



Fiserv and First Data to Merge – What Does This Mean to the Payment Industry?

16 January 2019 By: Krista Tedder

The payments industry woke up this morning to the news of two large payment firms merging together to make a behemoth for US payment processing. Fiserv is in the position to stabilize the First Data business while entering into new merchant markets. The merger will be difficult for both clients and employees who will be forced into changes. Other payment firms will have the opportunity to earn additional business and gain seasoned payment professionals while the new Fiserv takes shape.

Why the Deal Is Needed

Each company brings to the table something each other needs to compete in a market which is opening up to third party integration capabilities. First Data needs issuer payments. Fiserv needs merchant payments. The two companies are a good match from a capability perspective with the ability to expand operating margins and improve capital availability.

The merger should not come as a surprise. First Data's IPO was the first phase of a strategy to be consolidated into another company due to the debt load. First Data continues to carry a debt load of \$16.95 Billion from the KKR acquisition a decade ago, the debt was carried over into the IPO. Add in a disappointing 4Q2018 in the First Data stock evaluation, executives would have realized that the Vantiv/Worldpay merger was a stronger competitor than originally thought. Fiserv is paying \$22 Billion in stock for the full deal, but almost \$17 Billion is the debt load. But debt is debt, and it needs to be paid back, regardless of who is responsible.

Growth, however, will not solve the debt problem. Significant cost savings across organizations will need to be defined and difficult choices made as to what positions, possibly entire divisions, are eliminated. As with any large scale merger requiring consolidation, expect layoffs in the next 2 years as redundancies are identified and products are sunset. Reducing the debt is the only way to provide stability and profit return to investors. Investors were made aware that an annual recurring cost reduction of \$900 million in the next five years is expected. Reducing costs will improve cash flow with a focus on increasing shareholder returns in 18-24 months. To secure the financing to manage the existing debt, a cost reduction plan would be required.

The merger may not be easy from a regulatory standpoint either. Each company has subsidiaries in multiple countries with oversight requirements for payment firms. Most likely the merger will retain First Data and Fiserv corporate entities for a year after closing while they figure out the web of subsidiaries. Similar to the Vantiv/Worldpay consolidation, executive First Data leadership may stay to get through the consolidation phase but will most likely exit once completed.

The market implications will take weeks, possibly months, to understand as the buyout is finalized. Issuers, merchants, payment service providers, technology providers, and other payment ecosystem participants will be impacted.

Effects on Financial Institutions

- The Durbin Amendment of the Dodd-Frank Act requires issuing banks to enable a minimum of 2 debit processing networks to enable merchant choice in payment routing. First Data brings STAR Network and Fiserv has Accel Network, with Allpoint through the Cardtronics business. Will US regulators see issuers as meeting Durbin requirements if they use both networks which will be under the combined entity?
- Small to mid-size financial institutions will see an increase in costs due to a reduced competitive pool. Smaller credit unions and banks are on the First Data and Fiserv platforms through Group Service Providers like PSCU and Co-Op Network. For a decade, price compression of transaction processing has been used to offset the cost of added value services during contract discussions. Transaction pricing is tiered volume pricing with smaller volumes paying more. Without First Data as a competitor, FIS and Fiserv will be able to retain better margins and reduce signing incentives.
- Financial institutions that have contracts with both entities today will have bifurcated terms and customer service. Integrating the operations to provide consistent reliable service will not be an immediate priority and

issuers will suffer servicing challenges when something goes wrong. Many smaller financial services and group service providers of credit unions that use both First Data and Fiserv will live with uncertainty as operational details are figured out.

Effects on Merchants

- Will the joint venture between Bank of America and First Data survive? Bank America Merchant Services was founded in 2009 during the financial crisis. Merchant business from both companies were pulled together to gain market stability in a turbulent time. Bank of America may benefit from dissolving the organization and bringing services back to their full management.
- First Data has been in multiple partnerships with processing platforms to compete with Adyen and Worldpay. Fiserv's merchant business is not as strong as First Data's so partnerships are expected to be retained, however some of the partnerships might be good acquisition targets in 18 months to solidify the technology under the Fiserv brand.
- Merchant servicing capabilities for Fiserv clients will increase significantly, providing leverage to negotiate prices for new capabilities. For merchants, this merger is a win. For Fiserv, they can now offer payment access across the entire ecosystem.

Effects on Payment Technology Companies

- Many payment industry technology providers have existing contracts with Fiserv and First Data. Each company has had buying power due to scale. Combined, however, the unified Fiserv could become the largest client the technology providers have. Fiserv will have consolidated buying power to drive costs down. Most likely the price reductions will not be seen by clients, but will reduce operating capital for vendors to provide the same services for less.
- What will happen to the Jack Henry/PSCU/First Data partnership? Look for the combined Fiserv/First Data teams to emphasize the benefits of going direct instead of using intermediaries when going head to head against Jack Henry in opportunities involving card processing
- FIS and Worldpay have an opportunity to move into the smaller financial institution market. When a consolidation occurs, financial institutions and merchants take the opportunity to compete a RFP when their contract terms are set to expire. Servicing disruptions that come with mergers can be used to pull business away. FIS, Worldpay and other smaller processing platforms have the opportunity to expand business lines.
- FIS has the ability to use this year to advance Real Time Payments through the Mastercard and The Clearing House bill pay initiative. Product enhancements for both Fiserv and First Data will be minimal in 2019 as the product teams will not be focused on new product delivery but on efforts to merge the two organizations.
- The combined power of First Data and Fiserv will propel Clover products and services to rival Square and iZettle. First Data has placed a lot of investment in the platform, opening the solution to Fiserv merchants will provide the leverage to surpass competing mobile POS competitors.

As more information about the vision of the combined organization emerges, additional effects will be felt throughout the market. Fiserv has been a stable company, with the addition of First Data's historically volatile business model and debt load will Fiserv be able to retain their operating model? Time will tell.

Copyright ©2018 GA Javelin LLC, (dba as Javelin Strategy & Research). Javelin Strategy & Research is a division of Greenwich Associates. All rights reserved. No portion of these materials may be copied, reproduced, distributed or transmitted, electronically or otherwise, to external parties or publicly without the permission of GA Javelin LLC.