

## **WESTERN UNION (NYSE) - WU**

### **Company Description:**

The Western Union Company, is a leader in global money movement and payment services. Services are available through a global network of roughly 510,000 agent locations in more than 200 countries. About 90% of locations are outside of the United States. Spunoff from First Data Corp. on 9/29/06. Transaction fees accounted for about 71% of revenues; foreign exchange, 27%; other, 2%. International consisted of 75% of revenues. Employs 10,000. President & CEO: Hikmet Ersek. Chmn: Jack Greenberg. Englewood, Colorado [www.westernunion.com](http://www.westernunion.com). Software costs: 1%. Adv costs: 3%

### **Basic Description:**

The net profits have been flat for the past ten years, but EPS has been up slightly because of share repurchasing. The average P/E ratios have been in decline reflecting slow growth and are at 60% of the market's. In the meantime, dividends have increased as the payout ratio has moved above 30%. The dividend per share has also been enhanced by repurchases, creating an attractive, dividend yield of 3% currently. Since 2007, share repurchases have been sizeable. At the same time, debt levels have steadily expanded to a maximum level in light of flat earnings. Revenues do continue to rise slowly. However, operating margins are under pressure from compliance costs, increased depreciation and increased exposure to lower margin digital operations. A huge drop in the tax rate (amazing shift from 2011 to 2012) has been helpful in stemming the decline in net margins.

### **Profitability Description**

WU enjoys high profitability in its Consumer to Consumer segment. This segment primarily serves the "unbanked" population by means of agents who have costs tied up in other primary businesses. The result is that WU has a very low capital cost in this segment. However, the emergence of mobile phone, internet and digital media have been reducing profitability as WU has reduced its fees in order to process more volume. At the same time, competitive pressures are strong within the less profitable Consumer to Business (primarily US and Argentina) and the Business Solutions segment. The debt level is reduced when taking cash into account but the low tax rate combined with high dividends and share repurchases is a mystery.

### **Core Advantage Description:**

WU has created a powerful network of 500,000 agents to move cash for consumers and businesses. This network has limited capital intensity because the agents own the retail store fronts and the WU service is typically just another service. WU has been impacted by rules against exclusivity by agents in some markets. This is important as 40 agents drive 60% of revenues. On top of this "creamier" business model is a well-known brand that enhances the sense of trust and safety. These advantages are most compelling for the "unbanked" population - low income in developed countries and general populations in developing countries. Mobile phone applications are a competitive threat as phones become ubiquitous.

### **Investment Thesis:**

WU should be able to grow top and bottom lines by 2% and maintain the current lower operating margins. Some of the margin contraction has been for increased compliance costs which should offset increased spending for digital conversion. Share repurchasing should add 5%, assuming that repurchasing continues and at the low P/E levels currently trading. ACM is also assuming that WU will be able to manage to keep tax rates low due to global operations. We use a terminal P/E of 15 based on high cash flows and a low growth rate (a high estimate). An earnings buyback model with a 2% growth rate and a share repurchase P/E of 11 creates the same valuation outcome.

### **Purchase Description:**

Given the above factors, we would recommend patient, value-oriented investors purchase shares of WU at prices up to \$15 per share as a Tier III (capl charge and e.g.), with a targeted sales price of \$25 per share (capl charge).

<b>Observations:</b>	The ROEs have been high. However, with such high ROEs and over 60% level of retention, higher growth rates would follow. It seems likely, then, that the initial ROE was created by an abnormally low equity statement at UPS's inception.
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**Investment Characteristics**

Earnings Analysis:

Use Of Earnings Analysis:

Growth Rate % 3.85%

Avg Div Payout Rd 20.73%

Quality %: 100.5%

Avg Stk Buyback R 57.25%

	1995	1996	1997	1999	2000	2001	2002	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Rev.(mln)								3,524	3,987	4,470	4,900	5,282	5,084	5,193	5,491	5,665	5,542	5,607	5,484	5,430	5,550
RPS										\$5.80	\$6.54	\$7.44	\$7.41	\$7.94	\$8.87	\$9.90	\$10.04	\$10.75	\$10.92	\$11.31	\$12.07
Adj. Sales (mln)																					

