



# Mossberg's Investor Digest

November 2008

Issue #5

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## From the Editor...

*"Everybody's got plans... until they get hit."* –  
Mike Tyson

**Negative Working Capital** – In this challenging economic environment, cash and the ability to generate cash are king. In recent issues I've profiled two companies (Dell, November 8; and Liquidity Services, 10/23/08) that are able to generate "negative working capital", which means that they are able collect from their customers faster than they are required to pay their vendors. These companies are essentially cash generation machines. Other companies that generate "negative working capital" include McDonalds (NYSE: MCD) and Amazon (Nasdaq: AMZN).

Essentially, "negative working capital" generating businesses are able to finance part of their businesses on the back of their vendors. This is a free form of financing. The more free vendor financing, the more equity returns are magnified, which ultimately translates into higher valuation multiples. In the current market environment, these are the types of companies that are most likely to outperform.

Thank you for your interest in Mossberg's Investor Digest and I invite you to become a subscriber.

Dave Mossberg

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## November 2008 Issue

### **Western Union (NYSE: WU)**

*November 8, 2008 Page 2* – Western Union is a cash flow generating machine with relatively small requirement for capital to grow its business. It has a natural monopoly position and is 5x larger than its nearest competitor.

### **Dell (Nasdaq: DELL)**

*November 8, 2008 Page 3* – A large portion of Dell's business still generates "negative working capital", which means it collects cash from its customers faster than it pays its suppliers. This cash generation machine has been used to repurchase 20% of the outstanding shares in the past 3 ½ years and will fund another \$5 billion in repurchases. Michael Dell has stepped back into the CEO position and appears to be making the right moves to fix past operating missteps.

### **Express Scripts (Nasdaq: ESRX)**

*November 24, 2008 Page 4* – It seems simple, but, despite what happens in the economy, people are still going to get sick and they are going to need prescription drugs to feel better. Generic drugs, which represents approximately 2/3 of ESRX subscriptions, are particularly recession resistant.

### **Amdocs (NYSE: DOX)**

*November 24, 2008 Page 5* – Amdocs' solutions provide mission critical activities including billing, customer service, and revenue enhancement for cable, satellite and telephone service providers. Services, which represent 95% of total revenue, are provided under long term contract, which provides recurring revenue with significant visibility.

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## Idea Profile

### Western Union (NYSE: WU)

#### DESCRIPTION:

Since it began offering telegraph services in 1871, Western Union has become the largest and most recognized money transfer service provider in the world. The company operates a network of more than 365,000 agent locations in over 200 countries and territories. Approx. 85% of revenue is generated from fees associated with consumer-to-consumer money transfers...the remainder is from consumer-to-business, mostly for bill payments. WU became an independent, publicly traded company when it was spun out of First Data Corporation in Jan 2006.

#### KEY INVESTMENT CONSIDERATION:

**Stable business in a weak economy** – Looking back over the last 30-40 years, the remittance industry has grown every year but two and those were not even recession years. WU's customers are people who need to send money, this is not a discretionary spend, it is an important thing for families.

**Competitively differentiated with high barriers to entry** - WU is 5x larger than its nearest competitor MoneyGram (NYSE: MGI). Its economies of scale and scope gives it many sustainable competitive advantages. **1) Brand** – The Western Union brand is 150 years old and is recognized for trust, speed and reliability. These are important when consumers entrust WU with their hard-earned cash. The company continues to invest in its brand to the tune of 6% of sales, or \$300 million+ per year. WU has reached critical mass to where it benefits from the **2) network effect**, which means the larger the number of people who use the service the more valuable the service becomes (think eBay). It also creates a larger moat around the business and the more difficult it is for competitors to enter. **3) Natural monopoly** – WU's business model is a direct marketing model similar to Avon. WU signs up master agents who, in turn, sign up smaller sub-agents and receive a portion of the revenue generated by the sub-agents. Competitors find it impossible to replicate the WU network since it has already tied up many of the most desirable partners as master agents, such as post office networks, in exclusive long term contracts (top 40 agents have been with WU for more than 12 years on average).

