February 2022

EXECUTIVE SUMMARY

A good story can outweigh fundamentals in the short term. As a result, popular narratives can drive a large gap between price and value. Our job as investors is to recognize when these gaps open up, identify the disconnect between fact and fiction, and position the portfolio to capitalize on those opportunities when reality closes that gap.

We believe our investment in Fiserv represents one such opportunity today. The popular narrative weighing on shares has become commonplace amongst "stodgy, legacy providers" competing with "sexy, rapidly-growing disruptors." As a result, the price of Fiserv currently sits at a 25% discount to the market versus the 60% premium valuation it was rewarded just a few years ago. On an absolute basis, the stock is cheaper today than it was at the depths of the pandemic. On a relative basis, shares have not been this cheap since the global financial crisis. We think this is a mistake. **While the consensus is myopically focused on emerging competitive threats, investors have ignored rapidly improving fundamentals and overlooked the company's increasingly valuable crown jewel.**

Fiserv is unlikely to generate sales growth anywhere near as fast as Silicon Valley's fintech darlings. But organic growth at the company should come in well ahead of the market for the next several years while providing something that most faster-growing upstarts ignore - real profits and actual cash flow to investors. **If Fiserv management can execute anywhere near their mid-term targets, driving predictable, mid-teens earnings growth, we think the stock will once again enjoy the premium valuation it deserves.**

BUSINESS DESCRIPTION

Fiserv is a global payment and financial technology firm, serving banks, credit unions, corporations, and merchants around the world. The company offers a range of services to its clients including digital banking solutions, card and payment processing, merchant acquiring and processing, and the Clover Point of Sale (POS) system.

In plain English, Fiserv provides the plumbing required for financial institutions to operate their businesses. Without these mission-critical services, they cannot operate.

Fiserv benefits from long-term, recurring contracts, which generate strong, recurring free cash flow, across three primary segments: Merchant Acceptance, Financial Technology, and Payments.

- **Acceptance.** Merchant Acceptance (~40% of revenue) is focused on helping merchants accept payments through a wide range of products, including physical Point of Sale (POS), e-commerce services, mobile payment services, and fraud protection. The majority of revenue is derived through processing transactions, including Fiserv's cloud-based POS system, Clover. Merchant Acceptance, the company's fastest growing segment, should generate long-term 9% - 12% organic revenue growth.

- **Fintech.** Financial Technology (~20% of revenue) provides financial institutions with technology to support operations as well as products and services to process deposit and loan accounts. Revenue is spread across a range of solutions - roughly half was derived from processing, a quarter from software maintenance and license fees, with the balance from professional services, output, postage, and hardware. Core bank processing is dominated by a handful of players, with minimal market share shifts (although FISV has gained about 75bps of share annually for the past five years). In a recent survey, over 90% of respondents indicated they were unlikely to switch providers. We estimate fintech should grow 4% - 6% annually.

- **Payments.** Payments & Network (~40% of revenue) provides corporations and financial institutions products and services to process digital transactions and offers other digital payment software and services (bill payment, account transfers, etc.). The business supports a range of industries and segment revenue is primarily driven by processing services. We expect this segment to generate 5% - 8% long-term revenue growth.

Fiserv's roots in mission-critical bank processing provide the company with one of the most defensive business models in the industry, with less sensitivity to economic cycles. The company also enjoys a competitive advantage because it can continually offer expanded services to its captive customer base. As core processing is integral to their operations, banks rarely switch systems, so they tend to sign multi-year contracts, with retention rates that approach 99% annually (excluding customers lost due to bank consolidation). Fiserv's leading position in these highly scalable businesses provides cost advantages, resulting in superior economics for the large incumbent.

We view Fiserv, a dominant player in payment processing, as an attractively-priced value investment, underappreciated in a growth industry, littered with investors chasing the latest and greatest new toy. We think investors are overlooking the value created by Fiserv's First Data acquisition, which transformed the company's organic growth profile and set the stage for significant margin improvement.

