# Computer Services & IT Consulting

## mPOS Deep Dive: PAY Safer Than Thought; Still Some Risk For MCRS

### Key Takeaway

**Our exhaustive research into the mPOS market yielded 3 key conclusions: 1) new mPOS market entrants have gained very limited penetration to date in the retail vertical, and pose little threat to incumbents such as Buy-rated PAY in the foreseeable future, 2) our in-store checks show larger US retailers' reported use of mPOS is overhyped, 3) mPOS is likely additive to PAY's addressable market, but could threaten MCRS' Hardware business in restaurants.**

**In-store checks suggest actual mPOS usage by larger US retailers to date is overhyped.** While numerous large US retailers have made public announcements about mPOS adoption, our recent in-store checks (summarized in Exhibit 1) showed that actual mPOS usage is quite limited relative to traditional countertop terminals from vendors such as PAY and Ingenico. We think mPOS adoption to date has been concentrated mostly among small merchants seeking to unclutter their countertop and speed up checkout while enhancing the consumer shopping experience.

**We believe mPOS is modestly additive for PAY...** In general, we view mPOS as accretive to the global addressable market for payment terminals, especially among large retailers who are mostly using mPOS solutions to augment (rather than replace) the legacy countertop environment. Our scenario analysis (Exhibit 35) suggests that if mPOS adoption in the US reaches 15% of the current install base of payment terminals over the next four years, and 50% of these mPOS units actually replace the legacy hardware, PAY could earn an incremental $56M in revenue over that period.

**...but could weigh on MCRS hardware business.** We consider MCRS' hardware/ hardware support business in the restaurant vertical to be at highest risk of disruption by lower cost mPOS devices. MCRS' restaurant business is split around 30% chain and 70% independent. Our checks indicate that mPOS vendors have become successful in the independent restaurant space potentially leading to lower MCRS win rates, although alternative mPOS vendors have not gained traction with chains. We expect MCRS to face hardware pricing pressure, with our base case analysis suggesting a $0.25-$0.30 EPS headwind over the next three years. While this is only 10% of earnings, it is meaningful for a company growing mid-single digits organically.

**New mPOS market entrants haven't dented incumbents' share.** Industry estimates suggest that only about 80,000 mPOS tablets have been deployed to date, a drop in the bucket compared with PAY's global installed base of about 20M POS units. We see the newer entrants and tablet-based POS solutions in general as being a better fit for small businesses than large retailers, who already have sophisticated POS environments, and likely have more focus on security than ever before, following the recent series of retailer POS breaches (ie, Target). While mPOS remains a very small piece of PAY's business today, PAY has recently become more aggressive in its mPOS distribution strategy (PAYware and GlobalBay), while establishing a partnership with tablet supplier Lenovo.

**Maintain Buy on PAY and raising PT; reiterate Hold on MCRS.** Our work on the mPOS space suggests the perceived threat to PAY is overhyped. We maintain our non-consensus Buy rating on PAY, as we see improved execution against achievable near-term estimates by the new management team. Our new $34 PT on PAY (vs. $29 prior) is based on blend of 15x (market multiple) our unchanged F16 pro forma EPS estimate of $2.19 and our DCF model. We are also making PAY a Franchise Pick. Our Hold rating on MCRS is unchanged, based on incremental headwinds from lower priced hardware. Our $54 PT on MCRS is based on 18x CY15E EPS, below the three-year average of 21x due to slower growth.

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| Company Name | Ticker | Mkt. Cap (MM) | Rating | Price | Price Target | Cons. Next FY | Current EPS Estimates 2013 | 2014 | 2015 | Previous Est. 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| VeriFone Systems, Inc. | PAY | $3,106.1 | BUY | $28.76 | $34.00▲ | -- | $1.45 | $1.40 | $1.74 | $1.40 | $1.74 |

# Executive Summary

**Our exhaustive research into the mPOS market yielded four key conclusions:**

- **In-store checks suggest actual mPOS usage by larger US retailers to date is overhyped.** While numerous large US retailers have made public announcements about mPOS adoption, our recent in-store checks (summarized in Exhibit 1) showed that actual mPOS usage is quite limited relative to traditional countertop terminals from vendors such as PAY and Ingenico. We think mPOS adoption to date has been concentrated mostly among small merchants seeking to unclutter their countertop and speed up checkout while enhancing the consumer shopping experience.
- **We believe mPOS is modestly additive for PAY…** In general, we view mPOS as accretive to the global addressable market for payment terminals, especially among large retailers who are mostly using mPOS solutions to augment (rather than replace) the legacy countertop environment. Our scenario analysis (Exhibit 35) suggests that if mPOS adoption in the US reaches 15% of the current install base of payment terminals over the next four years, and 50% of these mPOS units actually replace the legacy hardware, PAY could earn an incremental $56M in revenue over that period.
- **…but could weigh on MCRS hardware business**. We consider MCRS' hardware/hardware support business in the restaurant vertical to be at highest risk of disruption by lower cost mPOS devices. MCRS' restaurant business is split around 30% chain and 70% independent. Our checks indicate that mPOS vendors have become successful in the independent restaurant space potentially leading to lower MCRS win rates, although alternative mPOS vendors have not gained traction with chains. We expect MCRS to face hardware pricing pressure, with our base case analysis suggesting a $0.25-$0.30 EPS headwind over the next three years. While this is only 10% of earnings, it is meaningful for a company growing mid-single digits organically.
- **New mPOS market entrants haven't dented incumbents' share yet, but warrant monitoring.** New mPOS market entrants haven't dented incumbents' share yet, but warrant monitoring. Industry estimates suggest that only about 80,000 mPOS tablets have been deployed, a drop in the bucket compared with PAY's global installed base of about 20M POS units. First Data's tablet solution (Clover) is just now coming to market and will be interesting to watch, given First Data's huge, established distribution channel. We see the newer entrants and tablet-based POS solutions in general as being a better fit for small businesses than large retailers, who already have sophisticated POS environments which are tightly integrated with back-office IT systems. While mPOS remains a very small piece of PAY's business today, PAY has recently become more aggressive in the mPOS space, increasing the distribution footprint for its mPOS solutions which include PAYware (hardware) and Global Bay (software), while establishing a partnership with tablet supplier Lenovo.

**Our work on the mPOS space suggests the perceived threat to PAY is overhyped. We maintain our non-consensus Buy rating on PAY, as we see improved execution against achievable near-term estimates by the new management team. Our new $34 PT on PAY (vs. $29 prior) is based on blend of 15x (market multiple) our unchanged F16 pro forma EPS estimate of $2.19 and our DCF model. Our Hold rating on MCRS is unchanged, based on incremental headwinds from lower priced hardware. Our $54 PT on MCRS is based on 18x CY15E EPS, below the three-year average of 21x due to slower growth.**





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## In-Store Checks Suggest mPOS Usage Is Overhyped

In order to determine the effect the proliferation that mPOS has had on a major, big box retailers, we chose a group of 10 retailers to visit that had publicly announced the use of mPOS devices within their stores (see Exhibit 1). Following our proprietary checks, in which we spent time exploring the sales floor and speaking with sales associates, we learned that the majority of roll-outs had hit some kinks, and to date, have been limited largely to line-busting, particularly during heavy shopping periods. In addition, these mPOS deployments have generally been additive to the retailers' existing countertop POS environment, rather than replacing legacy terminals.





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**Exhibit 1: Summary Of In-Store mPOS Checks**

| | Summary | mPOS Provider | Existing Terminal Provider |
|---|---|---|---|
| Apple | Apple was the first to use the Infinite Peripherals hardware on an Apple device, launching in stores with 10,000 units in November 2009. Infinite's hardware adds a bar code scanner and a magnetic strip reader to the iPod Touch. Apple uses an iOS app that integrates with the company's Oracle backed retail software. According to our recent checks, Apple no longer utilizes any traditional countertop cash registers/terminals. | Infinite Peripherals | None |
| C. Wonder | C. Wonder (a women's clothing and home decor retailer) opened in January 2012 using only VeriFone PAYware mPOS devices, in lieu of traditional countertop cash registers. During a recent visit to a New York City location during the busy holiday shopping season, we learned that associates have actually been standing behind a physical countertop (but still using mPOS devices) ringing up customers waiting in a line. To date, mPOS sleds have been buggy and C. Wonder plans to incorporate a traditional cash register and POS terminal in the near future, according to our checks. | VeriFone | N/A |
| Coach | Ahead of the 2013 holiday shopping season, Coach planned to provide sales associates with iPad Minis that will be able to complete in-aisle checkout and enable customers to browse catalogs online. Coach planned to simultaneously remove fixed, countertop POS terminals in an effort to maximize floor space. However, when we visited a Coach store recently, it was apparent that while associates did carry mPOS devices, we did not see any associates use them for transactions, and countertop cash registers remained in place and customers were lined up to checkout. | Unknown | Unknown |
| Home Depot | Home Depot initially rolled out 34,000 of it's F.I.R.S.T. phones in 4Q10 (at a reported cost of $64M), and completed nearly 1 million mPOS transactions in the quarter, according to the company. Home Depot rolled out 25,000 FIRST Junior units in June-2012, a stripped down version capable of price and inventory checks, but not in-aisle checkout. But a recent in-store conversation with an HD sales associate indicated managers are the only employees that actually carry FIRST phones capable of in-aisle checkout and they are rarely used to check out customers, usually only in situations with long checkout lanes and within the checkout area. | Motorola | Ingenico |
| JC Penney | The arrival of Ron Johnson (formerly of Apple) as JCP's CEO in Nov-11 led the company to engage in an ambitious mPOS rollout, using iPods wrapped in card-swiper sleeves made by PAY. According to JCP, during a sample week in 4Q12, 25% of transactions were completed using mPOS. But our recent in-store checks indicate that since Mr. Johnson's departure in April-13, use of mPOS technology has been de-emphasized at JCP, but not eliminated. We believe PAY was one of multiple incumbent providers of traditional POS at JCP, and got incremental business as part of JCP's adoption of mPOS. | VeriFone | Multiple Provider including VeriFone, Symbol |
| Macy's | According to a May-12 article in Retail Info Systems News, Macy's has provided sales associates in certain departments with mPOS enabled iPods capable of in-aisle checkout, inventory lookup, and online shopping. However, after speaking with a number of sales associates as part of our recent in-store checks, we learned that only employees in particularly highly trafficked areas had mPOS devices, and typically sent customers to traditional registers (connected to PAY terminals) except during periods of unusually high volume. | Unknown | VeriFone |
| Nordstrom | Starting in April-2012, Nordstrom rolled out 6,000 mobile payments devices in 117 of its 258 stores (including 117 traditional Nordstrom's and 141 Nordstrom Racks). We believe the majority of mPOS deployment to date has been in Nordstrom Rack, (rather than full-line stores) due to additional challenges integrating the mPOS solution into the IT environment of full-line stores. Using an iPod touch with a mag stripe acceptance sleeve and barcode scanner, associates are able to both check out customers and manage inventory in-aisle. According to our checks, associates do have, and are knowledgeable about, the iPod based mPOS device, and mentioned that if they are helping a customer they traditionally offer to check them out using the mPOS device. The company also maintains a traditional countertop ECR checkout area, and in times of high volumes, uses sales associates to help "line-bust" with mPOS. | Infinite Peripherals | VeriFone |
| REI | We believe REI began incorporating iPod based mPOS devices into their stores in spring 2012 and currently uses them in the majority of their 130+ stores nationwide. During our recent visit to a local REI store, we discovered that only some of sales associates actually carry the mPOS devices. Our conversations suggested that these devices do provide for in-aisle checkout, and that traditionally sales associates offer to checkout individuals waiting in-line during periods of high traffic. However, during our visit (in which there was a long line for checkout), we did not see any sales associates performing either in-aisle checkout or conducting mPOS transactions for in-line consumers. | Unknown | Ingenico |
| Urban Outfitters | CEO Calvin Hollinger announced that Urban Outfitters removed cash registers from stores in early Sept-2012, replacing them with iPads and iPod touches to facilitate in-aisle checkout. The company expected to have 1,100 devices active by year end 2012. However, we observed during a recent store visit that the sales associate we spoke with did not carry an mPOS device, and the location we visited was reliant on traditional countertop POS devices, provided by PAY. | Infinite Peripherals | VeriFone |

**Source: Jefferies**





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# History And Background of POS Terminals

Electronic payment acceptance during the early days of the payment card industry relied upon carbon paper for card capture and the cardholder's signature for authentication. At the end of the day (or any designated period), the merchant would collect the paper receipts and the merchant acquirer would then be responsible for delivering these to the card-issuing bank for collection of funds (similar to how paper checks have traditionally been processed).

Electronic point of sale (POS) and instant transaction approval originally entered the landscape via telephone technology. The process of authorization was usually done over the phone and transaction costs were high enough to often require minimum transaction amounts. In 1979, Visa introduced the first POS terminal, and soon thereafter, credit cards began including mag stripes in order to facilitate timely electronic transactions. The evolution of POS terminals took a large step forward with introduction of VeriFone's ZON line in the early 1980's, the first payment terminal cheap enough for widespread merchant acceptance.

The widespread distribution of electronic POS terminals at merchants and the move from paper based to electronic acceptance and authorization laid the foundation for the rapid expansion of electronic payments in the 1980's. In order to incentivize merchants away from the traditional paper based method of card acceptance (knuckle-buster machines), the large payment networks instituted lower interchange rates for merchants who made the transition to electronic POS terminals, in turn creating the first two-tiered interchange system. The networks hoped that POS terminals would decrease transaction costs, increase efficiency, and reduce fraud.

More recently, from 2008 – 2012, global POS terminal shipments have grown at a CAGR of 9.7%. The majority of new POS terminal sales between 2008-2012 were in international markets, where shipments grew at a 12.5% CAGR during the period (see Exhibit 2). In 2012, over 18 million POS terminals were sold internationally (up from 15.3M in 2011 and 11.4M in 2008), driven by robust demand from Asia/Pacific and Latin America (growing at CAGR's of 22.8%/15.3%, respectively).

