

# Global Payments Inc. (NYSE: GPN) Long Memo

Nov. 29 <sup>th</sup> , 2014	Global Payments Pay Global	Jessica Jie Gao (3 <sup>rd</sup> Year)
E-mail: jg7cg@virginia.edu		Cell: (434) 270-4623

Share Price (11/29/2014)	\$ 86.36
<u>Diluted Shares Outstanding (mm)</u>	<u>67.64</u>
Market Capitalization	\$ 5841.39M
Total Cash	581.87
Total Debt	1833.81
<u>Minorities/Preferred</u>	<u>135.57</u>
Enterprise Value	\$ 7,228.90M
Earnings per Share	\$ 3.60
Vol/Avg. (30 days)	0.27M/0.58M
Fiscal Year end	May 31 <sup>st</sup>

## COMPANY OVERVIEW

Global Payments is a leading provider of electronic payments transaction processing services for consumers, merchants, financial institutes, and multi-national corporations. The company serves an intermediary to facilitate electronic payments and operates in two business segment: North America Merchant Services and International Merchant Services.



## INVESTMENT THESIS

Global Payments is a **growing company** in a **promising industry** with **fair valuation**. Future growth is driven by expansion of electronic transactions, especially on **ecommerce** and **mobile payment** platforms. With improving leverage of **technology** and **global expansion** through joint ventures, this company is well-positioned to deliver growth in the long run both domestically and globally.

Attractive shareholder returns are driven by **financial flexibility**, **discipline corporate development roadmap**, and **reinvestment in the business**.

## BUSINESS MODEL

### 1) How a card transaction works? (Exhibit #1)

A typical non-cash transaction begins when a cardholder presents a card for payment at a merchant location where the card information is captured by a point of sale ("POS") terminal card reader or mobile device card reader, which may be sold, leased, or rented, and serviced by Global Payments. Alternatively, card and transaction information may be captured and transmitted to our network through a POS device by one of a number of products that we offer directly or through a value added reseller ("VAR"). The terminal electronically records sales draft information, such as the card identification number, transaction date and value of the goods or services purchased.

### 2) How does Global Payments make money? (Exhibit #1)

During a typical payment transaction, the merchant and the card issuer do not interface directly with each other, but instead rely on merchant acquirers like Global Payments to facilitate transaction processing. We perform a series of services including authorization, electronic draft capture, file transfers to facilitate funds settlement and certain exception-based, back office support services such as chargeback and retrieval resolution.

## MISPERCEPTION

### 1) Misperception: Global Payment is compared with credit card companies like Visa and MasterCard

Fact: As illustrated above, Global Payment is a transaction processing company which acts as an intermediate between merchants and credit card issuing companies. From financial perspective, Global Payments has a higher operating margin than credit card companies. However, net revenue per transaction is largely relies on the policies of credit card companies.

### 2) Misperception: Merchant deals directly with credit card issuers (Exhibit #2)

Fact: Unbeknown to the cardholders, card-based transaction actually travels through the Black Box-a highly evolved group of intermediaries. Merchant acquirers help in completing the payment transaction cycle by ensuring the flow of funds to respective parties through authorization of transactions, clearing and settlement.

## KEY INDUSTRY THESIS (TAILWINDS)

### ***I. More transactions are made by non-cash payments (Exhibit #3)***

The value of noncash transactions will reach an estimated \$780 trillion by 2023 with CAGR of 7%. Payments revenues will reach an estimated \$2.1 trillion, a CAGR of 8%. Retail payments businesses will dominate led by account revenues and followed closely by credit cards. Wholesale transaction banking will see significant increases in revenues from account spreads.

### ***II. Ecommerce boosts credit card usage (Exhibit #4)***

Global e-commerce spending and mobile payments are growing rapidly. By 2016, e-commerce spending will reach \$2.0 trillion (up from \$1.1 trillion 3 years ago).