Sales Analysis:

Sales Analysis (last 5 yrs.):

Growth Rate % 1.96%

Growth Rate %: -0.22%

Growth Rate P 6.91%

Growth Rate PS % 5.00%

	1995	1996	1997	1999	2000	2001	2002	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Oper. Margin								33.10%	33.80%	31.70%	29.50%	28.40%	29.70%	29.40%	29.60%	28.60%	24.70%	25.20%	25.40%	25.50%	26.00%
Tax Rate								31.5%	31.1%	31.5%	29.9%	25.8%	25.0%	20.5%	24.9%	12.8%	13.9%	12.0%	11.0%	12.0%	14.0%
Deprec. (mln)								79	80	104	124	144	154	176	193	246	263	272	270	275	290
Depreciation %								10.5%	8.9%	11.3%	14.5%	15.7%	17.1%	18.5%	19.4%	23.3%	32.9%	31.9%	32.3%	33.1%	33.7%

Description:

Instructions:

Analysis:

Observations: The likely long term growth rate of the earnings will be simply a function of top line growth.

## Description & Analysis of Profitability (in mlns):

		2011		2012		2013		2014		2015		2016
<b>Gross Revenues:</b>	<b>-0.3%</b>	<b>5,491</b>		<b>5,665</b>		<b>5,542</b>		<b>5,607</b>		<b>5,483</b>		<b>5,423</b>
-1%	Consumer to Consumer	<b>4,608</b>		<b>4,584</b>		<b>4,434</b>		<b>4,486</b>		<b>4,344</b>		<b>4,305</b>
	Transaction	3,580		3,546		3,396		3,422		3,221		3,124
	Foreign Exchange	983		989		981		999		1,057		1,116
	Other	45		50		56		65		66		65
0%	Consumer to Business	<b>616</b>		<b>604</b>		<b>609</b>		<b>599</b>		<b>637</b>		<b>621</b>
	Transaction	582		574		579		573		612		597
	Foreign Exchange	34		30		29		26		25		25
20%	Business Solutions	<b>161</b>		<b>367</b>		<b>393</b>		<b>405</b>		<b>399</b>		<b>396</b>
	Foreign Exchange	155		332		356		363		357		353
	Transaction	7		35		37		42		42		43
-1%	Other	<b>106</b>		<b>109</b>		<b>107</b>		<b>118</b>		<b>103</b>		<b>101</b>
<b>Internal Costs:</b>	<b>1.0%</b>	<b>4,106</b>		<b>4,335</b>		<b>4,435</b>		<b>4,467</b>		<b>4,374</b>		<b>4,318</b>
1%	Cost of Services	3,102	75.5%	3,194	73.7%	3,235	72.9%	3,297	73.8%	3,199	73.1%	3,270
1%	Selling G & A	1,004	24.5%	1,141	26.3%	1,200	27.1%	1,169	26.2%	1,175	26.9%	1,048
<b>EBITDA:</b>	<b>-2.8%</b>	<b>1,578</b>		<b>1,576</b>		<b>1,370</b>		<b>1,413</b>		<b>1,378</b>		<b>1,368</b>
6%	Depreciation and amortization	193		246		263		272		270		263
<b>"Free" Cash Flow</b>	<b>-4.3%</b>	<b>1,415</b>		<b>1,308</b>		<b>1,129</b>		<b>1,234</b>		<b>1,113</b>		<b>1,138</b>
7%	Capital Expenditures	163		268		241		179		266		230
<b>Operating Margin:</b>	<b>-4.4%</b>	<b>1,385</b>		<b>1,330</b>		<b>1,107</b>		<b>1,141</b>		<b>1,108</b>		<b>1,105</b>
-5%	Consumer to Consumer	1,316	28.6%	1,267	27.6%	1,030	23.2%	1,050	23.4%	1,042	24.0%	1,009
-15%	Consumer to Business	147	23.9%	138	22.8%	122	20.0%	99	16.5%	104	16.3%	64
	Business Solutions	(10)	-6.0%	(55)	-14.9%	(27)	-6.9%	(12)	-3.0%	3	0.7%	21
	Other	(22)		(20)		(18)		4		(4)		11
<b>External Costs:</b>	<b>1.6%</b>	<b>220</b>		<b>304</b>		<b>309</b>		<b>281</b>		<b>261</b>		<b>238</b>
-4%	Taxes:	109		143		129		116		104		89
-45%	Interest and other income	(72)		(18)		(15)		(12)		(11)		(4)
-3%	Interest expense	182		180		196		177		168		153
<b>Earnings:</b>	<b>-5.7%</b>	<b>1,165</b>		<b>1,026</b>		<b>798</b>		<b>860</b>		<b>847</b>		<b>868</b>
<b>Dividend Paid/% of FCF:</b>	<b>9.9%</b>	<b>192</b>	13.6%	<b>246</b>	18.8%	<b>276</b>	24.5%	<b>261</b>	21.1%	<b>311</b>	28.0%	<b>307</b>
<b>Common Stock/% of FCF:</b>		<b>631</b>	44.6%	<b>750</b>	57.3%	<b>325</b>	28.8%	<b>511</b>	41.4%	<b>376</b>	33.8%	<b>427</b>
	Share buybacks: Stmt of C. F.			713		381		481		436		467
<b>Net Bness Acquisitions:</b>		<b>1,219</b>		<b>-10</b>		<b>0</b>		<b>19</b>		<b>0</b>		<b>0</b>

