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Does your integration playbook tackle tomorrow's M&A challenges?

Payments



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Payments: capturing M&A synergy in an ever-changing landscape

The payments sector is growing rapidly on a wave of disruptive technology and changing consumer behavior. Established businesses in the sector are turning to acquisition strategies to defend their territory. Identifying acquisition targets that offer achievable – and sustainable – synergies is essential for this strategy's success.

Payments businesses, including merchant acquirers, payment processors, point-of-sale providers and independent software vendors (ISVs), find themselves in a constantly changing landscape in their search for growth and the latest innovations.

Over the past five years, global payments transactions have enjoyed double-digit growth that looks set to continue. According to data from Dealogic, payments transactions had already reached US\$46b in the first six months of 2018 – surpassing the previous year's total of US\$33b. And 2019 already has three announced payments mega-deals by Fiserv, FIS and Global Payments for a total of US\$87b.

Larger, more established businesses are hunting for smaller companies to access new payments technology (mobile wallets, integrated payments), geographies, market segments (micro-merchants, person to person) and technology platforms or to build scale by running more customer transactions through their existing fixed cost infrastructure.

About this report

This report is part of the EY Buy and Integrate series of sector-specific reports that encourage CFOs, CDOs and transaction leaders to take a fresh look at how they identify and capture synergies during M&A. In the reports, we suggest leading strategies to improve your M&A and integration playbook.

For more EY Buy and Integrate perspectives, see the reports:

- ▶ Advanced manufacturing
- ▶ Banking and capital markets
- ▶ Health care
- ▶ Insurance
- ▶ Life sciences
- ▶ Technology, media and entertainment, and telecommunications
- ▶ Wealth and asset management

For example, First Data acquired CardConnect in 2017 to further its integrated payment solution capabilities with its payments partners and customers. Global Payments acquired AdvancedMD in 2018 to build out its presence in the health care industry vertical through AdvancedMD's medical office software. Also in 2018, TSYS completed its acquisition of Cayan to expand its omni-channel capabilities, and PayPal acquired iZettle to greatly increase its presence outside the US.

Private equity firms, meanwhile, are active market players with payments companies, such as the Nets and Concardis merger in June 2018. This €1.3b deal saw private equity firms Bain and Advent swap their holdings in Concardis for shares in Nets, which was owned by US private equity firm Hellman & Friedman.

With so much M&A activity and high prices in the payments sector, how can you expand the return on investment?

Multiple bidders? Know your synergies

Multiple bidders pursuing the same target are asked to refresh their best offer bid price to stay in the running. Doing so requires a clear vision of anticipated post-deal synergies. Buyers should not get caught up in a bidding war. Focus, instead, on justifying acquisition decisions. Demonstrate precisely how synergies can be captured and how a target company's value can be retained upon completion of the merger.

As bidding rounds ensue, successful bid participants must look for increased synergy opportunities without losing confidence in their initial synergy projections – all despite limited access to target company data, limited exposure to the target's management team, and legal and proprietary restrictions around sharing information to a potential competitor.

How can you achieve your anticipated synergies?

- ▶ **Define synergy objectives before you close the deal.** Effective integration and synergy capture planning start during buyer diligence, before the bid is accepted. Significant effort is spent on finishing diligence analysis prior to closing and agreeing on the purchase terms and conditions. Focusing on activities to close the deal can take away from laying out the overall integration plan that underpins synergy capture and realization.
- ▶ **Quantify your deal synergies early and identify potential hurdles.** Payments acquisitions often target a specific technology, a specific portion of the payments value chain, or a new or emerging market segment. The strategic objective is detailed in the deal thesis, highlighting the primary revenue or cost synergies, but buyers also need to know how sales teams, processors and other merchant relationships will be integrated into the company and whether they will create new synergies or risk destroying value.
- ▶ **Understand which synergies are more realizable than others.** Cost synergies tend to be more readily identifiable, fueled by overlapping and redundant staff, pricing differences

among common third-party service providers, and choice of one IT system over another. Revenue synergies tend to be more prospective and require pro forma planning of the combined companies: the ability to exploit the newly acquired market segment, cross-sell one set of products and services across companies, or set higher price points.

Payments businesses hope that by combining their technology with that of a target, they will be able to run more transactions through fixed cost back-end systems while extending their reach into other payment channels. But deals should also contribute to greater value and improved user experience among merchants and end customers by offering seamless methods to pay and connect across physical, internet and mobile channels.

