

## Alliance Data(ADS)

**\$105.65** (As of 01/27/20)

Price Target (6-12 Months): **\$111.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 12/24/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**4-Sell**

Zacks Style Scores:

VGM:A

Value: A

Growth: D

Momentum: A

## Summary

Alliance Data's organic growth has led to rise in revenues. The current trend in consumer-based businesses shifting their marketing spend to data-driven marketing strategies should help retain the momentum. Solid receivables growth in Card Services along with strong LoyaltyOne should drive the top line. Strategic acquisitions and divestitures have helped Alliance Data to grow inorganically expand the international footprint with the revenue growth. A strong balance sheet supports financial flexibility and effective capital deployment. However, its rising debt level leading to higher interest expenses and lower interest coverage ratio raises financial risk. Its increased cost of operations and higher general and administrative expenses burden on the margins. Also, the shares of Alliance Data have underperformed the industry in the past year.

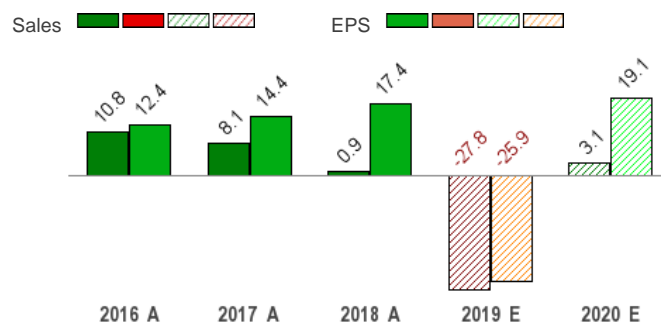
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	<b>\$182.95 - \$99.20</b>
20 Day Average Volume (sh)	<b>628,894</b>
Market Cap	<b>\$4.9 B</b>
YTD Price Change	<b>-5.8%</b>
Beta	<b>1.67</b>
Dividend / Div Yld	<b>\$2.52 / 2.4%</b>
Industry	<b><a href="#">Financial Transaction Services</a></b>
Zacks Industry Rank	<b>Top 27% (68 out of 255)</b>

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>-3.6%</b>
Last Sales Surprise	<b>-0.2%</b>
EPS F1 Est- 4 week change	<b>0.0%</b>
Expected Report Date	<b>01/30/2020</b>
Earnings ESP	<b>-0.3%</b>

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,375 E	1,409 E	1,465 E	1,567 E	5,795 E
2019	1,334 A	1,349 A	1,438 A	1,502 E	5,622 E
2018	1,884 A	1,904 A	1,947 A	2,056 A	7,791 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$4.65 E	\$4.74 E	\$5.26 E	\$5.40 E	\$20.05 E
2019	\$3.72 A	\$3.83 A	\$5.05 A	\$4.19 E	\$16.83 E
2018	\$4.44 A	\$5.01 A	\$6.26 A	\$7.04 A	\$22.72 A

\*Quarterly figures may not add up to annual.

P/E TTM	<b>5.4</b>
P/E F1	<b>5.3</b>
PEG F1	<b>0.3</b>
P/S TTM	<b>0.8</b>

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/27/2020. The reports text is as of 01/28/2020.

## Overview

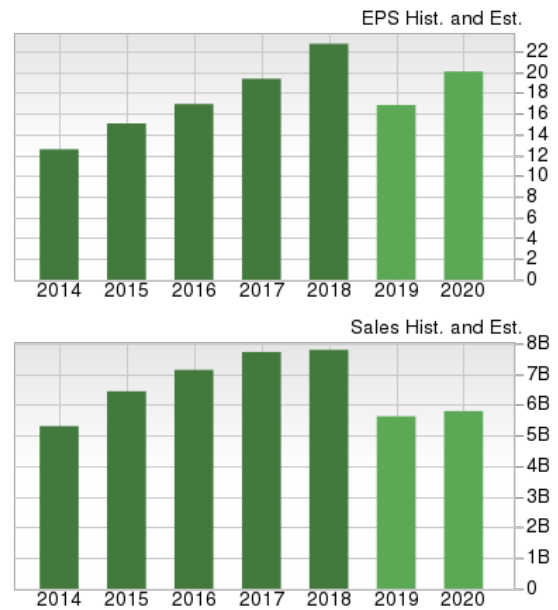
Headquartered in Plano, TX and founded in 1996, Alliance Data Systems Corporation is a private label credit card processing firm for mid-market specialty retail stores in the U.S. It provides transaction, marketing and credit services in the United States, Canada and internationally. Using transaction-rich data, Alliance Data creates and manages customized solutions that change consumer behavior and enable its clients to create and enhance customer loyalty to build stronger, mutually beneficial relationships with their customers. The company is a leading player among its competitors. Alliance Data is one of the largest third party payment processors in the United States and the second largest third party private label card issuer as measured by accounts. In Canada, it owns and operates the premier coalition loyalty-marketing program (AIR MILES).

