



MARKETPLACE: Hard Decisions are Fast Approaching for ATM Owners

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Earlier this month, E*Trade Bank announced the sale of its ATM operating unit and roughly 15,000 machines to Cardtronics. The move marked a strategic reversal for E*Trade; just over a year ago it had bought 4,000 ATMs from Xtra Cash in hopes of building up a formidable distribution network for its customers. Going forward, E*Trade says it plans to refund host machine surcharges, thereby letting its customers use any ATM worldwide for free. The Company is also looking into new approaches to deposit taking.

There has been much speculation regarding what drove E*Trade's recent sale. The Bank says it targets high net worth, investment-minded individuals and that most of its customers were not using E*Trade ATMs. The sale also netted E*Trade some serious cash – \$55 million pre-tax – to put toward more critical channels and businesses. Many analysts seem to believe that the machines were simply unprofitable for E*Trade, and with future prospects not looking any brighter, the Bank, many think, decided rightly to change its course.

Regardless of what influenced E*Trade the most, this much is clear: a number of recent events and converging trends will soon force other, more traditional banking institutions to consider a similar strategy. In fact, we believe we may soon see many banks and thrifts divesting their ATM networks (or at least the off-site portion of their networks), and choosing instead to provide convenience and access to customers through agreements with providers that decide to stay in the game. We will see many banks and thrifts outsourcing their ATM channels to large deployers, who will effectively become ATM correspondent bankers.

Why?

New regulations are forcing system overhauls. MasterCard and Visa have required that, by 2005, ATMs of participating institutions be Triple DES compliant. The heightened encryption methodology and new pin pad requirements are aimed at eradicating fraudulent transactions. In addition, while no timetable or specifications have been finalized, ATM operators will soon also have to make investments to ensure machines have audio and other capabilities for disabled customers. Finally, Check 21 will accelerate the demand for ATMs equipped with check scanners, functionality few possess today.

Fee income is vanishing. While ATM popularity continues to surge, per machine transaction volumes have rapidly declined for off-site ATMs, and with this, surcharge revenue has also declined. This trend is the result of the proliferation of independent service organization (ISO) deployments, fast growing popularity in debit card POS transactions, and strategic dares by large banks to forgo surcharge income now.

Money is tight. Banks have been living with compressed margins for over a year now, and many are running out of alternative revenue strategies and into expense reduction imperatives.

The big boys are upping the ante. BofA, Wells Fargo, and other large players have put significant resources behind web-enabling and enhancing the functionality of ATMs, driving further the distinction between the haves and the have-nots.

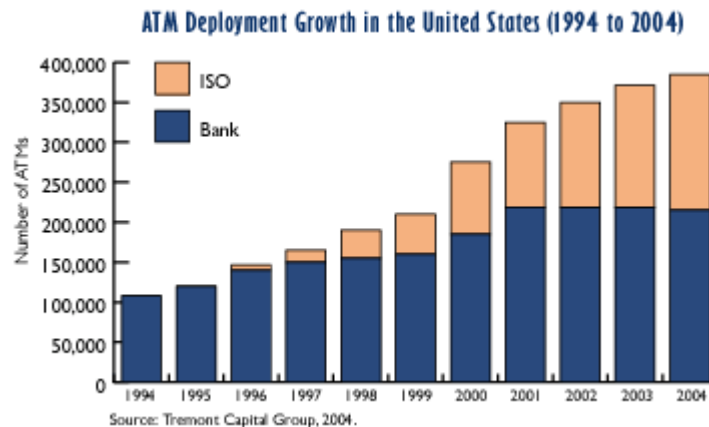
To remain ATM owners-operators, many banks will need to make enormous investments from a limited pool in a channel with declining marginal profitability. Estimates range from as little as

\$1,000 to retrofit an existing machine to over \$30,000 per machine to make thorough system overhauls.

Each bank that now owns and operates a sizable ATM network must act to optimize its decision with respect to future investment in this channel.

1. Confirm your strategy. Always start with strategy. In this case, it is critical to understand who your customers are and how they prefer to bank. What is your value proposition? How robust are your non-ATM distribution capabilities? Are internally owned ATMs critical to your success? As E*Trade hopes to demonstrate, you can still deliver convenience without owning the ATM channel, but at what sacrifice varies bank by bank.
2. Scrutinize your ATM network. Get a thorough and honest evaluation of your ATM network and how it stacks up against competitors in terms of functionality, convenience, and placement. Understand in detail transaction volumes and consider multiple future scenarios regarding machine income.
3. Identify and assess your alternatives. There are alternatives available in this decision process. Each bank should decide whether to be one of the players, put money and attention to other things (i.e., exit), or do something in between (e.g., stay the course). Diligent business cases are a must.
4. Make sure the financial expectations bear out. Regardless of the path your bank chooses, it is critical to track the results against business case projections. While it may be difficult to reverse a decision to sell, you can change your mind about continuing to invest in a proprietary ATM network. But you can't make accurate mid-course decisions if you don't know whether your strategy is working.

Finally, no matter what course you decide on now, reconsider your situation 6 months or a year down the line. Answers to some current questions may become clearer, and as a result, your prospects may have shifted.



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