Investors' Chronicle | Alpha

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Alpha Shares Analysis

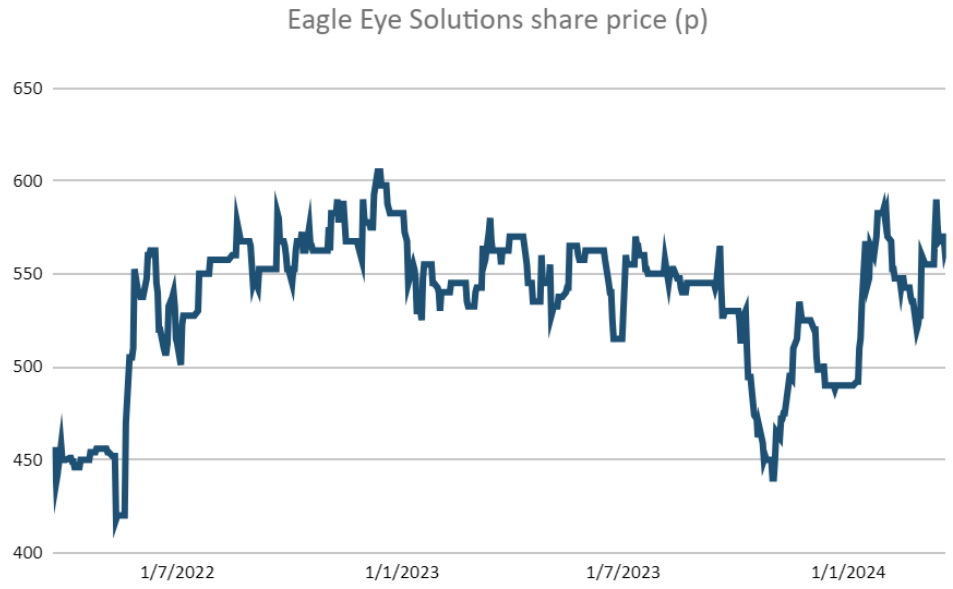
22 March 2024

Two businesses operationally in good shape

Businesses that do a good job for their customers tick an important box in what makes a good investment for shareholders. Our companies this week both have cause for optimism in growing their revenues and profit margins, although there are some important subtleties to be aware of when evaluating both that growth potential and what at face value don't look to be overly demanding valuations.

Analyst: Phil Oakley

Eagle Eye Solutions (EYE)



Source: LSEG

Eagle Eye Solutions (EYE) is a software as a service (SaaS) company which specialises in the digital marketing of customer promotions, rewards and loyalty schemes for the grocery, retail and hospitality industries.

It has a customer base which includes some of the biggest retailers in Europe such as Tesco, Asda, John Lewis, Carrefour, Ikea and Auchan as well as Canada's Loblaws and Pret.

Eagle sells transaction platform software to its customers which allows the real time distribution of offers, vouchers, rewards, personalised promotions and subscriptions to their customers.

Eagle's AIR technology is cloud-based and allows customer data to be linked to different retail selling channels in real time. It is now being complemented with an artificial intelligence offer, Eagle AI.

Through its systems, Eagle Eye is currently enabling more than 2.5 billion customer offers per week. Its customers can use them to offer points based loyalty schemes, cash back, gamified promotions and subscription schemes.

Big investments in customer loyalty

Eagle has tapped into a growing loyalty market, which is currently worth $10.2bn annually worldwide and is predicted to grow to $22.8bn by 2028.

Companies are investing heavily in customer loyalty schemes as a way of gaining an edge in fiercely competitive markets.

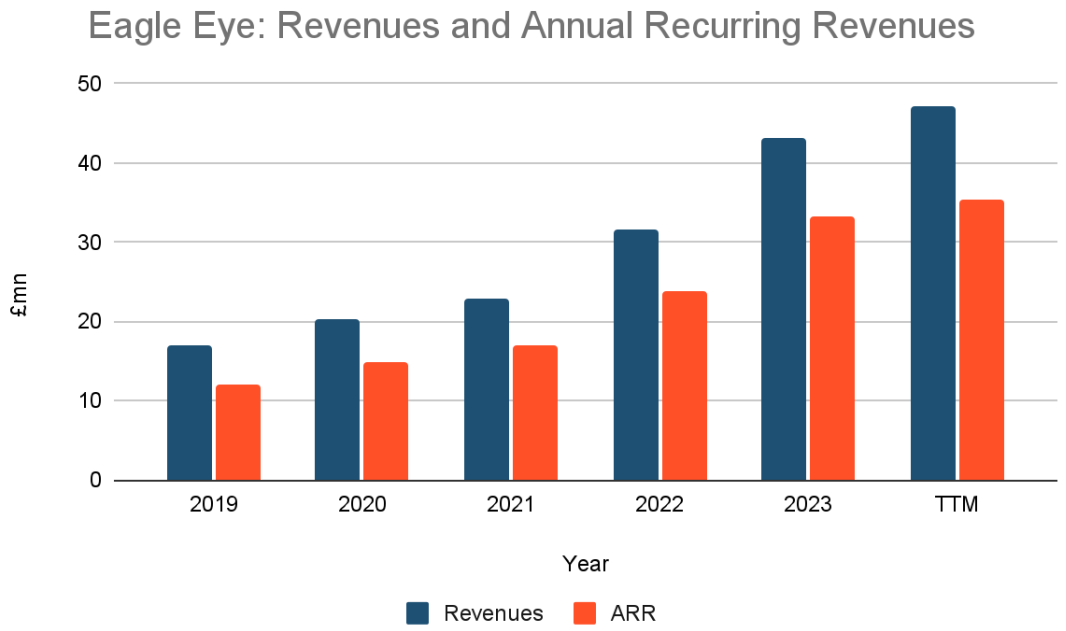
Instead of going down the mass marketing route where all customers get the same email in their inbox, the trend is moving towards more personal promotions and ones that are more engaging using games on mobile phones.