**Description:** Interesting: no country outside the US is more than 7% of the business.  
WU has 10,000 employees, 8,000 of which are outside the US.

**Instructions:**

**Analysis:** WU does appear to have an opportunity in the ctob segment bc of the increased minimum costs of a bank account.  
ctoc going up at 4%, but revenues down - pricing pressure

**Observations:**

## Balance Sheet (in mlns):

	2012	2013	2014	2015	2016
<b>Assets:</b>	<b>-0.1%</b>	<b>9,466</b>	<b>10,121</b>	<b>9,890</b>	<b>9,420</b>
Cash	1,777	2,073	1,783	1,316	878
Settlement assets	3,115	3,270	3,314	3,309	3,749
Property, Plant and Equipment	196	210	206	232	221
Goodwill	3,180	3,172	3,169	3,164	3,162
Intangible Assets	879	834	748	705	664
Other	320	562	670	734	746
<b>Liabilities:</b>	<b>0.0%</b>	<b>8,525</b>	<b>9,017</b>	<b>8,590</b>	<b>8,517</b>
Accounts payable	556	639	600	607	1,130
Settlement obligations	3,115	3,270	3,314	3,309	3,749
Income taxes payable	218	217	166	212	407
Deferred Income Tax	352	319	305	273	86
Long-term debt	4,029	4,213	3,720	3,226	2,786
Other	255	358	484	429	359
<b>Shareholder's Equity:</b>	<b>-1.0%</b>	<b>941</b>	<b>1,105</b>	<b>1,300</b>	<b>902</b>
Common Stock	6	6	5	5	5
Capital Surplus	333	391	445	557	641
Retained earnings	755	877	969	977	419
Accumulated other comprehensive	-153	-169	-119	-144	-163

