

Equity Research

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Industry Report

Financials

Financials

Amidst Market Carnage, Opportunities Emerge in Oversold Financials: KW, VOYA and SQ Merit a Look

As the U.S. equity market got off to its worst-ever start to a year last week, the Financials sector was not immune to the carnage, declining by almost 7%. While the damage was widespread, we noted that a few stocks within the space were particularly beaten down without any apparent idiosyncratic justification for their disproportionate declines. We believe investors should consider taking advantage of the outsized weakness in three stocks from BTIG's Financials coverage universe: Kennedy-Wilson Holdings (KW, Buy, \$33PT), VOYA Financial (VOYA, Buy, \$50 PT) and Square (SQ, Buy, \$15 PT).

► Kennedy-Wilson Holdings

The only headline that emerged from KW during the first week of the year was an announcement that Kennedy-Wilson Europe (LSE: KWE) had bought a 95% interest in La Moraleja Green Shopping Center in Madrid for €71mm, as the company continues to pursue mispriced opportunities in Spain. Yet shares of KW nevertheless declined by 13.8% during the first four trading days of the year, dipping to a level at which they have not traded since December 2013.

Why would KW trade off so sharply? Perhaps the decline may have been driven by concerns about the global real estate market in which the company operates, particularly as it pertains to the \$5.46bn of real estate and acquired in place lease values on its balance sheet, net of accumulated depreciation and amortization, as of September 30. However, KW's strategy is predicated on taking advantage of distortions in the real estate markets in which they focus, and CEO William McMorrow and his team have an excellent track record of investing in markets in advance of an upturn, from California after the financial crisis to Japan to Ireland. Some degree of distress expands KW's opportunity set and plays to its management's strengths.

Funding is an essential part of KW's business model, so it is conceivable that the reversal in the company's share price was due in part to concerns about whether global volatility would cause the capital markets to freeze up, thereby cutting it off from the funds it needs to make additional investments. However, KW just a month ago announced that it had put in place a new, \$475mm unsecured revolving credit facility that added to its already ample liquidity position.

We suspect that the disproportionate weakness in KW shares last week had less to do with fundamentals than with the fact that a significant portion of its shareholders are hedge funds that may have seen the need to raise cash or to simply get out of the way until things settle down. While we believe KW is inexpensive based on our net asset value (NAV) analysis, especially inasmuch as its assets are held on its balance sheet at cost rather than their market value, the stock's movement is normally driven more by the progress and growth demonstrated in its quarterly results than any catalysts that could be realized between quarters. We believe hedge funds in particular are more likely to sell such names – those with no identifiable near-term catalysts – when they need to sell stocks.

► **Voya Financial**

Perhaps more surprising than the fact that shares in VOYA traded off by 12.3% last week is the fact that the stock is now trading at just under 0.57x the company's book value ex. accumulated other comprehensive income (AOCI) as of September 30, which is not much higher than the level at which the stock was valued when the company went public in May 2013. The reason we find that valuation surprising is that it doesn't jibe with the amount of progress VOYA has made during the past two and a half years. During that period the company executed on all aspects of its strategy, reaching its 2016 adjusted ROE target two years ahead of time and using its ample excess capital to repeatedly expand its aggressive capital return program.

We believe the outsized drop in VOYA last week may have been driven in part by concerns that the market volatility and slowdown in China and various emerging markets could cause the Federal Reserve to slow the pace of interest rate increases. Given the positive impact of higher rates on the performance of and prospects for the use of reinsurance at the company's Closed Block Variable Annuity (CBVA) unit, the potential forestalling of rate hikes could have dampened enthusiasm for the stock. However, we believe the decline of more than 12% over a four-day period on shares that already looked very inexpensive prior to the sell-off represented an overreaction.

The silver lining to VOYA's share price weakness is that it increases the already steep discount to book value ex. AOCI and makes its share buybacks even more accretive. The company during 3Q15 continued to take advantage of that discount by repurchasing over 11mm shares for \$481mm, then at the end of the quarter entered into a share repurchase arrangement in which it is expected to buy back

another \$100mm during 4Q15. VOYA at September 30 had \$170mm remaining under its share repurchase authorization.