To have effective personalised promotions, companies need technology which can leverage their customer data and this is where Eagle Eye has made its sales pitch.

Judging by its recent business performance, Eagle has a product and service that is going down well with its customers.

The company continues to win new contracts and customers. It has made significant progress in the US – the world's biggest loyalty market – which accounts for just under half its annual revenues.

What is particularly impressive is that once a customer has signed up with Eagle they tend to stay with them as the customer churn rate is virtually zero.



Source: Company reports

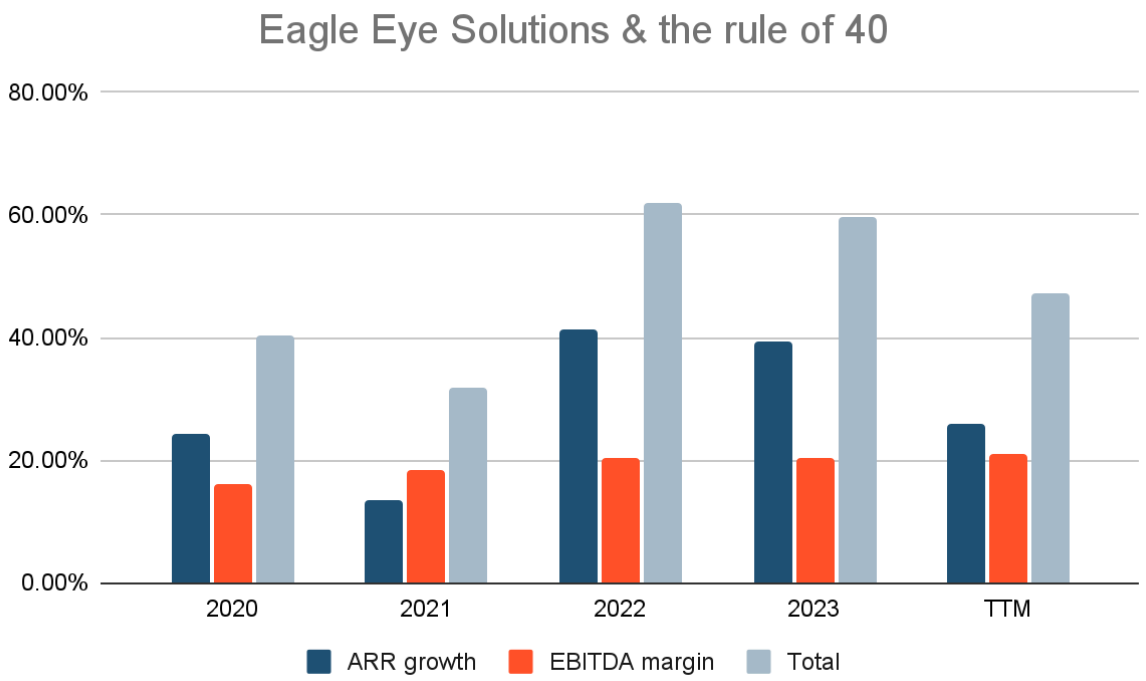
One of the key attractions of SaaS businesses which sell subscriptions is that they have very reliable and predictable revenues. While there are initial revenues for contract start ups, the annualised recurring revenues (ARRs) make up around three quarters of Eagle's total revenues right now. This percentage should increase as the business matures.

The company's operations are based around five core markets: UK, US, France, Canada and Australia. Its medium-term ambition is to become a business with annual revenues of more than £100mn, with Ebitda (earnings before interest, taxes, depreciation and amortisation) margins of at least 25 per cent.

Matching up to the rule of 40

Many investors weigh up how well SaaS companies are performing by subjecting them to the test of the 'rule of 40'. This can take a variety of forms, but a common one is to take the rate of ARR growth and add it to the Ebitda margin. If the sum is 40 per cent or more, the company is deemed to be performing well.

The rule of 40 is used as a way of seeing how well a SaaS company is leveraging its costs. High levels of revenue growth and high profit margins should translate into healthy returns on investments and good profits for shareholders.



Source: Company/Investors' Chronicle

Apart from a subdued performance in 2021, Eagle seems to be matching up well against this measure. However, a closer look at its profitability and margins suggests that it is not as profitable as it says it is.

Adjusted profits and share-based payments

On reading the company's recent half-year results statement, you cannot help but notice how many times the word "adjusted" is used.

