

## **IS THIS THE RIGHT TIME TO SELL?**

By Paul A. Rianda, Esq.

Although most people I talk to in the bankcard industry are not being hurt significantly by the changing economic conditions, one segment of our business that has been impacted is the sale of merchant portfolios. In the last six months to a year, the landscape in that market has changed such that sellers are at a considerable disadvantage compared to the status they enjoyed at the end of 2007 and early into 2008. Below I will discuss the changes in that segment of our industry and what you can expect if you are selling a portfolio in the current market.

The past years, I was constantly amazed by the calls I used to get from people trying to break into the business of buying portfolios. Every so often I would get a call from someone backed by a hedge fund or large institutional investor that had a substantial amount of money they wanted to deploy to buy portfolios. Banks, hedge funds and other institutions had a lot of cash and they were looking for new places to invest. Many saw the merchant-acquiring business as a new way of being able to invest their cash and get a superior return due to the relative low level of institutional investing in our industry.

Over the past years, because of this ready supply of cash the market for selling portfolios, be it just a residual stream or a fully portable portfolio of merchants, had gotten better and better from a seller's perspective. In the last three to four years, prices had been creeping up ever so slowly in favor of sellers. Buyers continued to innovate by devising new products to provide sellers with opportunities to sell entire portfolios, individual merchants and hybrids of those types of arrangements. Sellers were getting multiple offers for their portfolios just like home sellers were getting many offers on their homes. All that changed over the last year or so as the credit markets tightened up and cash became a lot harder to come by.

The height of the market was exemplified by the fate of Pipeline Data and the transactions it was involved in over the last year and a half. At the end of 2007 and into early 2008 the market for sellers of portfolios was about as good as it was going to get. In November of 2007, Pipeline Data sent out a press release stating, among other things, it was buying CoCard for \$101 million and that Pipeline itself was getting \$160 million in funding from a major financial institution. Fast forward to February of 2009, and the CoCard deal never did close, the company has been through a restructuring and the market capitalization of Pipeline Data is hovering around \$7 million total. The story is the same for the portfolio sales market as a whole.

Beginning in the middle of 2008 some disturbing trends began to appear. The multiples paid by buyers that they used to calculate purchase prices on portfolios were getting too high for the transactions to make sense from a return on investment perspective. Buyers were paying prices that were so high I was thinking to myself they would never be able to get their investment back in 8 years, if they ever got their investments back at all. In addition, some deals were not closing. Buyers went through the entire process of making an offer, negotiating the definitive agreement to buy the portfolio and then when the closing date came around, were unable to come up with the cash to pay the purchase price.

Compounding the problem was that the merchant attrition rates were increasing due to the number of merchants that were going out of business. As mentioned above, buyers were paying extremely high multiples for accounts when the market was hot. The only way they could justify these prices was by assuming that merchant attrition would be very low if not non-existent. Given the market conditions, the rate of business failures has accelerated and for most businesses that are staying open, their credit card volume has fallen. The worsening financial climate meant most of the financial models the buyers were using to justify the high prices they were paying could not be relied upon and the returns the investors were getting were far less than expected.

As it stands now, the market for selling portfolios has slowed considerably. Many buyers do not have the cash to enter into any transactions. Most all buyers are reliant upon some form of funding (i.e. bank or hedge fund) and do not have the cash on hand themselves to buy portfolios. Given those sources of funding have dried up, many buyers are no longer active in the market for buying portfolios.

So what does that mean to you as a seller? You should expect to take longer to sell your portfolio. Given the lack of buyers, it is also harder to get multiple offers on a portfolio. Buyers are being more choosy and may not want a portfolio if it has even a few flaws. Buyers are more cautious and are moving slower given there is not much competition. So, if you could sell your portfolio in a couple of months at the height of the market today you may be looking at 6 months or more to close a transaction, if you are lucky enough to find a good buyer.

That also leads to the conclusion that you need to look as closely at your potential buyer as that buyer is looking at you. It may not be polite to ask but in this climate I would be requesting that a potential buyer prove to you the buyer has the cash to close the transaction. I have seen a number of people waste a lot of time, energy and money working on a transaction that never closes. Also, look to buyers that have a proven track record in the industry and that can show they have already closed a number of transactions. These are the type of buyers you should seek out, assuming you have a choice

Of course, you should expect to get paid less for your portfolio than you might have in the past. Across the board prices are down as to what buyers are willing to pay. For mid-sized portfolios (in the \$100,000 to \$300,000 per month category for example) the multiples as measured by the number of months times the average monthly residuals being paid are down by 5 to 10 or more. This could cut a third or more off the price you would have gotten a little over a year ago. In that respect, it is very similar to the drop in the housing market in many states in the 30-50% range which may not just be a coincidence, but more of a reflection of how many assets were similarly overvalued by the market.

Overall, it is not a good time to sell, so if you have the choice it is likely better to wait out the market. Buyers understandably are worried about buying portfolios in this market given concerns about merchant attrition and how long this recession will last. This is compounded by the lack of cash to make purchases right now. I think that it could be a great time to be a buyer if you are bullish on the economy for 2010 given the low prices in the market. I believe and hope that things will stabilize in the next 6 months to a year. Then, with the economy on an upswing, cash will become more readily available, leading to more buyers and an increase in the prices offered for portfolios. Only time will tell if that is the case or not.

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