EDISON

Optimal Payments

Business acquisitions

Growing US presence

Software & comp services

Optimal has announced plans to acquire two US-based payment processing businesses for up to $225m. The deals should significantly strengthen Optimal's presence in the US and fit with the company's strategy of increasing the geographical coverage of its STP business. We estimate that the combined deals are earnings accretive, even without the inclusion of any cost synergies.

Year end	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/12	179.1	18.8	12.0	0.0	63.4	N/A
12/13	253.4	42.7	26.5	0.0	28.7	N/A
12/14e	341.1	63.4	34.5	0.0	22.0	N/A
12/15e	439.6	83.5	40.6	0.0	18.7	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

US payment processing acquisitions

Optimal is acquiring two US-based payment processing businesses – Meritus Payment Solutions and Global Merchant Advisors, Inc, for up to $225m ($165m cash, $60m equity), funded by own cash and new $100m term/$50m revolving debt facilities. The company has previously spoken of its desire to expand its payment processing business into additional geographies – these acquisitions give Optimal much greater presence in the US market and reduce the company's reliance on its largest customer and the online gambling market. Optimal continues to consider additional acquisitions, with the same goal of increasing geographical coverage.

Earnings accretive

The businesses together generated revenues of $82.7m in 2013 and EBITDA of $17.6m (21.3% margin). For the acquired businesses, we assume 15% growth in 2014 and 2015, and EBITDA margins rising to 22.5% by 2015. We have not factored in any cost synergies. This results in EPS upgrades of 12.9% in 2014 and 19.1% in 2015. We forecast 'own cash' falling to a net debt position of $34.2m by the end of 2014, returning to a net cash position of $25.7m by the end of 2015.

Valuation: Growth key to upside

The acquisitions are being acquired for 12.8x combined 2013 EBITDA (compared to 19.2x 2013 for Optimal pre-acquisition). Including the acquired businesses, Optimal trades at a premium to peers on an EV/EBITDA (2014 16.3x vs average 10.8x) and P/E basis (2014 22.0x vs average 18.8x), although this can be justified by its higher than average revenue and earnings growth. We note that Optimal continues to trade at a discount to its closest peer, Wirecard (FY14 EV/EBITDA 22.7x, P/E 33.9x). With several drivers of organic growth (existing customer base, US online gambling, principal membership of Visa/MasterCard), the potential for further upgrades remains. We expect that Optimal will also continue to seek inorganic growth in the STP business.

9 July 2014

Price	**446.0p**
Market cap	**£720m**
	$1.705:£
Net cash ($m) at end FY13 *On own cash basis	82.9*
Shares in issue	161.4m
Free float	97.4%
Code	OPAY
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	13.3	25.9	160.4
Rel (local)	15.6	23.4	147.5
52-week high/low		510.00p	174.0p

Business description

Optimal Payments is an independent alternative payments processor with two business lines: NETBANX (STP), which provides payment processing services to merchants; and NETELLER (SV), which provides stored value services including eWallets and pre-paid cards to consumers and retailers.

Next event

Interim results	September 2014

Analysts

Katherine Thompson +44 (0)20 3077 5730

Dan Ridsdale +44 (0)20 3077 5729

tech@edisongroup.com

Edison profile page

Optimal Payments is a research client of Edison Investment Research Limited

US payment processing acquisitions

Optimal has announced that it is acquiring two US payment processing businesses: Meritus Payment Solutions and Global Merchant Advisors, Inc (GMA).

Background

Meritus is headquartered in Orange County, California and was founded in 2008. The business has grown its customer base to 8,000 small and medium business (SMB) merchants in the US. Meritus has its own processing platform and has an automation process that enables it to on-board new merchants quickly. Customers are from a wide range of e-commerce verticals and do not include any online gambling companies. The business has approximately 100 employees, including a direct sales force, and processed transactions worth c $3bn in 2013.

GMA, also based in California, was launched in 2010 and is focused on those SMB merchants that struggle to get a service from the larger payment processors. The business has a direct sales approach and has relationships with a network of acquiring banks, third-party processors and technology partners.