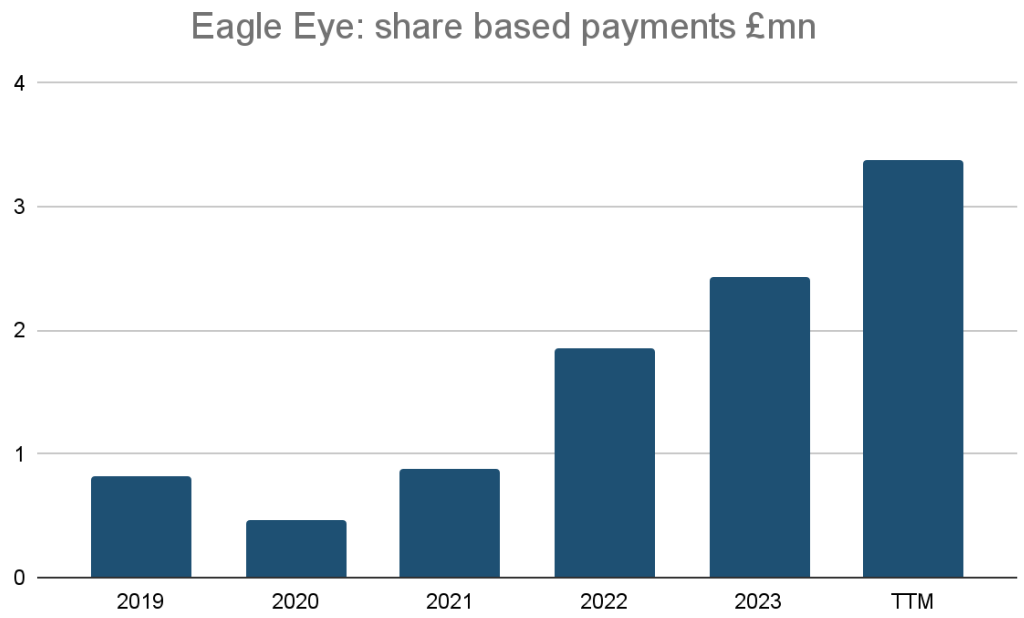
Adjusted profits are part and parcel of company reporting these days, but investors should always look at what the adjustments are and whether they are reasonable or not.

Some companies take adjustments to an extreme and eliminate costs which are actually a regular and ongoing cost of doing business. One of the most common examples of this is share-based payments where employees receive shares as part of their pay.

As these payments are not an outflow of cash, some companies think it is acceptable to ignore them when calculating their adjusted profits. When they are doing this, they are trying to tell you that paying someone in shares does not matter and that you should ignore it.

The thing is, it very much does matter. By paying an employee with shares there is a loss of value to the company and its shareholders. The value of the shares granted is what could have been raised by the company by selling shares to investors on the open market, but instead that value has been given to an employee.

Often a share-based payment can result in the future issue of new shares which will dilute the interests of existing shareholders. Since 2018, Eagle's shares in issue have increased by 16.8 per cent, but the number of diluted shares has increased by nearly 30 per cent.

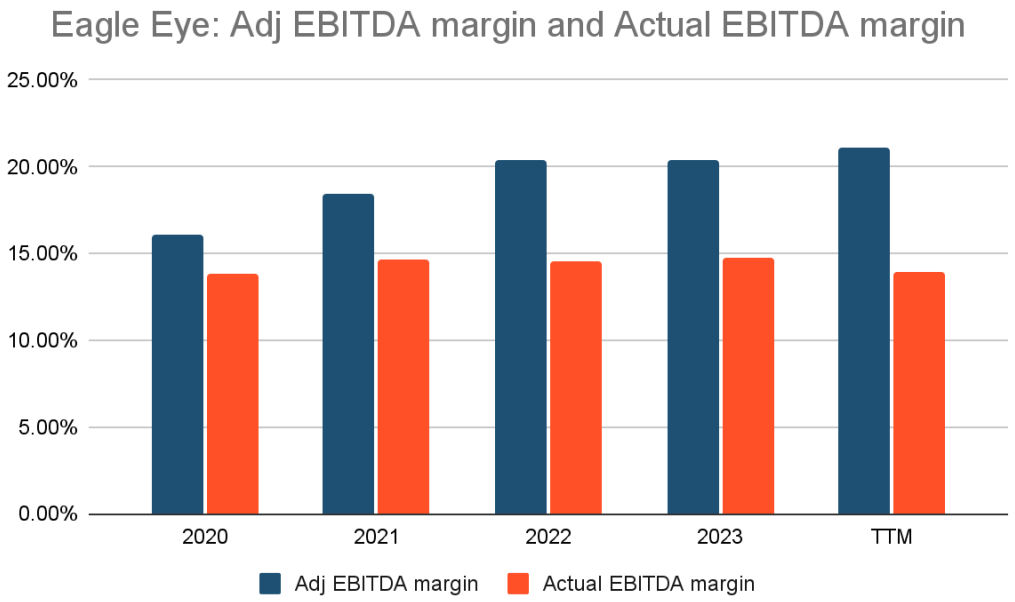


Source: Company reports/Investors' Chronicle

Share-based payments are currently running at an annual rate of £3.4mn, which is a significant chunk of last year's Ebitda of £9.9mn.

