I recommend going long Outerwall Inc (OUTR), a provider of automated retail solutions, which currently trades at $63.65 per share. I believe that there is a 68% upside as the market does not fully appreciate OUTR's products competitive advantages, most notably, Redbox. To caveat, the company's accounting policies understates FCFF generating capabilities.

Additionally, the company plans to repurchase shares outstanding with FCF, an accretive capital allocation strategy. This has not been incorporated into the base case.

Key investment risks include a failure of Redbox to maintain its competitive advantages, a faster than expected shift from a paper-based economy to a digital-based economy, and a longer and/or bigger than expected cash burn of OUTR's New Ventures segment.

If hard pressed to identify a catalyst that could increase OUTR share price, the elephant in the room is OUTR massive short interest (37% of shares outstanding). Trading at 10x FCFF, with great capital structure optimization optionality, and plans to return excess capital back to investors, a 37% of shares outstanding short interest is a god-sent.

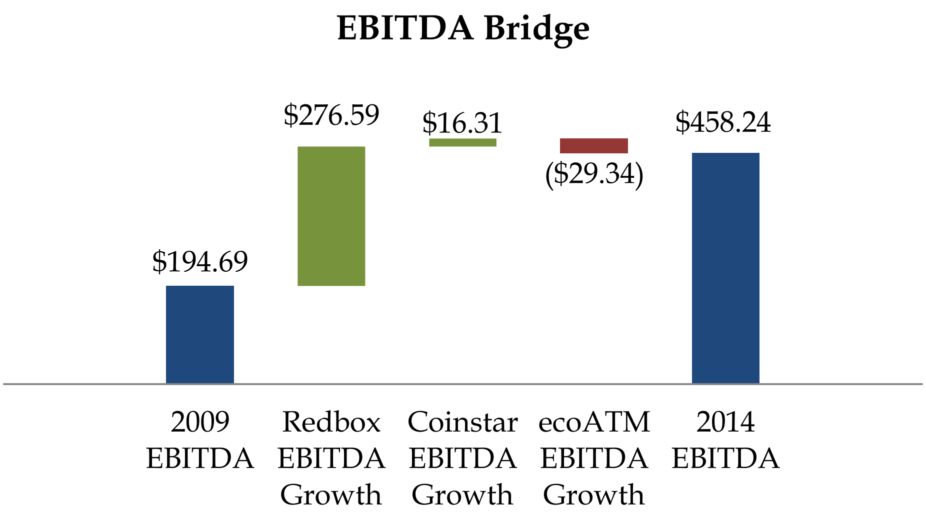
Company Background

Outerwall Inc operates in three segments: Redbox, Coinstar and ecoATM.

Revenue	2009	2010	2011	2012	2013	2014
Redbox	$773.43	$1,159.71	$1,561.60	$1,908.77	$1,974.53	$1,893.14
Coinstar	$258.52	$275.98	$282.38	$290.76	$300.22	$315.63
ecoATM	$0.68	$0.73	$0.07	$0.35	$31.85	$94.24
Total Revenue	$1,032.62	$1,436.42	$1,844.05	$2,199.88	$2,306.60	$2,303.00

Adjusted EBITDA	2009	2010	2011	2012	2013	2014
Redbox	$96.02	$183.79	$276.48	$375.26	$383.93	$372.61
Coinstar	$100.75	$94.64	$99.44	$97.51	$99.81	$117.06
ecoATM	-$2.08	-$8.22	-$5.53	-$8.96	-$19.68	-$31.42

Total revenue for FY 2014 was $2.3 billion, with an adjusted EBITDA of $458 million. EBITDA growth has largely come from revenue growth and margins expansion from the Redbox segment.



Redbox	2009	2010	2011	2012	2013	2014
Revenue Growth		49.9%	34.7%	22.2%	3.4%	-4.1%
EBITDA Margins		15.8%	17.7%	19.7%	19.4%	19.7%

Share Price	$63.65
Shares Outstanding	18.97
Market Capitalization	$1,207.44
(+) Total Debt	$962.86
Enterprise Value	$2,170.30

*No excess cash

EBITDA	$458.24
EV/EBITDA	**4.7**

CAPEX	$97.92
EBITDA - CAPEX	$360.32
Tax Rate @ 40%	$144.13
FCFF	$216.19
EV/FCFF	**10.0**

Pre-tax Interest Expenses	$50.40
Interest Expenses Tax Shield	$20.16
Post-tax Interest Expenses	$30.24
FCFE	$185.95
Market Cap/FCFE	**6.5**

OUTR is currently trading for 4.74x EV/EBITDA, 10x EV/FCFF and 6.5x Market Capitalization/FCFE.