In 2010, Asia/Pacific became the largest POS purchasing region (surpassing Europe), and in 2012 purchased nearly 8.3M terminals (41% of all terminals shipped globally vs. 26% in 2008), as Latin American terminal purchases surpassed 3.5M (up from 2M in 2008). During the same period, North America terminals shipments fell to 1.9M in 2012 (vs. 2.4M in 2008), falling at a 6.5% CAGR. We believe that international terminal sales grew much faster than US sales due to the secular electronic payments tailwind and a previously underpenetrated payments infrastructure.





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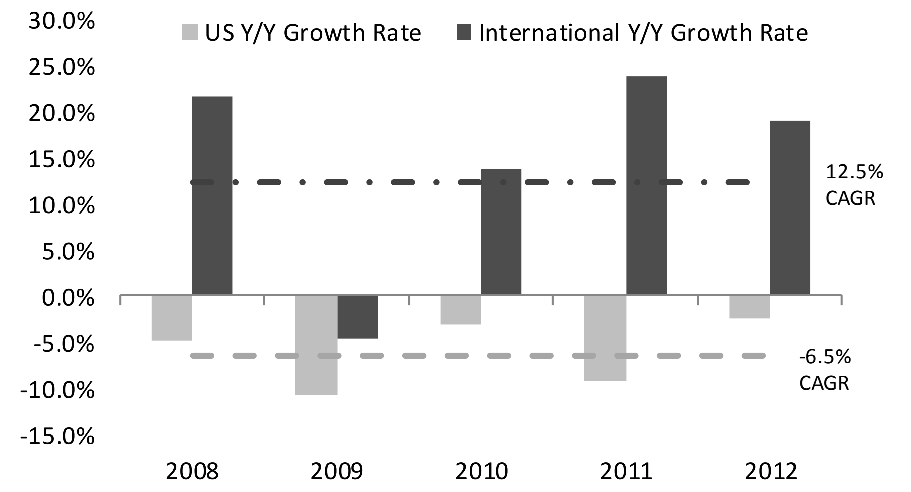
**Exhibit 2: Domestic and International Terminal Shipment Growth Rates**




**Source: Nilson Report, Jefferies**

**US POS Terminal Market Led By VeriFone**

Although VeriFone and Ingenico accounted for nearly 55% of terminals shipped globally in 2012 (or greater than 70% ex Asia/Pacific), the United States POS market has been historically led by VeriFone (61% of terminals shipped in 2012, with a 75% share of top 200 U.S. multi-lane retailers). Ingenico and Hypercom (which was renamed Equinox following the purchase of Hypercom by VeriFone in August 2011 and the subsequent forced divestiture of Hypercom's domestic assets to private equity firm Gores Group, the same firm that purchased PAY from HPQ in 2001), have also held a sizeable (yet shrinking) market share in the US.

Despite a slowdown in domestic terminals shipped (-6.5% CAGR from '08-'12 – see Exhibit 6), VeriFone has been able to increase its share of the domestic terminal market from 50.9% in 2008 to 60.8% in 2012 (see Exhibit 3 - Exhibit 5), largely at the expense of both Hypercom/Equinox (14.2%/12.9% in 2008/12, respectively) and Ingenico (24.2%/11.6% in '08/'12). At the same time, "Other" producers have gained a larger share of the pie, as smaller vendors including Chinese suppliers such as PAX Global have become somewhat more significant competitors. Of note, these POS shipment numbers are limited to traditional countertop POS terminals, and do not include smartphone or tablets.





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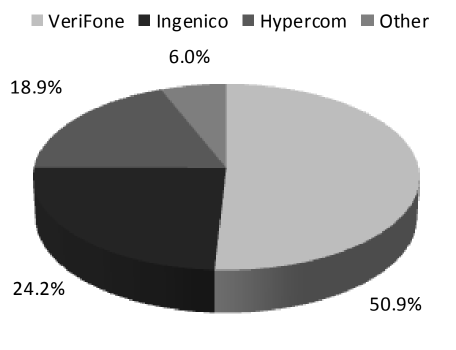
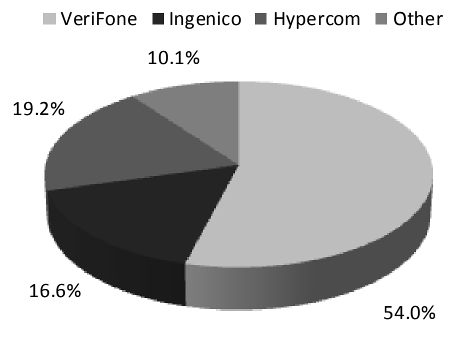
**Exhibit 3: 2008 US POS Market Share**



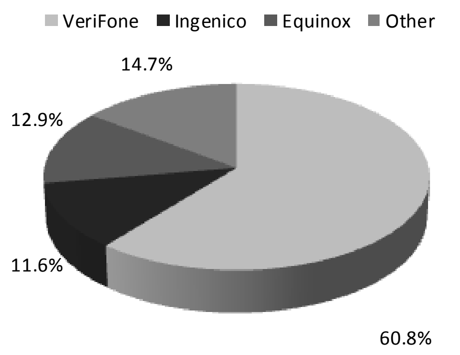

Source: Nilson Report, Issue 934

**Exhibit 4: 2010 US POS Market Share**



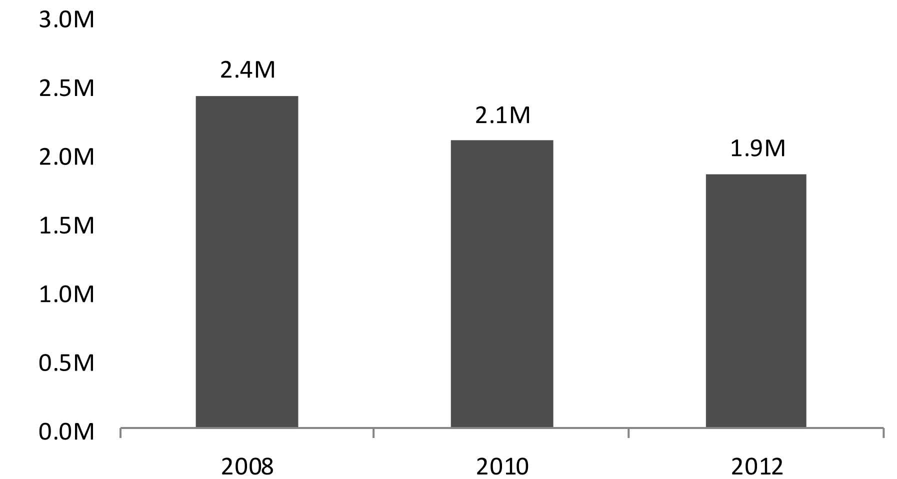

Source: Nilson Report, Issue 980

**Exhibit 5: 2012 US POS Market Share**




Source: Nilson Report, Issue 1027

**Exhibit 6: US Terminal Shipments By Year**




Source: Nilson Report

To date, the bulk of the perceived disintermediation threat for traditional POS terminals has been in developed and mature payments markets (ie, US, Europe), where electronic card acceptance has been widespread. Not surprisingly, these have been the regions where we have seen the bulk of new mPOS market entrants. With that said, we note that going forward, emerging markets present a large opportunity for mPOS providers as card-based payments become more ubiquitous and smartphone/tablet prices continue to decline.

## Mobile POS Initially Burst On The Scene With "Dongles"

The rapid growth of smartphones and tablets has provided an alternative to the traditional countertop POS terminal, especially in developed payments markets, such as the US. Since the introduction of the iPhone in June 2007, smartphone shipments have increased at a greater than 35% CAGR from '08-'12 (Exhibit 7). Leveraging the increasing





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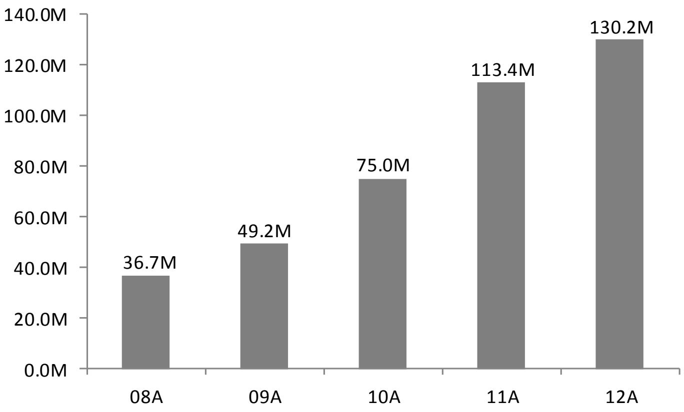
computing capability and cellular connectivity provided by smartphones, card acceptance became practical for micro-merchants (ie, personal trainers, dog walkers, plumbers, etc) who historically could not easily accept card-based payments, either because a merchant acquirer wouldn't underwrite the risk or the fact they are a mobile merchant without a fixed storefront.

The dongle/magnetic card reader is plugged into the headphone jack of the merchant's smartphone/tablet (Exhibit 8). After a card swipe, the dongle reads the data, encrypts it, and converts it into an audio signal. The microphone picks up the audio signal which is converted to digital data by the phone's processor and passed to the smartphone app. The data is then transmitted up to the payment network (Visa, MasterCard, etc) via the wireless telecom provider for processing.

**Exhibit 7: Growth in SmartPhone Sales**




**Source: IDC**

**Exhibit 8: Square Mobile Card Reader/Dongle**


**Source: Company**

Privately-held Square enjoyed an initial first mover advantage in terms of dongle distribution and merchant uptake, launching its product into the market in 2010. Square's go-to-market strategy of targeting micro merchants introduced a previously excluded merchant tier to electronic payments.

By legitimizing small volume merchants as a profitable merchant class for electronic payments (assuming the correct pricing scheme), Square's success has encouraged additional "dongle" market entrants (ie, Intuit, PayPal, Groupon, Chase, etc) due to the relatively low barriers to entry. In order to compete with Square (and its first mover advantage), recent market entrants have entered the market with competitive pricing schemes and sturdier dongles (see Exhibit 9 - Exhibit 11). On December 9, 2013, Square introduced its fourth generation "dongle" (available in 2014 at 30,000 retail locations), with a slimmer profile and proprietary components replacing previously off-the-shelf parts, although the new dongle still does not process EMV (chip-card) transactions.





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**Exhibit 9: PayPal Here**


Source: Company

**Exhibit 10: Chase Mobile Checkout**


Source: Company

**Exhibit 11: Bank of America Mobile Pay on Demand**

Source: Company

### Tablets – Next Generation Of POS

The introduction of tablet computers has allowed mobile/portable POS providers to move upmarket and target larger merchants with greater transaction volumes. These providers have looked beyond individual micro-merchants to small businesses that currently utilize a traditional countertop POS terminal. These new tablet-based e-register apps target small businesses (such as cafes, small restaurants, and retailers), and to date, still require a merchant processor if the underlying transaction is card based.

The central idea behind these tablet-based POS software offerings is that, in lieu of a traditional cash register and/or countertop POS terminal (see Exhibit 12 and Exhibit 13), merchants accept payment by using the touch screen of the tablet, along with an attached card swiping sleeve or dongle. E-Register apps often connect via Bluetooth to a cash drawer and/or receipt printer, enabling the merchant user to still accept payments in cash (and checks) in addition to cards.

For many small merchants, the cost savings of employing a tablet-based POS system when compared to an entry level cash register and free-standing VeriFone terminal (see Exhibit 12 and Exhibit 13) are minimal, and in some cases, the tablet may even be more expensive. With that said, as electronic cash register (ECR) complexity increases and additional hardware is required (ie, a restaurant incorporating touch screen systems and computer installation), the cost benefits from moving to tablet-based POS systems become significantly more pronounced, as traditional ECR/POS systems can run into the thousands of dollars per register as compared to a tablet (which could run in the hundreds). As discussed later, we view this dynamic as a potential threat to MCRS. In addition, for many small merchants a tablet-based POS provides a solution to countertop clutter, and freeing up valuable counter space.





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**Exhibit 12: Casio Entry Level Cash Register**

**Source: Company**

**Exhibit 13: VeriFone Entry Level Countertop POS**


**Source: Company**

It is important to emphasize, however, that motivation to move to a tablet-based system likely does not come from cost savings alone, and that a growing number of tablet-based POS solution providers offer merchants front office functionalities (ie, loyalty, promotion) and specialized back office solutions (ie, inventory, accounting, analytics—all specific to a particular vertical sector such as restaurants and hospitality). Such functionality could be attractive for a small business that historically has not had access to these types of tools.

Likewise, in-aisle/in-store mobile checkout via a tablet may provide an opportunity for e-register app providers among businesses (ie, a specialty retailer) for whom it makes sense to accept customer payments away from the traditional POS counter, in an effort to increase consumer intimacy and shorten checkout lines. But even in that environment, our industry research suggests the mPOS deployment is generally additive to the fixed countertop POS setup, rather than displacing the legacy payment terminals.

We believe the most common retail environment where a table-based POS solution has displaced a legacy payment terminal is small merchants who don't have much need for in-aisle checkout, but choose to adopt a fixed tablet-based POS solution because it frees up countertop space and can provide more advanced functionality, for example in terms of analytics which can help the store owner make more informed decisions regarding inventory and promotions.

A number of mPOS providers have created their own POS hardware that allows for a more robust platform as they target SME merchants, while maintaining the tablet's increased flexibility and scalability. For example, Square introduced Square Stand, in May-2013 (see Exhibit 14). The $99 (down from $299 when launched in May) piece of hardware (which doesn't include the tablet itself), is currently being sold at retailers including Apple and Staples, and includes a dedicated magnetic card reader, and allows merchants to more easily connect cash drawers, scanners, and receipt printers, while maintaining a cleaner aesthetic.

In addition, Clover, owned by First Data, debuted its SME focused tablet-based POS system in October '13, which includes fixed, full-time connectivity, rather than depending on wireless (see Exhibit 15). After installing Clover (which the company says can be done





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in under 15 minutes), merchants then choose from a set of apps that are appropriate to their vertical and specific to their business (see Exhibit 16).

