Checking In on Davis + Henderson

Description

By Dave Van Geem

Davis + Henderson (TSX:DH) has been trending in the newsfeeds lately. D+H is trading near three-year highs and has a yield approaching 5%. In this two-part series, I'll explore revenue streams, acquisition strategies, valuation, and whether this stock deserves a spot in your dividend portfolio.

Ask any business person to describe what Davis + Henderson does and they will likely say "cheques". Oddly, that it is hardly true anymore. Like cash, cheques have been slowly dying out as a means of conducting business.

In fact, you could be forgiven if you felt that D+H was in the business of acquisitions — there have been five over the past three years, including a mammoth $1.2 billion deal to purchase Harland Financial that closed in August. Is it too late to buy? Let's cheque in!

If they don't print cheques, what do they do?
First, a point of clarification. D+H still does print cheques, but its businesses have expanded considerably. Payment Solutions is the segment where you'll find the legacy cheque business, along with other innovative products including smart phone payments and credit cards.

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revenue streams

Source: Davis + Henderson 2012 Annual Report

Registry and Recovery automates mortgage and loan registrations and discharges hand-in-hand with collection of delinquent accounts and bankruptcy processes. Loan Servicing aids subscribing institutions in the collection and reporting of loans, including student debt. Lending Technologies offers up a host (no pun intended) of "software as a service" lending products from origination to decision making to booking and monitoring. All other products are included in Business Services.

Exciting acquisitions!
D+H purchased Assett in January 2011 and Mortgagebot in May of the same year. In May 2012, it acquired loan origination company Avista and then completed the acquisition of cloud computing Compushare at the beginning of 2013. Finally, D+H closed the Harland deal in August for a cool US$1.2 billion, dwarfing all preceding transactions.

Many leading business websites and news sources trumpeted the all-cash deal. Harland shareholders definitely were paid cash, but no one has $1.2 billion in the couch cushions, so D+H financed it.

It issued $200 million 6% convertible bonds with a strike of $29.05, and issued subscription receipts (shares) for a tick over $400 million. The markets responded favorably, so D&H sold an extra 2.805 million shares for a cool $90 million. The other $600 million came in the form of renegotiated lines of credit.

If you count Compushare twice (it bought a sizable chunk in 2012 and then exercised an option to purchase the balance of the company this year), you have a convincing argument for six acquisitions in the last three years.

acq

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Source: Davis + Henderson Annual Reports

How do you eat an elephant?
You have to eat an elephant one bite at a time. D+H has been in training, warming up for a big acquisition for a while. In January 2011, D+H had an enterprise value of roughly $1.548 billion.

D+H management has doubled the size of the company in three years through acquisitions totaling $1.585 billion. This works out to an average compound growth rate of an astonishing 26%, with most of that growth coming in the first nine months of 2013, and most of that growth is the Harland acquisition.

No one thinks that D+H can continue to grow through acquisition at this rate in a mature market — not even the CEO, Gerrard Schmidt. While not quite ruling out further acquisitions, he did hint that the executive team was concerned with the level of debt. In answer to an analyst's question about the possible addition of more bolt-on acquisitions, Schmidt said, "Further down the road … once we're comfortable that the leverage is coming down to a level that's more in line with our historical practices."

In summary
Peter Ustinov famously called Toronto "New York run by the Swiss". He was referring to cleanliness and efficiency but it is fair to say Toronto is carving out a place as a global financial centre as well. D+H is contributing to that reputation. It has been focused on buying expertise in a complex U.S. banking environment. This strategy allows it to get up to speed quickly from a regulation standpoint and focus on executing from a customer service perspective — something the company has been doing since 1875.

How well D+H does integrating Harland into the fold is a story to watch closely.

The Motley Fool's top two stock ideas
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Disclosure: At the time of publication, Dave Van Geem had no position in any companies mentioned.

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