The company operates in two reportable segments: LoyaltyOne and Card Services.

**Card Services (81% of 2018 Revenues)** provides risk management solutions, account origination, funding, transaction processing, customer care and collections services for the company's private label retail credit card programs.

**LoyaltyOne (19%)** uses information gathered through loyalty programs to help clients in designing and implementing marketing programs. Clients include financial services providers, grocers, drug stores, petroleum retailers and specialty retailers. The company derives revenues primarily from the company's coalition and short-term loyalty programs through its AIR MILES Reward Program and BrandLoyalty.

**Epsilon:** On Jul 1, 2019, Alliance Data sold Epsilon business to Publicis Groupe.



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## Reasons To Buy:

- ▲ Shares of Alliance Data have lost 41% in the past year against the industry's increase of 45.9%. Nonetheless, the company's solid fundamentals should help the shares gain momentum. Valuation is also attractive. Price to earnings of 4.98X is much lower than the industry average of 28.16X. The company carries a Value Score of A.
- ▲ Organic growth has been a key strength at Alliance Data, indicated by its revenue growth story. We believe the company to retain its revenue momentum in the coming quarters with ample opportunities from the current trend in consumer-based businesses shifting their marketing spend to data-driven marketing strategies.
- ▲ Alliance Data divested Epsilon to Publicis Groupe for \$4.4 billion in July this. The business has been witnessing declining sales for some time. The divestiture will help the company focus more on market-leading high-growth, high-ROI Card Service segment, which contributes the lion's share of Alliance Data's total revenues. Alliance Data estimates the divestiture to be accretive to 2019 core earnings and be highly accretive on a GAAP basis. Also, the company estimates the divestiture to provide significant liquidity to return capital to shareholders and improve capital structure. It estimates pro forma leverage ratio of about 1.7.
- ▲ Alliance Data has made several strategic acquisitions to grow inorganically. Acquisitions have helped the company expand international footprint, consolidate its position in digital agency, boost the LoyaltyOne business, strengthen position in the digital marketing channels, expand its Omni-Channel distribution capabilities and widen presence in Brazil. With solid financial strength and flexibility, we expect Alliance Data to pursue strategic acquisitions that supports international expansion, with solid revenue growth opportunities.
- ▲ Alliance Data remains focused toward returning value to its shareholders. It uses share repurchases as a tool to mitigate the adverse impact of foreign exchange and intends to focus more into share buybacks and then into mergers and acquisitions. As such, the board approved a new share buyback program of \$1.1 billion in July 2019. Alliance Data targets return on equity (ROE) of more than 30%. Its ROE of 47.4% compares favorably with the industry average of 42.6%.
- ▲ The company retired debt worth \$2.4 billion deploying net proceeds from Epsilon divestiture. This helped pro forma debt leverage ratio to reduce to 1.6.

Alliance Data's high-ROI Card Service segment, solid inorganic background, strengthening its balance sheet to gain financial flexibility and effective capital deployment bodes well for growth.

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## Reasons To Sell:

- ▼ Taking into account the divestiture of Epsilon, anticipated Dutch tender and cost reductions at the corporate location, Alliance Data estimates core EPS in the range of \$16.75 to \$17.00. The mid-point of the guidance indicates year-over-year decline of 3.5%.
- ▼ Alliance Data has been witnessing a rise in operating expenses for the past few years due to higher cost of operations and an increased general and administrative expense. Total operating expenses have escalated 40.2% in the last five years. In the first nine months of 2019, operating expenses increased 5.7% to \$3.1 billion. The company must strive to improve revenues else margin will be dented.
- ▼ Alliance Data's long-term debt has increased 43% in five years' time. As a result interest expenses have more than doubled over the same time frame. Its debt to equity ratio of 1506.4% compares unfavorably with the industry average of 53.3%. An increase in leverage thus might lead to heightened financial risk for the company and burden on margins. The company must continue to service its debt uninterrupted, else creditworthiness will be dented.
- ▼ With more than 60% of the Canadian households collecting reward miles, the AIR MILES Reward Program has positioned itself as Canada's premier coalition loyalty program. In the event of actual redemptions by AIR MILES Reward Program being more than expected or if there is an increase in costs related to redemption of AIR MILES reward miles, profitability will likely be affected. In addition, AIR MILES reward miles issued is directly proportional to AIR MILES reward miles available for redemption in the future. This in turn, might affect revenues. AIR MILES issued decreased 0.2% in the first nine months of 2019.