**Exhibit 14: Square Stand**

Source: Company

**Exhibit 15: Clover POS Terminals**

Source: Company

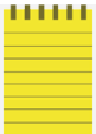
**Exhibit 16: Select Clover Apps**

**Register** - Your home base for quickly creating and charging for orders. View all of your inventory in one place. Ideal for quick serve restaurants and retail businesses.

**Tables** - Full service restaurants: this is your home. Assign tables to servers and manage table ordering, printing, and paying from here.

**Reporting** - Reports give you powerful insight into your business. Get instant access to payments, cash logs, and employee sales.

**Orders** - Track and find your orders, add tips, and refund payments.



**Notes** - Managers can display a digital note on all their Clover devices. Say goodbye to sticky notes taped to register screens!

Source: Company

The flexibility and speed of adopting cloud based software can provide benefits for both large and small merchants, although for different reasons. The value proposition for larger merchants (Tier 1-3) will likely focus on the flexibility and ability to build ancillary programs on the platform which could then be quickly/easily be implemented across their registers, as well as providing a more positive consumer shopping experience (ie, in-aisle checkout), while smaller merchants benefit from the speed and simplicity with which they can begin to accept electronic payments (Tier 4-5 - see Exhibit 17).





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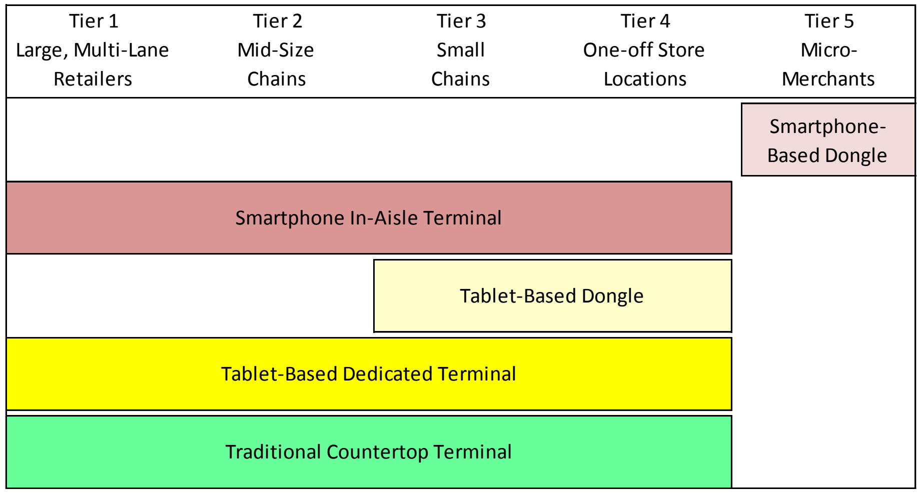
**Exhibit 17: POS Target by Merchant Size**




**Source: Jefferies**

With that said, larger, more established merchants could potentially run into a number of problems when deploying tablet-based mPOS systems. For merchants with existing POS infrastructure, particularly large, multilane retailers, moving from legacy hardware and software systems to tablet solutions may prove both cumbersome and expensive, particularly migrating merchant specific data and processes to the tablet. Furthermore, the conversion to mobile may make certain consumers uncomfortable (particularly older demographics), which could limit widespread adoption. Coupled with reliability and connectivity concerns, particularly for tablets that lack Ethernet ports and depend on wireless connectivity (ie, iPads), and durability issues, we believe significant up-market penetration for tablet-based mPOS may face near-term hurdles.

With that said, we recognize that a number of large merchants have moved to include mPOS in the retail environment to provide a differentiated shopping experience for the consumer. Initially, a few large retailers (most notably Urban Outfitters in 2010) introduced mPOS enabled devices to improve checkout times during high volume periods (ie, holiday shopping), helping to ease the burden on traditional checkout lanes. Since then, a number of retailers have announced plan to adopt mPOS terminals, which in some cases replace legacy countertop units, but we believe more often augment the traditional POS environment, as described earlier. For example, on PAY's last earnings call, the company announced new mPOS wins with Sephora and Under Armour, and we believe in both cases the retailers are adding mPOS to their environment, rather than replacing their existing countertop terminals.

Of note, the larger mPOS deployments to date have not been "dongle" based (ie, inserting a dongle into headphone jack of a smartphone/tablet), but have depended on more robust "sleeves" (see Exhibit 18). These sleeves wrap entirely around the mobile device, incorporating card swipe capabilities. In addition, these larger mPOS deployments may include sophisticated integration into the retailer's back end IT systems.





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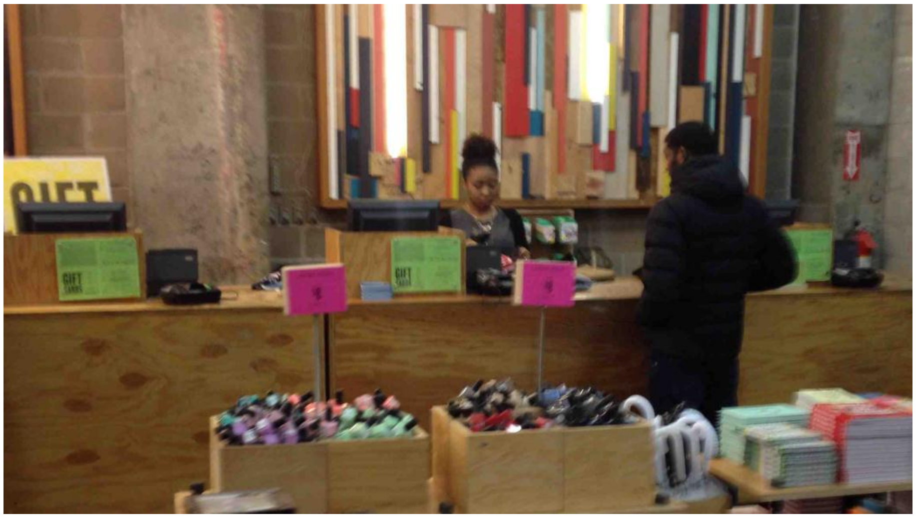
**Exhibit 18: Example of mPOS In-Aisle Hardware Used By Large Retailers**

**Source: Company**

During Urban Outfitters' 2012 Analyst Day, COO Calvin Hollinger announced that they had moved entirely to iPod/iPad based POS systems, citing costs as one of the primary drivers. According to Hollinger, iPod Touch and iPad POS systems, fully configured, loaded and installed cost ~$500 and $1000, respectively, compared to the company's legacy registers at $5000. Of note, as of our own recent visit to a New York Urban Outfitter's location, the company still used VeriFone countertop terminals for checkout (see Exhibit 20), and according to a sales associate, primarily use mPOS devices for inventory lookup and rarely for checkout (although they have the capability).

**Exhibit 20: Photo of URBN's Current POS Environment**



**Source: Jefferies**

Below are two other case studies regarding mPOS deployments at large US retailers.





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**mPOS Case Study #1 – JC Penney**

In November 2011, JCP hired Ron Johnson as CEO. Mr. Johnson was hired from Apple, where he had been in charge of Apple's retail store network. One of Mr. Johnson's initiatives upon arriving at JCP was to attempt to transform the in-store consumer shopping experience by replacing traditional cash wraps (including traditional electronic cash registers) with mPOS technology, specifically iPods encased in a card-swiper sleeve. The goal of this mPOS platform was to enable in-aisle checkout (line-busting), while also giving sales associates a tool to enhance customer service by using their mPOS device to check inventory and search the company's on-line store (JCP.com) for product availability when necessary. As part of this effort, some of JCP's traditional cash wraps were removed, also freeing up valuable floor space to sell merchandise.

Subsequently, in April 2013, Mr. Johnson was replaced as CEO. Our in-store checks at JCP within the past month suggest that since Mr. Johnson's departure, the use of mPOS devices has been de-emphasized, though the sales associates generally still have the devices. Our checks also indicated that the mPOS devices were used on a limited basis during the peak holiday shopping season as a line-busting technique, but sales associates we spoke with said that the devices are often not as effective as traditional POS for multiple reasons: 1) challenges providing bags to consumers using in-aisle checkout, 2) erratic response times for the software running on the mPOS device, lengthening the checkout process, 3) consumers using in-aisle checkout but wanting a hardcopy receipt required sales associates to search the mPOS software for the closest receipt printer, and then walk over to that fixed printer and bring the receipt back to the consumer (JCP's mPOS devices do not have built-in printers).

The mPOS technology we observed at JCP as part of our recent checks included Apple's iPod, encased in a card-swiper sleeve made by PAY. JCP's traditional POS includes electronic cash registers made by NCR, attached to terminals provided by multiple providers (we saw both POS terminals from VeriFone and Symbol Technologies at different JCP locations). So while JCP was initially an early adopter of mPOS technology in the department store vertical, the company has more recently been re-thinking this strategy, and seems to be utilizing more of a hybrid POS approach, which favors the traditional platform over the mobile platform. The JCP case study also illustrates an example where PAY was not the sole incumbent POS provider, and got incremental business when JCP adopted mPOS technology.

**mPOS Case Study #2 – C. Wonder**

C. Wonder, a retailer focused on women's clothing and home decor, opened in January 2012 using only VeriFone PAYware mPOS devices (15-20/store), in lieu of traditional countertop cash registers. During a recent visit to a C. Wonder store during the busy holiday shopping season, we learned that in fact, not all associates carry mPOS devices. The majority of sales associates that do carry the devices typically stand behind a countertop ringing up customers waiting in a line, using an iPod touch and PAYware sled. Despite the physical countertop, only a few of the associates had access to cash drawers (the individual we used to checkout could only accept electronic payments), which was a cause of complaint from sales associates.

We learned that the mPOS setup has been buggy, and during busy periods, associates have problems with Wi-Fi connectivity, particularly when there are a large number of associates using their devices in the same area (ie, behind the countertop), which in turn slows down the checkout experience. We also learned that due to the inconsistent mPOS checkout experience, C. Wonder plans to incorporate a traditional cash register and POS terminal in the near future.

Our in-store checks show that many of these retailers still rely on traditional countertop Electronic Cash Register/POS systems alongside mPOS hardware, and have developed a hybrid platform. We expect these merchants will maintain a dedicated checkout channel, supplemented with associates using mPOS enabled devices. Our checks show that the majority of devices in use are iPod Touches, as in many cases the iPad (and tablets in general) are too bulky for sales associates to carry with them. However, in-aisle usage of iPads may increase in the future, as they may provide more cross-selling/product comparison capability, due to their larger, more user-friendly screens.

Going forward, we believe that mPOS providers will continue to look upstream to larger merchants. While these merchants already have card-acceptance capability, as well as integration with both front and back office systems (ie, inventory) in place, the benefits of




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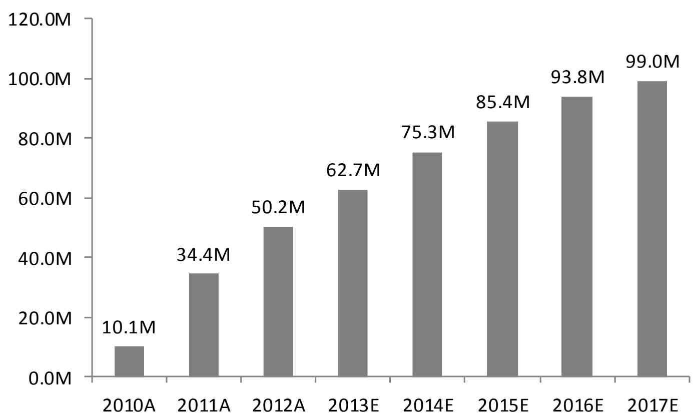
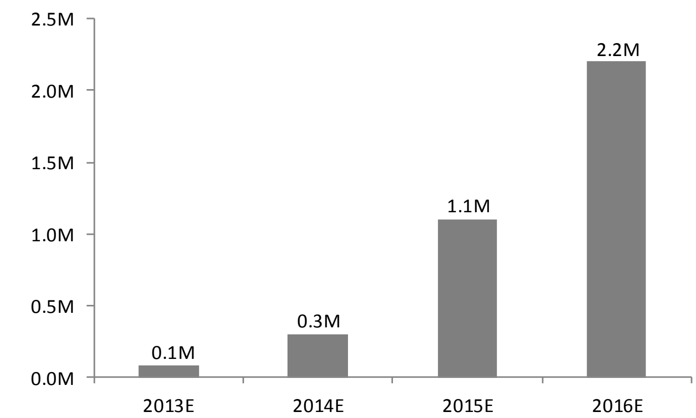
mobility (ie, in-aisle checkout) may be enough to overcome the costs of the transition from the countertop to the cloud. According to a report from pymnts.com, Home Depot expects to process nearly 100,000 mPOS transactions weekly by 1Q14 (a still relatively small sliver), and Coach has announced plans to completely replace their point of sale system with more mobile offerings. By freeing the terminal from the countertop, larger merchants hope to increase sales by making the sales staff more efficient, promoting up-selling, making checkout quicker, and saving valuable real estate, and as a result, the Mercator Advisory Group estimates 1.1M tablets will be used for POS by 2015 (see Exhibit 22).

**Exhibit 21: Growth in Total North America Tablet Sales**




**Source: IDC**

**Exhibit 22: Number of Affixed POS Tablets**




**Source: Mercator Advisory Group**

# Tablet Based POS Competitive Landscape

The increased computing power and larger screen size of tablets have spurred a set of software offerings that are layered on top of card acceptance that aim to provide more robust POS technology to smaller merchants, while helping merchants of all sizes enhance the consumer shopping experience. Many of these providers leverage the increased processing capacity of tablets and integrate either front office capabilities (ie, sales, marketing, loyalty) or back office offerings (ie, accounting, inventory, invoicing) into the point of sale environment, along with new analytical capabilities (see Exhibit 23). And with a larger screen size, tablets (unlike smartphones previously) are able to potentially replace legacy electronic cash registers at checkout.