**Description:**

**Instructions:**

**Analysis:**

**Observations:**

Description & Analysis of Debt Levels (in mlns):		
Summary:	Debt is a four-letter word. Debt causes the years of repayment of capital to equity shareholders to stretch out into the more distant future. Even worse, debt can cause the best business model to become the property of bondholders in a rough economic environment.	
Total Debt-Capital:	The measure of total debt to total capital is useful when book value is a good measure of a firm's worth. This is particularly true of traditional businesses where property, plant and equipment are important. Further, it helps to have this ratio in capital intensive businesses with cyclical earnings.	
	Total Debt	8,517 Here, deferred income taxes have been excluded.
	Total Capi	9,420 Here, deferred income taxes have been excluded.
	Ratio:	90.42%
Long Term Debt-Cap.:	The measure of long term debt to total capital is useful when total debt is distorted by the high presence of current assets being financed by current liabilities. Again, the measure works best within a traditional industry setting. The ratio helps position the equity shareholders.	
	L. T. Debt:	2,786 Here, the current liabilities have been excluded.
	L. T. Capi	3,688 Here, the current liabilities have been excluded.
	Ratio:	75.54%
Net Income Payback:	The measure of how quickly debt is repaid by net income is a conservative measure, as it includes some debt, such as current liabilities that are financed by current assets and excludes some sources of cash, such as noncash amortization numbers.	
	Total Debt	8,517
	Net Incom	868
	Years Pay	9.8
	L.T. Debt:	2,786
	Net Incom	868
	Years Pay	3.2
Addback Net Inc. Payb	The measure of how quickly debt is repaid by addback net income is a good measure, as it starts with GAAP net income and adds back expenses on an after-tax basis that are clearly discretionary, such as business acquisitions to better analyze the strength of the repayment stream.	
	L.T. Debt:	1,909 Add in overseas cash
	Net Incom	868
	Addback:	0 Merger charges, writedowns above the line, dep. Amort below the line less capex
	Years Pay	2.2
	Our standard for a "Fort Knox" balance sheet is a 4 year payback; a multiple of 10 is preferred with a "utility." 0-4 year payback means that this analysis can be ignored. 4-7 year payback means that the company should	

Description & Analysis of Pension Issues(in mlns):										
Summary:	Corporate defined benefit or "pension" plans are a major obligation of companies. Because of the actuarial changes involved, obligations can move significantly. As a result, corporations have steadily moved toward defined contribution plans as they froze or terminated pension plans. These obligations are measured in two ways: accumulated and projected. As the name implies, projected is what is likely and a greater number than accumulated. This obligation is typicawu in three categories: US, non-US and post-retirement. There are assets which are set up to fund these plans. The difference is the funded status. This number provides an indication of the additional potential obligation of the company and is included in the balance sheet - typicawu in "other assets" and "other liabilities." That may not be the accurate value of the obligation in the event that assumptions are unreasonable. Because pensions are funded over time, it is less likely to have an immediate funding need that cripples the company or its earnings. Rather than focus on these assumptions, we estimate the size of plan's underfunding relative to the market value of the company. The greatest financial risk involves companies which are small relative to these funding requirements. For our purposes, we set this limit at 25% for the total underfunded as a percentage of market capitalization.									
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Pension Pl	Yes	Yes	Yes							
Frozen:	Yes	Yes	Yes							
Taft-Hartle	No	No	No							
Underfund:	Yes	Yes	Yes							
Amount:	75	69	69							
Market Cap	9,600	9,600	9,600							
Ratio:	0.78%	0.72%	0.72%							

Description & Analysis of Stock Options (in mlns):		
Summary:	Stock options are a difficult form of compensation to assess. Heavy use of stock options creates stock issuance and a demand for stock repurchasing in some industries. This can be dilutive to shareholders if no repurchasing occurs or can absorb cash flows in the event that repurchasing occurs to offset issuance. Uses "share-based incentive" language	

FASB ASC 718	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
After tax E	28.20	29.90	29.90							
Net profits:	914.00	857.30	919.00							
%	3.09%	3.49%	3.25%							
Cash net of	481.00	435.50	466.60							
Net share r	511.16	376.27	426.72							
Difference	-30.16	59.23	39.88							
% of Net pr	-3.30%	6.91%	4.34%							

## Industry Overview

WU is within the financial services industry - a broad and diversified field. WU is in the payment processor sector - an area that includes banks and credit card companies as well as other payment processors. WU shares a small space of the "unbanked" sector - a major sector within developing countries, but much smaller within the U.S. The "unbanked" has been fairly unsophisticated and not been driving better bargains. Wal-mart is starting to compete within the U.S. Outside the U.S. is still open, but more forced competition is in some developing markets. The consumer - to business and business - to business area is much more competitive.

