

ATM Players Push Consolidation Buttons

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These ATM transactions aren't worth \$100-more like \$100 million.

Over the summer, the roughly \$1.5 billion-in-annual-revenue independent ATM operating industry has generated two large deals, its largest player is going public and another big player is on the block.

Takeout multiples, meanwhile, are rising, said an industry source.

The ATM industry has seen a spurt of growth over the last several years. Dozens of M&A deals have occurred, and the number of off-site (non-bank) machines has nearly tripled in the last four years. ATMs will dispense about \$670 billion in cash this year in 11 billion transactions, according to an estimate from Tremont Capital Group.

But there are factors working against ATM operators-saturation is evident, margins are razor thin and fees for transactions have hit a ceiling. These issues have participants scratching their heads over the future of the industry.

Nevertheless, one recent deal, by all accounts the largest in the industry's history, yielded a big multiple. In July, Cardtronics Inc. paid \$106 million for E*Trade Financial Corp.'s 13,100 ATMs. One person familiar with the deal said marquee assets in the space typically sell for seven to nine times EBITDA. Privately held Cardtronics paid above that range, he said.

Cardtronics paid up partly because E*Trade presented a diverse portfolio, with machines located in different retail categories. Diversity is key in this space, noted the source, "If you had a bunch of ATMs at K-Mart [Holding Corp.], you're not doing so well," he said.

But other observers questioned the high price. Sources said E*Trade's business had very low levels of EBITDA, but Cardtronics did the deal to drum up the attention for its upcoming public offering. The E*Trade transaction made Cardtronics the world's largest ATM player, with about 25,000 machines, or 7% of the estimated 380,000 machines in the United States.

A spokesman at Cardtronics declined comment, saying the company is in a quiet period. The Houston-based firm, founded in 1989, plans to raise up to \$115 million in the offering.

Meanwhile, one of the country's other large ATM players, owned by eFunds Corp., appears to be a target.

Paul Walsh, chief executive officer of eFunds, said on the company's second quarter earnings call it is actively looking at "options" for the ATM business. He added that the \$725 million market cap firm probably will not build that business through M&A. Investors "should not anticipate us putting more capital into this segment," he said. Scottsdale, Ariz.-based eFunds also operates electronics payment, risk management and outsourcing businesses. A spokeswoman at eFunds said executives were unavailable for further comment.

In an Aug. 5 note, Jefferies & Co. analyst Craig Peckham writes, "Based on E*Trade's recent sale of 13,100 machines to Cardtronics for \$106 million cash, we think \$60 [million to] \$80 million is a decent starting point, given that eFunds owns about 2,000 ATMs and has management contracts on another 15,000, according to the 2003 10-K."

As for multiples, most deals in the space are small and between privately held companies, so data is hard to come by. Thomson Financial did not track enough numbers to generate a significant chart.

"Acquirors in this industry use a surprisingly wide range of valuation methodologies," said Sam Ditzion, president and CEO of Boston-based Tremont. He said he is one of the few bankers in the country focusing on ATM deals. Tremont advised IntelliCash ATM Inc. on its sale to SwipeUSA LLC in February. San Francisco-based SwipeUSA did not disclose deal terms.

Among factors acquirors consider are the length of the machines' contracts, the quality of their technology and location and whether they are owned or only serviced, he said. "Dozens of industry specific performance metrics need to be thoroughly evaluated in order to establish a multiples range for a specific deal," he said.

Tremont has tracked dozens of deals in the space in the last several years. Ditzion added it is now a seller's market for the strongest portfolios and that deal flow has "picked up considerably over the last several months."

Another recent deal saw a below-average multiple. American Express Co. sold the 5,483 boxes it operated in 7-Eleven stores to 7-Eleven Inc. on Aug. 17 for \$44 million. 7-Eleven paid between three and four times EBITDA, said sources, partly because there were no other corporate bidders.

A spokeswoman at 7-Eleven declined to comment about the EBITDA multiple, only saying "We got a good deal. Two cents accretive in five months is pretty good." American Express bought the machines from Electronic Data Systems Corp. in 2000.

For 7-Eleven, the acquisition is part of a broader financial services initiative it is developing in its stores. The convenience-store company offers money transfer, check cashing and bill payment through its virtual commerce, or "Vcom" kiosks. 7-Eleven is trying to offer "more functionality" than a typical ATM with Vcom, said the spokeswoman. The Dallas-based company has placed Vcom boxes in 1,000 7-Eleven stores, or 4% of the \$2.2 billion chain's total stores, with expansion anticipated.

Functionality could be the only path to survival for ATM players, said a few industry sources. But Ditzion downplayed the idea. "There certainly have been a lot of excitement in recent years over advanced features and functionality at ATMs, but making those enhancements justifiably profitable has been an elusive goal," he said.

Gordon Metcalfe, president and founder of Toronto-based Ezee ATM LP, has acquired nine ATM players over the last three years. The largest was its most recent—the \$13 million purchase of Meta-4 Business Networking Solutions from CGI Group Inc. in July.

Metcalfe said his firm is "probably the only significant consolidator in Canada," with 2,500 of the country's 42,000 machines. Backed by Toronto-based Newport Capital, Ezee is ready to complete as many more purchases as it can, said Metcalfe. He said buyers and sellers can calculate values using EBITDA or a multiple based on an average fee per transaction.

Metcalfe said the dwindling number of large, quality ATM portfolios is putting upward multiple pressure on bidders for those remaining assets. He said he typically pays four to six times EBITDA, though he has paid as low as 2.5 times "recently."

The ATM industry is mature in the U.S. Even though the amount of ATM transactions is growing 2% to 3% per year, the number of ATMs increases at almost five times that rate according to Cardtronics. Adding to the problem, consumers in most markets will not tolerate operators raising fees any further.

Other recent deals include Portland-based TRM Corp.'s June purchase of Mighty Cash Financial Services Inc.'s 72 machines in Canada for an undisclosed amount. TRM, with a \$100 million market cap, has also expanded in the U.K., another market less competitive than the U.S. TRM declined comment.

Before selling to Cardtronics, E*Trade bought 4,000 machines in February 2003 from San Diego-based ExtraCash ATM Inc. Cardtronics also was active last year, with four acquisitions. Acquisitions are part of the company's ongoing strategy, according to its prospectus.

Looking ahead to 2004 and 2005, Ditzion predicted, "Increased scrutiny and regulation as well as continued rapid consolidation through portfolio acquisitions will be major trends."

And the anonymous source noted that the drive towards economies of scale in the space will fuel M&A. After all, he said, in the ATM business, "It's getting harder and harder to make a buck."