Western Union (WU)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Western Union - business

- Consumer-to-Consumer - money transfer services, including walk-in money transfer, online money transfer, account based money transfer, and mobile money transfer through a network of third-party agents using multi-currency and real-time money transfer processing systems
- Global Business Payments
  - business-to-business payment solutions for cross-border and cross-currency transactions
  - Travelex global business payments services through phone and Internet
  - services that allow consumers to send funds to businesses and government agencies using cash and debit cards
  - Quick Cash, a cash disbursement service for businesses and government agencies to send money to employees or individuals
  - Western Union Convenience Pay, a service to send payments by cash or check to utilities and telecommunication providers
  - walk-in and cash bill payment services under the Pago Fácil and Western Union brand names
  - Speedpay, a service that allows consumers to make payments to various businesses using credit cards, debit cards, automated clearing house (ACH), and checks
  - Equity Accelerator service, which enables consumers to make mortgage payments by ACH
  - money orders for making purchases, paying bills, and as an alternative to checks
  - prepaid cards that allow consumers to load money or receive a direct deposit onto the card for use.
- Network of 500,000 agent locations

Western Union – business (cont’d)

- Consumer-to-consumer
  - EMEASA 43 % 44 % 45 %
  - Americas 32 % 31 % 32 %
  - APAC 9 % 9 % 8 %
  - Total consumer-to-consumer 84 % 84 % 85 %
- Global business payments 14 % 14 % 14 %
- Other 2 % 2 % 1 %
- >85% consumer-to-consumer transactions with at least one non-United States location

Western Union - Misc thoughts

- 3.7B cash outside USA (tax on repatriation)
- What can go wrong?
  - No growth/decline of cross border money transfer (2009, 5% growth 2012)
  - Regulation (anti-money laundering, anti-terrorist activities, consumer protection)
  - Competition: other providers, banks, post offices, informal networks (going down?), e-commerce, mobile, cards

Western Union - Misc thoughts

- Opportunities:
    - Continuing growth of cross border money transfer
    - Growth of related services

Strategic considerations

- Moat (*switching costs*, *habit*, *low cost*):
  - What are the moats? Availability, brand, cost
  - What does it take to sustain the moats? Sustain the above
  - Bargaining power of suppliers/customers? None (but see regulation)
- Is it a low risk business? Somewhat.
- Is there high uncertainty? No.
- How capital intensive is the business? Not.
- Future growth – Unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Possibly understated, but unknown

Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Piotroski Score

Only applicable to Graham Cos – N/A to WU

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9

Is it a good business?

- 7 year history of profits
- ROE:
  - 2009: 240 2010:156 2011 (ROIC):36 2012 q1 (ROIC):35
- Margins
  - 2009: 17 2010:17 2011: 21 2012q1:18
- 3 year sales growth 3%, earnings growth 5%
- No dilution (share buybacks)
- Complex balance sheet
  - Goodwill, negative tangible assets
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - << ROE

Is it a good business? Cash flow

- OK 2012 cash flow:
  - 2012 q1 247M earnings, 215M operating cash flow, 140-195 FCF (FCF = OCF – capital expenditures)
  - Free Cash Flow/Share lower than dividends paid

Is business cheap? - Buffettology calculations

- Unrealistic
- ROE 30%
- Earnings in 10 years = ROE*Equity*$(1+\text{ROE})^9$ = \$3B
- Equity in 10 years = Equity*$(1+\text{ROE})^9$ = \$10.2B
- Market cap = 3B x P/E (15) = \$45B
- Rate of return = 15% after tax (calculations omitted)

- 9 year earnings growth: 19%. Assuming 19% earnings growth: 24% share price growth.

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 990M (FCF ~780)
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $9.6B current valuation
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $8.9B current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $12B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 990M / (9.8B+3.7B-1.3B) = 8% (6% assuming 780M FCF)

- What makes up the margin of safety? Brand/moat
- Is there a sufficient margin of safety? Maybe.

Is business cheap? - Graham investment considerations

- N/A for WU – included for completeness
- 10 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)