## Industry Comparisons

### Operating Statistics:

Company	Debt pbk.	Revenue	ROC	Operating Margin
WU	2.2	5,423	17.70%	25.5%
MGI	9.0	1,455	12.10%	12.4%
PYPL	0.0	9,250	9.00%	23.0%

### Market Statistics:

Company	P/B	P/E	Div. Yld.	EV/Sales
WU	6.67	11.6	3.36%	2.4
MGI	nmf	14.4	0.00%	1.0
PYPL	3.40	35.0	0.00%	5.0

## Qualitative Characteristics

### Positives:

### Negatives:

#### Product/Service:

**Pricing Power:**

**Durability:**

**Brand Appeal:**

**Unique Importance:**

**Role Of Media:**

**Toll Bridge:**

**Global Opportunity**

**Competition**

**Economic Risk:**

**Government Role**

**Role Of Technology:**

**Supply/Demand:**

#### Financial:

**Business Model:**

**High Capital Reinv.:**

**Effective As Public:**

**Ownership:**

**Growth:**

**Concentration:**

#### Management:

**Characteristics:**

**Proxy Information:**

Continuous Need.

Long history; well-known

Size matters; 500,000 agents

Yes

Yes

Scale helps WU leverage technology

Growing demand in developing countries

Quasi-creamier because agents own shops

No

Yes

No concentration

Good without share issuance

Solid.

Limited

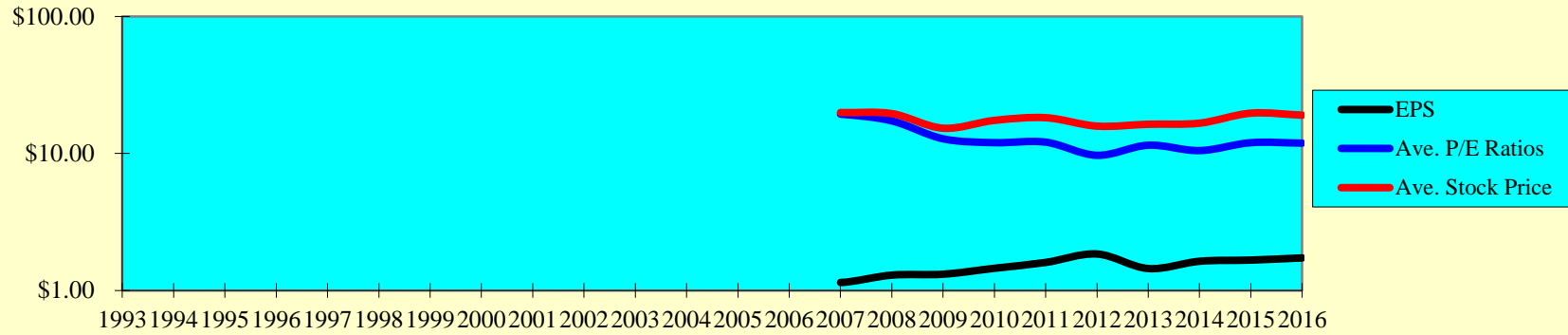
Faces competition directly from moneygram; faces tech innovation from xoom and mobile phones

Economic cycles drop valuations.

