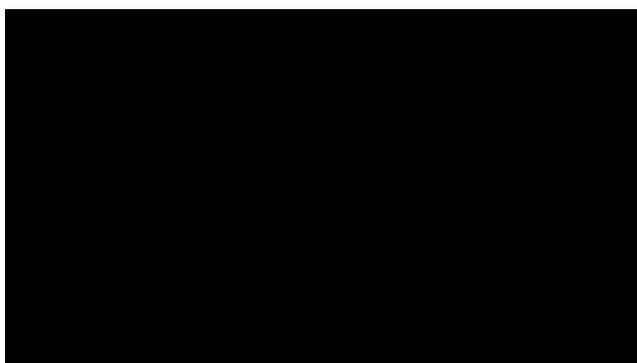


Investors in First Data IPO May Need to Take the Long View

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Will KKR's First Data Bet Pay Off?

- ▶ Company seeks to raise as much as \$3.2 billion on Wednesday
- ▶ Payments processor bought by KKR faces new rivals, big debt

Since KKR & Co. took payments processor First Data Corp. private in 2007, in what ended up being the firm's biggest equity bet ever, it's taken years of overhaul for the deal to pay off.

Investors will have to embrace the same long-term thinking for First Data's initial public offering -- for a company that's posted only one quarterly net profit since it was taken private. A bet on the IPO is a bet on the ability of Chief Executive Officer Frank Bisignano, known as "Wall Street's [Mr. Fix-It](#)," to turn around a business that's laden with debt and fending off younger, more agile competitors.

First Data makes most of its money from processing payments for merchants, and it held the top spot by that measure last year, with 23 percent market share, according to Bloomberg Intelligence. At the same time, it's facing increasing competition from startups such as Square Inc. and Stripe Inc., while also being squeezed as retailers demand better terms. While First Data's revenue has accelerated under Bisignano's leadership, growth is much slower than the pace of global payments, which is a sign the company is losing market share, according to

Sanford C. Bernstein & Co.

“Their IPO is happening at a time when they have to make the case to potential investors as to why they are going to be relevant in the next few years,” said David Robertson, publisher of the Nilson Report, a payments-industry newsletter. “Turning around a ship that big takes time.”

Mark Murphy, a spokesman for First Data, declined to comment, citing a quiet period before the IPO.

Easing Debt

First Data is seeking to raise as much as \$3.2 billion in an offering scheduled to price Wednesday in New York. That would make it the biggest U.S. IPO this year, according to data compiled by Bloomberg. The company is selling 160 million shares for \$18 to \$20 each and plans to use the proceeds to repay debt -- which stood at about \$21 billion at the end of June -- and for general corporate purposes.

The money could help the company pivot to better compete, rather than directing most of its resources to keeping expenses low to meet its debt obligations, according to Lisa Ellis, an analyst at Sanford C. Bernstein. First Data has been trying to develop a variety of services and products, such as systems for accepting credit cards and preventing fraud.

Ellis said First Data has not been able to use enough of its funds to grow, instead suffering from “chronic underinvestment as the company has cut costs to meet its debt-servicing requirements.”

First Data’s revenue has been climbing at a 2 percent rate compared with 11 percent growth in global payments volume, according to Sanford C. Bernstein estimates.

Market Volatility

The shares are poised to debut in a less-than-ideal equity market. Volatility, which kept companies on the sidelines in the third quarter amid an August stocks rout, prompted Caribbean mobile-services company Digicel Group Ltd. to [cancel](#) its IPO last week.

Concerns haven’t subsided with regard to the Chinese economy, which sparked the market rout, and uncertainty about when the U.S. Federal Reserve may raise interest rates. Supermarket chain Albertsons Cos. is also scheduled to price its IPO Wednesday, seeking to raise as much as \$1.7 billion.

Relative Value

At the high-end of the proposed price range, First Data would have an enterprise value of about \$40 billion, after adding pro forma debt and minority interest, according to David Ritter, an analyst at Bloomberg

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That puts its enterprise value at about 14 to 15 times trailing 12-month earnings before interest, taxes, depreciation and amortization. That's in line with faster-growing competitors like Vantiv Inc., which holds the No. 2 spot in the merchant-payments market, and Global Payments Inc. Still, those companies have been increasing earnings per share at a rate in the mid-teens, while First Data posts net losses, Ritter wrote.

For some investors, it's too early to bet on the company's transition. Brian Barish, who helps oversee about \$12.5 billion as president and chief investment officer of Cambiar Investors LLC, is skeptical.

"The amount of debt is too high relative to earnings and the cash flow generation of the business," said Barish, whose firm held shares of First Data before it was taken private. "On that basis, we'll probably take a pass."

Still, KKR's \$3.9 billion investment hasn't been short-term, and for investors with patience, there may be an upside.

The company has made a number of "innovative" investments during a difficult period and has the scale to do even more, according to Steve McLaughlin, founder of Financial Technology Partners LP, which advises payments and banking technology companies. Whether they are sustainable is another matter.

"It should be in a good position to differentiate itself against the larger players in the industry," McLaughlin said. "But has the growth and profitability been engineered for the short-term or the long-term by the private-equity owners? That's the big question for investors at this point."

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