A number of providers have layered card processing on top of their SaaS based POS software offerings. These companies to date have largely been existing payments companies or have strong merchant relationships (ie, Square, PayPal, Groupon), with enough scale to receive advantageous rates from back end processors (ie, Chase Paymentech, Wells Fargo). These providers typically charge a monthly subscription fee for the POS software, and a per transaction fee for card processing. The majority of these offerings are focused on merchants previously priced out of accepting electronic payments (ie, micro-merchants), new SME business owners looking to start accepting electronic payments, or existing merchants in a number of verticals (ie, restaurants, cafes,





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retail) that could benefit from either cost benefits or an improved consumer experience that would come from moving to a tablet-based mPOS system.

Separately, other newer market entrants (such as Breadcrumb, NCR Silver, and ShopKeep) focus purely on POS functionality, rather than payment processing. As a result, these offerings are largely processor agnostic, and in order to reach the necessary scale, many distribute their product in conjunction with acquirers/ISOs. For these providers, we believe the economic model is dependent on hardware sales, SaaS subscription fees, and/or downloads of apps to customize the operating environment, rather than processing fees. We believe many of the tablet solutions will create an app-store type environment that when combined with an open publishing platform for developers to create apps, can create an additional revenue stream for the platform.

In order to compete with Square and its first mover advantage, a number of mPOS tablet based providers have come to market with aggressive pricing schemes. Groupon's Breadcrumb offers free processing on the first $5,000 in credit card transactions. Similarly, in May 2013, PayPal began its “Cash For Registers” program, offering select merchants free processing through 2013 if they were willing to trade in their legacy cash registers and move to mPOS based acceptance, using either PayPal's own Here solution or any of PayPal- “pre-integrated partners” (which include NCR Silver, Leaf, ShopKeep, Vend, Erply and Leapset).




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**Exhibit 23: Comparison of mPOS Offerings**

| | | Pricing (POS Software and Payment Processing) | Services Offered | Number of Merchants | Hardware | Cost of Hardware | Payment Processor | Additional Partnership |
|---|---|---|---|---|---|---|---|---|
|  | Clover | Determined by reseller | Wide ranging offerings depended on apps downloaded (ie, Register, Order tracking, Analysis) | n/a | Proprietary hardware (incl. tablet, printer, cash drawer) | Determined by reseller | Bank of America Merchant Services | First Data |
|  | GoPago | $69/month | Consumers can use app to pre-order items from GoPago merchants | | Proprietary Android tablet | $0 for hardware including cash drawer/printer and wireless connection | Choose your own processor | Amazon purchased technology and engineering team; POS business and merchant relationships purchased by DoubleBeam |
|  | Groupon Breadcrumb **POS** | 1.8% + $0.015/transaction | Focused on full-service restaurants and bars, salons, photo studios, outdoor activity places, and small retails establishments. Integrated restaurant management capabilities | | Ipad running iOS 5.0 or later | $1,194 for hardware (incl. iPad) and router. | Choose your own processor | VeriFone |
| | Groupon Breadcrumb **PRO** | $99/month for 1 iPad up to $399/month for up to 10 iPads (on top of per txn costs) | More focused on restaurants. Includes table management, capability to link to kitchen printer, and ability to split checks | | | | | |
|  | Intuit GoPayment | **Per Transaction** - Swipe rate = 2.75%, Keyed rate = 3.75%; **Monthly** - $12.95/month, Swipe rate = 1.75%, Keyed rate = 2.75% | Integration with Intuit Quickbooks product suite | | Proprietary dongle; Merchant provides iOS or Android device | $0 for hardware (ex. Tablet/Smart Phone Cost) | n/a | Verizon Wireless |
|  | Leaf | $50/month | Core offering accepts payment, while incorporating marketing, feedback, and analytics. Includes open API. | 500-1000 | Proprietary Android tablet | $250/LeafPresenter | Choose your own processor | Heartland Payments, PayPal |
|  | NCR Silver | $79/month for first device, and $0.10/transaction on any additional devices (up to $29/device per month) | Combines payment acceptance with order processing, email marketing and sales analytics. | | Receipt printer, cash drawer and card reader | $499 (ex. iPad) | Choose your own processor | Vantiv, PayPal |
|  | PayPal Here | Swipe rate = 2.7%, Keyed rate = 3.5% + $0.15 | Focused on cash-based businesses looking to upgrade or more sophisticated small and midsize businesses working with mPOS providers. Compatability with PayPal's mobile wallet offering. Of note, provides live telephone based customer support | | Proprietary dongle; Merchant provides iOS or Android device | $0 for hardware (ex. Tablet/Smart Phone Cost) | Wells Fargo | |
|  | Revel Systems | $49/month service fee. 3 subsequent pricing tiers, depending on the number of locations and items. | One of the initial players in tablet based mPOS, provides analytics, payroll, and inventory. Focus on restaurant, retail, and grocery verticals with $500,000 in yearly revs | >1,000 (as of 4/13) | Requires purchase of cash drawer, card reader, stand and receipt printer from Revel. Does not include iOS device. | ~$800 for hardware from Revel (ex. Price of iOS device) | Choose your own processor (thru USAePay gateway) | PayPal, Mercury Payments, Priority Payments, Merchant Warehouse, Best Buy's Geek Squad |
|  | Shopkeep | $49/month per register. Includes updates and customer service | Incorporates front and back office capabilities including sales, analytics, and inventory management | 8000 | Ipad running iOS 5.0 or later | $649 for POS stand, receipt printer, cash drawer, and card reader (ex. Price of iOS device) | Choose your own processor | PayPal |
|  | Square Register | Swipe rate = 2.75%, Keyed rate = 3.5% + $0.15 | Compatability with Square's mobile wallet offering | | Stand - Proprietary hardware/stand; Merchant provides iPad | $99 for Square Stand, $0 for dongle (both ex Tablet/Smartphone costs) | Chase Paymentech | |
| | VeriFone GlobalBay Merchant | Determined by reseller | Includes inventory and employee management, as well as reporting and back-end intergration with Quickbooks | | iPad and VeriFone PAYware "sleeve" | Determined by reseller | Choose your own processor | ISOs/Acquirers |

**Source: Jefferies, Company**





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## mPOS Partnerships Are Evolving

While a number of tablet based mPOS providers have the scale necessary to go direct to merchants with competitive processing rates, others have struck partnerships with payments companies that already enjoy wide-ranging merchant relationships. As tablet solution providers look for greater scale, acquirers and POS hardware producers look to offer their existing customer base a new rapidly growing product set and defend themselves against mew competitive threats. And because many of these offerings focus on pure POS functionality rather than transaction processing, these offerings are largely processor agnostic and merchants are able to remain with their legacy provider.

***Incumbent Acquirers/Processors***

In May 2013, Vantiv announced a partnership with NCR Silver to offer Vantiv Mobile Checkout. Using Silver's software and hardware bundle (ie, printer, cash drawer, and magnetic card reader - which NCR sells independently for $499), Vantiv will lease the hardware to merchants for $49/month and provide payment processing for 1.99% per transaction. Separately, Heartland Payments (HPY) has agreed to sell Leaf's mPOS product through its salesforce and develop apps on the Leaf platform (HPY also made a $20M investment in the company), while Global Payments (GPN) has partnered with Shopkeep to sell Shopkeep POS to GPN's merchant base.

First Data took a slightly different approach when it took a majority stake in mPOS startup Clover in an attempt to expand into the SME portion of the POS market. Clover provides a complete set of acceptance hardware, including an Android based tablet, printer, and scanner that First Data claims can be setup in less than 15 minutes. Merchants then choose from a set of apps that are appropriate to their vertical and specific to their business.

Clover terminals will initially be distributed exclusively through Bank of America Merchant Services (a JV with First Data), starting January 1, 2014, before rolling out to other resellers over time. Currently, pricing for Clover is determined by the reseller, but is expected to be in-line with competitors. Clover looks to differentiate itself from competitors through an open API that allows developers to create and sell apps, as well as a focus on aesthetics of the countertop POS hardware.

Although PayPal offers its own mPOS solution (the "dongle" based PayPal Here solution), it has also been particularly active in partnering with tablet-based mPOS providers. Historically, smaller mPOS providers (ie, ShopKeep and Vend), were unable to offer a competitive payment processing rate to low volume issuers. As a result, ShopKeep partnered with PayPal, leveraging PayPal's volumes to offer better processing terms. We believe that PayPal has similar deals with a number of other mPOS players, including NCR Silver, Leaf, Erply, booker, vend, and Leapset. This is part of PayPal's ongoing strategy to increase penetration of the bricks-and-mortar channel, we believe.

***Incumbent POS Terminal Providers Are Adopting mPOS Solutions***

In August 2013, Groupon and VeriFone announced a partnership agreement that will allow merchants to use Groupon's Breadcrumb solution as their "virtual cash register" while maintaining a traditional VeriFone POS terminal to accept electronic payments. Recognizing the difficulty in changing merchant behavior, Groupon now offers merchants using traditional cash registers and countertop POS systems (although Groupon notes that only some terminals are currently compatible) the ability to use Breadcrumb to process transactions (at the traditional price of 1.8% and $0.15/swipe). In addition, merchant can also access analytics software through the company's online Payments Portal. The agreement is noteworthy as the legacy terminal providers had previously




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primarily chosen to compete (rather than collaborate) with potential disruptors (ie, Square). With this partnership, merchants using Breadcrumb can either use their existing POS terminal (VeriFone or Ingenico, we believe), purchase a new VeriFone vx520 terminal (for $150/terminal), or rent one directly from Groupon ($15/month).

**Exhibit 24: Groupon Breadcrumb/VeriFone Partnership**


**Source: Company**

Ingenico, the largest global POS terminal supplier, took majority control of ROAM Data (of which it previously held a minority interest) in February 2012 to increase its presence in mPOS. Within the US, Ingenico white-labels its ROAM product, leveraging its strong partner network to distribute ROAM hardware. In addition to the hardware, ROAM provides merchants a payment gateway and accompanying software.

**Exhibit 25: ROAM Data Hardware Offering**


**Source: Company**

# PAY Has A Full Suite of mPOS Offerings

In response to evolving customer demand patterns, VeriFone has looked to aggressively expand within mobile payments, combining POS hardware (PAYware and Sail) with their mobile retail software offerings, Global Bay Enterprise and Merchant. Used together, VeriFone looks to leverage both hardware and software to develop an encompassing mobile acceptance platform that merchants can leverage to enhance their consumer relationships.

VeriFone initially launched two separate mPOS products: SAIL, focused on micro-merchants (see Exhibit 26), and PAYware, aimed at larger, traditional POS users (see Exhibit 27). SAIL, a smartphone/tablet dongle, was originally distributed direct to merchants, with VeriFone acting as the acquirer and charging merchants 2.7%/transaction. In December 2012, PAY divested these SAIL assets and chose to rely on traditional channel partners for distribution of its dongle, citing unprofitable economics due to high customer acquisition costs and extremely thin margins.





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PAYware is a card-swiper sleeve for smartphones and tablets aimed at larger, more-established retailers looking to improve efficiency and the customer experience by offering in-aisle checkout. PAYware sleeves are durable, PCI compliant, and offer EMV and PIN pad capability, the latter two which we believe many new mPOS entrants do not offer.

**Exhibit 26: VeriFone SAIL**

**Source: Company**

**Exhibit 27: VeriFone PAYWare Tablet Sleeve**


**Source: Company**

With PAY's purchase of Global Bay in November 2011, PAY added an enterprise-level software tool that allows merchants to move customer interaction away from the traditional POS terminal, while integrating inventory management, eCommerce, and ERP onto a mobile device (see Exhibit 28). We believe GlobalBay and PAYware represent a very small piece of PAY's revenues today, but are growing rapidly.

**Exhibit 28: GlobalBay Enterprise Offerings**


**Source: Company, Jefferies**

In September 2013, PAY expanded its GlobalBay suite, launching GlobalBay Merchant in response to a growing number of tablet-based offerings to SME merchants (see Exhibit 29 and Exhibit 30). GlobalBay Merchant is distributed through the company's resellers (rather than the direct model used for the Enterprise solution), who can independently price and market to their customers. As of the company's September 2013 earnings call, VeriFone announced they have teamed with a dozen ISOs to re-sell GlobalBay, representing nearly 500,000 merchants, with EVO representing 300,000. According to PAY, the company is currently in distribution talks with ISOs and acquirers that account for an additional 4 million merchants.





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**Exhibit 29: GlobalBay Merchant Fixed POS Solution**

Source: Company

**Exhibit 30: GlobalBay Merchant Mobile POS Solution**

Source: Company

GlobalBay Merchant includes SME merchant specific software and help desk support. The app connects to the PAYware gateway and is compatible with all VeriFone hardware offerings (including EMV/NFC compatible terminals). Currently, the app is only available on Apple iOS products, but we believe the company is looking to expand to include Android devices as well. While PAY hasn't released pricing specifics, they have stated that pricing is flexible and will allow resellers to determine the best pricing method for their merchants (ie, per click, monthly fee, or the existing structure used at the merchant).

Besides developing their own POS product set, PAY has partnered with tablet manufacturers. VeriFone and Lenovo announced a partnership in June 2013 to create an enterprise level tablet based POS solution. In order to ease the integration of tablets into the existing retail infrastructure, the new POS hardware combines a ThinkPad tablet running Windows 8 (currently used by many retailers to power their existing back-end and POS systems), with a specifically designed VeriFone PAYware acceptance sleeve. We believes the partnership is in-line with PAY's stated goals to appeal to the broadest base of merchants, and the company will continue to pair with hardware providers to provide POS solutions that are platform agnostic.

**Exhibit 31: Lenovo/VeriFone PAYware Offering**


Source: Company





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## MCRS mPOS Offering

MCRS introduced the mTablet in July 2013, with a MSRP of $899 for the regular version and $999 for the daylight viewing version. Additionally, MCRS also introduced the mStation at $499, a portable stand with peripheral connections to mimic a fully connected workstation. Our conversations with channel partners suggest the mTablet has been successful primarily in sport stadiums and other large venues where mobility is key. We believe the higher price of the mTablet, when compared to an iPad (average price $500), has prevented it from seeing more success in independent restaurants.