► **Square**

We have become accustomed to seeing shares of stocks of high-profile financial technology companies get buffeted by significant volatility during the period between their initial public offerings and their first earnings reports as public companies. However, we believe the 13.6% decline in shares of SQ last week was excessive even for a company facing uncertainty in advance of its debut earnings presentation. While CEO Jack Dorsey and his team laid out their vision for SQ's future during the IPO road show, investors are seeking affirmation of the company's expectations with regard to revenue growth and eventual margin expansion as well as responses to recent questions about expense control and monetization potential.

We believe that when SQ reports its 4Q15 results next month the presentation will refocus investors on how the company's value proposition of reducing the cost of processing credit- and debit-card payments for more than 2mm small businesses has positioned it to sustain its rapid growth. The report also should serve as a reminder that SQ is evolving from a payments company to a commerce company, aggressively building products around the extremely valuable data it collects during the payment process.

We believe the consolidation of the mobile payments industry is likely to continue and accelerate during 2016 with technology giants that have made significant pushes into payments such as Apple (AAPL, Buy, \$150 PT, Analyst: Walt Piecyk), Samsung and Google likely to be joined by others that have made initial forays or have explored the possibility such as Microsoft, Amazon and Facebook (FB, Buy, \$117 PT, Analyst: Rich Greenfield). SQ's strong position in the space combined with its relatively small size makes it a legitimate acquisition candidate such that a takeout at a healthy premium to its current price is a real possibility, in our view. As such, we think that as buzz about consolidation builds it will provide support, if not a boost, to SQ shares.

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

Kennedy Wilson Holdings (KW, Buy)

Valuation: Our price target of \$33 per share for KW is based on our NAV analysis.

Risks: The primary risk to achieving our target price include a global recession, a prolonged European recession, access to the capital markets, key man risk and the ability to source profitable deals.

Square Inc. (SQ, Buy)

Valuation: Our price target of \$15 for SQ is based on 12x the company's 2020E adjusted EBITDA of \$795mm

discounted back at 12%.

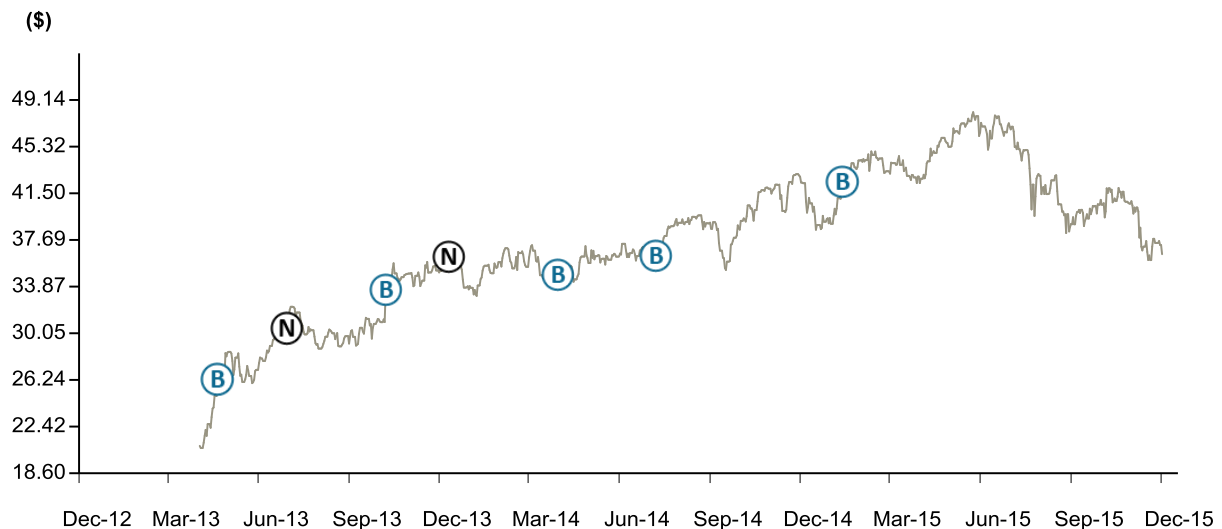
Risks: The primary risks to our thesis include: Competition, risk of data breaches, risk of fraud, macroeconomic risk, risk associated with international expansion, management risk and litigation risk.

Voya Financial, Inc. (VOYA, Buy)

Valuation: Our price target of \$50 is based on 0.90x VOYA's YE16E book value per share (ex. accumulated other comprehensive income [AOCI]) of \$56.93 discounted back at 10%

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		Mark Palmer	Neutral
06-Nov-13	33.59	37	Mark Palmer	Buy
09-Jan-14	36.30		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

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