



Mossberg's Investor Digest

Idea Profile

Alliance Data Systems (NYSE: ADS)

DESCRIPTION:

Alliance Data Systems provides transaction based marketing and loyalty solutions services through three business segments. 1) The Loyalty Services segment operates the AIR MILES® Reward Program. This is the largest rewards program in Canada with more than 120 participating sponsors and 70% of Canadian households active in the program. Unlike other loyalty programs, the AIR MILES program reward points can be earned from over 100 sponsors including grocery stores, gas stations, credit cards, etc. 2) Epsilon Marketing Services integrates database marketing technology and analytics with a broad range of direct marketing services. For example, Epsilon helps Barnes & Nobel send emails regarding new book releases to customers who have read prior works by the same author. 3) Private Label Credit and Services provides integrated loyalty-driven credit card processing, account origination and administration services. If you have a credit card from Crate & Barrel, Victoria's Secret or Pottery Barn, it is managed by Alliance Data.

KEY INVESTMENT CONSIDERATIONS:

Recession resistant – ADS' transaction based solutions allow clients to market to customers on a micro-segment basis. While clients may be cutting back on print, TV and other mass marketing programs, clients continue to invest in targeted marketing programs like ADS provides that can provide very measurable ROIs. ADS' business development pipeline is as large as it's ever been. They are expecting 6 to 7 customer announcements this year, up from a recent rate of 4 to 5 per year.

Credit risk may be misunderstood – There are 11 million active households using private label credit programs run by ADS. 85% of credit card holders are female with mid-to high-income levels and an average bureau score of 700. The average balance per account is approximately \$350. Investors may not understand that the women that carry these cards are not carrying them because they need the credit...it's about customer loyalty. This is not a portfolio of sub prime borrowers.

KEY RISK:

Customer concentration – The company's top ten clients account for approximately 40% of revenue. One customer, the Bank of Montreal represents approximately 10% of revenue. While it's rare for the ADS to loose customers, they lost Lane Bryant last year, which reduced growth rates for 2008. A similar loss could make it challenging for valuation multiples to expand.

CATALYSTS:

Short covering – Approximately 7.7 million shares, representing 12% of ADS's stock float and about 5 days of trading volume, are sold short. Short interest is likely due to arbitrage players who still hold a profit after the breakup of the Blackstone Deal earlier this year and increasing concern over credit risk. As the company continues to prove to the market that its credit portfolio is in good shape, remaining arbitrage players will be replaced by both long term value and growth investors. Adding more pressure for short covering, the company has announced a \$1.8 billion share repurchase program. \$1 billion is still remaining.

Blackstone deal breakup fee – Earlier this year, Blackstone backed out of a deal to acquire ADS for \$81.75 per share. The acquisition agreement was reached in May of last year and Blackstone had second thoughts due to the credit crises. The company is suing Blackstone for payment of a \$170 million breakup fee.

VALUATION:

ADS enterprise value is approximately 7x the 2008 EBITDA estimate of \$700 million. This appears to be an attractive valuation for an industry leader with a track record of 27 consecutive quarters (nearly 7 years) of delivering on expectations. Valuations are likely to improve as ADS continues to perform and investors get a better grasp of customer buying trends and credit risk.

(NYSE: ADS)	
Investment Data (as of 9/17/08)	
Recent Price	\$53.34
52-Week Range	39.54 - 80.79
Fiscal Year End	Dec
Dividend	N/A
Yield	N/A
Shares Outstanding	67.3 MM
Average Trading Volume (3 mos)	1.7 MM
Market Capitalization	3.6 B
Cash	0.2 B
Long Term Debt	1.5 B
Enterprise Value (EV)	4.9 B
LT Debt/ Equity	1.7
BV/ Share	12.2
TTM Revenue	2.4 B
P/ Revenue	1.5x
TTM EPS	1.99
P/ EPS	26.8x
TTM EBITDA	583 MM
EV/ TTM EBITDA	8.4x

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