- ▶ **Understand the key assumptions driving your synergies.** Initial synergy opportunities are often ascertained through preliminary review of data provided by the seller through the diligence phase. This process involves applying the buyer's knowledge of the target's business model, systems, merchants, partners and third-party agreements to the limited information offered by the seller. To confirm and refine synergies, synergy assumptions and drivers should be documented and retested as additional information is gained and more of the buyer's team members are brought into the deal. Conduct what-if analyses on these assumptions to better understand what synergy value is at risk under different market or operational scenarios. For example, how quickly can independent sales organizations (ISOs) be converted to the new platform, and how will attrition impact overall transaction volumes?
- ▶ **Assess your ability to achieve the projected synergies.** Determine the cost, complexity and risks to achieve and sustain your planned synergies. These can often be overlooked or underestimated, leading to erosion of the overall premium paid. Each functional area from the buyer's team should be involved in the synergy-sizing effort. Dependencies between synergies may stagger their realization over many months after closing. Synergy achievement will often involve coordination between different buyer teams that must also support existing business priorities. For instance, transitioning merchant acquirer portfolios requires decisions on target systems, development work to account for gaps in functionality or residual payment attributes, and cross-training of sales and customer service teams.
- ▶ **Set up a synergy tracking model.** An effective synergy management program details the drivers, costs and expected results for each synergy and assigns accountability to the relevant business groups (including shared services functions). Understand synergy dependencies such as transition service agreements (TSA) exits or staff training and manage them as part of the overall integration plan. Set specific metrics and goals associated with hard-to-track synergies such as cross-sell revenue initiatives to create appropriate clarity to enable synergy capture progress.

Case study: How do you manage a merger of equals?

Challenge

A leading US payments processor acquired a leading US merchant solutions provider in a deal totaling over US\$2b. The companies needed help with post-close activities. Integration included the transition of buyer's merchants and partners over to the acquired platform.

Approach

We worked with the buyer to develop near-term and medium-term integration priorities and to establish integration teams and the overall approach to integration. Team charters, work plans and milestones were defined, and critical team interdependencies were identified, giving participants a clear road map for roles and targets.

An overall governance process, including progress updates, was instituted. An integration dashboard was developed, aligning partners by organizational business unit.

Independent sales organization and independent software vendor partner transitions were prioritized based on fee-sharing complexity, originating platform, size of portfolio, products supported and so on, with a boarding process created for this purpose. Transition planning was also introduced for shared service functions, including finance, human resources, technology, legal and compliance.

Result

The buyer had an overall partner transition plan to coordinate resources across the two companies. The buyer was able to follow a boarding process and timeline for transitioning partners that covered partner communications, as well as configuring residual payment schedules and training new platform users (e.g., partners, sales).

A boarding process for new merchants and partners aligned them to the appropriate platform and established uniform agreements and pricing schedules. Sales commission and compensation schedules were realigned with the new payments platforms.

Shared service functions were transitioned to the parent company, including employee transitions; sales recruiting resources and approaches; consolidated residual, commission and financial reporting; and consolidated statement printing and distribution.

The buyer was able to successfully complete its largest acquisition to date, integrate the target company into its business model, and continue identifying and acquiring new targets to execute on its growth strategy.

- ▶ **Align goals and milestones across work streams.** Up-front planning typically allows for a smoother integration that manages disruption to merchants, partners, sales teams and employees. Set and adjust integration goals and milestones, such as platform conversions and consolidation of sales team commission structures that become anchor points across all work streams. Align synergy capture targets and other key integration activities to those milestones. Understand key dependencies across work streams that cover people, processes, systems and third parties. Track progress against those dependencies to assess and manage any potential slippage against milestones, particularly those that have impact to ISOs and other payments partners. An integration management office (IMO) can help coordinate work streams, define deliverables and timeline, and provide an ongoing forum for reviewing progress and issues.

Build a talent retention strategy

Integration challenges can be just as difficult on employees as they are on merchants and other partners. Establish a dedicated change management program and joint communications structure to better engage with the two organizations around common goals. Deliver a combined organizational structure as early as possible, laying out reporting lines, roles and responsibilities, and rationale.

Spend the time to understand the cultural differences between the two companies and create an inclusive environment. Larger

companies tend to have a more formal and rigid organizational structure, processes and overall culture. Smaller businesses are typically more agile and often take pride in doing more with less, with greater roles and responsibilities. Their success is typically driven by the ambition and personality of a founder or other leaders of its management team. Discuss and address these key differences openly.