### ***III. Mobile Payments are driven by growing smart phone users and more convenient payment method, such as Apple Pay (Exhibit #5)***

Mobile payments will reach \$670 billion by 2015 (up from \$240 billion 3 years ago). Global Payments has several mobile-based products and solutions that will allow the company to take advantage of this rapidly rising tide.

## KEY COMPANY THESIS

### ***I. Solid Global expansion is achieved through joint ventures and acquisitions (Exhibit #9)***

- 1) International merchant services revenue increases with better margin performance
  - i. Segment revenue increased \$75.0 million, or 11.2%, to \$745.2 million in FY 2014 from \$670.2 million in FY 2013.
  - ii. Segment operating margin of international merchant services segment increases from 31.5% to 32.2%, which is two times the margin for North America merchant services.
- 2) The growth is due to growth across our European markets and in the Asia-Pacific region.
- 3) Most recent acquisition of Ezidebit enable Global Payments recur payments verticals in New Zealand, Australia, and other Asia Pacific regions where these types of solutions have not been offered before. (Exhibit #5)

### ***II. Integrated payment solution gives Global Payments an edge in Ecommerce and Mobile payment transactions***

- 1) Software differentiate through innovations
  - i. OpenEdge is the combination of APT and PayPros, a single integrated solutions business drives payments innovation. It adapts scales and simplifies how payments are processed, across platforms and points-of-interaction, in an increasingly complex landscape.
  - ii. OpenEdge serves more than 2,000 technology partners across 60 industry verticals throughout the United States and Canada.
  - iii. value-added reseller program provides customized proven solutions with multiple benefits (Exhibit #)
- 2) PayPal is the most critical partner in ecommerce payment market
- 3) OpenEdge announced full support of Apple Pay. Global Payments is one of the earliest merchant acquirers incorporate mobile payments in the market.

### ***III. With the consolidation of market of large merchants, Global Payments taps underserved small and mid-market merchants in diversified vertical markets***

- 1) Vertical market base is the most diversified one compared to its competitors: Automotive, Ecommerce, Education, Education, Gaming, Government, Healthcare, Lodging & Hospitality, and Retail
- 2) Experts in specific industries with reliable volume of noncash transactions, such as automotive, dental, field services, healthcare, retail, restaurant, self storage, and veterinary.
- 3) Sales distribution shifted focus from large scale merchants to small and mid-sized merchants who are underserved by top-tier merchant acquirers.

### ***IV. Unsurpassed service and technology for casinos make Global Payments the No.1 merchant acquirer in North American gaming industry***

- 1) The company expands North America gaming business vertical by entering into a strategic agreement to acquire Fidelity National Information Services, which is a complimentary to its existing gaming business and brings revenue synergy
  - i. PlayerCash is a full- electronic product that allows customers to complete transactions on a signature capture

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device, eliminating the need to print and deposit paper drafts. Integrated security features reduce fraud and help prevent against chargebacks. Funds are deposited directly into the establishment's accounts.

- ii. With VIP Preferred, both paper and E-checks can be cashed in seconds with funding 100% guaranteed by Global Payments.
- 2) Potential expansion to Macau, China (VAR)