On Jan 9, 2014, MCRS announced a new tablet in partnership with Dell, to be released in summer 2014. We expect this tablet to be priced at similar levels to NCR Silver and the iPad so that MCRS can compete better in the restaurant segment.

**Exhibit 32: MCRS mTablet + mStation**

**Source: Company Data**

# Proprietary Scenario Analysis Suggests mPOS Is Additive For PAY

With the emergence of mobile POS solutions and a steady stream of new market entrants, the potential for disintermediation to legacy terminal providers such as PAY has become a concern for some investors. While we acknowledge the theoretical competitive threat (especially in the US) and potential cannibalization from new mPOS devices, we believe that the expected mPOS replacement of legacy countertop terminals at retailers has been more muted than initially expected, and when combined with PAY's own mPOS products and partnerships, as well as its huge install base (20M lanes globally), we believe mPOS will continue to be additive to PAY's addressable market for the foreseeable future. This view is supported by our scenario analysis below.

Existing PAY customers who decide to incorporate mPOS solutions into their POS ecosystem, must first decide whether they plan on continuing to use VeriFone hardware or incorporate alternative mPOS providers. In the case where a merchant decides to use a non-PAY mPOS vendor, the merchant can either use the competitor to replace their existing PAY terminal, or they can use the alternative mPOS provider to augment their existing PAY terminal infrastructure. If the merchant decides to use PAY as their mPOS provider, they can either replace their existing countertop terminals with mPOS devices or they can add mPOS units alongside legacy countertop terminals (see Exhibit 32).




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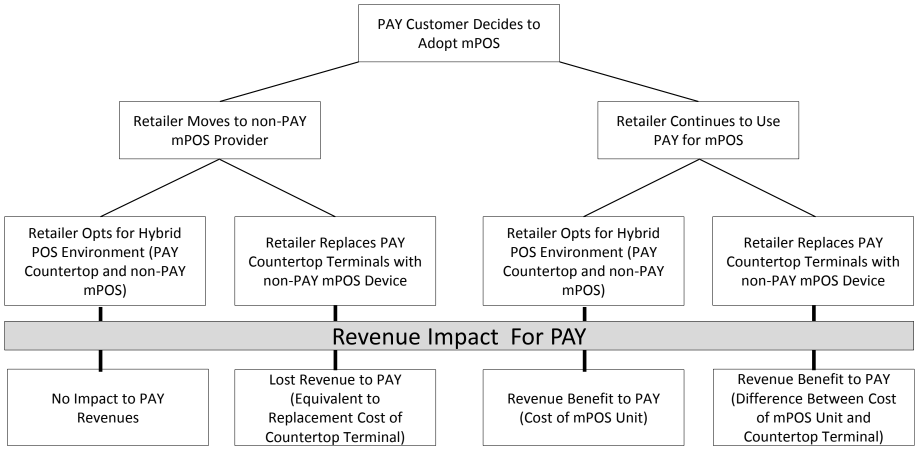
**Exhibit 32: Retailer mPOS Decision Tree**




**Source: Company, Jefferies**

PAY estimate, there are currently about 8M customer-facing POS devices in the United States, of which VeriFone terminals account for roughly 5M. We have focused on potential mPOS adoption over a 4 year time period to align with the traditional replacement cycle for POS equipment (3-5 years), and also in recognition of the fact that big changes in the merchants POS environment typically take a while to transpire. In addition, we assume that 62.5% of mPOS units (equivalent to the company's current US marketshare) bought by existing VeriFone customers over the next four years will remain with VeriFone and the remainder will go to competitors. We also assume that new mPOS units for PAY are marginally more expensive than PAY's traditional countertop terminals ($400/$350, respectively).

Based on these assumptions, we see the downside risk for PAY of mPOS disintermediation as limited. Even in our worst case scenario, which envisions 25% of PAY's current US install base being replaced by a competitor's mPOS solution, we estimate this would result in only a $37.5M cumulative revenue headwind over the next 4 years (see Exhibit 35), which when evenly split across the time period, would account for only about 50 bps of revenue drag in F15 (see Exhibit 34). Focusing on our base case scenario (15% adoption of mPOS across PAY's existing US install base, with 50% of these mPOS units replacing PAY's legacy countertop terminals with a competitor), VeriFone F15 revenues would benefit by ~$14M, or ~70bps (see Exhibit 36).





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**Exhibit 33: Scenario Assumptions**

| | |
|---|---|
| Aggregate US Customer-facing POS devices | 8,000,000 |
| VeriFone's Marketshare | 62.5% |
| VeriFone's Domestic Install Base | 5,000,000 |
| VeriFone Payware ASP | $400.00 |
| Traditional Countertop Terminal ASP | $350.00 |
| % of mPOS Units Captured by PAY | 62.5% |

**Source: Jefferies, Company**

**Exhibit 34: Impacts to F15 JEFe Revs**

| | |
|---|---|
| Best Case | 2.8% |
| Base Case | 0.7% |
| Worst Case | -0.5% |

**Source: Jefferies**

**Exhibit 35: Cumulative Revenue Impact For PAY From mPOS Adoption ($M)**

Adoption of mPOS Over Next 4 Years (As % of Current PAY US Install Base)

| % Replacement | 5% | 10% | 15% | 20% | 25% | % Additive |
|---|---|---|---|---|---|---|
| 20.0% | $45.0 | $90.0 | $135.0 | $180.0 | $225.0 | 80.0% |
| 35.0% | $31.9 | $63.8 | $95.6 | $127.5 | $159.4 | 65.0% |
| 50.0% | $18.8 | $37.5 | $56.3 | $75.0 | $93.8 | 50.0% |
| 65.0% | $5.6 | $11.3 | $16.9 | $22.5 | $28.1 | 35.0% |
| 80.0% | -$7.5 | -$15.0 | -$22.5 | -$30.0 | -$37.5 | 20.0% |

**Source: Jefferies**

**Exhibit 36: Example of Base Case Revenue Impact**

| | |
|---|---|
| Adoption of mPOS (As % of PAY US Install Base) | 15% |
| Additional mPOS Units Sold Over Next 4 Years | 750,000 |
| % of mPOS Units Captured by PAY | 62.5% |
| Additional Units Captured by PAY | 468,750 |
| % Replacing Legacy PAY Terminals | 50.0% |
| Incremental Revenue from Replacement Sales ($M) | $11.7 |
| % Additive mPOS Units | 50.0% |
| Revenue from Additive mPOS Sales ($M) | $93.8 |
| **Additive Revenue to PAY ($M)** | **$105.5** |
| mPOS Units Moving to Competitors | 281,250 |
| % Replacing Legacy PAY Terminals | 50.0% |
| PAY Terminals Replaced by Competitor mPOS Units | 140,625 |
| **Lost Revenue to Competitors ($M)** | **-$49.2** |
| **Cumulative 4-Year Net Impact To PAY Revenues** | **$56.3** |
| **F15 Impact to PAY Revenues** | **$14.1** |

**Source: Company, Jefferies**

Using the above estimates, and applying a more normalized 15% post-F14 restructuring operating margin and steady share count, we believe that our worst case condition could drive a $0.04 EPS headwind over a 4 year period (or ~60 bps of JEFe F15 EPS assuming the EPS drag is spread evenly throughout the period – see Exhibit 38). Using our base case assumptions, the adoption of mPOS could drive ~90 bps of EPS expansion compared to JEFe.





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**Exhibit 37: Scenario Assumptions**

| | |
|---|---|
| PAY Forward Operating Margin | 15.0% |
| PAY Tax Rate | 14.5% |
| PAY Share Count | 114.5 |

**Source: Jefferies, Company**

**Exhibit 38: Impacts to F15 JEFe EPS**

| | |
|---|---|
| Best Case | 3.5% |
| Base Case | 0.9% |
| Worst Case | -0.6% |

**Source: Jefferies**

**Exhibit 39: Cumulative EPS Impact For PAY From mPOS Adoption**

Adoption of mPOS Over Next 4 Year (As % of Current PAY US Install Base)

| % Replacement | 5% | 10% | 15% | 20% | 25% | % Additive |
|---|---|---|---|---|---|---|
| 20.0% | $0.05 | $0.10 | $0.15 | $0.20 | $0.25 | 80.0% |
| 35.0% | $0.04 | $0.07 | $0.11 | $0.14 | $0.18 | 65.0% |
| 50.0% | $0.02 | $0.04 | $0.06 | $0.08 | $0.11 | 50.0% |
| 65.0% | $0.01 | $0.01 | $0.02 | $0.03 | $0.03 | 35.0% |
| 80.0% | -$0.01 | -$0.02 | -$0.03 | -$0.03 | -$0.04 | 20.0% |

**Source: Jefferies**

Not only do we view the worst case mPOS scenario as very manageable for PAY, we note that VeriFone currently has approximately 75% market share among US multilane retailers, and we believe this incumbency could position PAY well to provide the mPOS solutions to these large retailers, if they decide to pursue such a strategy. While we believe that to date PAY accounts for a relatively small share of mPOS hardware deployment (trailing providers such as Infinite Peripherals), we believe that improved mPOS hardware and software offerings from PAY (ie, PAYware and Global Bay) and sticky merchant relationships will likely result in mPOS adoption being neutral to modestly positive for PAY's financials.

## Valuation

We raised our price target on PAY to $34 from $29, and we maintain our Buy rating. Our new price target is based on a blend of 15x (market multiple) our F16 pro forma EPS estimate of $2.19 and our DCF model. Given the early stage of PAY's turnaround, we believe our F16 estimate is a reasonable approximation of something close to PAY's normalized earnings power, and there could be upside to this normalized figure depending on the pace of execution, product development, and cost savings from current fiscal year investments. In the meantime, we believe quarterly performance, product certifications, market share recovery, and effective R&D/product investments are key potential catalysts for the stock. We also believe the recent series of POS security breaches (ie, Target) provide support for PAY shares, as investors consider the potential for acceleration in EMV terminal deployment (we view this as more of a "headline" catalyst than big upside to numbers), as well as feeling more confident in PAY's industry position as a trusted partner for retailers in terms of payment security.





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# Micros Revenue/ Profit at Risk

MCRS operates in three verticals: Hotel, Restaurant and Retail. We believe the mPOS disruption risk is mainly in the restaurant hardware/ hardware support business. In our downgrade note from 3/1/13 (MCRS downgrade), we estimated the revenue/ profit at risk in the restaurant business.

**Restaurant Hardware Scenarios**

We lay out three scenarios for the restaurant hardware business:

- **Best Case: Minimal EPS impact (Negative $0.00 to $0.05 in three years).** This assumes no cannibalization of PC-based Workstations; modest declines in PC-based Workstation prices (5-10% a year) and gross margin (around 100bp per year); and significant unit volume of Micros branded Tablet-based Workstations (building to a 40K unit run-rate over 3 years).
- **Base Case: Meaningful EPS impact (Negative $0.15-0.20 in three years).** Around 10% cannibalization of PC-based Workstations; modest declines in PC-based Workstation prices (5-10% a year) and gross margin (around 100bp per year); modest volume of Micros branded Tablet-based Workstations (building to a 15K run-rate over 3 years).
- **Worse Case: Very Meaningful EPS impact (Negative $0.30-0.35 in three years)** Around 10% cannibalization of PC-based Workstations; meaningful price declines in PC-based Workstation prices (around 15% a year) and gross margin (around 300bp per year); very modest volume of Micros branded Tablet-based Workstations (building to a 10K run-rate over 3 year).

**Exhibit 41: Restaurant HW Best Case**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| **Assumptions** | | | |
| PC Workstation Units (000s) | 66 | 66 | 66 |
| PC Workstation ASP ($) | 1400 | 1300 | 1200 |
| Tablet Units (000s) | 0 | 20 | 40 |
| Tablet Workstation ASP ($) | 600 | 600 | 600 |
| Branded Peripherals (% of workstation rev) | 50% | 50% | 50% |
| Unbranded Peripherals (% of workstation rev) | 70% | 70% | 70% |
| Tablet Peripherals (% of tablet rev) | 50% | 50% | 50% |
| GM on PC Workstation | 45% | 44% | 43% |
| GM on Tablet Workstation | 25% | 25% | 25% |
| GM on Branded Peripherals | 45% | 44% | 43% |
| GM on Unbranded Peripherals | 15% | 15% | 15% |
| GM on Tablet Peripherals | 15% | 15% | 15% |
| **PC-based Revenue ($M)** | | | |
| PC Workstation | 92 | 86 | 79 |
| Branded Peripherals rev | 46 | 43 | 40 |
| Unbranded Peripherals rev | 65 | 60 | 55 |
| Total | 203 | 189 | 174 |
| **Tablet Revenue ($M)** | | | |
| Tablet Workstation | - | 12 | 24 |
| Tablet Peripherals | - | 6 | 12 |
| Total | - | 18 | 36 |
| **Total Restaurant related Hardware Rev** | **203** | **207** | **210** |
| Gross Profit | 72 | 70 | 67 |
| *Gross Margin* | *35%* | *34%* | *32%* |
| **EPS** | **0.69** | **0.67** | **0.65** |

Source: Jefferies estimates

**Exhibit 42: Restaurant HW Base Case**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| **Assumptions** | | | |
| PC Workstation Units (000s) | 66 | 60 | 54 |
| PC Workstation ASP ($) | 1400 | 1300 | 1200 |
| Tablet Units (000s) | 0 | 10 | 15 |
| Tablet Workstation ASP ($) | 600 | 600 | 600 |
| Branded Peripherals (% of workstation rev) | 50% | 50% | 50% |
| Unbranded Peripherals (% of workstation rev) | 70% | 70% | 70% |
| Tablet Peripherals (% of tablet rev) | 50% | 50% | 50% |
| GM on PC Workstation | 45% | 44% | 43% |
| GM on Tablet Workstation | 25% | 25% | 25% |
| GM on Branded Peripherals | 45% | 44% | 43% |
| GM on Unbranded Peripherals | 15% | 15% | 15% |
| GM on Tablet Peripherals | 15% | 15% | 15% |
| **PC-based Revenue ($M)** | | | |
| PC Workstation | 92 | 78 | 65 |
| Branded Peripherals rev | 46 | 39 | 32 |
| Unbranded Peripherals rev | 65 | 55 | 45 |
| Total | 203 | 172 | 143 |
| **Tablet Revenue ($M)** | | | |
| Tablet Workstation | - | 6 | 9 |
| Tablet Peripherals | - | 3 | 5 |
| Total | - | 9 | 14 |
| **Total Restaurant related Hardware Rev** | **203** | **181** | **156** |
| Gross Profit | 72 | 62 | 52 |
| *Gross Margin* | *35%* | *34%* | *33%* |
| **EPS** | **0.69** | **0.59** | **0.50** |