**Strong international growth opportunity** - While the U.S. market is mature and its growth rate has slowed, WU is much less dependent on the U.S. for growth (33% of revenue is from North America) and delivered 28% growth outside of the U.S. this past quarter. The company already has a significant 17%

share of the remittance market worldwide. With its strong brand and the network effect, WU is well positioned to grow its market share for many years to come.

**Solid Balance sheet and Cash Flows** – Western Union is a cash flow generating machine with relatively small requirement for capital to grow its business. The company is on track to generate \$1.2 billion in cash flow during 2008, and will spend less than \$175 million on capex. The remaining cash is used to payoff debt and/or buy back stock. At the time of its spin-off, WU took on \$3.5 billion in debt from First Data. Because it generates more than \$1 billion in cash flow per year, it can pay back this debt in 3.5 years. It has already paid back \$400 million of this debt and has over \$1 billion in cash on its balance sheet. Since going public WU has repurchased about 86 million shares, or 11% of the original shares outstanding at time of spin off for \$2 billion at an average price of \$22.69. At quarter end, the company had about \$1 billion remaining under its authorization for stock buyback through 2009.

#### VALUATION:

Shares currently trade at 12X and 11X 2008 and 2009 EPS estimates, respectively. This is an attractive multiple for one of the few companies that is expected to deliver double digit growth next year.

(NYSE: WU)	
Investment Data (as of 11/8/08)	
<b>Recent Price</b>	<b>\$15.49</b>
52-Week Range	13.38 - 28.62
Fiscal Year End	Dec
Dividend	\$0.04
Yield	0.3%
Shares Outstanding	716 MM
Average Trading Volume (3 mos)	7.9 MM
<b>Market Capitalization</b>	<b>11 B</b>
Cash	1.1 B
Long Term Debt	3.1 B
Enterprise Value (EV)	13 B
LT Debt/ Equity	N/A
Tangible BV/ Share	N/A
TTM Revenue	5.3 B
<b>P/ Revenue</b>	<b>2.1x</b>
TTM EPS	1.23
<b>P/ EPS</b>	<b>13x</b>
TTM EBITDA	1.6 MM
<b>EV/ TTM EBITDA</b>	<b>8x</b>

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Dell (Nasdaq: DELL)

### DESCRIPTION:

Founded in 1984, Dell is the number one supplier of PCs in the U.S. and number two globally (15% global market share, 2007, IDC). In addition to PC's (60% of revenue), Dell offers Software and Peripherals (16%), Servers and Networking (11%), Services (9%) and Storage (4%). Dell benefits disproportionately from the U.S. corporate market, with over 50% of its revenues and more than 60% of profits coming from this segment.

### KEY INVESTMENT CONSIDERATION:

**Decline in margin is due to operating missteps, which are fixable** – Since Michael Dell stepped down from the CEO spot in 2004, operating margin has declined from 8.6% in 2005 to 5.3% in 2007. Over the past year, Michael Dell has returned to the CEO spot, replaced the executive management team, and is putting in place new strategies that will drive operating margin improvements. The new executive team, which now totals 12 (down from 22 under the former CEO), is less bureaucratic and includes top-level talent including Mike Cannon, former CEO of Solectron, Steve Schuckenbrock, former COO of Electronic Data Systems Corporation, and Ron Garriques, former president of Motorola's Mobile Devices segment.

**Cash generation machine** – While the company is making changes to its business model, including ramping its retail channel sales, Dell's direct-to-customer business model is still the primary way it sells products to its customers. This means a large portion of its business still generates "negative working capital". This happens because customers pay for goods and services faster than Dell has to pay its vendors. For example, receivables and inventory were \$9.2 billion at the end of the last quarter, \$2 billion less than accounts payable. The end result is that the company needs less cash to finance its growth, and can use cash to repurchase shares, and/or make acquisitions.

**Share repurchase** – In the past 14 quarters, Dell has repurchased over 500 million shares for \$15 billion at approximately \$30 per share. This represents approximately 20% of shares outstanding. During the current fiscal year, the company has repurchased 112 million shares or \$2.5 billion. The company has \$5 billion remaining on its current share repurchase authorization, and expects to continue to buy back shares in the back half of its fiscal year. Apparently Michael Dell shares the view that the shares are undervalued. Since late June, he has bought an additional \$200 million of stock for a little above \$20 per share.