### V. **With best financial performance, Global Payments is undervalued compared to its competitors (Exhibit #11)**

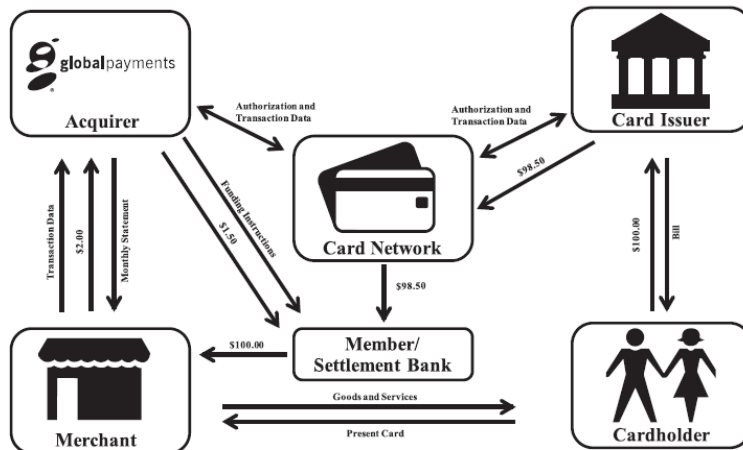
- 1) Forecasted EPS growth of 16.50%, slightly higher than that of industry average of 14.62%. However, forward PE of 18.15, which is much lower than industry average of 42.50.
- 2) CAPEX is reduced by 26.9 million due to the completion of data center infrastructure and authorization platform
- 3) FY 2015 guidance was raised after the Q1 earnings release
  - i. Despite the acquisition of PayPros, the cash operating margin remains steady at 38.4% and \$87 million free cash flow is generated at the FY 2015 Q1.
  - ii. Despite the acquisition of Ezidebit, the company raised expectation for FY 2015. It expected reported revenue to grow 7% to 9%, ranging from \$2.74 billion to \$2.79 billion, and EPS to 13% to 15%, ranging from \$4.65 to \$4.75.
- 4) Recent acquisitions started contributing to the company's results faster than expected.

### RISKS

- 1) Net revenue per transaction varies across merchant base and is subject to change based on changes in discount rates and interchangeable rates.
- 2) Inability to safeguard customer data from cyber attacks will affect the reputation among client as well as incur penalties and legal claims.
- 3) Core business segment is contract based, which makes competition especially fierce among players.
- 4) Non-traditional competitors may have advantage in rising electronic payment markets
- 5) Significant amount of goodwill and intangible assets accumulate from acquisitions.
- 6) Currency exchange rate fluctuations may decrease revenues.
- 7) As part of the business nature, the company faces Merchant losses when it is unable to collect amounts from merchant customers for any charges properly reversed by the issuing bank.

### Exhibit #1: How a card transactions works

**Illustrative Card Transaction Flow**



**Exhibit #2: Blind Perspective vs. Real Transaction Network**

Figure 1  
The Boundaries of the Black Box

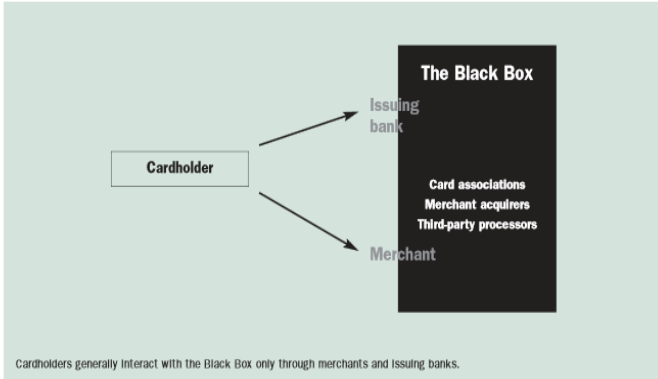
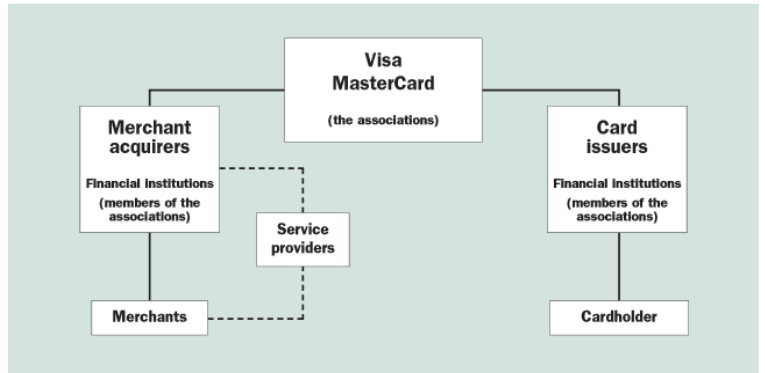