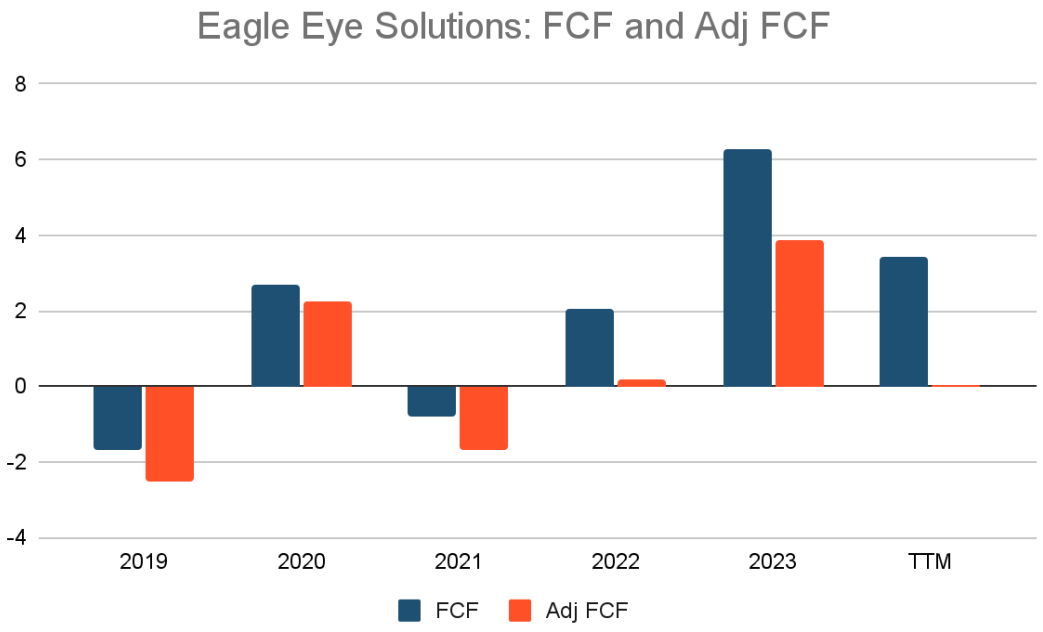
If these costs are actually factored into the calculation of Ebitda then Eagle's profit margins look very different.

Eagle would still be just about hitting the rule of 40 on the lower Ebitda numbers, but its performance would not be as good.



Source: Investors' Chronicle

The other thing to bear in mind when a company has a large share based payment is that it flatters its free cash flow compared with a cash expense. This is one reason why big US tech companies look great on measures such as free cash flow conversion (free cash flow as a percentage of net income).



Source: Investors' Chronicle

Amazon.com (US:AMZN), to its credit, does show a calculation of free cash flow by deducting share based payments. Applying the same adjustments to Eagle shows that it is not currently generating any free cash flow.

The lack of free cash flow is not a major concern as the company is increasing its investment in the business. This is helping it win new customers and generate increased revenues, but investors need to be aware of the issues relating to share-based payments.

In a good place operationally but real profits need to start flowing

From an operational perspective, Eagle is performing well. It ended 2023 with a sales pipeline two and half times bigger than it was a year ago and is doing a very good job for its existing customers.

Its AI platform has won two new customers, while the company continues to innovate and bring improvements such as the ability to reward consumers for behavioural actions rather than just transactions.

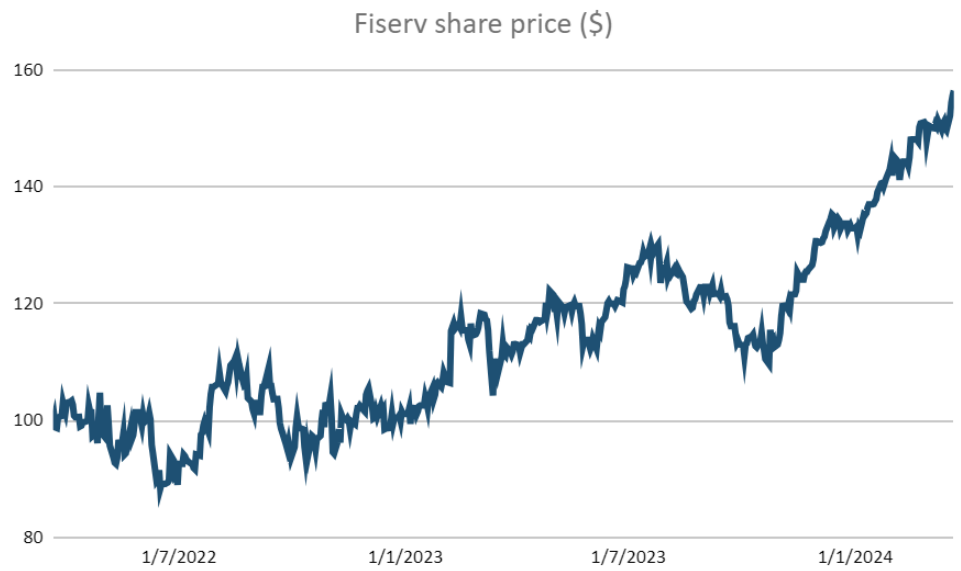
City analysts continue to forecast Eagle's profits ignoring the costs of share-based payments and the dilution that comes from them. On this basis, earnings per share (EPS) is expected to increase from 11.3p in the year to June 2024 to 19.2p in 2026.