In contrast to today's popular narrative, the investment case for Fiserv is straightforward, and boils down to three primary drivers. First, the business remains exceptionally well positioned, benefitting from several long-term tailwinds, scale economics, and a healthy competitive moat. Second, cost savings and revenue synergies should drive significant operating leverage, translating into accelerating earnings growth. And last but not least, today's obsession with venture-backed startups has blinded investors to Fiserv's crown jewel, driving the stock to a record low valuation even before considering the increasing value of that asset hiding in plain sight.

INDUSTRY OVERVIEW

Unless you've spent a decade in the back office of a financial institution, the global payments ecosystem is much more complex than a simple swipe of a credit card at the grocery store. From the outside looking in, the industry is complex, with a lot of interconnected, moving parts that create a convoluted labyrinthine that's as clear as mud. Until recently, Mastercard and Visa were about the only companies in the sector with any degree of familiarity. Today, there are dozens of venture-backed, ambitious upstarts, littered throughout the industry, all of which have painted bulls-eyes on the back of "antiquated" incumbents.

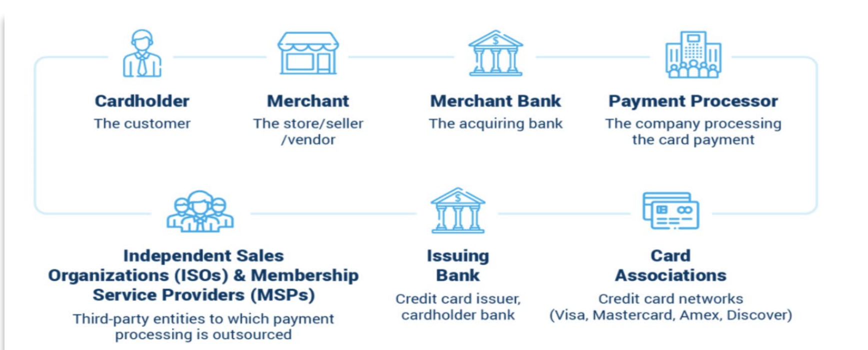
Given the attention and enthusiasm that these fintech companies enjoy, it's no wonder that the industry's legacy providers have been largely ignored. Conventional wisdom is that these dinosaurs will eventually go extinct as faster, younger, and scrappier competitors assault their outdated business models. Relative to the sex appeal of Silicon Valley, Brookfield, Wisconsin isn't exactly known as a hub of innovation. But investors would be ill-served to ignore Brookfield, home of an eight-hundred-pound gorilla in the payments industry (or perhaps "bored ape" is the better analogy in this case), with a history of consistent earnings power, and a future marked by incredibly valuable hidden assets.

Payment processing is a big business. In a recent report on global payments, McKinsey estimated that the amount that people spend using credit cards in North America is over $3 trillion per year and growing by ~ 8% annually. Payment processing fees add up to around $85 billion per year, traditionally, dominated by a few large banks.

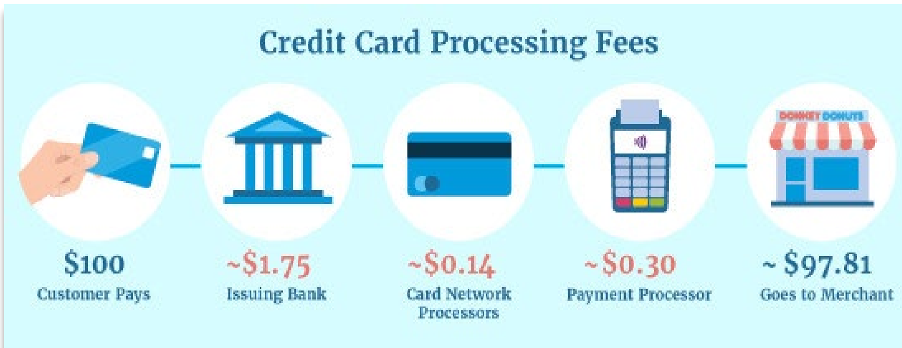
Payment processing companies allow merchants to accept credit and debit cards. These companies go by many names which can get confusing very quickly. They are sometimes called acquirers, aggregators, merchant service providers, processors, or payment providers. Payment processors are generally thought of as service providers that work directly with businesses to set up payment processing accounts, providing sales and support of all hardware and software needed to process payments.