Regulatory issues are sizeable; some non-controllable

Declining need in developed countries

### Average Stock Price vs. Average P/E vs. EPS



	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
EPS	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$1.19	\$1.14	\$1.30	\$1.31	\$1.45	\$1.60	\$1.85	\$1.45	\$1.63	\$1.67	\$1.73
Ave. P/E Ratio	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	20.30	19.40	17.30	12.80	12.00	12.10	9.70	11.50	10.50	12.00	11.90
Ave. Stock Price	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	20.45	19.90	19.55	15.30	17.45	18.25	15.85	16.35	16.65	19.70	19.05

Price/Earnings Ratio: used - **\$1.73**  
 Eleven year average low **9.6**  
 Eleven year average high **15.4**  
 If we set the purchase at the ave. Eleven year lo  
 the price implied is: **\$16.61**  
 If we set the sell at the ave. Eleven year high P/E  
 the price implied is: **\$26.64**

Price/Sales Ratio: used - **\$11.31**  
 Eleven year average low **1.66**  
 Eleven year average high **2.67**  
 If we set the purchase at the ave. Eleven year low P/S,  
 the price implied is: **\$18.77**  
 If we set the sell at the ave. Eleven year high P/S,  
 the price implied is: **\$30.16**

Price/Book Ratio: used - **\$3.00**  
 Eleven year average low **9.61**  
 Eleven year average high **15.35**  
 If we set the purchase at the ave. Eleven year lo  
 the price implied is: **\$28.82**  
 If we set the sell at the ave. Eleven year high P/B  
 the price implied is: **\$46.05**

Price/Cash Flow Ratio: used **\$2.30**  
 Eleven year average low **7.9**  
 Eleven year average high **12.8**  
 If we set the purchase at the ave. Eleven year low P/CF,  
 the price implied is: **\$18.24**  
 If we set the sell at the ave. Eleven year high P/CF,  
 the price implied is: **\$29.38**

<b>Initial Rate of Investment</b>		
	<b>Current Price</b>	\$20.00
	<b>Current EPS</b>	\$1.73
	<b>Initial ROI</b>	<b>8.65%</b>

<b>Valuation as an Equity Bond:</b>		
	<b>Current BV</b>	\$3.00
	<b>Current ROE</b>	57.64%
	<b>Retained %</b>	12.01%
	<b>Net BV Growth</b>	6.92%
	<b>BV in Year 10</b>	\$5.86
	<b>EPS in Year 10</b>	\$3.38
	<b>Valueat14.P/E</b>	\$47.28
	<b>Total Dividends</b>	\$9.49
	<b>Total F.Value</b>	\$56.78
	<b>Purchaseat14%</b>	<b>\$15.32</b>

<b>Relative Value to Investment In T-Bonds</b>		
	<b>Current EPS</b>	\$1.73
	<b>T-Bond Rate</b>	4.00%
	<b>Relative Value</b>	<b>\$43.23</b>

<b>Valuation on Earnings Growth:</b>		
	<b>Current EPS</b>	\$1.73
	<b>EPS in Year 10</b>	\$3.40
	<b>Ave. P/E Ratio</b>	13.59
	<b>Valueat14.P/E</b>	\$57.12
	<b>Price Return</b>	9.06%
	<b>Dividend Return</b>	3.36%
	<b>Total Return</b>	12.42%
	<b>Purchaseat14%</b>	<b>\$15.41</b>
	<b>Sellat6%</b>	<b>\$31.89</b>

Capital "charge" approach

1,368 ebitda  
0.12 required return  
0.02 growth rate (not on EPS) (no acquisitions)  
1 % not required  
0.1 denominator  
13,682 ev  
1,909 debt  
11,773 equity value  
480 shares  
24.53 share value  
14.72 buy at 60%  
29.43 sell at 120%

### **History of Buys/Sells**

ACM bought to 1.5% on 10/7/2014 at \$15.98

### **Discussion of Buys/Sells**

What: The return of the purchase of WU (bought 10/7/2014 to present) was 17% and SP 6% for an outperformance of 11% (nearly 1 year). Since the spinoff in 2006, WU has underperformed the SP with heightened volatility with 9% and SP 58% for an underperformance of 49% (nearly 9 years).

So what: It appears that we ended up purchasing an "equity bond" at a time of shrinking margins but high dividends and share repurchasing. On our 2014 purchase, we paid nearly 10X current earnings.

Now what: Our discipline can capture "equity bond" companies on bad news but has to be careful if growth estimates are too strong.

Takeaway: our Tier III companies can generate superior returns but only if actively bought and sold.

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