At 526p, the forecast PE ratio declines from just over 49 times to just over 29 times. This is not cheap by any means, especially when profits are arguably inflated which would make the true valuation higher.

The business is operating in an attractive growth market and doing well, but a reduction in share-based payments and ongoing dilution would strengthen the investment case for the shares.

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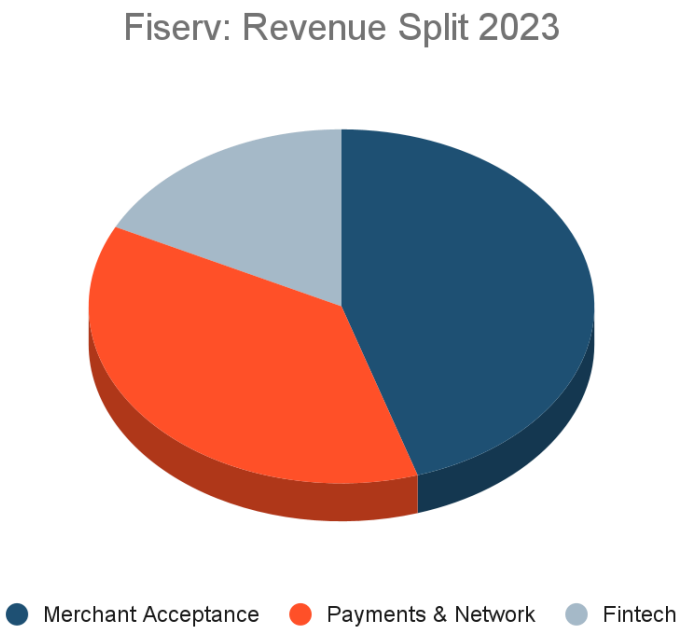
Fiserv (US:FI)



Source: LSEG

Fiserv (US:FI) is a payments and financial services technology company. Its business is concerned with helping the movement of money between people and businesses.

The company has historically been split into three different business units.



Source: Company/Investors' Chronicle

Acceptance is the main source of growth

The Merchant Acceptance division has been the real driver of Fiserv's business in recent years and is expected to keep on being so. The business enables its retail customers to securely accept payment transactions online or in person.

The key product is the Clover cloud-based point of sale integrated operating system which is targeted at small businesses.

It offers many capabilities beyond accepting payments. These range from online ordering to e-commerce services, billing, data reporting, stock management, payroll, workforce scheduling and customer engagement tools.

Fiserv also uses Clover to offer funds to small businesses through a cash advance system.

The Clover business received a big boost from Covid-19 when many essential retail transactions went online and needed payments services and software to enable them. Since then, the business has thrived as consumer spending in the US has held up and the company has added more customers.

Clover is currently being sold in eight countries with plans to move into five new ones – Brazil, Mexico, Australia, Singapore and Hong Kong – by 2026.

Fiserv's great success with the product is in no small part due to its ability to sell users more value added services beyond payments, which brings richer profit margins. Value-added services made up 19 per cent of Clover's revenues in 2023 and are expected to make up 27 per cent by 2026.

The business is underpinned by a very strong direct sales force and relationships with software vendors and partnerships. Combined, they give Fiserv a competitive edge in distributing its products and services.

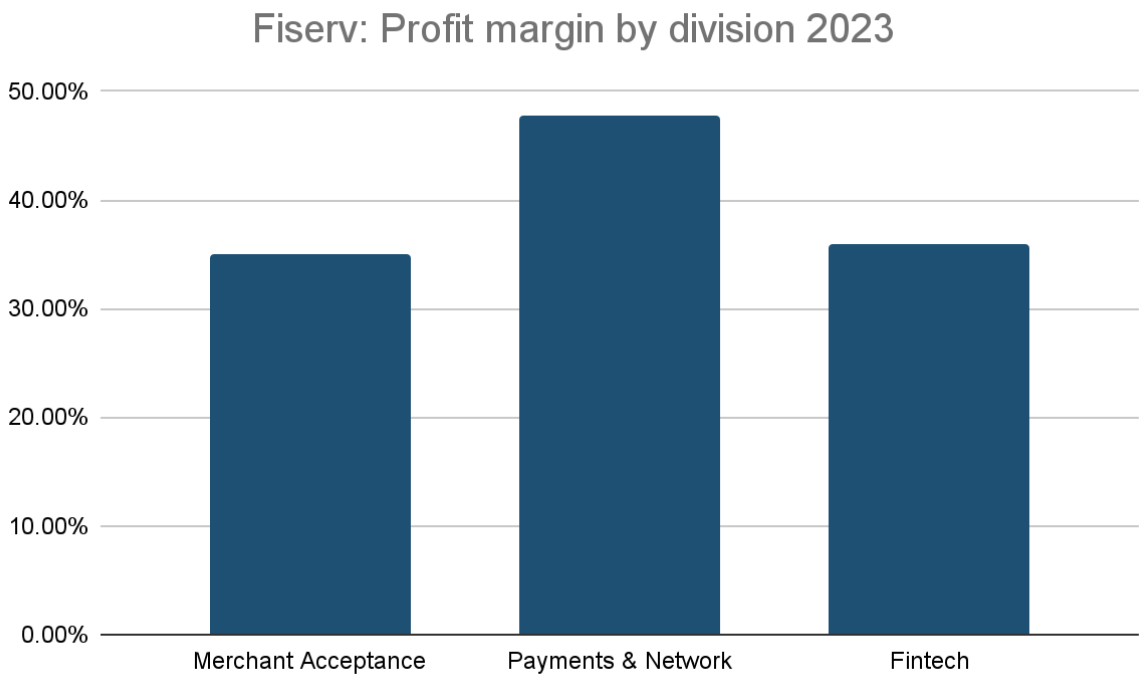
A similar product and service, Carat, is targeted at bigger retailers. It specialises in maximising payment approval rates, limiting fraud and reducing the number of card chargebacks.