Alliance Data's increasing expenses due to higher cost of operations and an increased general and administrative expense and high leverage with low times interest earned raise concern.

## Last Earnings Report

### Alliance Data Misses Q3 Earnings Estimates, Cuts View

Alliance Data Systems Corporation's operating earnings of \$5.05 per share for the third quarter of 2019 missed the Zacks Consensus Estimate by 3.6%. The bottom line declined nearly 6% year over year.

Soft performance of the Card Service and Loyalty segments weighed on the results.

Shares of the company lost 3.2% in the pre-market trading session owing to the lower-than-expected results.

Quarter Ending **09/2019**

Report Date	Oct 24, 2019
Sales Surprise	-0.20%
EPS Surprise	-3.63%
Quarterly EPS	5.05
Annual EPS (TTM)	19.64

### Behind the Headlines

Alliance Data reported total revenues of \$1.4 billion, up 1% year over year. The upside was due to higher revenues from Card Services segment. The top line missed the Zacks Consensus Estimate by 0.2%.

Operating expenses increased 20.2% year over year to \$1.1 billion. Operating income decreased 36.6% year over year to \$304.2 million largely due to higher expenses.

Adjusted EBITDA (net of funding costs) declined 16% year over year to \$367 million.

### Segment Update

Card Services revenues were \$1.2 billion, up 3% year over year. Adjusted EBITDA was \$328 million, down 21% year over year. The results reflect performance improvements across several key metrics, including net charge-offs, credit card and loan receivables and credit sales. New business wins contributed 6% to year-over-year growth in reported credit sales.

LoyaltyOne revenues totaled \$246 million, down 6% year over year. Adjusted EBITDA decreased 8% to \$58 million. AIR MILES reward miles issued remained flat year over year.

The company incurred \$42 million in restructuring and other charges owing to initiatives implemented during the quarter to lower operating costs at both the AIR MILES Reward Program and BrandLoyalty.

### Financial Update

As of Sep 30, 2019, cash and cash equivalents was \$4.5 billion, up 18.2% from Dec 31, 2018-level.

At quarter end, debt level dropped 50.3% from 2018-end to \$2.8 billion. Alliance Data retired \$2.4 billion of corporate debt, which is expected to yield annualized interest cost savings of approximately \$120 million.

Cash from operations decreased 24.4% year over year to \$1.5 billion in the first nine months of the year. Capital expenditure at Alliance Data declined 20.2% year over year to \$119.2 million in the same period.

### Dividend Update

The board of directors approved quarterly dividend of 63 cents, to be paid out on Dec 17, 2019 to stockholders of record as of Nov 14.

### Guidance

Alliance Data estimates core EPS in the range of \$16.75 to \$17.00 in 2019, down from \$19.50 - \$19.75 estimated earlier.

Accounting for the full-year effect of lower share count, debt retirement and company-wide expense reductions, the company projects core EPS in the range of \$20.50 - \$20.75.

The company estimates low-single digit revenue growth in 2020 and mid-twenties to high-twenties year-over-year improvement in core EPS.

Enterprise-wide expense reduction program is expected to generate more than \$100 million of incremental annualized savings.

### Business Update

Alliance Data successfully completed a "modified Dutch Auction" tender offer, buying back 5.1 million shares for \$750 million, exclusive of fees and expenses related to the tender offer. It expects to opportunistically allocate the remaining net proceeds of \$350 million based on management's assessment of potential investments to accelerate organic growth, its cash requirements, and the benefit from additional share buybacks.

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## Valuation

Alliance Data shares have lost 40.9% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Finance sector are up 45.9% and 27.3%, respectively.

The S&P 500 index is up 21.9% in the past year.

The stock is currently trading at 4.98X forward 12-month earnings, which compares to 28.16X for the Zacks sub-industry, 25.59X for the Zacks sector and 18.62X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.06X and as low as 4.49X, with a 5-year median of 11.92X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$111 price target reflects 5.23X forward 12-month earnings.