Merchants are the customers of the payment processing industry. There are more than 31 million businesses in North America and approximately 36% of them accept credit cards. These businesses pay a fee to the payment processing ecosystem to accept credit cards. The largest 150 merchants generate more than half of payments revenue in North America, while the smallest 80% generate 2% of revenue.

Other players in the payment processing value chain include: Merchant Acquirers and Payment Processors (Fiserv, FIS, PayPal, Clover, Square, Stripe, etc.), Credit Card Networks (Visa, Mastercard, etc.), Issuing Banks (Bank of America, Wells Fargo, Capital One, etc.), and Independent Sales Organizations (ISOs). Each plays a specific role in the payment processing cycle, to enable merchants to accept credit cards and to ensure consumers have a safe, efficient, and secure way to pay.



Companies in the industry split an overall fee of around 2.0% - 2.5% of the transaction amount. The issuing bank takes most of the fees (70% - 80% of the total) since they also assume most of the risk in the event a customer is unable to pay. The card networks take another 5% - 10% of the transaction. The rest (15% - 20% of the total fee) goes to the payment processor for actually processing and completing the transaction.[1]



A comprehensive overview of the industry is beyond the scope of this write-up, so we aim to publish an in depth white paper on the global payments ecosystem later this year. But for now, we'll return our attention to the opportunity at hand.

WHY DOES THE OPPORTUNITY EXIST?

In January 2019 Fiserv agreed to acquire First Data, a major handler of credit, debit, and gift card transactions to expand into the merchant acquiring business. One of the primary reasons for the merger was the increased revenue potential in cross-selling products across the combined firm's 15,000+ financial institutions--revenue synergies that still seem unappreciated by the Street.

In addition to the benefits of scale, the acquisition should drive organic growth above historical levels because the merchant acceptance segment should grow faster than Fiserv's other two business segments. Plus, it offers additional upside potential in e-commerce and digital payments.

Despite the success of the acquisition--which has continued to exceed expectations on just about every metric--investors have preferred to focus on the competitive threats to new business segments from fintech sweethearts like Square and Stripe, rather than the enhanced growth profile of the business. As a result, shares of Fiserv and old-school payment processors have been under pressure as digital upstarts monopolize the dreams of venture capitalists and capture incremental share of incumbent's markets.

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1 Credit Card Processing Fees

	January 2019 Announcement		Updated Target	Results to Date
2022 Significant free cash flow generation	More than $4B annual free cash flow	2022	$4.4B	$3.6B
2024 Substantial cost savings	$900M cost synergies	2022	$1.2B	$950M
2024 Enhanced revenue growth potential	More than $500M revenue synergies	2024	>$600M	$190M
2024 Strong adjusted EPS accretion	More than 40% accretive	2024	✓	~50%
2021 Strong financial position	Reduce debt to adjusted EBITDA ratio to historical level	2021	✓	3.7x

Source: Fiserv Investor Day, December, 2020

In addition to longer-term competitive concerns, the business was not as defensive as expected during the pandemic, as high-margin small business spending collapsed and shifted to lower-margin online enterprises and marketplaces, where Fiserv has less exposure. As a result, shares have underperformed peers, leading to the erosion of Fiserv's premium valuation, as investors worry that the acceleration of e-commerce adoption has exposed Fiserv's legacy technology. Concerns over insider selling (KKR has been a consistent seller over the past year, although their stake has been slashed from 110 million shares to less than 50 million shares today) have also weighed on sentiment, and a surprise CEO change didn't exactly inspire confidence.

