

## Equity Research

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## Industry Report

## Financials

### Financials

#### In Aftermath of Market Pullback, FDC, VOYA, AMBC Look Particularly Inexpensive Among Financials Stocks

While the recent stock market pullback has created a wide variety of dislocations, within the BTIG Financials coverage universe three stocks appear to have been particularly beaten down amidst the volatility and now represent potential gems for opportunistic investors, in our view: First Data Corporation (FDC, Buy, \$28 PT), Voya Financial (VOYA, Buy, \$59 PT) and Ambac Financial Group (AMBC, Buy, \$26 PT).

#### First Data Corporation

- ▶ The recent, sharp sell-off in shares of FDC was especially stark in light of the stock's powerful surge between April 25 and September 14, when it appreciated by over 75%. Since then the stock has fallen by over 32%, with the bulk of that retracement occurring after the company on October 29 released a 3Q18 report including reduced FY18 guidance stemming from foreign exchange fluctuations. In particular, FDC was negatively impacted by weakness in the Brazilian real and the Argentinian peso, which, at the end of 3Q18, were down by 20% and 50%, respectively, versus the prior year period.
- ▶ If there was another factor contributing to FDC's share price weakness it was a "modest" revenue decline during 3Q18 in the company's challenged bank joint venture channel. We believe many investors had expected the channel to report modest growth during 2H18. Management said the rate of decline within that channel had moderated, adding that they expected it to post another year-over-year decline in 4Q18 before returning to growth during 2019.
- ▶ We believe the downdraft in FDC's share price following the company's 3Q18 print was unwarranted inasmuch as the factors that had caused the stock to rally hard between late April and mid-September remain very much in place. In particular, we believe FDC's core deleveraging story remains intact. The company during 3Q18 generated \$444mm in free cash flow, enabling it to reduce its net leverage to 5.3x at September 30 from 5.6x at June 30, and management said the company remains on track to bring down net leverage to close to management's target of about 4.0x at YE19.
- ▶ At the same time, we continue to believe FDC continues to be well positioned to generate revenue growth in the mid-single digits that would be supportive of a higher valuation for its shares.

- ▶ In particular, we think FDC's North America Global Business Solutions (GBS) unit will be able to post growth in the mid-single digits context even if the bank JV channel takes more time than originally anticipated to return to growth.
- ▶ We also believe the market has failed to fully acknowledge the rapid growth and future potential of FDC's Clover point-of-sale (POS) platform, which during 3Q18 posted annualized gross payment volume (GPV) growth of 45% to about \$70bn. We further note that management maintains that the company would make the investments needed for the platform's volume to double over the next three years.
- ▶ We observe that FDC continues to trade at a significant gap with merchant acquiring peers Worldpay (WP, Not Rated), Global Payments (GPN, Not Rated) and TSYS (TSS, Not Rated).. FDC trades at 10.7x FY19E EV/EBITDA, a 32% discount to WP, GPN and TSS, which trade at 15.3x, 13.7x and 13.5x, respectively.

#### Voya Financial

- ▶ Shares of VOYA have retreated by 14.2% since October 4, a period during which the S&P 500 declined by 5.7%. And what did the company do during that span to drive that underperformance? VOYA on October 31 posted an emphatic 3Q18 adjusted earnings beat, and last Tuesday the company in conjunction with its 2018 Investor Day announced new guidance of annual adjusted operating earnings per share growth of at least 10% through 2021. Management stated that such growth would be achieved through a combination of organic growth, cost savings and capital deployment.
- ▶ We believe there is a significant disconnect between VOYA's improved earnings-growth prospects and its discount valuation. The company's shares, which trade at just 0.94x its book value ex. AOCI as of September 30, are inexpensive relative to its earnings growth profile, ample free cash flow and potential as a takeover target, in our view.
- ▶ The updated targets that management offered during VOYA's Investor Day only served to underline the potency of the company's self-help story and the extent to which that is likely to translate into improved profitability going forward. They announced \$100mm in cost savings, which is incremental to the \$110mm to \$130mm in cost reductions that they had previously announced through mid-2019, as well as the \$20mm in cost savings they said last month that the company would realize given their decision to cease writing new individual life insurance policies at YE18.
- ▶ A key aspect of VOYA's self-help story has been, and will continue to be, its ample share buybacks. Management stated that they would focus 80% to 85% of the company's excess capital on share buybacks,

organic growth and strategic M&A, with the other 15% to 20% focused on stock dividends with a goal of VOYA shares having a 1% dividend yield by mid-2019.