Carat has been growing nicely, but at a slower rate than Clover. It faces very strong competition from big rivals such as Stripe and WorldPay.

Management remains very bullish on the outlook for Clover with Wall Street analysts expecting continued strong revenue and profit growth.

Payments and Networks remains very profitable

Despite strong growth in Acceptance, Payments and Networks remains Fiserv's biggest source of profit and highest margins.



Source: Company

The Payments segment provides financial institutions, business and public sector customers with the products and services required to process digital payment transactions.

This includes card transactions such as debit, credit and prepaid card processing and services. There is also a range of network services such as funds access, debit payments, cardless ATM access and surcharge-free ATM networks, security and fraud protection products.

The business is underpinned by the ownership of the Accel , STAR and MoneyPass networks, which provide access to funds for debit card purchases through any physical and online channel. The networks are available to all card issuers and merchants in the US.

Payments has been a steady business for Fiserv and should continue to be able to deliver rich profit margins as more spending moves online and away from cash. That said, the industry remains fiercely competitive.

Fintech – struggling to grow

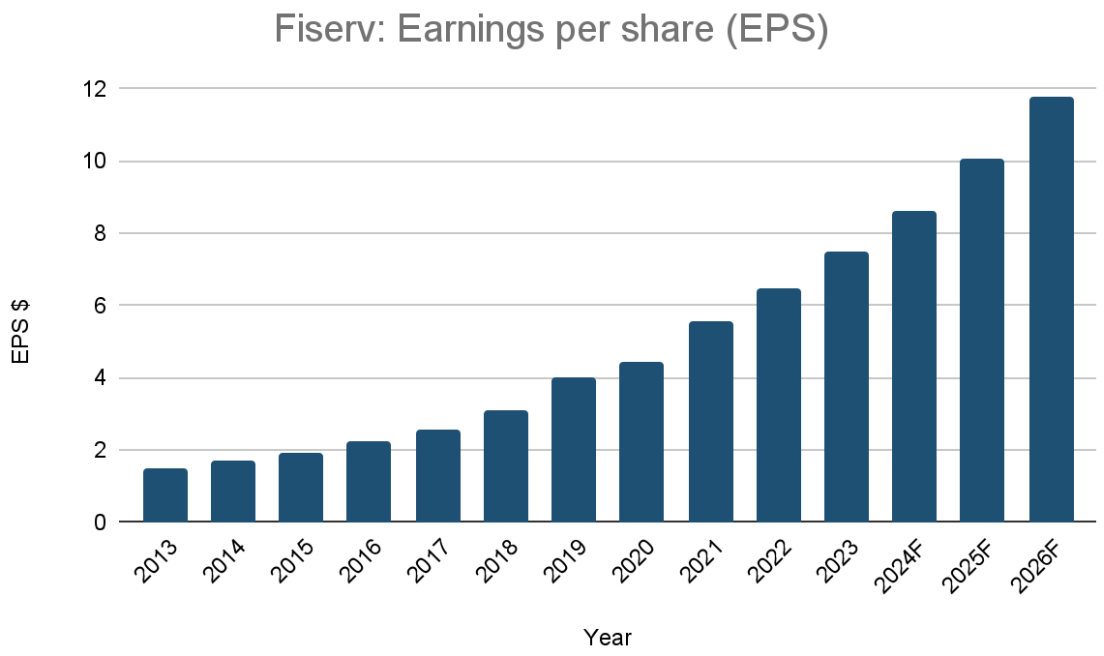
This business is aimed at helping small to mid sized banks run their businesses. Services include processing customer deposit and loan accounts and the management of a bank's general ledger and central information files.

Additional services include online banking, financial and risk management services and cheque processing.

This business has been very subdued but stable with not much profit growth expected in the future.