Figure 2  
Parties Involved in a Card Program: A Four-Party Network



**Exhibit #3: Global Noncash Transactions**

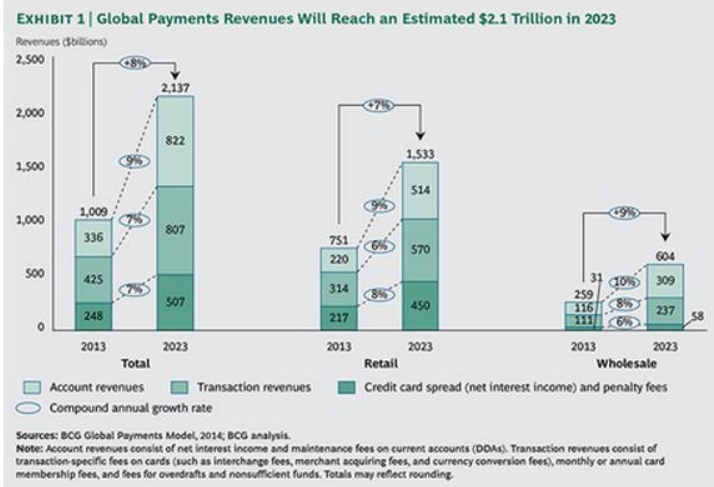
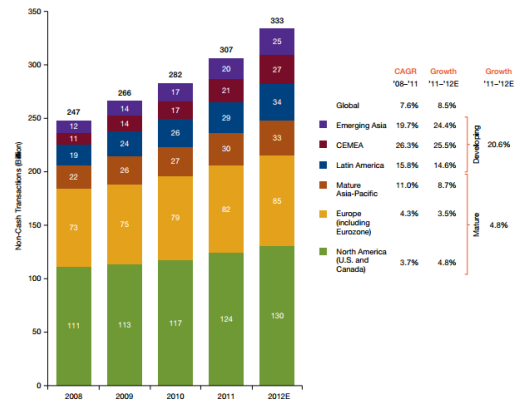


Figure 1.5 Number of Worldwide Non-Cash Transactions (Billion), by Region, 2008-2012E



**Exhibit #4: Ecommerce Trends**

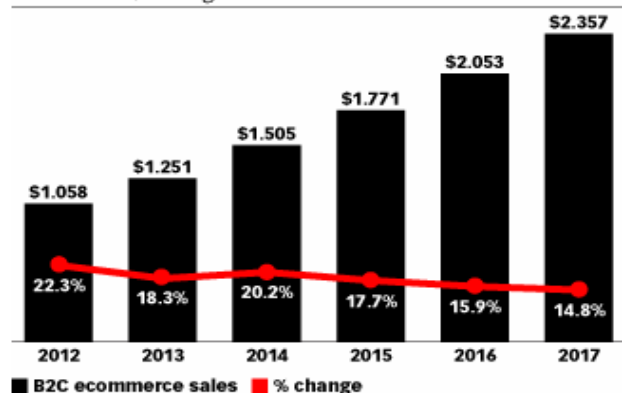
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- 1) Worldwide B2C ecommerce sales will increase by 20.1% this year to reach \$1.5 trillion. Growth will come primary from the rapidly expanding online and mobile user bases in emerging markets.
- 2) Massive gains in China, as well as in India and Indonesia, will push Asia-Pacific's growth ahead.
- 3) Argentina, Mexico, Brazil, Russia, Italy and Canada will drive ecommerce sales growth in other regions across the world.

Conclusion: transaction processing company like Global Payments will benefit from above trends by collecting transaction fees between merchant and issuing banks more frequently.