- ▶ Management during VOYA's Investor Day highlighted the company's deferred tax asset (DTA), which they projected would have a net present value of approximately \$1.2bn at YE18 that translated into \$9.05 per share. They noted that the VOYA would use 50% to 60% of its DTA during the next 5-6 years.
- ▶ To illustrate how inexpensive VOYA shares had become, management noted that if the \$9.05 per share representing the DTA were to be removed from its stock price its implied multiple of FY19 adjusted operating EPS would be just 6.9x, which was well below the multiples of its peers in the Retirement or Investment Management spaces.

#### **Ambac Financial Group**

- ▶ Shares of AMBC had been relatively resilient through the broad market's October weakness, with the stock apparently buoyed by the improving economic situation in Puerto Rico given the company's \$1.88bn of net insured exposure to the Commonwealth's debt as of September 30. In particular, AMBC was positioned to benefit from significant de-risking in light of the increasing likelihood that a deal to restructure the COFINA sales tax bonds would be consummated in January 2019 or soon thereafter with the company recovering north of 90 cents on the dollar. The COFINA bonds represented more than 80% of the principal and interest on Puerto Rico's debt that the company had insured.
- ▶ However, after AMBC on November 7 reported its 3Q18 results, the company's shares began to sink, falling by almost 16% as of Friday's close. The apparent initial drivers of the weakness were the company's 7.6% sequential decline in its adjusted book value (ABV) per share to \$28.50 stemming from the AMPS exchange transaction that closed on August 3, and management's comment during the company's 3Q18 conference call that its representation and warranty (R&W) trial against Bank of America (BAC, Not Rated) scheduled to begin February 25, 2019 might be pushed back due to potential appeals of motions that had been heard earlier that week.
- ▶ Exacerbating the weakness in AMBC shares was a November 11 report that President Trump did not want to give Puerto Rico any additional federal funding to aid its recovery from Hurricane Maria given his belief that the Commonwealth government was using the funding to pay bondholders. While this belief was apparently the result of a misread of a media report – the drafters of the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) specifically prohibited using disaster funds to pay down the island's debt – the report nevertheless weighed on AMBC's stock price.

- ▶ We were taken aback by the extent of the negative reaction to AMBC's 3Q18 report in part because when the company announced the AMPS transaction on June 25 management had made clear the reduction in its ABV per share that would occur due to the deal. We believe the reduction was a relatively small price to pay for the simplification of AMBC's capital structure and the deleveraging of its balance sheet that resulted from the transaction, and it was hardly "new news."
- ▶ As for the potential delay in the start date for the BAC R&W trial, we had published a note on October 4 that management during a BTIG-hosted non-deal roadshow had stated that a February start date was unlikely to occur given some outstanding appeals that needed to be resolved and BAC's strategy of trying to delay the proceedings. Again, management's comments during AMBC's 3Q18 call should not have been viewed as news, and we continue to believe any investor with a reasonable investment horizon should continue to view a potential settlement with BAC as a pending catalyst for the stock.
- ▶ We had a strong sense of déjà vu when the report of President Trump's statement that he did not want to give Puerto Rico more funds for hurricane recovery inasmuch as we had seen shares of AMBC and its municipal bond insurance peers trade off in early October 2017 after Trump had said that the island's debt would have to be wiped out. As it became clear that such would not be the case, both Puerto Rico's debt and the monoline stocks began what would become a strong, year-long rally.
- ▶ We believe President Trump's latest comments on Puerto Rico are likely to have a similarly negligible impact inasmuch as he does not have the authority to halt disaster aid that already has been approved by Congress. We also believe any additional hurricane-relief aid to Puerto Rico is likely to be included in omnibus spending bills in which aid to the island would be just one line item, making it unlikely that the President would block it.