An exceptional record of EPS growth

Fiserv has a very impressive record of growing its earnings per share (EPS). It has posted double-digit EPS growth for an impressive 38 consecutive years and is expected to keep up this record for at least the next three.



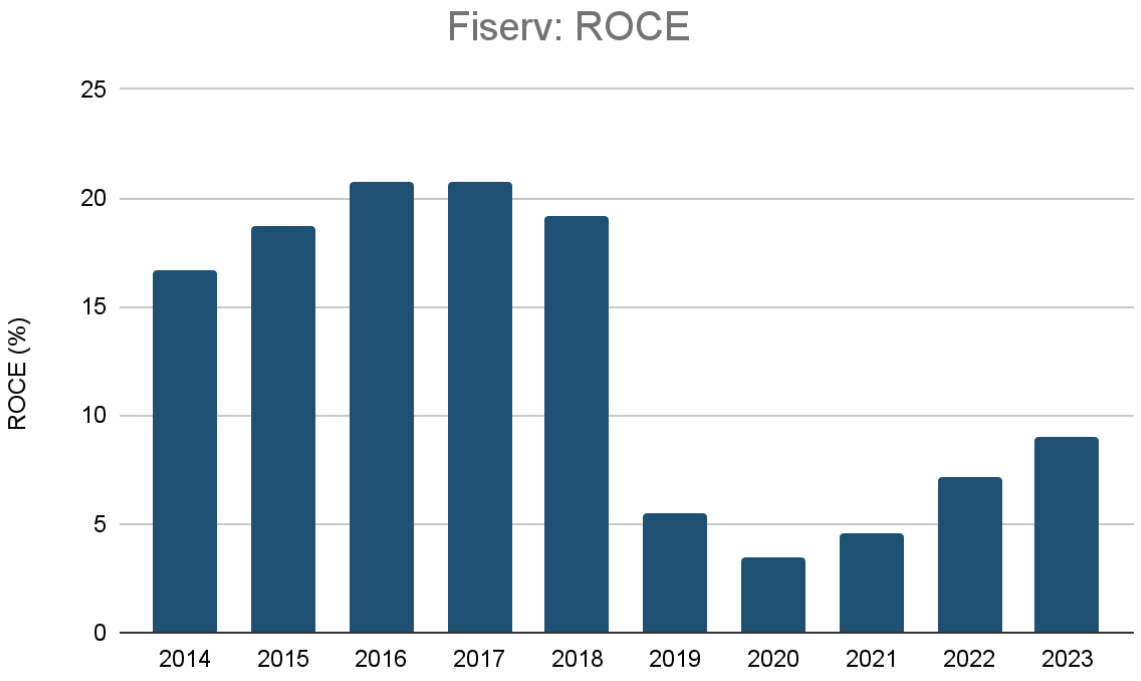
Source: FactSet

The company has partly achieved this by making regular acquisitions and spending considerable sums on buying back its own shares.

Its return on capital employed (ROCE) performance is less impressive, especially after its acquisition of First Data in 2018. ROCE has picked up in recent years, but was still only 9 per cent last year - which is nothing to shout about - according to FactSet data.

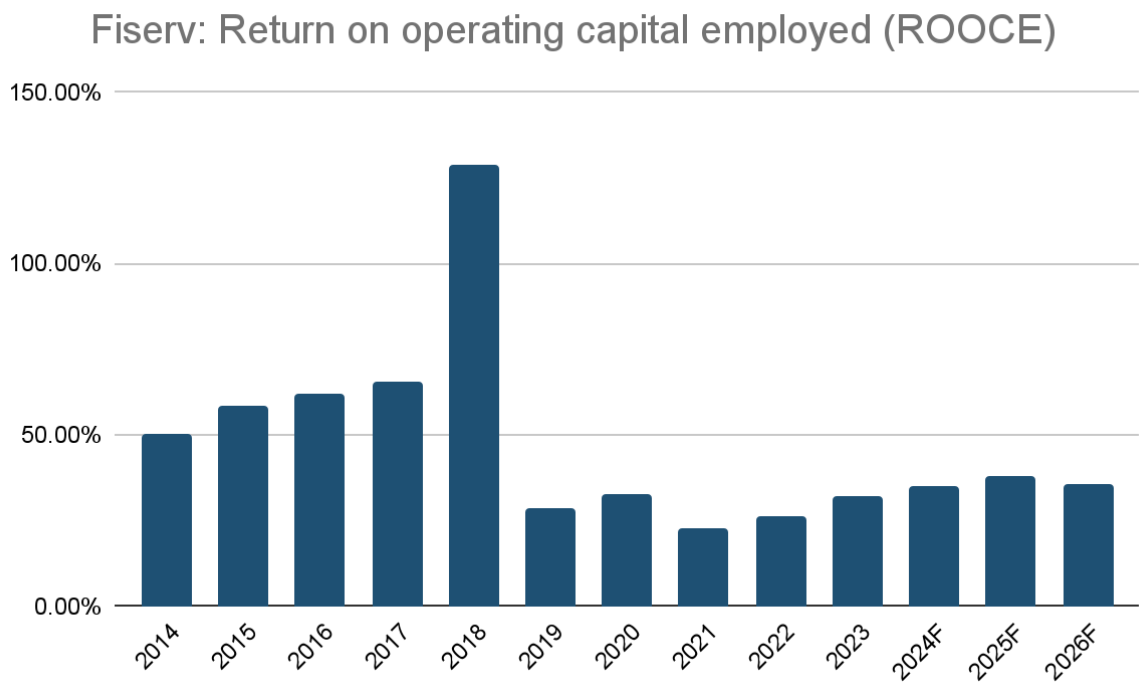
First Data was a business with a troubled history and it seems that Fiserv has struggled to make this acquisition pay off. Its purchase caused Fiserv's balance sheet to balloon with huge amounts of goodwill and customer relationship assets.