We believe these concerns are overblown and that recent pressure on the stock is overdone. Contrary to consensus expectations, Fiserv's growth has continued to chug along at a measured pace, and the company is finally benefiting from years of investments that have modernized its platforms.
Simply put, our research failed to support the increasingly popular disruption narrative, which has been seeking signs of melting ice for years. A few examples of expert feedback we've collected are highlighted below.

- These guys have great positions, the accounts are sticky. It's a slow-moving thing.

- I think they're open-minded, and they're nimble, so they can do things that folks need. Also, if there are regulatory changes in card issuing or processing, they're going to be better able to quickly address them, and regulation changes constantly in this space . . . being nimble is important for them.

- I think that the primary competitive advantage is the strength of the products and services for the payments industry, and then secondarily, banking and credit unions. I used to joke that Fiserv was the biggest company nobody ever heard of before and we were excited when I was there.

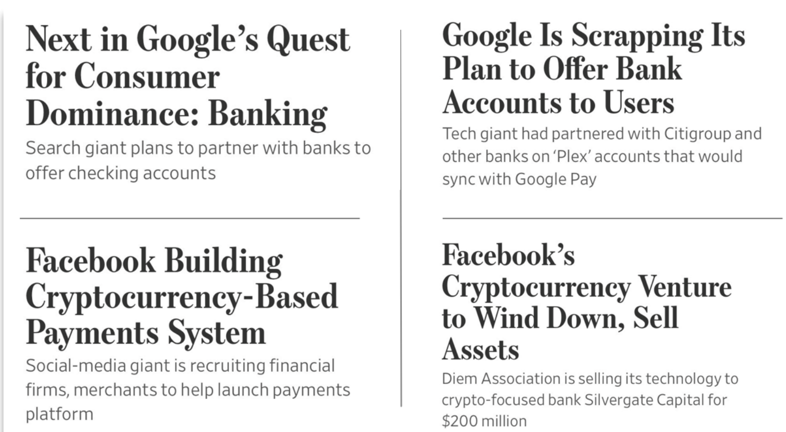
- That's gold. They've already got the client relationships. It's just a matter of connecting and winning market share on stuff. One, it makes them sticky. It makes the relationship stickier with that client. They're spending money anyway. Might as well write the check to me than write the check to three other players. Then you'll even be more satisfied because it's one less contract to deal with. One less relationship you have to deal with.

Management has also announced some big wins over the past year, validating the strength and innovation of Fiserv's product offerings, while improving the growth profile of its business.

- Alliance Data Systems announced it is moving its two-decade-old, in-house, private-label processing operations to Fiserv. In making the decision, Alliance's Chief Information Officer highlighted anticipated cost savings and the increased flexibility of Fiserv's platform, providing seamless integration with additional payment products in the future.[2]
- Brazil's largest bank, CAIXA, signed a 20-year agreement enabling merchants in Latin America's largest economy to accept payments through Fiserv. With the biggest distribution network and the largest client base in the country, this is a marquee win which could quickly become a top ten client of the firm.[3]
- Synchrony recently expanded the company's strategic partnership with Fiserv allowing small businesses to accept private label credit card payments via Clover.[4]
- Fiserv also announced a new partnership with PayPal enabling Clover customers to accept additional payment methods like Venmo.[5]

For the past decade, corporate boardrooms have lived in fear of Big Tech, as these companies have attacked one industry after another with virtually unlimited resources. As Jeff Bezos has been known to say, "Your margin is my opportunity." With access to more data than just about anyone on the planet and a track record of disruption, it's no wonder the financial services industry is worried about disintermediation.

But reality on the ground has proven to be less disruptive than the pie in the sky narrative. Amazon has been exploring bank accounts since at least 2018 with nothing yet to show for those efforts. Uber has dialed back its own financial ambitions, while Google and Facebook have both scrapped plans to conquer banking and payments. Maybe, just maybe, there are a few things Big Tech can't do. Financial services may be one of them.


