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MA Wins Stock of the Day Award

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MasterCard (MA) is clearly the stock of the day, ripping higher by double-digit percentages in afternoon trading.

MasterCard is one of the most misunderstood financial service stocks that I have ever owned or covered.

As it currently stands, consensus estimates call for MasterCard to earn \$6.91 in 2008. I believe that these estimates are based on a continued contraction by the consumer and not the benefits of fiscal and monetary stimulus. Furthermore, expectation for growth outside the U.S. remains below potential.

The bottom line is that estimates will have to be raised. At the very least, I would expect a quick bump up to \$7.00 for 2008. Based on that, I believe that a \$250 price target for MasterCard is attainable.

MasterCard reported fourth-quarter 2007 EPS of \$2.26 on net revenue of \$1.07 billion. Included in these results were one-time gains from the sale of its Brazilian credit card unit, which equated to \$1.37 per share of after-tax earnings. Excluding this non-recurring item, the company earned 89 cents. For full year 2007, MasterCard earned \$8.00 on a GAAP basis, including \$1.87 of non-operating one-time items equating to operating EPS of \$6.13.

EPS grew 132% year over year, and revenue rose 17% year over year. Pricing adjustments contributed 2% to revenue growth. Operating margins rose 10.3%, to 16.0%.

MasterCard has not seen the impact on its business that the slowdown in the U.S. economy has had on other financial services institution. Continued weakness does have the ability to slow the company's U.S. growth rate in the future.

MasterCard, however, believes that it is well-positioned in times of economic uncertainty for several reasons:

- Data from the 2001 recession indicate that transaction volumes grew at a rate that exceeded growth of dollar volumes.

Half of MasterCard's business is generated outside of the U.S., where economic conditions are better than that of the U.S.

- There is a secular shift from paper to plastic transactions.
- The company sees no risk of credit write-offs because it is not an issuer of cards and hence has no credit risk exposure. (This is a significant fact that has escaped the minds of many shorts for a long time.)

MasterCard repurchased \$600 million of its \$1.25 billion repurchase program.

No other repurchase was authorized today.

There is no significant update to U.S.-based litigation. The company plans to file an appeal in Europe to a ruling with respect to cross-border transaction rates.

Gross dollar volumes rose 15.2% on a local currency basis and 20.2% in U.S. dollars. U.S. gross dollar volumes were 10%, and U.S. purchase volumes rose 11.1%. Cross-border volumes increased 27.7%.

In 2008, MasterCard expects slower net revenue growth than in 2007, but that growth will still be in double digits. General and administrative expenses are expected to grow at a slower rate than revenue in 2008 and below 2007 general and administrative growth rates.

MA Preview: Estimates Bumped Up

Mastercard (MA) is scheduled to report fourth-quarter and full-year 2007 results and conduct its quarterly conference call on Thursday, Jan. 31 before the markets open. The company is expected to grow EPS by 129% year over year, to 71 cents, for the quarter and by 62% for the full year, to \$5.53. Revenues are expected to rise 17% year over year, to \$983.2 million, for the quarter and nearly 20% for the full year, to \$3.99 billion.

While shares of MasterCard were sliced down in the recent market pullback from its all-time high of \$227.18, last week's **FOMC** action provided a bounce and support for MasterCard, which closed the week at \$193.43. Clearly, the company will benefit from both fiscal and monetary domestic stimulus. As a result, analysts' consensus estimates for 2008 were bumped up by 5 cents last week, to \$6.96, implying expectations for 25% year-over-year growth in the year ahead.

The international consumer also remains strong and has been taking advantage of the weak U.S. dollar, especially during the holiday shopping season when U.S. consumers held back on their wallets vs. 2006.

Also helping MasterCard are the rumors around the Street that Visa is postponing its anticipated IPO. While credit card issuers such as **Bank of America** (BAC), **American Express** (AXP) and **Capital One** (COF) have noted escalating consumer credit losses, MasterCard is immune to such credit issues because it is a processor and, as such, does not take consumer credit onto its balance sheet.

In a strange way, MasterCard may actually benefit because it is one of the largest debit card processors around the world. Thus, as consumers cut down on accumulating debt, they nevertheless will spend more using a debit feature.

The key for MasterCard will be on the expense side. If the company rightfully anticipated the fourth-quarter consumer slowdown and reacted by cutting its advertising budget, then the company should have been able to not only maintain its margins but absorb any domestic slowdown.

The wildcard will be overseas, where continued consumer spending should drive EPS growth. As always, we will look out for MasterCard-specific metrics, such as gross dollar spending and transaction counts.

Let me throw another wildcard down on the table to consider. At the end of 2006, MasterCard had \$2.6 billion in cash and short-term investments plus \$0.8 billion in receivables offset by \$1.5 billion in accounts payable. As of the end of third quarter 2007, MasterCard had \$3.4 billion in cash and short-term investments plus \$0.9 billion in receivables offset by \$1.6 billion in accounts payable.

MasterCard should generate more cash in the quarter. There is a very good chance that MasterCard announces upward of a \$500 million package of

returning capital to investors through a significant buyback and a bump in the dividend.

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At the time of publication, Rothbort was long MasterCard, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.

Rothbort holds an MBA in finance and international business from the Stern School of Business of New York University and a BS in economics and accounting from the Wharton School of Business of the University of Pennsylvania. He is a Professor of Finance and the Chief Market Strategist for the Stillman School of Business of Seton Hall University.

For more information about Scott Rothbort and LakeView Asset Management, LLC, visit the company's Web site at www.lakeviewasset.com. Scott appreciates your feedback; [click here](#) to send him an email.

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