Deal terms

Optimal is acquiring all of the partnership interests of TK Global Partners LP (which trades as Meritus Payment Solutions) for $150m in cash up-front and a further $60m in deferred equity. Priced at £3.93 per share (the VWAP over the five trading days before the announcement), this equates to 8,954,621 shares. A quarter of the shares will be issued to the sellers on each of the four yearly anniversaries of the closing of the acquisition. Optimal is also acquiring the trade and assets of GMA for up to $15m in cash: $10m up-front and $5m on the first anniversary of the closing of the acquisition, subject to a minimum level of revenues being generated. The closing of each deal is dependent on the closing of the other deal. The company expects both deals to close in Q3 – for modelling purposes we assume they close at the end of July.

To fund the acquisition, Optimal has arranged a $100m term loan and a $50m revolving loan facility with Bank of Montreal. Both loans mature on the third anniversary of the deals closing.

Financials and valuation

Meritus generated revenues of $74.4m (+94% y-o-y) and clean[1] EBITDA of $13.0m in 2013 (y/e 31 December). This equates to an EBITDA margin of 17.5%. GMA generated revenues of $8.3m and clean EBITDA of $4.6m in 2013 (EBITDA margin 55.4%). Combining the two entities, 2013 revenues were $82.7m and EBITDA was $17.6m (margin 21.3%). Optimal is paying up to 12.8x trailing EBITDA and 2.7x trailing revenues. This compares to Optimal’s trailing valuation metrics (pre-acquisition) of 19.2x 2013 EBITDA and 4.0x 2013 revenues.

Deal rationale

Management made it clear that this deal is not about cost synergies but instead is about gaining better payment processing presence in the US market by acquiring a US customer base and US salesforce. Meritus has not been able to sign up merchants that require processing outside of the US. As part of Optimal, Meritus will be able to offer more international services and this should increase its addressable market.

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[1] Clean: before management drawings.

For the time being, Optimal plans to leave Meritus and GMA operating as standalone businesses, with Meritus continuing to use its own payment processing platform and GMA maintaining its third-party payment processor relationships. At some point, the company may decide to combine Meritus and Netbanx on a single platform (as with the Neovia/Optimal acquisition), but this is yet to be decided. Similarly, the company expects to be able to identify other areas of potential cost savings over the next three to four months. The deal has the added benefit of reducing Optimal's reliance on its largest customer (an online gambling company that generated 41% of 2013 revenues) and the online gambling market (Meritus/GMA have no online gambling customers).

Future M&A still possible

Despite the assumption of up to $150m of debt, the company believes it still has headroom to make additional acquisitions. It could fund these through additional debt and/or equity issuance. The business is highly cash generative (the CFO commented that the business generates c $5m in cash per month) so the gross debt balance should reduce fairly rapidly.

The acquisition strategy is unchanged – the company is keen to increase its geographic coverage, and on the assumption that businesses are available at reasonable prices, sees this as a cheaper and faster way to build out coverage than building up its own operations on a country-by-country basis.

Changes to forecasts

- **Revenues:** we have assumed 15% growth in the combined acquired businesses for 2014 and 2015.
- **Gross margins:** we factor in the combined businesses at a gross margin of 35%. This reduces the overall GM to 50.2% in 2014 (from 52.3%) and 47.7% in 2015 (from 51.9%).
- **EBITDA:** we estimate that the acquisitions add $9.7m to EBITDA in 2014 and $25m in 2015.
- **Debt/interest:** we have factored in interest payable on the new term debt and credit facility.
- **Tax**: the addition of US-based companies that pay tax at 40% results in an increase in the overall tax rate in 2014 and 2015 to a maximum of 13%.
- **Capex:** we have factored in minimal additional capex of $0.5m per year for the combined businesses.