The table below shows summary valuation data for ADS

Valuation Multiples - ADS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	4.98	28.16	25.59	18.62
	5-Year High	21.06	28.16	25.59	19.34
	5-Year Low	4.49	20.78	18.77	15.18
	5-Year Median	11.92	22.92	20.56	17.45
P/S F12M	Current	0.83	10.67	4.07	3.46
	5-Year High	2.86	11.65	5.13	3.46
	5-Year Low	0.79	7.19	3.09	2.54
	5-Year Median	1.58	8.69	3.63	3
P/B TTM	Current	3.25	8.26	5.01	4.43
	5-Year High	10.78	12.79	6.72	4.55
	5-Year Low	2.61	5.34	4.13	2.85
	5-Year Median	7.2	7.91	5.3	3.62

As of 01/27/2020

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## Industry Analysis Zacks Industry Rank: Top 27% (68 out of 255)



## Top Peers

Diebold Nixdorf, Incorporated ( <b>DBD</b> )	Outperform
The Western Union Company ( <b>WU</b> )	Outperform
Equifax, Inc. ( <b>EFX</b> )	Neutral
Fidelity National Information Services, Inc. ( <b>FIS</b> )	Neutral
Fiserv, Inc. ( <b>FISV</b> )	Neutral
Global Payments Inc. ( <b>GPN</b> )	Neutral
MarketAxess Holdings Inc. ( <b>MKTX</b> )	Neutral
Synchrony Financial ( <b>SYF</b> )	Neutral

Industry Comparison Industry: Financial Transaction Services				Industry Peers		
	ADS Neutral	X Industry	S&P 500	FIS Neutral	FISV Neutral	WU Outperform
<b>VGM Score</b>	<b>A</b>	-	-	<b>D</b>	<b>C</b>	<b>B</b>
Market Cap	4.87 B	2.51 B	23.86 B	89.97 B	81.11 B	11.38 B
# of Analysts	9	6	13	13	13	7
Dividend Yield	2.39%	0.00%	1.81%	0.96%	0.00%	2.95%
<b>Value Score</b>	<b>A</b>	-	-	<b>D</b>	<b>D</b>	<b>B</b>
Cash/Price	0.91	0.07	0.04	0.01	0.01	0.12
EV/EBITDA	5.63	19.18	13.94	36.99	44.36	9.42
PEG Ratio	0.33	1.74	2.00	2.60	1.74	1.12
Price/Book (P/B)	3.25	4.38	3.25	1.82	2.41	NA
Price/Cash Flow (P/CF)	3.34	18.05	13.46	15.10	25.88	10.55
P/E (F1)	5.38	23.16	18.67	23.19	24.07	13.73
Price/Sales (P/S)	0.79	5.12	2.62	9.82	10.54	2.11
Earnings Yield	18.98%	4.31%	5.35%	4.31%	4.16%	7.29%
Debt/Equity	8.91	0.34	0.72	0.34	0.66	-164.87
Cash Flow (\$/share)	31.61	2.62	6.92	9.69	4.61	2.57
<b>Growth Score</b>	<b>D</b>	-	-	<b>C</b>	<b>B</b>	<b>C</b>
Hist. EPS Growth (3-5 yrs)	13.11%	16.43%	10.68%	17.58%	16.43%	3.73%
Proj. EPS Growth (F1/F0)	19.17%	17.64%	7.51%	14.62%	23.71%	11.45%
Curr. Cash Flow Growth	10.08%	10.67%	13.40%	10.67%	18.73%	-27.60%
Hist. Cash Flow Growth (3-5 yrs)	12.90%	10.92%	8.78%	16.71%	8.93%	1.43%
Current Ratio	2.10	1.15	1.22	0.86	1.08	0.96
Debt/Capital	89.90%	36.09%	42.92%	25.61%	39.69%	99.03%
Net Margin	7.54%	10.25%	11.39%	8.24%	12.11%	21.07%
Return on Equity	47.40%	19.33%	17.19%	12.07%	16.73%	-475.84%
Sales/Assets	0.21	0.44	0.54	0.22	0.26	0.59
Proj. Sales Growth (F1/F0)	3.08%	10.50%	4.09%	27.54%	6.99%	-0.82%
<b>Momentum Score</b>	<b>A</b>	-	-	<b>D</b>	<b>C</b>	<b>B</b>
Daily Price Chg	-1.63%	-1.20%	-1.40%	-1.03%	-1.27%	0.18%
1 Week Price Chg	-4.88%	0.00%	-1.09%	0.56%	0.13%	-2.41%
4 Week Price Chg	-4.55%	2.78%	-0.25%	5.62%	3.32%	1.38%
12 Week Price Chg	3.24%	2.64%	3.64%	11.75%	13.31%	2.03%
52 Week Price Chg	-40.90%	39.58%	18.08%	40.37%	40.01%	49.42%
20 Day Average Volume	628,894	430,390	1,615,215	2,721,059	2,412,799	5,250,392
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.16%	0.18%	0.00%
(F1) EPS Est 12 week change	4.43%	0.64%	-0.17%	0.90%	2.84%	1.63%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-0.24%	0.00%	0.00%

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	D
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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### Disclosures

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