

Elaine Hansford (214-929-4898)  
[hansforde@aol.com](mailto:hansforde@aol.com)  
 Kim Redmond (281-794-5231)  
[Kim014@yahoo.com](mailto:Kim014@yahoo.com)  
 Daphne Lo (972-489-5239)  
[dlo@smu.edu](mailto:dlo@smu.edu)



## Recommendation: SELL

### Quantitative Highlights:

- ◆ Low to no growth over past 5 years
- ◆ ROE is average (32.71%)
- ◆ Overvalued by 23% or approximately \$6
- ◆ Catalina's P/E is high (20.68) and entire industry's P/E is also high

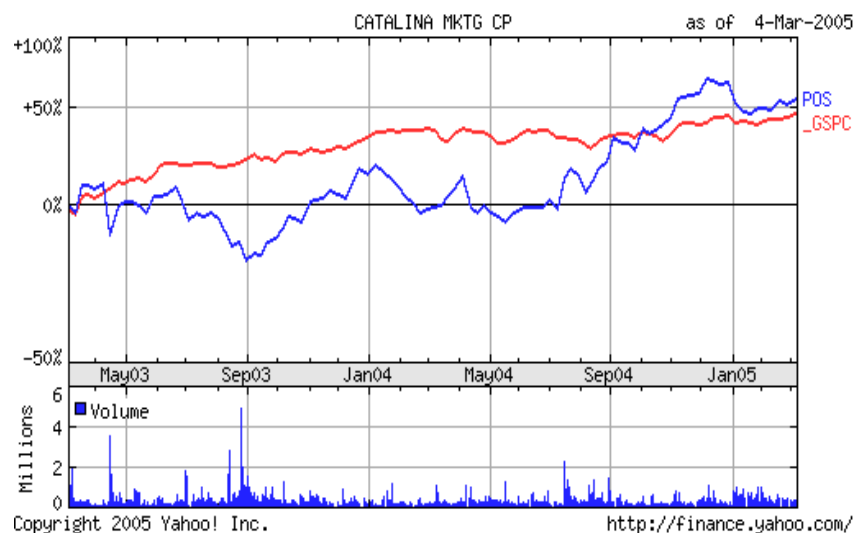
### Qualitative Highlights:

- ◆ Faces lower revenues due to a reduction in spending by General Mills, one of its main customers.
- ◆ Loss of revenue linked to the sale of its loyalty card business and CMRS division
- ◆ Higher retailer fees puts pressure on expenses
- ◆ Increased uncertainty in France due to recent consumer price legislation
- ◆ Industry has remained stagnant over the past 5 years.

#### **Financial Highlights**

Price as of 3/22/2005	\$26.37
Symbol	POS
Exchange	NYSE
52 - Week Range	\$15.91 - \$31.00
Shares Outstanding	52.3 M
Market Cap (\$B)	1.44 B
Beta (Reuters)	0.66
5 yr Projected EPS Growth	7.83%
2005 P/E	20.68
2006 P/E	19.23
PEG	2.75
ROA	16.94%
ROE	32.71%
Current Ratio	2.12
Debt/Equity (Book)	0.28
Fiscal Year Ends	3/312005

#### Exhibit: POS vs 2 yr S&P Return



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### **Investment Thesis**

At this time, we feel that we should sell Catalina Marketing. In the past 4 or 5 years that the fund has held Catalina, its performance has been lackluster and basically unchanging. We feel that it is not beneficial for the fund to hold such a name that has not had any outstanding growth and does not signal to investors the possibility of future growth.

Catalina is facing lower revenue due to a reduction in spending by consumer food giant General Mills, one of its main customers. They are also facing a loss of revenue linked to the sale of its loyalty card business and CMRS division. Catalina also faces increased uncertainty in France due to recent consumer price legislation. These events lead to higher retailer fees and therefore put pressure on its expenses.