Look to lessen or expedite any corporate processes, such as capital investment approvals or steering committee decisions, that may be viewed as speed bumps or barriers to progress and may sow ill will with new employees.

Avoid predictable pitfalls

Many within the payments industry have already been through several deals, and confidence levels may be high when it comes to the next integration or divestiture. But not all buy-side integrations are the same.

- ▶ **Don't underestimate the complexity of your integration.** The most common driver of complexity is integration of technology and subsequent conversion of merchant accounts. All customers, including merchants, would rather avoid any conversion activities that risk business disruption and require implementation and training. Many payment integrations converting to a single platform attempt to limit impact to the merchants and partners by building additional formats and functionality into their systems to accommodate the target's idiosyncrasies of conducting its payments business.

For example, residual payment tables across different payment processors and acquirers often differ in fee and pricing attributes, merchant bank identification number formats and field definitions. While a combined rationalized normative payment table is preferred, a “Frankentable” is often stitched together to accommodate the multiple pricing bases, with the ultimate goal being convergence. This added complexity is pushed on to sales, operations and technology teams to manage, rather than attempting to move merchants to new pricing formats that may risk opening up contract renegotiations.

- ▶ **Include long-term identity and branding in the deal conversation.** Given the pace of innovation in the payments space, newer startups have created their own branding with merchants, ISOs and ISVs, small businesses, and other customers that identifies them as agile, innovative and current. Branding strategy and approach should be developed early in the deal cycle to leverage the newly acquired brands and determine how they will fit within the buyer’s branding strategy. Establishing a branding and marketing strategy can mitigate the potential for confusion or ambiguity in the marketplace with not only your merchants and partners but also with your employees who may not be sure about the future direction of the combined companies.
- ▶ **Establish a boarding plan for new merchants.** If multiple systems are involved, decide how new merchants will be added to which platforms and under what conditions. Confirm that the sales partners understand the new platforms they are selling and that commission systems account for cross-platform sales. Customer service, online FAQs, and other customer and sales support systems must provide one-stop and up-to-date services to avoid building customer and partner frustration.

Designate an experienced IMO to manage the integration

Payments companies often have strong leaders and teams that are subject-matter resources for their specific payments functions. But tapping them to run the overall integration approach while managing the business can push them out of their comfort zone and lead to miscues and delays, distracting them from normal business operations.

Identify key roles and requirements for the integration at the start of the transaction. Assess your team’s resources, skill sets and capacity to both support the integration and run the business.

A strong and dedicated IMO that knows how to manage integrations can set the direction, maintain the pace, identify critical dependencies, manage issues and run the implementation of a successful integration. The IMO should include in-house expertise from the buyer and the acquired company. The goal of an IMO is to lay out the overall integration methodology to bring the companies to legal closing and a fully integrated target state, free of any TSAs or other seller support. Additional post-close seller support may be required if the acquired business must be carved out of the seller’s company and may involve support activities such as hosting technology systems, management and settlement across deposit accounts, merchant boarding, and other support services.

Conclusion

As payments companies use M&A to keep up with the speed of change stemming from digital disruption and innovation, the key to expanding deal value lies in clearly articulating and capturing cost and revenue synergies. Don’t underestimate either the effort to plan for and execute the integration or the impact it will have on your customers and your employees. Integrations need the necessary time, resources and leadership from the initial deal discussions to hit deal targets, maintain business growth, limit disruption and retain talent.

Contacts

Global

Charlie Alexander
EY Global Banking & Capital
Markets Sector Leader
cpalexander@uk.ey.com

Kai-Christian Claus
EY Global Payments Leader
kai-christian.claus@ey-innovalde.de

Brian S. Salsberg
EY Global Buy and Integrate Leader
brian.salsberg@ey.com

EMEA
Michael Wada
Partner, Transaction Advisory
Services, Ernst & Young LLP
mwada@uk.ey.com

Andreas Habersetzer
Managing Director, Transaction
Advisory Services, Ernst & Young LLP
ahabersetzer@uk.ey.com

Americas
Aaron Byrne
Principal, Transaction Advisory
Services, Ernst & Young LLP
aaron.byrne@ey.com

Kieran Hooks
Managing Director, Transaction
Advisory Services, Ernst & Young LLP
kieran.hooks@ey.com

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