McTevia to US Banker - Private Equity Eyes Financial-IT Sector

Front & Center

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M&A: Private Equity Takes Aim At Financial-IT Vendors

More than $330 billion awaits deployment

By Lee Conrad

Financial-IT companies are expected to lure a growing number of private-equity investors over the next few years, thanks to the dynamics of the industry and the huge amount of funds these investors have raised and want to put to work.

The financial-IT sector has evolved into a fragmented industry filled with small competitors. That means it's tailor-made for a consolidation spree, says Jim McTevia, managing member of McTevia & Associates, a management and financial-consulting firm.

What's more, McTevia says, over the next five to 10 years many vendors will find it too hard to compete with low-cost competitors that outsource operations, priming the pump for even more consolidation in the industry.

On the private equity side, there's a huge amount of money raised from institutional investors that is seeking a home. According to research firm Dealogic, global private-equity transactions in the technology sector equaled $65.2 billion last year, up from $43.9 billion in 2005 and $1.7 billion in 1995.

Even with that activity, there's still a substantial amount still sitting in cash. According to a Wachovia Capital Markets report, more than $500 billion has been raised since 2005, with two-thirds of that - more than $330 billion - still to be invested. "This is a unique time in private equity," says Nick Golding, managing director and head of financial technology and services at Piper Jaffray Cos. "There's an unprecedented pool of capital and it's a good leveraged-lending environment."

The financial-IT industry is particularly attractive to private-equity investors thanks to long-term contracts signed with bank customers. Private-equity firms value these recurring revenue streams since they make the firms "highly leverageable," says Golding. That helps private-equity investors outbid strategic technology buyers.

Two deals announced in early April illustrate the attractiveness of financial-technology firms to the private-equity universe.

Kohlberg Kravis Roberts & Co. agreed to buy payments processor First Data Corp. for $29 billion on April 2, which represented a 26 percent premium over First Data's closing price the previous business day. KKR declined to comment and First Data did not return phone calls.

On April 3, Marshal & Ilsley announced that Warburg Pincus would invest $625 million for a 25 percent equity stake in its Metavante subsidiary. This is part of a deal in which Metavante will eventually be spun off as its own public company; existing Marshal & Ilsley shareholders retain the remaining 75 percent of Metavante.

Warburg Pincus declined to comment and Marshal & Ilsley did not return phone calls. But according to a company statement, leverage will play a role. The deal calls for $1.75 billion in new Metavante debt arranged by JPMorgan Securities.

And this consolidation wave shows no signs of abating. After KKR announced plans to buy First Data, First Data said it would buy FundsXpress, a provider of online banking bill payment. It also announced the completion of a previously announced deal to buy Instant Cash Network.

Dan Schatt, a senior analyst at Celent, notes that some of the benefits to a private-equity buyer comes from mixing and matching various pieces of firms in its portfolio. Any business unit that doesn't have a positive impact on the company's bottom line could be disassembled and added to another company in that portfolio that makes a better fit.

Private-equity funds are more nimble to make such moves than many publicly traded strategic acquires, adds McTevia. They do not have as many compliance issues as public companies do, and their investors are in it for the long-haul-giving them a stable base of cash. "This is bigger than just a U.S. story. This is a consolidation of industries that is global in scale," he says.