### **Company Profile**

Catalina Marketing Corporation (Catalina Marketing) offers behavior-based, targeted-marketing services and programs for consumer packaged goods (CPG) and pharmaceutical products manufacturers, marketers and retailers. These marketing solutions include discount coupons, loyalty marketing programs, informative newsletters, sampling, advertising, in-store, instant-win games and other incentives. The Company tracks actual purchase behavior and uses Universal Product Code-based scanner technology to target consumers at the checkout counter and National Drug Code information to trigger delivery of a newsletter to consumers in pharmacy prescription checkout transactions. The Company is organized and managed by segments, which include operations, such as Manufacturer Services; Retail Services; Direct Marketing Services (DMS); Catalina Marketing Research Solutions (CMRS); Catalina Health Resource (CHR), and international

operations, which include both manufacturer and retail services similar to those services provided in the United States (International). On March 31, 2004, Catalina Marketing sold its loyalty card and data entry services business. In November 2004, the Company sold its CMRS division to Schulman, Ronca & Bucuvalas, Inc., Billboard Business in Japan, and Card and Data Entry Services Business

### **Manufacturer Services**

Manufacturer Services serves the needs of domestic consumer product manufacturers, primarily within the CPG industry. Using the Catalina Marketing Network, this operating segment specializes in behavior-based marketing communications that are delivered at the point-of-sale (POS). The primary service line of the Catalina Marketing Network is the in-store delivery of incentives at the checkout lane of a retailer, typically a supermarket. Catalina Marketing links its software, computers, central databases and thermal printers with a retailer's POS controller and scanning equipment. The network prints customize promotions at the POS based on product Universal Product Codes or other scanned information. The printed promotions are handed to consumers by the cashier at the end of the shopping transaction. Manufacturer Services generates revenue primarily by providing in-store, electronic marketing delivery services via the Catalina Marketing Network.

The two primary programs of Manufacturer Services are Checkout Coupon and Checkout Direct. Through its Checkout Coupon service, Catalina Marketing delivers marketing communications to consumers at checkout, which is based on the products included in their current shopping basket. Through its Checkout

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Direct service, Catalina Marketing delivers marketing communications to consumers at the checkout counter using past purchase behavior, which is collected using frequent shopper or similar consumer identification methods. Nestle is its main client.

### **Retail Services**

The Company's Retail Services operation provides marketing solutions to approximately 80 retail chains nationwide. This operating group supports, maintains and expands the Catalina Marketing Network used by Manufacturer Services. In addition, it provides services to retailers, including promotional prints and analytical services that enable retailers to focus on changing consumer shopping patterns with targeted communications, motivate the consumers to visit a retailer more frequently, increase the size of purchase transactions, purchase specific products and develop brand loyalty.

### **CHR**

CHR services assist pharmaceutical products and CPG manufacturers, as well as retail pharmacies in providing consumers with condition-specific health information and direct-to-patient communications. CHR's programs and services enable the Company's clients to acquire and retain patients by providing educational information about their treatment along with the benefits of compliance and by encouraging dialogue between patients and their healthcare professionals.

CHR's primary product offerings employ an in-store, prescription-information-based technology to provide targeted and direct-to-patient communications on behalf of the Company's clients.

These communication services include messages and educational information to healthcare patients at pharmacies throughout the Health Resource Network. CHR primarily generates revenues by printing messages for pharmaceutical manufacturers and CPG manufacturers in the Health Resource Newsletter, CHR's primary client offering.

### **International**

The Catalina Marketing Network operates internationally, in a similar manner to the domestic business, by offering a full range of targeted marketing solutions to CPG manufacturers and enjoys relationships with major supermarket, hypermarket and other retailers based primarily on a syndicated platform. During the fiscal year ended March 31, 2004 (fiscal 2004), the Company provided in-store electronic targeted marketing services for consumers in France, Italy, the United Kingdom and Japan. In addition, in fiscal 2004, the Company expanded its behavior-based targeted marketing capabilities in Europe by launching a pilot test program in Germany. At the end of fiscal 2004, the network was installed in approximately 4,420 retail locations in Europe and approximately 1,130 locations in Japan and reached more than 65 million consumers each week.

### **DMS**

DMS provides services designed to reach consumers in their homes. DMS analyzes frequent shopper databases and identifies consumer lifestyle changes to develop strategic programs that meet multiple objectives for both brand manufacturers and retailers. These targeted direct mail programs are based on actual purchase behavior or consumer lifestyle changes. DMS provides services that enable

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manufacturers and retailers to influence the purchase patterns of targeted customers based on their actual purchase behavior and history. Clients use these services to support new product launches and line extensions, build loyalty to a retailer or brand and deliver timely messages to consumers.