Next in Google's Quest for Consumer Dominance: Banking
Search giant plans to partner with banks to offer checking accounts

Google Is Scrapping Its Plan to Offer Bank Accounts to Users
Tech giant had partnered with Citigroup and other banks on 'Plex' accounts that would sync with Google Pay

Facebook Building Cryptocurrency-Based Payments System
Social-media giant is recruiting financial firms, merchants to help launch payments platform

Facebook's Cryptocurrency Venture to Wind Down, Sell Assets
Diem Association is selling its technology to crypto-focused bank Silvergate Capital for $200 million

Source: Big Tech tries banking: a play in four acts

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2 Alliance Data moves credit card processing to Fiserv
3 Caixa Econômica Federal picks Fiserv for merchant acquiring services
4 Synchrony And Fiserv Expand Strategic Partnership With Payment Options For Merchants
5 Fiserv strikes up a bevy of new partnerships

While the consensus may view Fiserv as a chronic share doner, we think the company is more likely to gain share on the heels of the First Data acquisition. **Bottom line: we like Fiserv's combination of defensive businesses and high-growth assets like Clover, which should drive a return to pre-pandemic growth and valuation levels over time.**

INVESTMENT THESIS

Fiserv is a defensive growth story that should generate dependable, double-digit earnings growth over the next several years. While more speculative investors salivate over young upstarts promising to ride across the Silicon Valley rainbow to the pot of gold (or Bitcoin) that awaits in the distant future, we believe they are missing the opportunity right in front of their noses today. The investment case for Fiserv at current prices boils down to three primary drivers.

1. **The business remains exceptionally well positioned, benefitting from several long-term tailwinds, scale economics, and a healthy competitive moat.**

   The secular growth in electronic payments and card-based transactions, combined with continued growth in the number and value of deposit accounts, provides an attractive industry backdrop where the pie should grow fast enough for everyone to get a larger slice. Meanwhile, the company's core processing segment operates as the dominant player in a stable oligopoly. **This is a recession-resilient business, with predictable growth driven by banks' ongoing transition away from inefficient, legacy systems, and expanding online banking and bill pay which continues to replace traditional paper payments.**

   Fiserv's dominant position in the industry puts it at a competitive advantage as the company expands its product offerings, enabling it to cross-sell products across its large, captive customer base. This is a highly scalable business, resulting in cost advantages and a high degree of operating leverage, for large incumbents like Fiserv. Over time, First Data provides Fiserv the ability to expand its legacy businesses outside the US, while Fiserv provides an expanded distribution network of financial institutions for First Data to win merchant acquiring clients through. Adding it all up, we expect the company to grow sales at a mid-to-high-single-digit rate for the foreseeable future.

2. **Cost savings and revenue synergies should drive significant operating leverage, translating into accelerating earnings growth.**

   Visibility is high as accelerating revenue growth, combined with cost synergies from the First Data acquisition, should provide predictable margin expansion. For context, prior to the First Data acquisition, Fiserv targeted internal revenue growth of 4-8% and annual margin expansion of 50-100 basis points. Management now expects internal revenue growth of 7-9% and more than 125 bps of annual margin expansion. We expect adjusted operating margins to approach 37% by FY23 from 29.7% following the First Data acquisition in FY19 .

   Fiserv holds a strong track record in successfully extracting and achieving efficiencies, and management is well-incentivized to hit targets. Over the past 10+ years, the company has taken $800 million out of its expense base, exceeding internal targets by an average of ~36% since 2010. Its latest plan targets an incremental $200 million in cost reductions in addition to the $1.2 billion in synergies achieved through FY21, which itself was a 33% increase from management's initial $900 million target, and two years ahead of schedule.

   On top of the cost savings, Fiserv should reach $600 million of revenue synergies by the end of this year, eighteen months ahead of schedule, and the company recently refinanced its debt, resulting in nearly $300 million of additional savings. Importantly, management has proved itself a disciplined and intelligent allocator of capital, with a strong grasp of industry trends and competitive positioning. Capital allocation is an important component of every business, but it's paramount for those rare businesses able to generate recurring excess cash flow.