### B2C Ecommerce Sales Worldwide, 2012-2017

trillions and % change



Note: CAGR (2012-2017)=17.4%; includes products and services ordered and leisure and unmanaged business travel sales booked using the internet via any device, regardless of the method of payment or fulfillment  
Source: eMarketer, Jan 2014

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www.eMarketer.com

### B2C Ecommerce Sales Worldwide, by Region, 2012-2017

billions

	2012	2013	2014	2015	2016	2017
Asia-Pacific	\$301.2	\$383.9	\$525.2	\$681.2	\$855.7	\$1,052.9
North America	\$379.8	\$431.0	\$482.6	\$538.3	\$597.9	\$660.4
Western Europe	\$277.5	\$312.0	\$347.4	\$382.7	\$414.2	\$445.0
Central & Eastern Europe	\$41.5	\$49.5	\$58.0	\$64.4	\$68.9	\$73.1
Latin America	\$37.6	\$48.1	\$57.7	\$64.9	\$70.6	\$74.6
Middle East & Africa	\$20.6	\$27.0	\$33.8	\$39.6	\$45.5	\$51.4

**Worldwide \$1,058.2 \$1,251.4 \$1,504.6 \$1,771.0 \$2,052.7 \$2,357.4**

Note: includes products and services ordered and leisure and unmanaged business travel sales booked using the internet via any device, regardless of the method of payment or fulfillment; numbers may not add up to total due to rounding

Source: eMarketer, Jan 2014

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## Exhibit #5: Global Payments Market Share

U.S.	12%
Canada	20%
Spain	21%
U.K.	20%
Czech Republic	50%
Russia	23%
Asia-Pacific	25%

## Exhibit #6: Global Payments' Competitive Positioning

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Ranking (transactions)	Ranking (dollar volume)
1. First Data	1. Chase Merchant Services
2. BA Merchant Services	2. BA Merchant Services
3. Chase Merchant Services	3. First Data
4. Paymentech	4. Paymentech
5. Fifth Third Bank	5. Nova Information Systems
6. Global Payments	6. Fifth Third Bank
7. Nova Information Systems	7. Global Payments
8. Wells Fargo	8. Wells Fargo
9. Alliance Data Systems	9. First National Merchant Solutions
10. Heartland Payment Systems	10. Heartland Payment Systems

**Merchant acquirers holding at least 1 percent of U.S. market share in 2004 (by dollar volume), including partnerships and alliances**

1. First Data (including Chase Merchant Services, Paymentech, Wells Fargo, SunTrust, and PNC)
2. BA Merchant Services
3. Nova Information Systems (including KeyCorp)
4. Fifth Third Bank
5. Global Payments
6. First National Merchant Solutions
7. Heartland Payment Systems
8. TransFirst

Source: The Nilson Report (2005b)

**Exhibit #7: Competitors' List (domestic market)**

Real Competitors	False Competitors
Bank of America Merchant Services	MasterCard
Chase Payment	Visa
Elavon	American Express
First Data Corporation	PayPal
Heartland Payment Systems	Fidelity National Information Services

**Exhibit #8: Benefits of VAR (Value-added Reseller Program)**

- Every VAR Program participate will:
- Maximize residual payments through a dedicated sales channel
  - Have access to Partner Resource Portal for lead submission and monitoring
  - Have access to customized, branded marketing materials to aid in securing new customers
  - Have field and telesales support to help grow the program and develop new revenue opportunities

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### Exhibit #9: Recent Acquisitions

	<u>Date Acquired</u>	<u>Percentage Ownership</u>
<b><u>Fiscal 2014</u></b>		
American Express merchant portfolio (Czech Republic)	October 24, 2013	100%
PayPros (United States)	March 4, 2014	100%
<b><u>Fiscal 2013</u></b>		
Accelerated Payment Technologies (United States)	October 1, 2012	100%
Banca Civica (Spain)	December 12, 2012	100%
<b><u>Fiscal 2012</u></b>		
Alfa-Bank (Russian Federation)	December 5, 2011	100%
HSBC Malta (Republic of Malta)	December 30, 2011	100%
CyberSource merchant portfolio (United States)	January 31, 2012	100%