The Company's specific product offerings include Sample Logic, Retail Solutions and One-to-One Direct. Sample Logic uses consumer purchase data provided by retailers to deliver targeted product samples and promotions to consumers' homes. Retail Solutions develops and delivers direct mail customer campaigns, as well as customer reward and loyalty strategies. One-to-One Direct delivers coupons from multiple CPG manufacturers to consumers in their home in a single mailing. The Company suspended the One-to-One Direct service in December 2003.

## CMRS

CMRS provided a wide range of traditional marketing research services, including tracking studies and customer satisfaction surveys, as well as research products that took advantage of the Company's network of printers and behavioral data gathered throughout the Catalina Marketing Network. By combining traditional research services with the other segments' services, clients were given an integrated solution geared toward their specific needs.

## Comparable Analysis

	POS	AD	HHS	VCI
Revenue	\$472.95	\$1,245.84	\$944.58	\$916.52
EPS	\$1.33	\$1.84	\$1.27	\$1.94
ROE	32.71%	36.58%	17.45%	88.49%
ROA	16.94%	11.45%	12.39%	14.16%
04-05 EPS Growth	7.52%	27.17%	13.39%	14.43%
04 P/E	21.83	25.07	24.21	19.54
05 P/E	20.68	20.16	21.16	19.44
06 P/E	19.23	15.85	18.66	16.99
EV/EBITDA	44.17	10.55	12.99	10.33

Catalina has much lower revenue than its peers and the same goes for its EPS. Their ROE is average while having one of the better ROA. Our chart shows that the 04-05 EPS Growth Rate is substantially lower than the others signaling inactivity in the company. Catalina's P/E ratios are consistent with the others.

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## DCF Analysis

<b>Key Assumptions for the models:</b>	
Date of valuation	3/5/2005
Risk Free Rate:	3.60%
Equity Market Risk Premium:	7.00%
Long term inflation:	2.50%
Terminal Growth:	5.00%
Equity beta based on VL:	1.00
No. of shares (diluted):	52
Current Market Price per share:	\$27.40

The DCF analysis revealed an average value across models of \$21.02 which is about 23% (approximately \$6) overvalued from its current market price of \$27.40. In completing the analysis for Catalina, we used stable growth predictions for revenue, COGS, and SGA. Our assumption is due to Catalina's previous performance of zero to low growth for the past 5 years. We also used aggressive growth assumptions compared to analysts and found it to also result in being undervalued.

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### COMPARABLE ANALYSIS

Catalina Composite  
Equity Profiles  
(Dollars in Millions)

	<u>Catalina</u>	<u>Advo Inc</u>	<u>Harte</u> <u>Hanks, Inc.</u>	<u>Valassis</u> <u>Communications</u>	<u>Aggregate</u>
	<u>POS</u>	<u>AD</u>	<u>HHS</u>	<u>VCI</u>	- -
<u>(LFY Income Statement):</u>					
Latest Fiscal Year End Date	3/31/2004	9/25/2004	12/31/2003	12/31/2003	
Revenue	\$472.95	\$1,245.84	\$944.58	\$916.52	\$3,579.88
Gross Profit	\$286.74	\$330.07	\$256.84	\$296.59	
EBITDA	\$31.27	\$119.21	\$176.62	\$193.82	\$489.65
<u>(Per Share Income Statement Data)</u>					
LTM EPS Date	2003				
LTM EPS*	\$1.26	\$1.48	\$1.11	\$1.93	
CFY EPS Estimate	2005	\$1.33	\$1.84	\$1.27	\$1.94
NFY EPS Estimate	2006	\$1.43	\$2.34	\$1.44	\$2.22
*Excl. extra. Items, writeoffs, & one time charges					
<u>(Balance Sheet Data - Most Recent Quarter):</u>					
Cash and Cash Equivalents	119.44	15.21	19.14	205.14	358.92
Total Debt (incl. ST Debt and leases)	62.20	124.87	20.00	273.73	480.79
Total Common Equity (Book Value)	222.11	148.85	554.98	133.82	1,059.76
<u>(Stock Data):</u>					
	Stock Price As Of:	5-Mar	5-Mar	5-Mar	5-Mar
Stock Price		\$27.50	\$37.10	\$26.87	\$37.72
Common Shares Outstanding		52.31	30.95	85.32	51.27
Market Capitalization (MV of Equity)		\$1,438.53	\$1,148.25	\$2,292.55	\$1,933.90
Total Mkt. Capitalization		\$1,500.72	\$1,273.11	\$2,312.55	\$2,207.63
<u>(Financial Ratios excl. debt ratios-see Risk Section)</u>					
LFY Gross Margin		60.63%	26.49%	27.19%	32.36%
LFY EBITDA Margin		6.61%	9.57%	18.70%	21.15%
ROE		32.71%	36.58%	17.45%	88.49%
ROA		16.94%	11.45%	12.39%	14.16%
Receivable Turnover		6.69	8.79	6.44	4.37
Inventory Turnover		22.56	390.66	138.13	33.67
Current Ratio		2.12	1.81	1.38	1.59

