

Equity Research

February 10, 2016

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Financials

First Data Corporation

Upgrading to Buy (from Neutral) with \$13 PT; Despite Lack of FY16 Guidance, Valuation Compelling

We are upgrading First Data Corporation to Buy (from Neutral) with a **\$13 price target** based on 10X our 2017E adjusted EBITDA estimate of \$3,137mm. While the factors that had kept us on the sidelines since we initiated coverage are still in play – modest revenue growth and the burden of high leverage – we believe that the plunge in the company's share price has brought it to a level at which its valuation is compelling.

FDC

12 month target

\$9.85

\$13.00

BUY

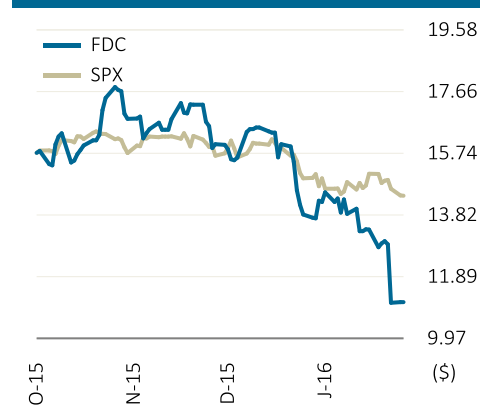
52 week range

\$11.08 - \$17.80

Market Cap (m)

\$10,222

Price Performance



Source: IDC

- ▶ FDC this morning reported 4Q15 earnings per share of \$0.32, which was in line with our estimate and beat the consensus estimate of \$0.26. We believe the steep decline in the share price was due in part to the fact that management neglected to provide revenue and earnings guidance for FY16, with 4Q15 revenue growth that was perhaps below some investors' expectations contributing to the downdraft.
- ▶ As we stated in a note on February 8, we believe the recent weakness in FDC shares was due at least in part to the fact that the bullish thesis on the stock is rooted in large part on the interest expense savings from the anticipated refinancing of the portion of the \$19.6bn in debt the company had as of YE15. With much of it callable at rates lower than current coupons, volatility in the corporate debt market has rendered the execution of FDC's plans potentially more difficult.
- ▶ Another factor in FDC's recent weakness applies to all payment processors: reduced expectations of Federal Reserve interest rate increases. While many investors focus on insurance companies and banks as beneficiaries of higher rates, the boost provided by rate increases to processors like FDC, given their handling of funds in transactions between processing and settlement, is substantial.
- ▶ However, with FDC shares now trading at 10.3x LTM EBITDA, we
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- ▶ **Valuation:** Our \$13 price target for FDC is based on 10X our 2017E adjusted EBITDA estimate of \$3,137mm.

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 E	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
EBITDA (Adj.)	563	702	703	763	2,731	715	745	758	770	2,987	3,137
Diluted EPS (Adj.)	0.00	0.00	0.00	0.32	0.74	0.36	0.39	0.40	0.41	1.55	1.73

Source: BTIG Research Estimates and Company Documents (\$ in millions, except per share amount)

Please Read: Important disclosures and analyst's certification appear in Appendix

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believe these headwinds, as well as reduced expectations for revenue growth, are now more than baked into the stock price. Moreover, we believe the company will be able to de-lever over time given its strong cash flow generation even if choppy credit markets make additional balance sheet repair more challenging.