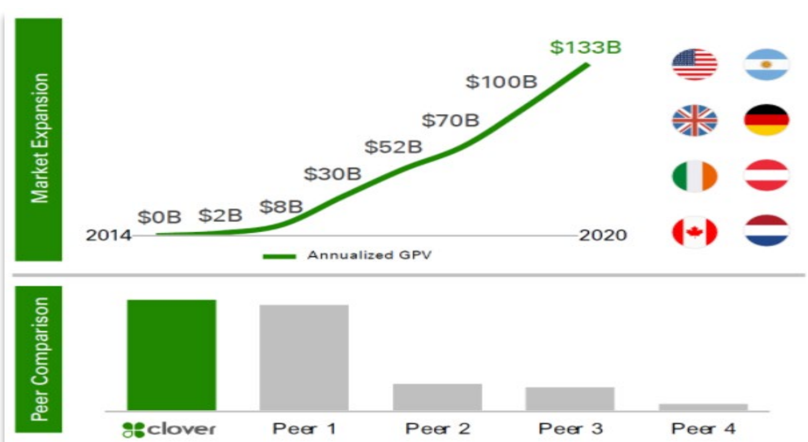
Free cash flow at Fiserv is abnormally high given the business's minimal capital requirements. While capital expenditures typically run at about 5% of sales, we expect free cash flow conversion to remain north of 105% over our forecast horizon. In recent years, buybacks have been minimal as most excess cash was directed towards paying down debt. Since the First Data acquisition, leverage has declined from a peak of 8.4x to 3.2x in the most recent quarter. With leverage closer to normal levels today and plenty of financial flexibility, we would expect and encourage accelerating share repurchases in the future.

Bottom line: defensive revenue growth, combined with low-risk margin expansion through cost synergies, should drive mid-to-high-teens earnings growth providing over $30 billion in cumulative capital available for allocation over the next five years. We'd note that this would represent roughly 40% of Fiserv's current market capitalization available for bolt-on acquisitions or to repurchase Fiserv's undervalued shares. While we don't expect all of that capital to be directed towards buybacks, it wouldn't be the first time shares outstanding declined by that magnitude. In the years leading up to the First Data acquisition, management bought back nearly half of Fiserv's shares outstanding.

3. **Today's obsession with venture-backed startups has blinded investors to Fiserv's crown jewel, driving the stock to a record low valuation even before considering the increasing value of that asset hiding in plain sight.**

The death of the payments industry has been greatly exaggerated. While Fiserv is unlikely to ever reach the stratospheric valuations of its Silicon Valley peers, the shares certainly deserve more respect than investors have granted them of late. It’s worth noting that Fiserv owns the third-largest debit network behind Visa and Mastercard, and it provides banks with access to Zelle, the third-largest electronic payment system behind Venmo and CashApp. Plus, Clover, Fiserv’s POS system, is the largest and fastest growing platform on the market.

We view Clover as Fiserv’s crown jewel - a high-growth business that remains underappreciated by investors today, despite its leading position in the industry. Clover has grown from nothing to over a $200 billion GPV (Gross Payment Volume) annual run rate in a just few years. Assuming net revenue yields of 70 – 80 bps (below Square’s ~ 110 bps yields reflecting different mix and distribution), we estimate the platform generated $1.4 - $1.6B of revenue for Fiserv in 2021, approaching 10% of total company sales and nearly a quarter of merchant acceptance revenue. Clover already processes more payment volume than Square, as GPV has grown at 35% - 40% annually (also faster than Square) for the past few years.



Source: Fiserv Investor Day, December 2020

This is another overlooked competitive advantage of incumbents: Fiserv can cross-sell products through its large, engrained distribution channels, driving faster growth than even its most rapidly growing peers. Importantly, most of this growth is incremental to Fiserv, as ~ 90% of Clover's clients are new to the company. And with Clover and Square accounting for less than 10% of a fragmented market, we think there is plenty of room for both to run.