**Dealing with a downturn in IT spending** - The good news about the products that Dell sells are purchases can be deferred, but they don't get eliminated. Customers can delay the purchase of IT for a period of time; however, at some point, it becomes counterproductive to have tools that are too old. If customers don't upgrade their productivity tools they start to fall behind. Dell also has many options at its disposal to deal with an environment where customers or potential customers scale back or delay their technology investments. Dell has committed to taking \$3 billion/ year out of its cost structure and \$9 billion in cash gives it lots of options.

### VALUATION:

Despite having 3x the revenue base and 2x the earnings, Dell's shares are currently trading at the same levels they were in 1998. The company is generating over \$1 billion in cash flow per quarter. After its minimal capital expenditure requirements, Dell generates over \$3.2 billion in cash flow each year. With an enterprise value of \$18 billion, the 5.6x free cash flow multiple is a very attractive price for a global leader.

### (Nasdaq: DELL)

Investment Data (as of 11/8/08)

<b>Recent Price</b>	<b>\$12.56</b>
52-Week Range	10.59 - 28.40
Fiscal Year End	Jan
Dividend	N/A
Yield	N/A
Shares Outstanding	2.0 B
Average Trading Volume (3 mos)	34 MM
<b>Market Capitalization</b>	<b>25 B</b>
Cash	9.0 B
Long Term Debt	2.0 B
Enterprise Value (EV)	18 B
LT Debt/ Equity	0.7
BV/ Share	\$1.44
TTM Revenue	64 B
<b>P/ Revenue</b>	<b>0.4x</b>
TTM EPS	1.34
<b>P/ EPS</b>	<b>9.4x</b>
TTM EBITDA	4.3 B
<b>EV/ TTM EBITDA</b>	<b>4x</b>

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### Express Scripts (Nasdaq: ESRX)

#### DESCRIPTION:

Headquartered in St. Louis, Missouri, Express Scripts is a leading pharmacy benefit management company (PBM) that manages prescription drug programs for insurers, employers and other health care payers. By leveraging the purchase power of several payers, Express Scripts, like other PBMs, essentially negotiates better pricing for prescription drugs. The company also uses its efficiencies of scale and scope to assist customers in the evaluation of drugs, promotion of generics, and other services. Approximately 80% of revenue is derived from PBM services and the remainder comes from specialty and ancillary services including the delivery of injectable drugs, and the distribution of pharmaceuticals and supplies. More than 95% (60,000) of retail pharmacies participate in one or more of the company's networks. The company was founded in 1986 and employs nearly 12,000 people.

#### KEY INVESTMENT CONSIDERATION:

**Generic Drugs are Recession Resistant** - It seems simple, but, despite what happens in the economy, people are still going to get sick and they are going to look for prescription drugs to feel better. In particular, generic drugs should be very recession resistant. Representing approximately 2/3 of its prescriptions, Express Scripts has one of the highest generic fill rates in the industry. This is important because the more generics that are used the lower the cost to the payer. In turn, ESRX, with its high generic fill rates becomes more valuable to its existing and potential clients.

**Consolidation will drive growth** – The PBM market is still relatively fragmented with many that operate on a local and regional basis. Express Scripts is one of the largest players (approximately 15% market share) and is likely to take advantage of depressed prices in the current economic environment to make acquisitions and further strengthening its buying power and scope.

#### KEY RISK:

**Government Regulations** – There are numerous regulations that affect the PBM industry. A change in regulations or the company's failure to follow the regulations could significantly affect results.

#### VALUATION:

Analysts are looking for EPS of \$3.68 for 2009, up 19% from \$3.10 in 2008. This equates to multiples of approximately 15x and 17x, respectively. Given the expected growth rate and a 6-year track record of delivering ROE above 20%, multiples at these levels appear very attractive.