Source: Jefferies estimates

**Exhibit 43: Restaurant HW Worst Case**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| **Assumptions** | | | |
| PC Workstation Units (000s) | 66 | 60 | 54 |
| PC Workstation ASP ($) | 1400 | 1200 | 1000 |
| Tablet Units (000s) | 0 | 5 | 10 |
| Tablet Workstation ASP ($) | 600 | 600 | 600 |
| Branded Peripherals (% of workstation rev) | 50% | 50% | 50% |
| Unbranded Peripherals (% of workstation rev) | 70% | 70% | 70% |
| Tablet Peripherals (% of tablet rev) | 50% | 50% | 50% |
| GM on PC Workstation | 45% | 42% | 39% |
| GM on Tablet Workstation | 25% | 25% | 25% |
| GM on Branded Peripherals | 45% | 42% | 39% |
| GM on Unbranded Peripherals | 15% | 15% | 15% |
| GM on Tablet Peripherals | 15% | 15% | 15% |
| **PC-based Revenue ($M)** | | | |
| PC Workstation | 92 | 72 | 54 |
| Branded Peripherals rev | 46 | 36 | 27 |
| Unbranded Peripherals rev | 65 | 50 | 38 |
| Total | 203 | 158 | 119 |
| **Tablet Revenue ($M)** | | | |
| Tablet Workstation | - | 3 | 6 |
| Tablet Peripherals | - | 2 | 3 |
| Total | - | 5 | 9 |
| **Total Restaurant related Hardware Rev** | **203** | **163** | **128** |
| Gross Profit | 72 | 54 | 39 |
| *Gross Margin* | *35%* | *33%* | *31%* |
| **EPS** | **0.69** | **0.52** | **0.38** |

Source: Jefferies estimates





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**Restaurant Hardware Maintenance Scenarios**

We lay out three scenarios for the restaurant hardware maintenance business:

- **Best Case: Minimal EPS impact ($0.00 in three years).** This assumes normal attrition of the base (around 5%), no change in existing attach and strong growth in branded Tablet based maintenance.
- **Base Case: Modest EPS impact (Negative $0.05 to 0.15 in three years).** Normal attrition of the base (around 5%), modest declines in existing attach rate (about 5pp a year) and modest growth in branded Tablet based maintenance.
- **Worse Case: Meaningful EPS impact (Negative $0.20-0.30 in three years)** High attrition of the base (around 10%), modest declines in existing attach rate (declining about 5pp a year) and low growth in branded Tablet based maintenance.

**Exhibit 44: Restaurant HW Maintenance Best Case**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Install Base of PC Workstations (M) | 1.23 | 1.17 | 1.11 |
| PC Workstation ASP | 1400 | 1400 | 1400 |
| Hardware Maintenance Rate | 12% | 12% | 12% |
| Estimate of Maintenance Attach | 60% | 60% | 60% |
| Install Base of Tablet Workstations (M) | 0 | 0.2 | 0.4 |
| Tablet Workstation ASP | 600 | 600 | 600 |
| Hardware Maintenance Rate | 12% | 12% | 12% |
| Estimate of Maintenance Attach | 50% | 50% | 50% |
| PC Workstation Maintenance Rev ($M) | 125 | 117 | 111 |
| Tablet Workstation Maintenance Rev ($M) | 0 | 7 | 14 |
| Total Maintenance | 125 | 124 | 125 |
| Gross Profit | 106 | 105 | 106 |
| *Gross Margin* | *85%* | *85%* | *85%* |
| EPS | **1.02** | **1.02** | **1.03** |

Source: Jefferies estimates

**Exhibit 45: Restaurant HW Maintenance Base Case**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Install Base of PC Workstations (M) | 1.23 | 1.17 | 1.11 |
| PC Workstation ASP | 1400 | 1400 | 1400 |
| Hardware Maintenance Rate | 12% | 12% | 12% |
| Estimate of Maintenance Attach | 60% | 57% | 55% |
| Install Base of Tablet Workstations (M) | 0 | 0.1 | 0.25 |
| Tablet Workstation ASP | 600 | 600 | 600 |
| Hardware Maintenance Rate | 12% | 12% | 12% |
| Estimate of Maintenance Attach | 50% | 50% | 50% |
| PC Workstation Maintenance Rev ($M) | 124 | 112 | 103 |
| Tablet Workstation Maintenance Rev ($M) | 0 | 4 | 9 |
| Total Maintenance | 124 | 115 | 112 |
| Gross Profit | 105 | 98 | 95 |
| *Gross Margin* | *85%* | *85%* | *85%* |
| EPS | **1.02** | **0.95** | **0.91** |

Source: Jefferies estimates

**Exhibit 46: Restaurant HW Maintenance Worst Case**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Install Base of PC Workstations (M) | 1.23 | 1.03 | 0.92 |
| PC Workstation ASP | 1400 | 1400 | 1400 |
| Hardware Maintenance Rate | 12% | 12% | 12% |
| Estimate of Maintenance Attach | 60% | 55% | 50% |
| Install Base of Tablet Workstations (M) | 0 | 0.05 | 0.15 |
| Tablet Workstation ASP | 600 | 600 | 600 |
| Hardware Maintenance Rate | 12% | 12% | 12% |
| Estimate of Maintenance Attach | 60% | 60% | 60% |
| PC Workstation Maintenance Rev ($M) | 124 | 95 | 78 |
| Tablet Workstation Maintenance Rev ($M) | 0 | 2 | 6 |
| Total Maintenance | 124 | 97 | 84 |
| Gross Profit | 105 | 82 | 71 |
| *Gross Margin* | *85%* | *85%* | *85%* |
| EPS | **1.02** | **0.79** | **0.69** |

Source: Jefferies estimates

**What's New since our Analysis?**

While the timing of the transition to mobile POS is debatable, we believe the biggest risk to our analysis laid out above is MCRS' recent announcement of a tablet solution, in conjunction with Dell. Historically, MCRS had branded hardware solutions in the restaurant industry, which earned 40%+ gross margins. The Retail hardware business was mainly pass-through hardware at much lower gross margins (< 20%GM). We expect the Dell tablet to have a lower price point vs. the mTablet and to have GMs similar to pass-through retail hardware. If the Dell tablet beomes the primary mPOS solution for MCRS in the restaurant vertical, restaurant hardware gross margins will be negatively affected, and the profit at risk will be higher than we previously estimated. Additionally, we believe MCRS will earn limited hardware maintenance on these tablets, thereby reducing the annual hardware maintenance revenue stream.

While we expect mPOS devices to replace terminals LT, there is a possibility that mPOS devices are complementary in the ST. For example, a QSR could purchase additional





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mPOS devices for line-busting or a TSR could purchase additional mPOS devices for table-side ordering. Initially, the restaurants will utilize both terminals and mPOS devices at the same time. In this scenario, GMs are still negatively affected but revenue growth will be higher, given incremental customer spending on tablets. LT, we believe customers will replace aging terminals with mPOS devices, instead of buying new expensive terminals.

## Customer Revenue over a 10-Year Period

Given the shift in POS hardware to tablets, we compare the revenue from an average customer over a period of 10 years. We believe an average restaurant customer purchases around 3-4 terminals from MCRS. We make assumptions around pricing and replacement cycles. We also ignore hardware peripherals in this calculation. In our previous analysis, we noted that hardware peripherals are typically 50% the price of the terminal and we believe tablet peripherals are likely to be priced similarly.

**Exhibit 47: Assumptions**

Restaurant buys an average of 4 PC Terminals per location
PC Terminal ASP is $1400; Tablet ASP is $600
Hardware maintenance is 12% for Terminals and Tablets
Replacement cycle is 3 years for a tablet and 8 years for a PC Terminal

**Source: Jefferies**

Over a period of 10 years, we calculate that MCRS will earn roughly double the revenue from a customer by selling PC terminals vs. selling tablets. In other words, as restaurant owners move from terminals to tablets, MCRS will have to sell twice the number of tablets to a customer to earn the same revenue over a 10-year period.

**Exhibit 48: PC Terminal vs. Tablet Revenue Comparison**

| | 10-Year Revenue |
|---|---|
| PC Terminal | $16,576 |
| Tablet | $8,484 |
| Revenue equivalence (in units) | 1.95 |

**Source: Jefferies**





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### Exhibit 48: PAY - income Statement ($ millions)