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(Growth/Return):

Historical 3 Year Revenue Growth Rate					
Historical 5 Year EPS Growth Rate	6.10%	0.90%	8.40%	-3.90%	
Projected ROE (CFY)	31.32%	38.26%	19.52%	74.33%	
CFY - NFY EPS Growth Rate	7.52%	27.17%	13.39%	14.43%	16.74%
Proj. Growth in EPS 5 Years	7.83%	12.33%	12.63%	10.71%	11.84%
Dividend Yield	1.09	1.19	0.74	NA	
VL Timeliness					

(Risk):

Beta	0.67	0.53	0.28	0.70	0.66
VL Safety					
LT Debt / Market Capitalization (MV of Equity)	0.04	0.11	0.01	0.14	0.09
LT Debt / Common Equity (BV of Equity)	28.00%	83.88%	3.60%	204.55%	18.29%

(Valuation):

MV of Equity / Book Value	6.48	7.71	4.13	14.45	5.07
04 Price / EPS Ratio ("P/E")	21.83	25.07	24.21	19.54	22.44
05 Price / EPS Ratio ("P/E")	20.68	20.16	21.16	19.44	20.30
06 Price / EPS Ratio ("P/E")	19.23	15.85	18.66	16.99	17.39
Total Market Capitalization / EBITDA	47.99	10.68	13.09	11.39	11.83
Relative P/E (CFY)					
CFY P/E to CFY-NFY EPS Growth Rate	2.75	0.74	1.58	1.35	1.21
CFY P/E to Proj. Growth in EPS 5 Years	2.64	1.64	1.68	1.82	1.71
EV	1381.29	1257.90	2293.41	2002.50	5434.37
EBIT	15.05	81.50	144.76	175.97	417.27
EV/EBIT	91.77	15.44	15.84	11.38	13.02
EV/EBITDA	44.17	10.55	12.99	10.33	11.10
EV/Sales	2.92	1.01	2.43	2.18	1.52

Earnings LTM					239.46
Earnings (05)					264.77
Earnings (06)					309.10
Future earnings based on LT growth					296.13

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**DISCOUNTED CASH FLOW ANALYSIS**

Valuation model used	Summary	
	Equity \$M	\$ Per Share
Unlevered value	<b>\$1,050</b>	<b>\$20.08</b>
Adjusted Present Value	<b>\$1,119</b>	<b>\$21.39</b>
Flow to Equity	<b>\$1,115</b>	<b>\$21.31</b>
WACC with FCF	<b>\$1,089</b>	<b>\$20.82</b>
AT-WACC with UFCF	<b>\$1,075</b>	<b>\$20.55</b>
Average across models	<b>\$1,099</b>	<b>\$21.02</b>
Price deviation across models	<b>\$2</b>	<b>4.1%</b>
<b>Key Assumptions for the models:</b>		Without APV: 3.7%
Date of valuation	<b>3/22/2005</b>	
Risk Free Rate:	<b>3.60%</b>	
Equity Market Risk Premium:	<b>7.00%</b>	
Long term inflation:	<b>2.50%</b>	
Terminal Growth:	<b>5.00%</b>	
Equity beta based on VL:	<b>0.66</b>	
No. of shares (diluted):	<b>52</b>	
Current Market Price per share:	<b>\$27.40</b>	