

Tomorrow's Looking Bright for EML Payments

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Canaccord Genuity has initiated coverage with a Buy recommendation on EML Payments suggesting the company offers investors good exposure to the growing prepaid financial products industry.

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-EML Payments seen offering above-average revenue growth

-Prepaid financial products industry shows signs for growth

Small cap specialist Canaccord Genuity has given ASX fintech EML Payments ((EML)) a Buy recommendation on its first commentary on the stock, with a price target of \$2.05 per-share. The stock currently trades around \$1.53.

EML –formally eMerchants– provides prepaid cards and has undergone strong growth in recent years, expanding its footprint with acquisitions in key markets such as the United States and Europe.

The company offers payment solutions for gift cards, incentives and rewards programs and supplier payments. After its expansion, EML now manages more than 850 prepaid programs across 13 countries in five currencies.

Key customer segments include gaming and wagering services, consumer lending, shopping malls and salary packing firms. Contracts are typically signed on exclusive five-year terms providing predictability to EML's revenue and gross profit with negligible customer churn.

Canaccord Genuity analyst Owen Humphries said in a note to clients that EML had experienced healthy growth, enjoyed gross profit margins of around 80% and had an attractive earnings profile.

"We believe EML offers investors exposure to the emerging and fast growing [general purpose reloadable] payments industry," Humphries said.

"The company's above-average organic revenue growth – fuelled by share gains, market growth and increased card usage – coupled with strong operating leverage, should support a meaningful sustainable valuation premium in our view.

"We are encouraged by EML's medium-term growth prospects and valuation metrics (higher growth, market multiple)."

EML had earnings before interest, tax, depreciated and amortisation (EBITDA) of \$5m in FY16. This is expected to rise to \$13.9m in FY17. The company's outlook

has earnings continuing to rise to \$25.5m and \$28.3m in FY18 and FY19 respectively.

EML also reported several large potential opportunities in its pipeline which could see more than 15% upside to Canaccord Genuity's FY18/FY19 EBITDA forecast, primarily in UK shopping malls, casinos and European online gaming.

Company and product background

EML is an issuer and processor of prepaid debit cards, ranging from reloadable cards such as gaming cards, fuel cards and corporate cards to traditional non-reloadable cards such as gift cards.

Prepaid cards allow the consumer to use a conventional plastic card linked to a unique account that is held at a financial institution, and similar to a debit card, the payments that are made deduct funds directly from the account. The cardholder has the ability to access these funds at an ATM, a point of sale location, or both.

Prepaid represents one of the fastest growing segments in the electronic payment space, says Humphries. The pre-paid card market is broken into four quadrants: closed or open loop, and reloadable or non-reloadable.

Open-loop cards connect to one of the major payment networks to complete transactions (e.g Visa or MasterCard). Closed loop networks largely rely on the retailer's private network and can sometimes require separate payment systems.

EML generates revenue through the various stages of a card's lifecycle. This comprises set-up fees (10% of gross profit), transaction fees (16%), interchange and breakage fees (59%), and interest earned on funds (15%).

Revenue is segmented into three product lines: Non-reloadable or single use cards (FY17 revenue \$45m, gross profit \$35.8m); Reloadable (FY17 revenue \$12.4m, gross profit \$9.1m); and Virtual B2B (FY17 revenue \$1.4m, gross profit \$1.3m).

Non-reloadable cards are branded for EML's clients. They can be used anywhere Visa or MasterCard are accepted and come pre-loaded with cash. Their primary use has been for welfare payments and as gift cards. In its first-half results for FY17, EML was generating interest revenue on around \$383m in non-reloadable card funds.

But it's in breakage fees where EML's revenue model really shines. For every \$100 loaded onto a non-reloadable card, approximately 5% remains on the card at the time of expiry with EML sharing this fee with the client. In the first half of FY17, breakage fees accounted for 72% of the gross profit generated from non-reloadable cards.

Reloadable cards have a smaller revenue profile than their single-use siblings, but represent a major driver of EML's growth profile. As the name suggests, reloadable cards can be regularly topped up.

The company has experienced success in the Australia domestic online gaming industry, issuing reloadable prepaid cards to Ladbrokes, Bet365, WilliamHill,

CrownBet and Sportsbet, which allows cardholders to receive winnings instantaneously from payment terminals.

EML is attempting to export the success demonstrated in Australia to the North American and European markets. It's had some early successes, signing up Bet365 in the UK and Caesars Entertainment and LuLaRoe in the US.

“This is the major driver of EML’s growth profile and in our view deserves a premium valuation given the predictable nature of its revenue streams,” Canaccord Genuity’s Owen Humphries said.

“The innovative approach to specific industry verticals is a key competitive advantage versus the incumbent banks, with EML working collaboratively with the corporate in designing/implementing a payment solution and acting as full service program manager.”

Virtual B2B is EML’s smallest product segment and remains in the start-up phase. It involves the automation and facilitation of payments from companies to their suppliers, and focuses on converting cheque payments to electronic payments over a virtual prepaid card.



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