Investment Thesis

The market's perception of OUTR is clear, it is negative, and it is easy to sympathize with the bear thesis. The market believes OUTR is a melting ice cube. I will start with Redbox.

Redbox

Redbox does movies and video games rental, primarily movies. It costs $1.50 and $2.00 per day to rent a single DVD and Blu-ray disc respectively. On the other hand, on-demand internet streaming media such as Netflix charges $7.99 a month for a massive collection of titles.

Obviously, Redbox would follow the path of Blockbuster. Not quite.

Empirical data, being Redbox financial results, runs contrary to the bear thesis.

Redbox has found a competitive edge with a lowest cost physical distribution model. To understand Redbox's niche, one must first understand the release schedule of a typical movie.

1) Cinemas
2) DVDs
3) Pay-Per-View Television
4) Cable Network and Internet Streaming
5) Free-to-air television

The reason to such a tiered release schedule system is simple, profits. Cinema generates massive profits for studios as compared to DVDs. What this creates is a form of time arbitrage for Redbox, between the cinemas exclusivity and internet streaming.

Redbox operates in (2), while Netflix operates in (4). Thus it is more relevant to analysis the DVD rental industry.

The DVD rental industry can be split into two segments: Brick and Mortar versus Automated Kiosks. The problem with the Brick and Mortar DVD rental model is that people typically want to rent newer released DVDs. After all, if it is available online, why rent? Hence the variety of DVDs is greatly narrowed to newer releases, creating massive inefficiencies for Brick and Mortar stores as space is wasted.

On the other hand, the Automated Kiosks DVD rental model minimizes space by only carrying the DVDs that customers want to rent. This cuts fixed costs massively and Automated Kiosks would be able to rent movie at a greater discount to what Brick and Mortar is offering.

In addition, space maximization means more Automated Kiosks. As a consumer, the two main factors I look at are (1) price and (2) conveniences. The Automated Kiosks dominates Brick and Mortar in both.

Also, this two factors, price and conveniences, are also what makes Redbox competitive advantage so substantial.

With over 40,000 locations, Redbox would be the natural choice for consumers as they would be able to return rented DVDs easily. It also gives Redbox a pricing advantage as costs would be driven down as operating expenses are spread across the locations.

Coinstar

Coinstar processes coins by having loose change poured into the machine. After the machine finishes counting the coins, it will issue a voucher, which the user can redeem for currency at the place of business.

I believe Coinstar is a stable business in a secular decline, the secular decline being the shift from a paper-based payment medium to a digital-based payment medium over time. However, this decline should be gradual.

ecoATM

In OUTR, the ecoATM segment is the pimple on the otherwise flawless skin.

ecoATM is basically an automated second hand electronic devices kiosks. It attempts to buy electronic devices and resell it at a higher price.

Personally, I find that this business model is flawed, and is a cash drain on OUTR. However, considering it is only 4% of revenue, potential damage is limited, although still substantial.

Valuation

One interesting factor to take into account before valuing OUTR is to understand that the company depreciates its assets faster than actual depreciation. For example, there are many Coinstar kiosks out there which are still running well after 13 years, but OUTR depreciates the asset within 5 years. The same can be said for Redbox, although the time period is shorter, but still significantly faster than reality (7 years versus 4 years).

What this means is that at the front end of the cash flow profile, depreciation would massively exceed maintenance CAPEX. I believe OUTR is near to the front end of this profile.

What this implies is that EBIT would be an inaccurate valuation measure as the company is asset-intensive, and thus depreciation and amortization consumes a huge chuck of EBITDA. Increasing the depreciation period from 4 years to 7 years would greatly impact valuation.

This is one of the reasons why the market does not appreciate OUTR.

PPE/Kiosks	2009	2010	2011	2012	2013	2014
Redbox	22400	30200	35400	43700	44000	43680
Coinstar	19200	18900	20200	20300	20900	21340
ecoATM	0	0	0	50	900	1980
Total Number of Kiosks	41600	49100	55600	64050	65800	67000
Net PPE	$386,433,000.00	$444,687,000.00	$499,178,000.00	$586,124,000.00	$520,865,000.00	$428,468,000.00
Net PPE/Kiosk	$9,289.25	$9,056.76	$8,978.02	$9,151.04	$7,915.88	$6,395.04

Logically, Net PPE/Kiosk should be on a slight upwards trend due to the effects of inflation, but in this case, the number is going lower, an effect of accelerated depreciation.

