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Total System Services Inc. (TSS): New Analyst Report from Zacks Equity Research - Zacks Equity Research Report



By Zacks Investment Research January 28, 2015 7:00 AM



Summary: Total System's fourth-quarter earnings topped the Zacks Consensus Estimate on improved revenues across segments, except merchant acquiring services, partially offset by higher operating expenses. Moreover, transaction volumes, new accounts and cash flows witnessed strong growth. Conservative debt and ample free cash also pave the way for incremental capital deployment. A diversified and restructured portfolio, strong network alliances, strategic acquisitions and technical competence augur long-term growth. However, risks from stiff competition, regulatory challenges, low interest rate and foreign exchange volatility raise concerns. Tapered synergies from Net-Spend justify the tepid guidance as well as our Neutral recommendation.

Overview:

Founded in 1982 and based in Columbus, Georgia, Total System Services Inc. provides electronic payment processing, merchant services and related services to financial and non-financial institutions in the U.S. and internationally. As of Dec 31, 2013, the company had 9,600 full-time equivalent employees.

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Total System is one of the world's largest companies for out-sourced payment services, offering a broad range of issuer- and acquirer-processing technologies that support consumer-finance, credit, debit, healthcare, loyalty and prepaid services for financial institutions and retail companies in more than 80 countries across the Americas, EMEA and Asia-Pacific regions. The company's services are divided into three broad operating segments:

North America Services (accounted for 46% of gross revenue in 2013) provides services to clients in the U.S., Canada, Mexico and the Caribbean. Total System processes information through its cardholder systems and provides issuer account solutions for financial institutions and other organizations throughout the U.S.

International Services (19%) provides services to clients in Europe, India, the Middle East, Africa, Asia Pacific and Brazil. Total System processes information through its cardholder systems to international financial institutions.

Merchant Services (25%) provides merchant services to financial institutions and other organizations primarily in the U.S.

Effective third-quarter 2013, NetSpend (10%) has been included as the fourth operating segment of Total System. Acquired in Jul 2013 for about \$1.4 billion, NetSpend offers reloadable prepaid debit and payroll cards as well as alternative financial services to the under-banked and to other consumers in the U.S. Total System raised \$1.1 billion through a two-part note offering in May 2013 to fund the acquisition. One set of 5-year notes worth \$550 million carries an annual interest of 2.375%, while the remaining \$550 million worth of notes are due to mature in 10 years and bear annual interest of 3.75%.

The company primarily functions through four business operations: Electronic payment processing, merchant services, reimbursable items and other services.

Electronic payment processing services include providing issuer processing services for con-

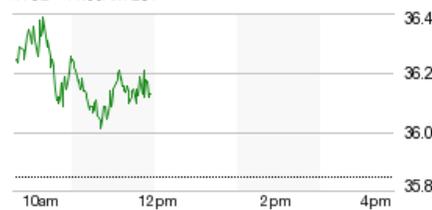
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sumer credit, retail, debit, stored value, government services and commercial card accounts. Merchant services include processing services, acquiring solutions, related systems and integrated support services. Reimbursable items are receipts for out-of-pocket expenses as revenues and expenses. The largest reimbursable expense item, for which clients reimburse the company, is postage. Changes in postal rates as well as volume of mailing activity by its clients affect the company's reimbursable items. Other services include business process management, mail and correspondence processing, tele-servicing, data documentation, offset printing, collections, and account solicitation and client services.

Total System continues to develop and enhance its processing solutions by developing solutions and strategic acquisitions to expand its service offerings. In 2008, Total System acquired Infox for an aggregate consideration of approximately \$50.6 million, with contingent payments over the next three years of up to \$25 million, based on performance.

In order to divest its non-strategic businesses, Total System sold Total Debt Management Inc. (TDM) in Aug 2009, followed by the sale of TSS POS Systems and Services LLC (TPOS) in Sep 2010. In Apr 2010, Total System acquired 51% ownership of a newly formed company named First National Merchant Solutions LLC (FNMS), under a joint venture with First National Bank of Omaha (FNBO), for approximately \$150.5 million. FNMS is the name under which FNBO currently conducts its merchant activities. On Jan 1, 2011, Total System acquired the remaining 49% of FMNS for \$169.6 million. Following the completion of the acquisition, Total System has renamed FNMS as TSSYS Merchant Solutions (TMS).

Additionally, in May 2011, Total System acquired TermNet Merchant Services, which is the 52nd largest merchant acquirer in the U.S. by dollar volume, according to The Nilson Report. The company has been re-branded as Total System and fully integrated into TMS. In Oct 2011, Total System purchased the merchant portfolio of Florida-based Vanguard Payment Systems Inc. In Aug 2012, Total System formed a joint venture (Central Payment Joint Venture (CPay)) with Central Payment Co. LLC by buying a 60% stake in the privately-held direct merchant acquirer for \$66 million, and inflated this holding to 75% in Feb 2014. In Dec 2012, the company acquired Utah-based privately-held payment solution provider ProPay for an undisclosed amount.

Meanwhile, the company vended of operations in Japan during second-quarter 2014. Thus, it is now a discontinued operation.

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