Historically, Fiserv has traded at a well-deserved 20% premium to the market, as investors sought out secular growth in the electronic payments industry and related companies' strong, recurring free cash flow, compliments of their high returns on capital, and low capital intensity. After peaking at a ~ 60% premium to the S&P in 2019, shares currently trade at 15x earnings, a 25% discount to the market.

We think this is a mistake and believe investors are missing a hidden treasure among Fiserv's complex collection of businesses. As a standalone entity, investors would likely reward Clover's rapid growth and competitive positioning with a premium valuation in line with fintech darlings like Square and Affirm, and incumbents, like Visa and Mastercard, trading at speculative extremes. Yet, shares of Fiserv trade at near-record lows in both absolute terms and relative to the market.

With the recent engagement of an activist investor, we expect to see increased disclosures around Clover, which should be a catalyst for shares to rerate higher. ValueAct estimates the platform is worth $30B - $45B today and may be worth nearly $200B by FY24, more than three times Fiserv's current market capitalization.[6] We are not quite that aggressive, but even under our more conservative assumptions, it is not hard to see how incredibly wrong Mr. Market is currently pricing shares of Fiserv.

Assuming Clover generated $1.4B - $1.6B in revenue in FY21, we estimate FY22 sales of $1.8B - $2.2B, assuming 30% - 40% revenue growth (in line with the past several years). At 8x – 16x FY22 sales (in line with Toast at the low end and Visa/Mastercard at the high end), the unit would be worth $15B - $35B today, more than Fiserv paid for all of First Data a couple of years ago, and more than half of Fiserv's current market capitalization at the high end of our range. **This implies that investors are getting the rest of Fiserv, which historically traded at north of 20x earnings, for a few turns of EBITDA.**

RECENT RESULTS

Fiserv reported results for the full year on February 8th, 2022. Organic revenue increased 11% to $15.4 billion, at the high end of management's 7% - 12% outlook. Acceptance grew 20% on the year, followed by 6% growth in the Payments segment, and 4% growth in Fintech. Earnings per share increased 26% to $5.58 as operating margins increased 250 basis points to 33.9% on the year. Free cash flow was $3.5 billion and repurchases totaled $2.6 billion for 23.3 million shares. Management expects 7% - 9% organic revenue growth in 2022, and another 150 basis points of margin expansion, resulting in earnings per share of $6.40 to $6.55 or 15% - 17% annual growth. On a two-year basis, this would put annual earnings growth at 21%, above the high end the 15% - 20% outlook range.

Fiserv invested ~ $850 million in M&A throughout the year, completing seven transactions, in addition to a number of strategic partnerships. Most recently, the company agreed to acquire Finxact, a leading developer of cloud-based digital banking solutions. And a new partnership with Google will enable customers to more easily order from Clover restaurant locations. When combined with the recent acquisition of BentoBox, the capabilities of Clover Dining, which serves over 200K restaurants, are improving rapidly. Given the tremendous growth of pure-play rival Toast, we think this purchase makes strategic sense. Especially when considering the relative value - TOST market capitalization peaked north of $30 billion, almost 20x sales, despite losing $120MM in EBITDA in FY20 and expectations of another $120MM in losses for FY22.