Using management's FY 2014 guidance, one can estimate the maintenance CAPEX needed for Redbox and Coinstar.

Maintenance CAPEX Estimation	Low	High	Average
Redbox	$22.0	$27.0	$24.5
Coinstar	$4.0	$5.0	$4.5

Corporate CAPEX Allocation	Low	High	Average
Redbox	$23.02	$28.77	$25.89
Coinstar	$3.84	$4.80	$4.32

Total CAPEX	Low	High	Average
Redbox	$45.0	$55.8	$50.4
Coinstar	$7.8	$9.8	$8.8

Redbox	$
EBITDA	$393.40
CAPEX	$50.39
EBITDA - CAPEX	$343.00
Taxes @ 40%	$137.20
FCFF	**$205.80**

Coinstar	$
EBITDA	$120.53
CAPEX	$8.82
EBITDA - CAPEX	$111.71
Taxes @ 40%	$44.68
FCFF	$67.02

Redbox Cost of Capital	
Sector Beta	0.85
Multiple of Sector Beta	1.5
Unlevered Beta	1.28
Debt/Equity Ratio	0.80
Levered Beta	1.89
Risk Free Rate	2.0%
Equity Risk Premium	6.0%
Cost of Equity	13.3%

Coinstar Cost of Capital	
Sector Beta	0.85
Multiple of Sector Beta	1.0
Unlevered Beta	0.85
Debt/Equity Ratio	0.80
Levered Beta	1.26
Risk Free Rate	2.0%
Equity Risk Premium	6.0%
Cost of Equity	9.5%

Pre-Tax Cost of Debt	5.23%
Post-Tax Cost of Debt	3.14%

Pre-Tax Cost of Debt	5.23%
Post-Tax Cost of Debt	3.14%

Equity % Capital	55.63%
Debt % Capital	44.37%

Equity % Capital	55.63%
Debt % Capital	44.37%

Cost of Capital	**8.80%**

Cost of Capital	**6.70%**

Redbox Value	
Terminal Growth Rate	1.0%
Intrinsic Value	**$2,665.39**

Coinstar Value	
Terminal Growth Rate	-2.0%
Intrinsic Value	**$754.90**

Using a multiple of OUTR sector unlevered beta to adjust for my perception of riskiness of the individual segments, one can get to the individual intrinsic value of the segments. Redbox is worth ~5x EBITDA, Coinstar ~6x EBITDA.

The tricky part comes in the valuation of the ecoATM segment. Assuming run-rate EBITDA and CAPEX, and attaching a 6x multiple on it, I estimate ecoATM to be worth ~ ($430).

ecoATM CAPEX	Low	High	Average
ecoATM	$35.00	$44.00	$39.50

Corporate CAPEX Allocation	Low	High	Average
ecoATM	$1.15	$1.43	$1.29

Total CAPEX	Low	High	Average
ecoATM	$36.15	$45.43	$40.79

ecoATM	$
EBITDA	-$30.39
CAPEX	$40.79
EBITDA - CAPEX	-$71.18
Multiple	6.0
Value	**-$427.07**

OUTR Valuation	$
Redbox	$2,665.39
Coinstar	$754.90
ecoATM	-$427.07
Enterprise Value	$2,993.22
(-) Debt	$962.86
Implied Market Capitalization	$2,030.36
Shares Outstanding	18.97
Intrinsic Value	**$107.03**

On the base case, using a SOTP methodology, I estimate OUTR to be worth $107 per share, or a 68% upside from current prices, $63.65.

On the bear case, I assume greater riskiness (2x sector unlevered beta) for OUTR and a negative perpetual growth rate of 1% for Redbox. Using these assumptions, the bear case value for OUTR is roughly $45 per share, or a 30% downside from current prices.

On the bull case, using the same riskiness profile as the base case but a growth rate in line with inflation rate, and a smaller negative value to ecoATM (4x EBITDA – CAPEX), I estimate OUTR to be worth roughly ~$136.80.

Using a 30%-50%-20% probability split between Bear-Base-Bull, I estimate Expected Value to be roughly **$94 per share, or a 47% upside**.

This does not take into account of the share repurchases plan that OUTR has in place. With an excellent cash generation position, share repurchases can add tremendous amount of value.