| | 2011 FY A | 2012 FY A | Jan '13A 1Q | Apr '13A 2Q | July '13A 3Q | Oct '13A 4Q | 2013 FY A | Jan '14E 1Q | Apr '14E 2Q | July '14E 3Q | Oct '14E 4Q | 2014 FY E | 2015 FY E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Net revenues: | | | | | | | | | | | | | |
| **System Solutions (non-GAAP)** | **1,036.7** | **1,345.6** | **281.8** | **279.1** | **250.8** | **259.4** | **1,071.2** | **256.5** | **265.2** | **273.4** | **287.9** | **1,082.9** | **1,165.3** |
| year-over-year growth | 25.1% | 29.8% | -10.4% | -18.8% | -28.5% | -22.8% | -20.4% | -9.0% | -5.0% | 9.0% | 11.0% | 1.1% | 7.6% |
| **Services (Non-GAAP)** | **272.8** | **540.7** | **147.8** | **150.6** | **166.7** | **172.9** | **638.0** | **171.5** | **173.2** | **180.0** | **188.5** | **713.2** | **768.0** |
| year-over-year growth | 58.1% | 98.2% | 31.0% | 11.1% | 17.2% | 13.5% | 18.0% | 16.0% | 15.0% | 8.0% | 9.0% | 11.8% | 7.7% |
| **Total net revenue (Non-GAAP)** | **1,309.5** | **1,886.3** | **429.7** | **429.7** | **417.5** | **432.3** | **1,709.2** | **427.9** | **438.4** | **453.4** | **476.4** | **1,796.1** | **1,933.3** |
| **year-over-year growth** | 30.7% | 44.0% | 1.0% | -10.4% | -15.4% | -11.5% | -9.4% | -0.4% | 2.0% | 8.6% | 10.2% | 5.1% | 7.6% |
| quarter-over-quarter growth | NA | NA | -12.1% | 0.0% | -2.9% | 3.5% | NA | -1.0% | 2.4% | 3.4% | 5.1% | NA | NA |
| Cost of net revenues: | | 245.0 | | | | | | | | | | | |
| **System Solutions (Non-GAAP)** | **610.0** | **758.8** | **162.2** | **165.3** | **158.1** | **160.1** | **645.7** | **158.1** | **160.3** | **159.7** | **165.7** | **643.9** | **672.7** |
| year-over-year growth | 19.6% | 24.4% | -9.9% | -13.2% | -18.8% | -17.3% | -14.9% | -2.5% | -3.0% | 1.0% | 3.5% | -0.3% | 4.5% |
| Gross Margin - System Solutions | 41.2% | 43.6% | 42.4% | 40.8% | 37.0% | 38.3% | 39.7% | 38.3% | 39.5% | 41.6% | 42.5% | 40.5% | 42.3% |
| **Services (Non-GAAP)** | **154.5** | **291.0** | **80.3** | **83.0** | **89.1** | **94.2** | **346.6** | **91.6** | **93.8** | **97.1** | **102.2** | **384.7** | **410.5** |
| year-over-year growth | 56.7% | 88.4% | 28.3% | 10.8% | 19.6% | 19.3% | 19.1% | 14.0% | 13.0% | 9.0% | 8.5% | 11.0% | 6.7% |
| Gross Margin - Services | 43.4% | 46.2% | 45.7% | 44.9% | 46.6% | 45.5% | 45.7% | 46.6% | 45.9% | 46.1% | 45.8% | 46.1% | 46.6% |
| **Total cost of net revenues (Non-GAAP)** | **764.4** | **1,049.7** | **242.5** | **248.3** | **247.2** | **254.3** | **992.3** | **249.7** | **254.1** | **256.8** | **267.9** | **1,028.5** | **1,083.2** |
| **year-over-year growth** | 25.6% | 37.3% | -0.1% | -6.4% | -8.2% | -6.7% | -5.5% | 3.0% | 2.3% | 3.9% | 5.4% | 3.7% | 5.3% |
| **Gross Profit (Non-GAAP)** | **545.1** | **836.6** | **187.1** | **181.5** | **170.3** | **178.0** | **716.9** | **178.2** | **184.3** | **196.6** | **208.5** | **767.6** | **850.1** |
| **year-over-year growth** | 38.6% | 53.5% | 2.5% | -15.2% | -24.0% | -17.6% | -14.3% | -4.8% | 1.5% | 15.4% | 17.1% | 7.1% | 10.7% |
| Gross Margin | 41.6% | 44.4% | 43.6% | 42.2% | 40.8% | 41.2% | 41.9% | 41.6% | 42.0% | 43.4% | 43.8% | 42.7% | 44.0% |
| Operating expenses: | | | | | | | | | | | | | |
| **Research and development (Non-GAAP)** | **104.2** | **139.1** | **36.6** | **39.8** | **43.9** | **44.3** | **164.5** | **46.8** | **47.3** | **48.3** | **48.7** | **191.1** | **204.5** |
| year-over-year growth | 45.6% | 33.6% | 14.3% | 11.7% | 21.7% | 24.8% | 18.2% | 28.0% | 19.0% | 10.0% | 10.0% | 16.2% | 7.0% |
| **Sales and marketing (Non-GAAP)** | **116.8** | **158.4** | **41.1** | **42.2** | **45.1** | **48.5** | **176.9** | **48.1** | **46.8** | **48.7** | **50.9** | **194.5** | **210.9** |
| year-over-year growth | 37.6% | 35.6% | 17.8% | 1.7% | 11.9% | 16.2% | 11.6% | 17.0% | 11.0% | 8.0% | 5.0% | 10.0% | 8.5% |
| **General and administrative (Non-GAAP)** | **80.1** | **126.5** | **31.0** | **33.1** | **37.7** | **38.6** | **140.4** | **38.1** | **37.1** | **35.8** | **40.1** | **151.1** | **161.3** |
| year-over-year growth | 13.0% | 57.9% | 8.9% | -4.9% | 6.6% | 38.5% | 11.0% | 23.0% | 12.0% | -5.0% | 4.0% | 7.7% | 6.7% |
| **Other operating expenses (Non-GAAP)** | - | **-** | - | - | - | - | **-** | - | - | - | - | 0.0% | 0.0% |
| year-over-year growth | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Amortization of purchased intangible assets and other | 14.8 | 83.8 | 24.7 | 92.1 | 23.9 | 24.5 | 165.2 | 24.5 | 24.5 | 24.5 | 24.5 | 98.0 | 98.0 |
| **Total operating expenses (Non-GAAP)** | **301.1** | **424.0** | **108.6** | **115.0** | **126.7** | **131.4** | **481.8** | **133.0** | **131.2** | **132.8** | **139.8** | **536.8** | **576.7** |
| year-over-year growth | 32.4% | 40.8% | 14.0% | 2.8% | 13.4% | 25.0% | 13.6% | 22.4% | 14.1% | 4.8% | 6.4% | 11.4% | 7.4% |
| as a % of revenue | 23.0% | 22.5% | 25.3% | 26.8% | 30.3% | 30.4% | 28.2% | 31.1% | 29.9% | 29.3% | 29.3% | 29.9% | 29.8% |
| **Operating Income (EBIT) (Non-GAAP)** | **244.0** | **412.6** | **78.5** | **66.4** | **43.6** | **46.6** | **235.1** | **45.2** | **53.1** | **63.8** | **68.7** | **230.8** | **273.4** |
| year-over-year growth | 47.2% | 69.1% | -10.0% | -35.0% | -61.2% | -58.0% | -43.0% | -42.4% | -20.1% | 46.3% | 47.4% | -1.8% | 18.4% |
| Operating Margin | 18.6% | 21.9% | 18.3% | 15.5% | 10.4% | 10.8% | 13.8% | 10.6% | 12.1% | 14.1% | 14.4% | 12.9% | 14.1% |
| **EBITDA (Non-GAAP)** | **292.3** | **590.4** | **104.7** | **93.6** | **72.1** | **76.3** | **346.7** | **90.2** | **98.1** | **108.8** | **113.7** | **410.8** | **453.4** |
| year-over-year growth | 37.6% | 102.0% | -12.0% | -39.1% | -54.5% | -52.0% | -41.3% | -13.8% | 4.8% | 50.9% | 49.0% | 18.5% | 10.4% |
| EBITDA Margin | 22.3% | 31.3% | 24.4% | 21.8% | 17.3% | 17.6% | 20.3% | 21.1% | 22.4% | 24.0% | 23.9% | 22.9% | 23.4% |
| **Interest Expense (Non-GAAP)** | **(13.3)** | **(48.5)** | **(12.4)** | **(11.7)** | **(11.5)** | **(10.1)** | **(45.7)** | **(9.9)** | **(10.5)** | **(9.8)** | **(9.6)** | **(39.8)** | **(36.3)** |
| year-over-year growth | 0.9% | 263.9% | 55.8% | -17.1% | -16.8% | -20.2% | -5.9% | -20.0% | -10.0% | -15.0% | -5.0% | -12.9% | -8.8% |
| **Interest income (Non-GAAP)** | **2.6** | **5.3** | **1.2** | **0.8** | **0** | **0** | **2.0** | **0** | **0** | **0** | **0** | **-** | **-** |
| year-over-year growth | 103.1% | 106.1% | -24.4% | -40.9% | 0.0% | 0.0% | -63.5% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| **Other income (expense), net (Non-GAAP)** | **(1.1)** | **(6.4)** | **(1.4)** | **(0.6)** | **(0.9)** | **(0.8)** | **(3.7)** | **(0.5)** | **(1.0)** | **(1.5)** | **(1.5)** | **(4.5)** | **(4.0)** |
| year-over-year growth | -40.6% | 465.6% | -18.7% | -63.3% | -60.8% | -7.7% | -43.2% | -63.6% | 73.0% | 66.7% | 87.5% | 23.2% | -11.1% |
| **Income before income taxes (Non-GAAP)** | **232.1** | **363.0** | **65.9** | **55.0** | **31.2** | **35.7** | **187.8** | **34.8** | **41.6** | **52.5** | **57.6** | **186.5** | **233.0** |
| year-over-year growth | 52.8% | 56.4% | -16.7% | -37.4% | -68.0% | -63.8% | -48.3% | -47.2% | -24.4% | 68.3% | 61.3% | -0.7% | 0.0% |
| as a % of revenue | 17.7% | 19.2% | 15.3% | 12.8% | 7.5% | 8.3% | 11.0% | 8.1% | 9.5% | 11.6% | 12.1% | 10.4% | 0.0% |
| **Provision for (benefit from) income taxes (Non-GAAP)** | **46.4** | **57.5** | **9.2** | **7.6** | **4.3** | **4.9** | **26.0** | **4.9** | **6.0** | **7.6** | **8.4** | **26.9** | **33.8** |
| year-over-year growth | 30.2% | 24.0% | -37.6% | -51.5% | -68.3% | -63.9% | -54.8% | -46.8% | -20.8% | 77.1% | 70.4% | 3.5% | 25.8% |
| Tax Rate | 20.0% | 15.8% | 13.9% | 13.8% | 13.8% | 13.7% | 13.8% | 14.0% | 14.5% | 14.5% | 14.5% | 14.4% | 14.5% |
| **Consolidated net income (non-GAAP)** | **185.8** | **305.5** | **56.7** | **47.4** | **26.9** | **30.8** | **161.8** | **29.9** | **35.6** | **44.9** | **49.2** | **159.6** | **199.2** |
| **Net income attributable to noncontrolling interests (Non-GAAP)** | **(0.3)** | **(3.3)** | (0.4) | (0.6) | (0.5) | (0.5) | - | - | - | - | - | - | - |
| **Net income (Non-GAAP)** | **185.5** | **302.2** | **56.3** | **46.8** | **26.4** | **30.3** | **161.8** | **29.9** | **35.6** | **44.9** | **49.2** | **159.6** | **199.2** |
| year-over-year growth | **60.1%** | 62.9% | -12.1% | -34.5% | -68.3% | -63.7% | -46.5% | -46.8% | -24.0% | 70.1% | 62.5% | -1.3% | 24.8% |
| Net Income Margin | **14.2%** | 16.0% | 13.1% | 10.9% | 6.3% | 7.0% | 9.5% | 7.0% | 8.1% | 9.9% | 10.3% | 8.9% | 10.3% |
| **EPS attributable to VeriFone shareholders - Diluted - Non-GAAP** | **1.91** | **2.74** | **0.51** | **0.42** | **0.24** | **0.27** | **1.45** | **0.27** | **0.31** | **0.39** | **0.43** | **1.40** | **1.74** |
| Weighted average shares used in computing net income per share: | | | | | | | | | | | | | |
| Diluted (GAAP) | 96.6 | 108.7 | 108 | 108 | 111 | 110 | - | - | - | - | - | - | - |
| Diluted (Non-GAAP) | 96.5 | 110.3 | 110.6 | 110.5 | 108.6 | 111.7 | 110.3 | 112.5 | 113.5 | 114.0 | 114.5 | 113.6 | 114.5 |
| **Net income (Non-GAAP)** | **185.5** | **302.2** | **56.3** | **46.8** | **26.4** | **30.3** | **159.7** | **29.9** | **35.6** | **44.9** | **49.2** | **159.6** | **199.2** |
| Amortization of step-down in deferred revenue at acquisition | (5.6) | (20.5) | (1.4) | (1.0) | - | - | - | - | - | - | - | - | - |
| Stock-based compensation | (34.1) | (44.6) | (12.4) | (10.0) | (9.6) | (16.9) | - | - | - | - | - | - | - |
| Acquisition related and restructuring costs | (56.7) | (64.4) | (37.2) | (41.3) | (38.2) | (41.2) | - | - | - | - | - | - | - |
| Amortization of purchased intangible assets | (34.0) | (124.3) | - | - | - | - | - | - | - | - | - | - | - |
| Patent litigation loss contingency expense | 0.0 | (17.63) | - | - | - | - | - | - | - | - | - | - | - |
| Non-cash interest expense | (15.6) | (15.6) | - | - | - | - | - | - | - | - | - | - | - |
| Non-operating (gains) losses and other | 5.20 | (5.69) | - | - | - | - | - | - | - | - | - | - | - |
| Income tax effect of non-GAAP exclusions | 237.8 | 55.5 | 6.7 | 29.1 | - | - | - | - | - | - | - | - | - |
| Other adjustments | 0.0 | 0.0 | (0.1) | (82.0) | 19.5 | (219.9) | - | - | - | - | - | - | - |
| Total Adjustments | 96.9 | (237.1) | (44.4) | (105.1) | (28.3) | (278.0) | (455.9) | (28.3) | (28.3) | (28.3) | (28.3) | (113.2) | (113.2) |
| **Net income (GAAP)** | **282.5** | **65.0** | **11.8** | **(58.4)** | **(1.9)** | **(247.7)** | **(296.1)** | **1.6** | **7.3** | **16.6** | **20.9** | **46.4** | **86.0** |