### Exhibit #10: Key Expansion Strategies

- Growth and control direct contribution by adding new merchants and partners
- Deliver innovative products and services by developing value-added applications, enhancing existing products and developing new systems and services to blend technology with customer needs
- Leverage technology and operational advantage solutions for leading global customers
- Provide customer services at levels that exceed our competition, while investing in technology, training and product enhancements, and
- Pursue potential domestic and international acquisition of, investments in, and alliances with companies that have high growth potential or significant market presence

### Exhibit #11: 1-Year Stock Chart



*Ideas for the club:*

**I. Further utilize coverage groups:**

My coverage group has 2 associates and 7 analysts. The relative small size allows them have a good amount of interactions with each other. I gave them a controversial stock at the very beginning of semester, and associates led analysts doing research and VAR during fall break and they had a debate after the break. Since they could not reach an agreement, they decided not to pitch this stock for the club but wait for the earnings release. It turned out the short side won because the company missed earning a lot.

From my standing point, I'm very glad that analysts in my team learned research skills, VAR, and risk management from this experience. However, I did observe some improvements can be made in the next semester:

- 1) Involvement: we changed policy this year that positions were randomly assigned to each associate. However, I did hear from several associates that they are genuinely not interested in their coverage stocks. Associates can involve more if the coverage is a mutual matching.
- 2) Communication: according to the feedback from one of my analysts, she feels she had no communication with other club members during the weekly meeting. I think associates can lead 5-minute group discussion about the stock pitch each time.
- 3) Manager's participation: I tried to be as approachable as I can, but due to various reasons, I missed some group meetings. But I believe both associate and analysts can benefit if manager shows up for the most of times and offer perspective and ideas.

**II. Management notes:**

It is the nature of student fund that the management team will change every year. Some challenges are unavoidable by this nature. It is hard for future generations to know the logistics behind our decisions, so I think an insider note shared only to management team can help solve this problem.

- 1) Take notes of why we made decision of entering, selling, covering, repurchase and etc.
- 2) It is especially important to record why and how we made mistakes
- 3) Each time that we send members for competitions, their experiences would benefit future generations. So we can take notes of their experiences and takeaways
- 4) Hopefully the management notes can be passed on through out generations

**III. Club wide portfolio competition:**

Members are encouraged to pitch ideas, but it is impossible to us to add every idea on our portfolio. It has no cost for us to organize a semester-long portfolio competition, but participates will benefit from following stocks on portfolio, adopting the right strategy, and watching the market. Financial information website such as MarketWatch allows to you hold a competition very easily. Another benefit of this competition is that we may find some talents in the club.

**IV. School wide/national stock pitch competition**

Some of our best analysts learned how to pitch stock by participating in stock pitch competitions. However, we have limited opportunities and limited budge to send members to other stock pitch competitions, so it would be great if we can hold/co-hold one.

It is possible for us to hold a national stock pitch competition like Georgetown and Michigan stock pitch competitions. Benefits include:



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- 1) Enhance relationship with local hedge fund, asset management firms, and private equities
- 2) Bring more opportunities to the club
- 3) Give members' more teamwork opportunities

However, if we decide to do so, we need to plan as early as possible; it takes very long to do the preparation.

### **V. Best Associate Award:**

While the contribution from each analyst varies, associates also involve with different level. It would give associates more motivation if we nominate best-performed associate each semester. Some criteria include:

- 1) Quality of coverage sock updates
- 2) Ability to engage analysts
- 3) Performance of the coverage team

### **VI. Newsletter**

We stress on the importance of following market. I know there are many ways to follow markets if you really want to, but we should understand it's hard to start and people get lazy sometimes. Still, it would be great if we can keep our member updated with latest financial new, government policies and etc. Newsletter is the easiest way.