Income Statement

First Data - Operating Model	Dec-12	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Dec-18	
\$ millions	2012A	2013A	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16E	2Q16E	3Q16E	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E	2018E	
Transaction and processing fees	6,452	6,464	1,561	1,672	1,679	1,719	6,631	1,605	1,667	1,673	1,691	6,636	1,669	1,734	1,740	1,759	6,901	1,744	1,812	1,818	1,838	7,212	7,573	
Product sales and other	867	837	204	235	224	254	917	217	279	309	323	1,128	226	290	321	336	1,173	236	303	336	351	1,226	1,287	
Total revenues (excluding reimbursable items)	7,319	7,302	1,765	1,907	1,903	1,973	7,548	1,822	1,946	1,982	2,014	7,764	1,895	2,024	2,061	2,095	8,075	1,980	2,115	2,154	2,189	8,438	8,860	
Cost of services	2,864	2,809	646	665	692	717	2,720	734	655	686	816	2,891	696	744	758	770	2,967	723	772	786	799	3,080	3,145	
Cost of products sold	336	334	80	81	83	92	336	77	85	96	99	357	90	96	98	99	384	94	100	102	104	401	399	
Selling, general and administrative	1,825	1,889	486	512	504	482	1,984	499	526	521	725	2,271	493	516	526	534	2,068	505	539	549	558	2,152	2,259	
Depreciation and amortization	1,192	1,091	265	263	269	259	1,056	251	252	257	262	1,022	265	267	270	273	1,074	275	278	281	284	1,118	1,163	
Restructuring	23	48	3	4	3	3	13	1	19	20	13	53	-	-	-	-	-	-	-	-	-	-	-	
Impairments	5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Litigation and regulatory settlements	-	8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total expenses (excluding reimbursable items)	6,245	6,179	1,480	1,525	1,550	1,553	6,108	1,562	1,537	1,580	1,915	6,594	1,544	1,623	1,651	1,676	6,494	1,597	1,690	1,719	1,745	6,750	6,967	
Operating Profit	1,074	1,123	285	382	353	420	1,440	260	409	402	99	1,170	351	401	410	419	1,581	383	425	435	444	1,688	1,893	
EBITDA	2,155	2,178	565	728	686	703	2,683	548	641	659	399	2,247	626	678	690	701	2,694	668	713	726	738	2,845	3,096	
Adjusted EBITDA	2,435	2,455	617	681	698	712	2,709	563	702	703	763	2,731	715	745	758	770	2,987	740	786	800	812	3,137	3,413	
Interest income	9	11	3	4	3	2	11	1	1	1	-	3	1	1	1	1	4	1	1	1	1	4	4	
Interest expense	(1,898)	(1,881)	(467)	(463)	(418)	(405)	(1,753)	(407)	(406)	(389)	(338)	(1,540)	(299)	(299)	(299)	(299)	(1,195)	(286)	(286)	(286)	(286)	(1,143)	(1,143)	
Loss on debt extinguishment	-	-	-	-	(260)	-	(260)	-	-	(108)	(960)	(1,068)	-	-	-	-	-	-	-	-	-	-	-	
Other income (expense)	(94)	(47)	1	82	56	21	161	35	(24)	(10)	28	29	-	-	-	-	-	-	-	-	-	-	-	
Loss before income taxes and equity earnings in affiliates	(910)	(794)	(178)	5	(266)	38	(401)	(111)	(20)	(104)	(1,171)	(1,406)	53	103	112	121	389	98	140	151	159	548	754	
Income tax expense (benefit)	(224)	87	37	40	(23)	29	83	3	10	32	56	101	-	-	-	-	-	-	-	-	-	-	-	
Equity earnings in affiliates	158	188	50	58	55	56	219	51	63	61	64	239	65	65	65	65	259	65	65	65	65	261	264	
Net income (loss)	(528)	(692)	(165)	23	(188)	66	(265)	(63)	33	(75)	(1,163)	(1,268)	118	167	177	185	648	164	206	216	225	810	1,018	
Less: net income attributable to noncontrolling interests	174	177	36	57	46	54	193	49	59	51	54	213	55	55	55	55	220	55	55	55	55	222	224	
Net income (loss) attributable to first data corporation	(701)	(869)	(201)	(34)	(235)	12	(458)	(112)	(26)	(126)	(1,217)	(1,481)	63	112	122	130	428	108	150	160	169	588	794	
Diluted EPS - Adjusted												\$0.32	\$0.74	\$0.36	\$0.39	\$0.40	\$0.41	\$1.55	\$0.39	\$0.44	\$0.45	\$0.46	\$1.73	\$1.99
Diluted shares outstanding												920.9	920.9	923.2	925.5	927.8	930.2	926.7	932.5	934.8	937.2	939.5	936.0	945.4
Net income (loss) attributable to first data corporation	(701.2)	(869.1)	(201.0)	(34.0)	(234.6)	11.8	(457.8)	(112.0)	(26.0)	(126.0)	(1,217.0)	(1,481.0)	63.1	112.5	122.2	130.4	428.2	108.1	150.1	160.4	169.1	587.7	793.7	