**Source: Jefferies estimates**





**Jason Kupferberg**, Equity Analyst, (646) 805 5412, jkupferberg@jefferies.com

**Exhibit 49: PAY – Statement of Cash Flows ($ millions)**

| | 2011 FY A | 2012 FY A | Jan '13A 1Q | Apr '13A 2Q | July '13A 3Q | Oct '13A 4Q | 2013 FY A | Jan '14E 1Q | Apr '14E 2Q | July '14E 3Q | Oct '14E 4Q | 2014 FY E | 2015 FY E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash & Equivalents at Beginning of Period** | **$445.1** | **593.502** | **$454.1** | **$476.7** | **$506.0** | **$309.3** | **$454.1** | **$309.3** | **$324.6** | **$337.6** | **$352.7** | **$268.2** | **$368.7** |
| **Cash Flow from Operations** | | | | | | | | | | | | | |
| Consolidated net income (GAAP) | **282.7** | **66.3** | 11.7 | (57.0) | (1.9) | (247.8) | **(295.0)** | 1.6 | 7.3 | 16.6 | 20.9 | **46.4** | **86.0** |
| Non-Cash Items: | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Impairment of goodwill and purchased intangible assets | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Depreciation and amortization, net | **48.3** | **177.8** | 50.9 | 50.3 | 52.4 | 54.2 | **207.8** | 45.0 | 45.0 | 45.0 | 45.0 | **180.0** | **180.0** |
| Stock-based compensation | **34.1** | **44.6** | 12.4 | 10.0 | 9.6 | 16.9 | **48.9** | 16.9 | 16.9 | 16.9 | 16.9 | **67.6** | **67.6** |
| Non-cash interest expense | **15.7** | **10.3** | - | - | - | - | - | - | - | - | - | - | - |
| Gain on bargain purchase of business | **(1.8)** | - | - | - | - | - | - | - | - | - | - | - | - |
| Gain on adjustments to acquisition related balances | **6.5** | - | - | - | - | - | - | - | - | - | - | - | - |
| Deferred income taxes | **(227.0)** | **(22.0)** | (3.9) | (38.3) | (18.8) | 203.9 | **142.9** | (8.0) | (8.0) | (8.0) | (8.0) | **(32.0)** | **(32.0)** |
| Other | **0.5** | **(5.8)** | (5.1) | 6.1 | 0.6 | 3.5 | **5.1** | - | - | - | - | - | - |
| Changes in operating assets and liabilities: | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Accounts receivable, net | **(72.4)** | **(53.9)** | 13.2 | 36.9 | 47.2 | (13.0) | **84.3** | 7.6 | (6.9) | (11.9) | (17.1) | **(28.2)** | **(1.9)** |
| Inventories | **23.2** | **(19.3)** | (8.1) | 6.4 | 8.9 | 19.5 | **26.8** | (6.8) | 0.9 | (3.7) | (3.8) | **(13.4)** | **(10.9)** |
| Other assets | **(1.8)** | **(19.9)** | (1.8) | (1.5) | (7.7) | 2.5 | **(8.5)** | 6.8 | (1.4) | 1.8 | (0.6) | **6.7** | **2.8** |
| Accounts payable | **29.5** | **31.8** | (39.3) | (2.2) | (39.2) | 3.7 | **(77.0)** | (2.1) | 2.0 | 1.2 | 5.1 | **6.2** | **4.6** |
| Income taxes payable | **6.4** | - | - | - | - | - | - | - | - | - | - | - | - |
| Deferred revenues, net | **14.8** | **27.3** | 28.2 | (16.1) | (5.3) | (6.7) | - | (1.2) | 1.7 | 1.6 | 2.0 | **4.1** | **1.8** |
| Other liabilities | **16.2** | **(19.2)** | (4.8) | 84.6 | 3.1 | 18.3 | **101.2** | - | - | - | - | - | **5.8** |
| **Net cash provided by operating activities** | **174.9** | **218.0** | 53.4 | 79.2 | 48.9 | 55.0 | **236.5** | 59.9 | 57.4 | 59.6 | 60.5 | **237.4** | **304.0** |
| **Cash Flow from Investing** | | | | | | | | | | | | | |
| Capital Expenditures | **(14.3)** | **(63.2)** | (20.8) | (21.4) | (18.1) | (17.2) | **(77.5)** | (25.0) | (25.0) | (25.0) | (25.0) | **(100.0)** | **(108.0)** |
| Cash Expenditures for Revenue Generating Assets | - | **(30.1)** | - | - | - | - | - | - | - | - | - | - | - |
| as % of non-GAAP revenue | **0.0%** | **-1.6%** | 0.0% | 0.0% | 0.0% | 0.0% | **0.0%** | 0.0% | 0.0% | 0.0% | 0.0% | **0.0%** | **0.0%** |
| Purchase of PPE and Capitalized Software Development | **(14.3)** | **(33.1)** | - | - | - | - | - | - | - | - | - | - | - |
| as % of non-GAAP revenue | **-1.1%** | **-1.8%** | 0.0% | 0.0% | 0.0% | 0.0% | **0.0%** | 0.0% | 0.0% | 0.0% | 0.0% | **0.0%** | **0.0%** |
| Acquisitions of businesses, net of cash acquired | **(49.2)** | **(1,069.4)** | (1.0) | (11.0) | (65.1) | 1.2 | **(75.9)** | 1.2 | 1.2 | 1.2 | 1.2 | **4.8** | **4.8** |
| Other | **(1.0)** | **14.6** | 6.1 | 1.9 | 0.0 | 0.7 | **8.7** | 0.7 | 0.7 | 0.7 | 0.7 | **2.8** | **2.8** |
| **Net cash used in investing activities** | **(64.5)** | **(1,118.0)** | (15.66) | (30.52) | (83.22) | (15.30) | **(144.7)** | (23.10) | (23.10) | (23.10) | (23.10) | **(92.4)** | **(100.4)** |
| **Cash Flow From Financing** | | | | | | | | | | | | | |
| Proceeds from debt, net of issue costs | **0.073** | **1,660.6** | 2.4 | 27.6 | 93.1 | 0.0 | **123.2** | 0.0 | 0.0 | 0.0 | 0.0 | **0.000** | **0.000** |
| Repayments of debt | **(10.233)** | **(619.3)** | (18.5) | (39.9) | (256.3) | (84.4) | **(399.1)** | (25.0) | (25.0) | (25.0) | (25.0) | **(100.000)** | **(100.000)** |
| Proceeds from issuance of common stock through employee equity inc | **48.534** | **30.3** | 3.0 | 2.1 | 4.6 | 1.4 | **11.1** | 1.4 | 1.4 | 1.4 | 1.4 | **5.600** | **5.600** |
| Increase in restricted cash | - | **(279.2)** | - | - | - | - | - | - | - | - | - | - | - |
| Contingent consideration paid | - | **(24.6)** | - | - | - | - | - | - | - | - | - | - | - |
| Distribution to non-controlling interest owners | - | **(1.7)** | (0.1) | (1.6) | (0.0) | - | **(1.700)** | - | - | - | - | - | - |
| Other | **0.300** | **2.0** | (5.0) | (4.3) | (0.6) | (1.1) | **(11.000)** | (1.1) | (1.1) | (1.1) | (1.1) | **(4.400)** | **(4.400)** |
| **Net cash provided by financing activities** | **38.674** | **768.146** | (18.2) | (16.0) | (159.2) | (84.1) | **(277.5)** | (24.7) | (24.7) | (24.7) | (24.7) | **(98.800)** | **(98.800)** |
| Effect of Exchange Rate Changes On Cash | **(0.7)** | **(8.6)** | 3.1 | (3.3) | (3.2) | 3.3 | (0.2) | 3.3 | 3.3 | 3.3 | 3.3 | 13.2 | 13.2 |
| **Change in Cash and Equivalents** | **148.4** | **(140.5)** | 22.6 | 29.3 | (196.7) | (41.1) | **(185.9)** | 15.4 | 12.9 | 15.1 | 16.0 | **59.4** | **118.0** |
| **Cash Balance, End of Period** | **593.5** | **454.1** | 476.7 | 506.0 | 309.3 | 268.2 | **268.2** | 324.6 | 337.6 | 352.7 | 368.7 | **368.7** | **470.6** |
| **Free Cash Flow** | **160.5** | **154.8** | 32.6 | 57.7 | 30.8 | 37.8 | **159.0** | 34.9 | 32.4 | 34.6 | 35.5 | **137.4** | **196.0** |
| year-over-year growth | 8.9% | -3.6% | 33.2% | 405.2% | -52.5% | -30.0% | 2.7% | 6.8% | -43.8% | 12.3% | -6.0% | -13.6% | 42.6% |
| **Free Cash Flow Per Share** | **1.66** | **1.40** | 0.30 | 0.52 | 0.28 | 0.34 | **1.44** | 0.31 | 0.29 | 0.30 | 0.31 | **1.21** | **1.71** |
| year-over-year growth | 8.9% | -15.6% | 32.0% | 406.3% | -51.7% | -30.8% | 2.6% | 5.0% | -45.3% | 6.9% | -8.3% | -16.1% | 41.5% |

**Source: Jefferies estimates**





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### Exhibit 50: PAY – Balance Sheet ($ millions)

| | 2011 FY A | 2012 FY A | Jan '13A 1Q | Apr '13A 2Q | July '13A 3Q | Oct '13A 4Q | 2013 FY A | Jan '14E 1Q | Apr '14E 2Q | July '14E 3Q | Oct '14E 4Q | 2014 FY E | 2015 FY E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | | | | | |
| **Current Assets** | | | | | | | | | | | | | |
| Cash and cash equivalents | **593.5** | **454.1** | 476.7 | 506.0 | 309.3 | 268.2 | **268.2** | 324.6 | 337.6 | 352.7 | 368.7 | **368.7** | **470.6** |
| Accounts receivable, net | **294.4** | **366.9** | 355.1 | 315.9 | 268.8 | 284.0 | **284.0** | 281.4 | 288.3 | 298.1 | 313.2 | **313.2** | **325.1** |
| Day Sales Outstanding (DSOs) | **82.1** | **71.0** | 75.4 | 67.1 | 58.7 | 59.9 | **60.6** | 60.0 | 60.0 | 60.0 | 60.0 | **63.7** | **0** |
| Inventories | **144.3** | **178.3** | 188.8 | 181.3 | 171.9 | 138.7 | **138.7** | 160.5 | 157.6 | 161.3 | 163.1 | **163.1** | **173.9** |
| Restricted cash | - | **0** | 0 | 0 | 0 | 0 | **0** | 0 | 0 | 0 | 0 | **0** | **0** |
| Other current assets | **127.1** | **136.2** | 138.2 | 139.5 | 148.8 | 134.1 | **134.1** | 140.9 | 139.5 | 141.4 | 140.8 | **140.8** | **143.6** |
| **Total current assets** | **1,159.4** | **1,135.4** | 1,158.7 | 1,142.7 | 898.8 | 825.0 | **825.0** | 907.5 | 923.0 | 953.5 | 985.8 | **985.8** | **1,113.3** |
| Property, plant and equipment, net | **65.5** | **146.8** | 152.1 | 147.2 | 157.7 | 172.2 | **172.2** | 157.5 | 162.9 | 171.8 | 180.7 | **180.7** | **186.3** |
| Purchased intangible assets, net | **263.8** | **734.8** | 719.1 | 672.2 | 664.8 | 642.9 | **642.9** | 632.9 | 622.9 | 612.9 | 602.9 | **602.9** | **562.9** |
| Goodwill | **561.4** | **1,179.4** | 1,206.0 | 1,186.2 | 1,224.7 | 1,252.4 | **1,252.4** | 1,252.4 | 1,252.4 | 1,252.4 | 1,252.4 | **1,252.4** | **1,252.4** |
| Other assets | **262.4** | **294.2** | 298.1 | 319.1 | 318.7 | 101.2 | **101.2** | 260.4 | 257.4 | 248.6 | 235.6 | **235.6** | **264.4** |
| **TOTAL ASSETS** | **2,312.5** | **3,490.6** | 3,534.1 | 3,467.4 | 3,264.7 | 2,993.7 | **2,993.7** | 3,210.7 | 3,218.6 | 3,239.2 | 3,257.4 | **3,257.4** | **3,379.3** |
| **LIABILITIES & EQUITY** | | | | | | | | | | | | | |
| **Current liabilities:** | | | | | | | | | | | | | |
| Accounts payable | **144.3** | **193.1** | 154.6 | 151.5 | 111.7 | 116.5 | **116.5** | 114.4 | 116.4 | 117.6 | 122.7 | **122.7** | **127.4** |
| Days payable Outstanding (DPOs) | **68.9** | **67.1** | 58.2 | 55.7 | 41.2 | 41.8 | **42.9** | 41.8 | 41.8 | 41.8 | 41.8 | **43.6** | **42.9** |
| Income taxes payable | **9.1** | **-** | - | - | - | - | **-** | - | - | - | - | **-** | **-** |
| Deferred revenue, net | **68.8** | **91.5** | 119.0 | 98.0 | 91.5 | 86.6 | **86.6** | 98.9 | 96.3 | 98.6 | 103.5 | **103.5** | **108.3** |
| Other current liabilities | **209.0** | **230.9** | 221.2 | 288.6 | 284.1 | 292.1 | **292.1** | 292.1 | 292.1 | 292.1 | 292.1 | **292.1** | **297.9** |
| Current portion of long term debt | **272.1** | **54.9** | 52.6 | 67.1 | 79.1 | 92.5 | **92.5** | 91.4 | 94.7 | 97.9 | 101.1 | **101.1** | **161.9** |
| **Total current liabilities** | **703.3** | **570.4** | 547.4 | 605.1 | 566.4 | 587.7 | **587.7** | 596.8 | 599.5 | 606.2 | 619.3 | **619.3** | **695.6** |
| Deferred revenue, net | **31.5** | **37.1** | 39.1 | 41.8 | 41.9 | 42.6 | **42.6** | 41.4 | 43.1 | 44.6 | 46.7 | **46.7** | **48.5** |
| Long-term debt | **211.8** | **1,252.7** | 1,239.0 | 1,212.2 | 1,040.3 | 943.3 | **943.3** | 826.9 | 823.6 | 820.4 | 817.2 | **817.2** | **630.3** |
| Other long-term liabilities | **171.6** | **285.0** | 287.6 | 279.6 | 275.4 | 268.5 | **268.5** | 278.2 | 282.9 | 292.0 | 305.0 | **305.0** | **317.9** |
| **Total stockholders' equity** | **1,194.2** | **1,307.8** | 1,383.7 | 1,291.5 | 1,303.5 | 1,114.6 | **1,114.6** | 1,430.4 | 1,432.5 | 1,438.8 | 1,432.1 | **1,432.1** | **1,650.1** |
| Non-stockholders' equity | **1.3** | **37.7** | 37.4 | 37.2 | 37.2 | 37.0 | **37.0** | 37.0 | 37.0 | 37.0 | 37.0 | **37.0** | **37.0** |
| **Total liabilities and equity** | **2,313.6** | **3,490.6** | 3,534.1 | 3,467.4 | 3,264.7 | 2,993.7 | **2,993.7** | 3,210.7 | 3,218.6 | 3,239.2 | 3,257.4 | **3,257.4** | **3,379.3** |

Source: Jefferies estimates





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Please see important disclosure information on pages 32 - 35 of this report.

## Company Description

VeriFone is a global provider of technology that enables electronic payment transactions and value-added services at the point of sale. VeriFone's solutions consist of point of sale electronic payment devices that run proprietary operating systems, security and encryption software and certified payment software as well as third party, value-added applications. The company's solutions process a wide range of payment types including signature and PIN-based debit cards, credit cards, contactless, cards, smart cards, pre-paid gift and other stored-value cards, electronic bill payment, check authorization and conversion, signature capture and electronic benefits transfer. VeriFone also offers merchants payments-as-a-service (PaaS) solutions.

## Analyst Certification

I, Jason Kupferberg, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

I, Ross MacMillan, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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## Company Specific Disclosures

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## Meanings of Jefferies Ratings

Buy - Describes stocks that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

Hold - Describes stocks that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.

Underperform - Describes stocks that we expect to provide a total negative return (price appreciation plus yield) of 10% or more within a 12-month period.

The expected total return (price appreciation plus yield) for Buy rated stocks with an average stock price consistently below $10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated stocks with an average stock price consistently below $10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated stocks with an average stock price consistently below $10, the expected total return (price appreciation plus yield) is minus 20% within a 12-month period.

NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Jefferies policies.

CS - Coverage Suspended. Jefferies has suspended coverage of this company.

NC - Not covered. Jefferies does not cover this company.

Restricted - Describes issuers where, in conjunction with Jefferies engagement in certain transactions, company policy or applicable securities regulations prohibit certain types of communications, including investment recommendations.

Monitor - Describes stocks whose company fundamentals and financials are being monitored, and for which no financial projections or opinions on the investment merits of the company are provided.

## Valuation Methodology




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## Other Companies Mentioned in This Report

- Amazon.com, Inc (AMZN: $386.28, BUY)
- Apple Inc. (AAPL: $550.50, BUY)
- Coach, Inc. (COH: $48.30, HOLD)
- eBay, Inc. (EBAY: $52.88, BUY)
- Groupon (GRPN: $10.00, HOLD)
- Intuit Inc. (INTU: $73.06, HOLD)
- JPMorgan Chase & Co. (JPM: $55.09, BUY)
- MasterCard, Inc. (MA: $76.05, BUY)
- MICROS Systems, Inc. (MCRS: $54.67, HOLD)
- The Home Depot, Inc. (HD: $78.94, BUY)
- Urban Outfitters, Inc. (URBN: $36.28, BUY)
- VeriFone Systems, Inc. (PAY: $28.76, BUY)
- Visa, Inc. (V: $216.22, BUY)

## Distribution of Ratings

| Rating | Count | Percent | IB Serv./Past 12 Mos. Count | IB Serv./Past 12 Mos. Percent |
|---|---|---|---|---|
| BUY | 887 | 48.87% | 207 | 23.34% |
| HOLD | 782 | 43.09% | 123 | 15.73% |
| UNDERPERFORM | 146 | 8.04% | 4 | 2.74% |





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