<b>(Nasdaq: ESRX)</b>	
Investment Data (as of 11/24/08)	
<b>Recent Price</b>	<b>\$53.72</b>
52-Week Range	48.37 - 79.10
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	247MM
Average Trading Volume (3 mos)	2.8 MM
<b>Market Capitalization</b>	<b>13.3 B</b>
Cash	0.3 B
Long Term Debt	1.8 B
Enterprise Value (EV)	14.9 B
LT Debt/ Equity	2.1
BV/ Share	3.50
TTM Revenue	18.5 B
<b>P/ Revenue</b>	<b>0.7x</b>
TTM EPS (non-GAAP)	2.79
<b>P/ EPS</b>	<b>19x</b>
TTM EBITDA	1.3 B
<b>EV/ TTM EBITDA</b>	<b>11x</b>

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**Amdocs (NYSE: DOX)**

### DESCRIPTION:

Amdocs is a leading provider of software and services for wireless and wire line telecom, broadband cable and satellite service providers. The company offers OSS (Operational Support Systems) Software and services, which are essentially like ERP systems (think SAP/ Oracle) that telephone and cable companies use to track customer data, process orders and customer billing, monitor problems and in the processes, improve productivity, reduce customer churn and enhance revenue. Headquartered in St. Louis Missouri, with major operations in Israel, Amdocs has more than 17,000 employees and serves customers in more than 50 countries around the world.

### KEY INVESTMENT CONSIDERATION:

**Solid Recurring Revenue Base provides support in challenging market** – Amdocs' solutions provide mission critical activities including billing, customer service, and revenue enhancement. Services, which represent 95% of total revenue, are provided under long term contract, which provides recurring revenue with significant visibility.

**Competition among service provider types will drive growth with existing customers** – The company currently generates two thirds of its revenue from U.S. based customers. Among these customers, which include wire line and wireless telecom, cable and satellite service providers, there is an intense rivalry. As long as there is competition among these players, Amdocs software and services will be in demand to allow the competitors to roll out new differentiated services and increase customer loyalty.

**Emerging Markets present a significant growth opportunity** – Over the past several years, Amdocs has expanded its presence in emerging markets. In 2005, the company entered mainland China by way of acquisition and has offices in India, and in the Middle East. The company is focused on growing in these areas as well as Africa and Latin America. Collectively, 87% of all new subscribers will come from these markets, according to Pyramid Research.

**Amdocs should benefit from new wireless applications** – According to Nielson, mobile video and mobile internet usage is still in its infancy with only 4 million of the 240 million wireless subscribers are using mobile video. This represents a significant opportunity for Amdocs, which will likely be a leading provider for the billing solutions for this type of content.

### KEY RISK:

**Customer Concentration** – AT&T, Sprint, Nextel and Bell Canada, combined account for approximately 50% of DOX's revenue, and more than 10% each. If one of these significant customers were to change to a competing provider, earnings could suffer significantly.

### VALUATION:

Shares are trading near the 52-week lows, 5x EV/EBITDA and 8x TTM EPS. By any measure this is a bargain multiple for a global leader, with a recurring revenue base, strong growth opportunities and a rock solid balance sheet.

(NYSE: DOX)	
Investment Data (as of 11/14/08)	
<b>Recent Price</b>	<b>\$17.72</b>
52-Week Range	16.19 - 35.30
Fiscal Year End	Sep
Dividend	N/A
Yield	N/A
Shares Outstanding	205 MM
Average Trading Volume (3 mos)	2 MM
<b>Market Capitalization</b>	<b>3.6 B</b>
Cash	1.2 B
Long Term Debt	0.5 B
Enterprise Value (EV)	2.9 B
LT Debt/ Equity	0.2
Tangible BV/ Share	4.92
TTM Revenue	3.2 B
<b>P/ Revenue</b>	<b>1.1x</b>
TTM EPS (non-GAAP)	2.29
<b>P/ EPS</b>	<b>8x</b>
TTM EBITDA	611 MM
<b>EV/ TTM EBITDA</b>	<b>5x</b>

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The goal of the Best Idea Profiles in this newsletter is to describe all of relevant investment merits and risks of a company in one page. It is not intended to be an exhaustive report including every detail of a company. With limited space available, I am forced to include only those data points that I feel are most important for subscribers to know before they begin their own due diligence. Thank you for your interest in Mossberg's Investor Digest.

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