Profits have been unable to grow at the same rate and this is why Fiserv's ROCE has been so poor.



Source: FactSet

If the value of goodwill is stripped out to look at the return on operating capital employed (ROOCE), you can see that Fiserv is very profitable with high returns. According to our estimates using FactSet forecast data, the returns are expected to increase which is a good sign.



Source: FactSet/investors' Chronicle

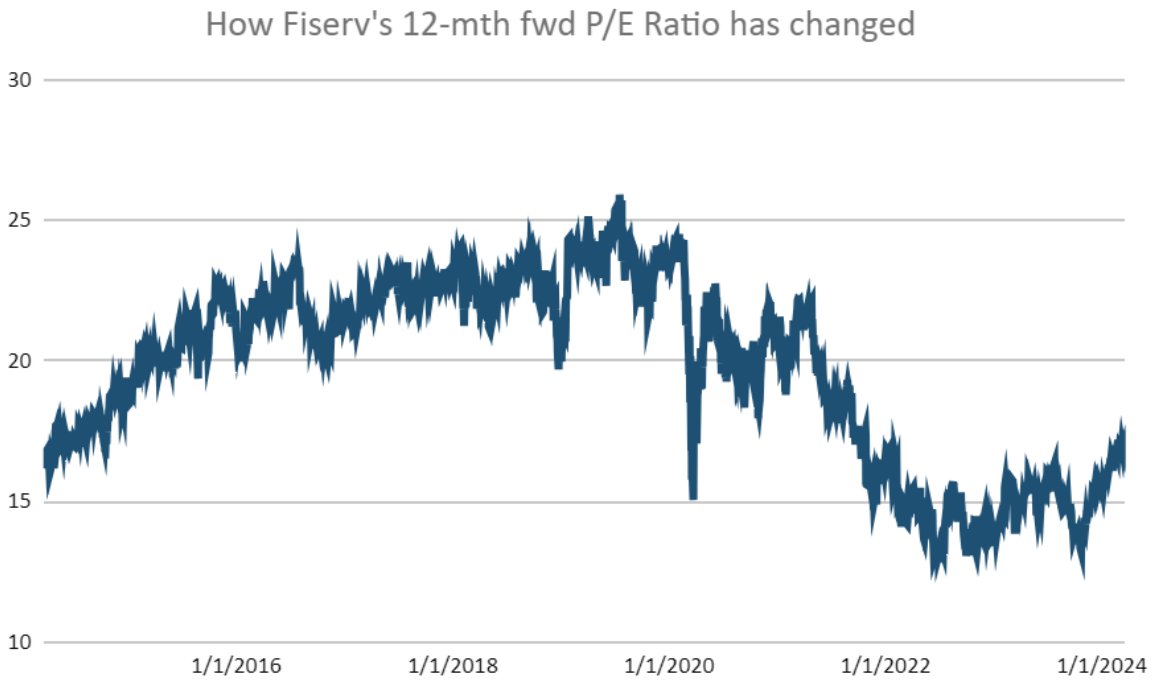
Buoyant outlook not reflected in modest valuation

Fiserv is a business in good shape and remains very bullish on its outlook for 2024 and beyond.

It expects its Merchants Acceptance business to deliver organic revenue growth of between 25 per cent and 28 per cent. This figure needs to be treated with caution as just under a third of the growth is due to the impact of very high inflation in Argentina.

That said, the Clover product has a lot of momentum behind it right now with revenue growth and margin expansion. This is expected to lead to overall company organic revenues and EPS growth of 16 per cent in 2024.

You would expect this kind of outlook to attract a high valuation from the stock market, but at $156, the shares only trade on 17.5 times the next year's forecast EPS. In the not too distant past (albeit before the interest rate tightening cycle affected valuations), the shares have commanded a forward PE multiple in the low 20s.



Source: FactSet

Some Wall Street analysts have expressed concern about the levels of volume growth in the Acceptance division and fears of a consumer slowdown.

The company has also been linked with an acquisition for payment processing firm **Shift 4 Payments (US:FOUR)**.

The rumoured price tag of Shift 4 Payments mentioned in the press has been around $7 bn, which would be a hefty premium to its current market capitalisation of £4.5bn. This would equate to a takeout PE multiple of 28.6 times, which could lead to an acquiring firm being open to accusations of overpaying.

It seems harsh to penalise a company for something that it hasn't done, which leaves Fiserv shares looking decent value. The rerating of the shares since the end of 2023 could have further to run.

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