Adjustments for non-wholly-owned entities	(6.8)	(2.4)	(2.0)	(8.0)	(7.0)	(7.0)	(24.0)	(7.0)	(6.0)	(6.0)	(7.0)	(26.0)	-	-	-	-	-	-	-	-	-	-	-	
Depreciation and amortization	1,191.6	1,091.3	265.0	263.0	268.7	259.3	1,056.0	251.0	252.0	257.0	262.0	1,022.0	264.6	267.3	269.9	272.6	1,074.5	275.4	278.1	280.9	283.7	1,118.1	1,163.5	
Interest expense	1,897.8	1,880.7	467.0	463.0	417.6	405.2	1,752.8	407.0	406.0	389.0	338.0	1,540.0	298.8	298.8	298.8	298.8	1,195.3	285.8	285.8	285.8	285.8	1,143.0	1,143.0	
Interest income	(8.8)	(11.1)	(3.0)	(4.0)	(2.5)	(1.5)	(11.0)	(1.0)	(1.0)	(1.0)	-	(3.0)	(1.0)	(1.0)	(1.0)	(1.0)	(4.0)	(1.0)	(1.0)	(1.0)	(1.0)	(4.0)	(4.0)	
Loss on debt extinguishment	-	-	3.0	-	260.1	-	263.1	-	-	108.0	960.0	1,068.0	-	-	-	-	-	-	-	-	-	-	-	
Other items	150.5	135.4	6.0	(58.0)	(2.0)	1.0	(53.0)	5.0	45.0	32.0	(11.0)	71.0	-	-	-	-	-	-	-	-	-	-	-	
Income tax benefit (income)	(224.0)	86.5	37.0	40.0	(23.1)	28.6	82.5	3.0	10.0	32.0	56.0	101.0	-	-	-	-	-	-	-	-	-	-	-	
Stock based compensation	11.8	38.1	29.0	5.0	11.0	5.0	50.0	7.0	16.0	8.0	299.0	330.0	89.7	67.3	67.9	68.6	293.5	72.1	72.8	73.5	74.2	292.6	316.5	
Costs of alliance conversions	77.2	68.3	7.0	6.0	4.0	3.0	20.0	3.0	2.0	-	-	5.0	-	-	-	-	-	-	-	-	-	-	-	
KKR related items	33.6	31.8	6.0	8.0	6.0	7.0	27.0	6.0	5.0	6.0	83.0	100.0	-	-	-	-	-	-	-	-	-	-	-	
Debt issuance costs	13.7	5.3	3.0	-	-	-	3.0	1.0	(1.0)	4.0	-	4.0	-	-	-	-	-	-	-	-	-	-	-	
Adjusted EBITDA	2,435.4	2,454.8	617.0	681.0	698.2	712.4	2,708.6	563.0	702.0	703.0	763.0	2,731.0	715.2	744.8	757.9	769.5	2,987.5	740.3	785.8	799.5	811.8	3,137.4	3,412.7	
Tax rate	24.6%	-10.9%	-20.8%	800.0%	8.7%	75.7%	-20.6%	-2.7%	-50.0%	-30.8%	-4.8%	-7.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Average cost of debt	8.3%	8.2%	8.1%	8.1%	8.0%	7.7%	8.3%	7.7%	7.7%	7.3%	6.9%	7.8%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.8%	5.8%	
Revenue growth	1.9%	-0.2%	1.1%	4.0%	3.7%	4.6%	3.4%	3.2%	2.0%	4.2%	2.1%	2.9%	4.0%	4.0%	4.0%	4.0%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%	5.0%	
EBITDA growth	-5.6%	1.1%	22.1%	28.5%	25.5%	16.8%	23.2%	-3.0%	-12.0%	-4.0%	-43.3%	-16.2%	14.1%	5.7%	4.7%	75.7%	19.9%	6.8%	5.2%	5.2%	5.2%	5.6%	8.8%	
Cost of services as % of revenue	39.1%	38.5%	36.6%	34.9%	36.4%	36.3%	36.0%	40.3%	33.7%	34.6%	40.5%	37.2%	36.8%	36.8%	36.8%	36.8%	36.8%	36.5%	36.5%	36.5%	36.5%	36.5%	35.5%	
Cost of products sold as % of revenue	4.6%	4.6%	4.5%	4.2%	4.3%	4.7%	4.4%	4.2%	4.4%	4.8%	4.9%	4.6%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.5%	
Selling, general and administrative as % of revenues	24.9%	25.9%	27.5%	26.8%	26.5%	24.4%	26.3%	27.4%	27.0%	26.3%	36.0%	29.3%	26.0%	25.5%	25.5%	25.5%	25.6%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	
Operating margin	10.1%	10.4%	10.8%	13.5%	12.6%	14.6%	12.9%	9.6%	14.2%	20.3%	4.9%	15.1%	18.5%	19.8%	19.9%	20.0%	19.6%	19.3%	20.1%	20.2%	20.3%	20.0%	21.4%	
EBITDA margin	29.5%	29.8%	32.0%	38.2%	36.1%	35.7%	35.5%	30.1%	32.9%	33.2%	19.8%	28.9%	33.0%	33.5%	33.5%	33.5%	33.4%	33.7%	33.7%	33.7%	33.7%	33.7%	34.9%	
Adjusted EBITDA margin	33.3%	33.6%	35.0%	35.7%	36.7%	36.1%	35.9%	30.9%	36.1%	35.5%	37.9%	35.2%	37.7%	36.8%	36.8%	36.7%	37.0%	37.4%	37.2%	37.1%	37.1%	37.2%	38.5%	

Source: BTIG Research Estimates and Company Reports

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Company Valuation and Risk Disclosures

First Data Corporation (FDC, Buy)

Valuation: Our \$13 price target for FDC is based on 10X our 2017E Adjusted EBITDA estimate of \$3,137mm.

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. Upside risks include: Greater-than-expected revenue growth and reversal of market share losses in merchant acquiring and issuer processing.

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