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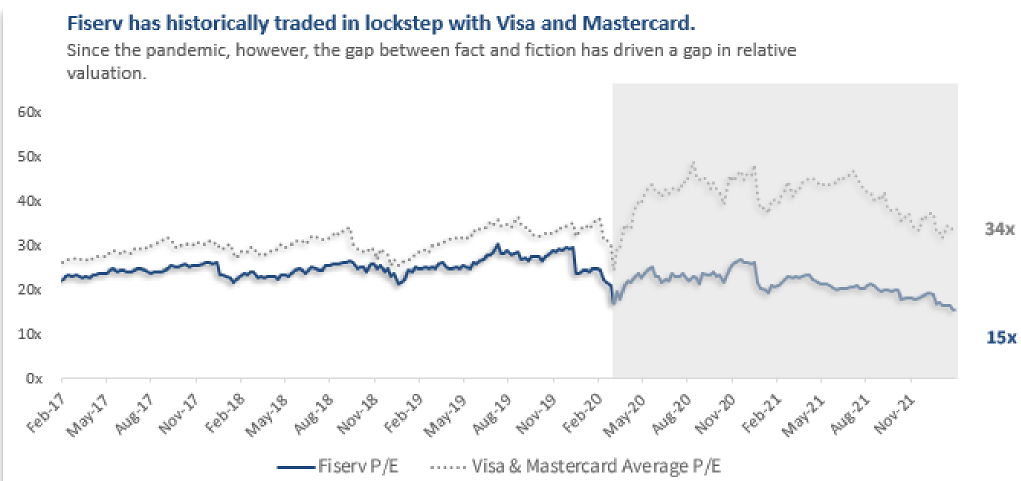
6 ValueAct Builds $1.2 Billion Fiserv Bet, Touts Square Rival, Bloomberg article published 8/19/2021.

BOTTOM LINE: WHAT'S IT WORTH

At the company's most recent investor day, management provided mid-term guidance of 7% - 9% organic revenue growth and 15% - 20% earnings per share growth (including $1.2 billion in cost synergies and over 500 bps of margin expansion), which should generate over $30 billion in cumulative capital available for allocation over the next five years (roughly 40% of the current market capitalization), assuming 105% free cash flow conversion.

We wouldn't be surprised if this mid-term guidance proves conservative. Management's track record and execution to date increase the odds that cost synergies are exceeded. At the same time, higher-margin, cross-border transactions should rebound along with a recovery in travel, providing additional operating leverage. And inflation provides a natural lift to sales as a good portion of Fiserv's contracts come with embedded CPI clauses and transaction-based revenues increase alongside increasing transaction values.

Fiserv is unlikely to post sales growth anywhere near as fast as Silicon Valley's fintech darlings. But organic growth at the company should come in well ahead of the market for the next several years, while providing something most faster growing upstarts ignore - real profits and actual cash flow to investors. Yet shares trade more than one standard deviation below their five-year average and at less than half the multiple of more household names in the industry.



Source: Broyhill Asset Management, Bloomberg historical market data

If management can execute anywhere near their mid-term targets, driving predictable, mid-teens earnings growth through 2025, we think investors will again reward the stock with the premium valuation it deserves. We see $8 - $10 in earnings power a few years out, which would imply a 50% - 100% gain, assuming shares just return to the low-end of their average valuation. And this ignores the stand-alone value of Clover, which should become increasingly evident and increasingly valuable as growth continues to ramp.

Investors today spend the majority of their time searching for something that nobody else knows. But the easy money is made searching for what others are about to know. Simply stated, more money is made getting the crowd to agree with you . . . later. At the moment, Fiserv is priced at a discount to the market, despite its faster growth profile and higher quality fundamentals than the average company in the market. Ultimately, continued execution should highlight the growing disconnect between fact and fiction. When it does, we fully expect the crowd to closes that gap . . . later.

ABOUT BROYHILL

Broyhill Asset Management is a boutique investment firm, initially established as a family office in 1980 and guided by a disciplined value orientation. Founded in the foothills of North Carolina's Blue Ridge Mountains, we operate outside of the fray and invest with a rational, objective, long-term perspective.

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Performance is calculated using time-weighted rates of returns, net of fees. Since these platforms report returns to Broyhill gross of fees, in order to report net returns, a 1.5% annual management fee has been subtracted from gross reported returns. This methodology has also been applied to the extracted attribution returns. Average position size is calculated from average capital invested divided by average portfolio capital in fully invested accounts.

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