## BTIG Covered Companies Mentioned in this Report

AMBAC FINANCIAL GROUP, INC. (AMBC, Buy, \$26.00 PT; Current Price: \$17.77; Analyst: Mark.Palmer)

FIRST DATA CORPORATION (FDC, Buy, \$28.00 PT; Current Price: \$17.82; Analyst: Mark.Palmer)

VOYA FINANCIAL, INC. (VOYA, Buy, \$59.00 PT; Current Price: \$44.48; Analyst: Mark.Palmer)

## Appendix: Analyst Certification and Other Important Disclosures

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I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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### Company Valuation and Risk Disclosures

#### First Data Corporation (FDC, Buy, \$28.00 PT)

**Valuation:** Our price target of \$28 for FDC is based on 12x our FY19E adjusted EBITDA of \$3,588mm. We believe the multiple we employ is appropriate as it represents a modest discount to FDC's faster-growing, less indebted peers in the payments space.

**Risks:** The primary risks to our thesis include: Competition, significant leverage and interest rate risks, the overhang associated with majority ownership, chargeback liability, security breaches, foreign exchange risks and consolidation of card-issuing banks.

# First Data Corporation (FDC)



*Note: Closing Price and Target Price have been adjusted for corporate actions.*

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
17-Nov-15	16.82	NA	Mark Palmer	Neutral
10-Feb-16	9.35	13	Mark Palmer	Buy
07-Mar-16	13.34	NA	Mark Palmer	Neutral
01-Aug-16	13.02	15	Mark Palmer	Buy
17-Nov-16	15.40	18	Mark Palmer	Buy
19-Jun-17	18.44	23	Mark Palmer	Buy
14-Jun-18	21.61	27	Mark Palmer	Buy
30-Jul-18	23.34	28	Mark Palmer	Buy

## Voya Financial, Inc. (VOYA, Buy, \$59.00 PT)

**Valuation:** Our price target of \$59 for VOYA is based on 1.1x the company's FY19E book value ex. accumulated other cumulative income (AOCI) of \$53.44.

**Risks:** The primary risks to VOYA include a continuation of the current low interest rate environment that could adversely affect the company's profitability; downgrades or potential downgrades of the company's credit ratings that result in a loss of business and affect its operating results; risks to the company's investment portfolio that may diminish the value of its investment returns and the investment returns credited to customers, which could reduce the company's revenues, assets under management (AUM) and operating results; larger-than-expected losses if mortality rates, morbidity rates, persistency rates or other underwriting assumptions differ significantly from the company's pricing assumptions; the fact that the performance of the company's closed block variable annuity segment depends on assumptions that may not be accurate; and the fact that ING Groep's continued interest in the company as its ultimate parent may result in conflicts of interest that affect its ability to operate and finance its business.

# Voya Financial, Inc. (VOYA)



*Note: Closing Price and Target Price have been adjusted for corporate actions.*

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
20-May-13	26.26	31	Mark Palmer	Buy
29-Jul-13	30.43	NA	Mark Palmer	Neutral
06-Nov-13	33.59	37	Mark Palmer	Buy
09-Jan-14	36.30	NA	Mark Palmer	Neutral
29-Apr-14	34.83	41	Mark Palmer	Buy
06-Aug-14	36.38	45	Mark Palmer	Buy
11-Feb-15	42.44	50	Mark Palmer	Buy
02-Jan-18	49.74	59	Mark Palmer	Buy

## Ambac Financial Group, Inc. (AMBC, Buy, \$26.00 PT)

**Valuation:** Our \$26 price target for AMBC is based on a sum-of-the-parts analysis in which we assessed the value of AMBC's operating company, its holding company, and its adjusted operating earnings through FY19E.

**Risks:** The primary risks to achieving our recommendation and price target include the possibility that reserves against losses associated with RMBS and other insured instruments may prove inadequate, that fiscal stress of state and local governments could translate into increased losses, declines in value of investment portfolio could impede Ambac's ability to pay its liabilities and Ambac Assurance Corp. may be unable to exit rehabilitation.



# Ambac Financial Group, Inc. (AMBC)

(\$)



*Note: Closing Price and Target Price have been adjusted for corporate actions.*

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
16-May-13	23.67	31	Mark Palmer	Buy
04-Mar-14	34.49	NA	Mark Palmer	Neutral
01-Mar-17	21.90	28	Mark Palmer	Buy
11-May-17	17.34	26	Mark Palmer	Buy

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Ambac Financial Group, Inc. (AMBC)

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Ambac Financial Group, Inc. (AMBC)

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