Exhibit 1: Changes to forecasts

$'000s	FY14e old	FY14e new	Change	FY15e old	FY15e new	Change
STP revenues	220,452	261,790	18.8%	242,469	351,839	45.1%
SV revenues	78,589	78,589	0.0%	87,097	87,097	0.0%
Total revenues	299,742	341,079	13.8%	330,266	439,636	33.1%
Gross margin	52.3%	50.2%	-2.1%	51.9%	47.7%	-4.2%
EBITDA	67,631	77,283	14.3%	77,032	102,086	32.5%
EBITDA margin	22.6%	22.7%	0.1%	23.3%	23.2%	-0.1%
Reported adjusted EBITDA	67,631	77,283	14.3%	77,032	102,086	32.5%
Reported adjusted EBITDA margin	22.6%	22.7%	0.1%	23.3%	23.2%	-0.1%
Normalised PBT	55,542	63,378	14.1%	62,289	83,508	34.1%
Normalised net income	51,654	58,307	12.9%	57,929	72,652	25.4%
Normalised EPS (c)	30.5	34.5	12.9%	34.1	40.6	19.1%
Reported EPS (c)	28.1	28.5	1.7%	31.8	40.9	28.6%
Net cash/(debt) (own cash basis)	122,566	(34,206)	-127.9%	176,559	25,739	-85.4%

Source: Edison Investment Research

Exhibit 2: Financial summary

$'000s	2009	2010	2011	2012	2013	2014e	2015e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	62,178	61,547	127,972	179,072	253,367	341,079	439,636
Cost of Sales	(26,953)	(12,112)	(53,868)	(89,648)	(121,484)	(169,966)	(229,805)
Gross Profit	35,225	49,435	74,104	89,424	131,883	171,113	209,831
EBITDA	7,850	9,853	18,738	28,275	53,106	77,283	102,086
Company EBITDA		11,158	17,453	27,563	52,213	77,283	102,086
Operating Profit (before amort acq intang, SBP and except.)	1,508	3,258	6,698	20,599	43,688	65,241	87,303
Amortisation of acquired intangibles	0	0	(4,700)	(4,100)	(4,100)	(4,100)	(4,100)
Exceptionals	(8,858)	(6,215)	(25,675)	(7,123)	(1,368)	(6,500)	0
Share-based payments	(2,646)	(985)	(1,007)	(3,931)	(4,512)	(3,000)	(3,000)
Operating Profit	(9,996)	(3,942)	(24,684)	5,445	33,708	51,641	80,203
Net Interest	0	0	(1,540)	(1,800)	(995)	(1,864)	(3,795)
Profit Before Tax (norm)	1,508	3,258	5,158	18,799	42,693	63,378	83,508
Profit Before Tax (FRS 3)	(9,996)	(3,942)	(26,224)	3,645	32,713	49,778	76,408
Tax	183	142	27	(2,461)	(1,235)	(3,982)	(9,933)
Profit After Tax (norm)	1,691	3,400	5,185	16,338	41,081	58,307	72,652
Profit After Tax (FRS3)	(9,813)	(3,800)	(26,197)	1,184	31,478	45,795	66,475
Average Number of Shares Outstanding (m)	119.9	119.9	125.9	128.7	146.4	160.6	162.5
EPS - normalised (c)	1.4	2.8	4.1	12.0	26.5	34.5	40.6
EPS - FRS 3 (c)	(8.2)	(3.2)	(20.8)	0.9	21.5	28.5	40.9
DPS (c)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	56.7%	80.3%	57.9%	49.9%	52.1%	50.2%	47.7%
EBITDA Margin (%)	12.6%	16.0%	14.6%	15.8%	21.0%	22.7%	23.2%
Company EBITDA Margin (%)	12.6%	18.1%	13.6%	15.4%	20.6%	22.7%	23.2%
Operating Margin (before am and except.) (%)	2.4%	5.3%	5.2%	11.5%	17.2%	19.1%	19.9%
BALANCE SHEET							
Fixed Assets	39,901	46,287	72,672	67,393	65,551	296,609	295,727
Intangible Assets	32,073	36,968	63,337	58,526	53,231	276,531	274,831
Tangible Assets	7,828	9,319	9,335	8,867	12,320	20,078	20,896
Other Fixed Assets	0	0	0	0	0	0	0
Current Assets	153,536	163,914	172,743	219,167	307,902	322,114	357,471
Cash & cash equivalents	61,070	51,116	57,956	82,174	164,379	173,774	203,719
Restricted cash	5,152	2,294	2,833	5,423	1,636	1,636	1,636
Qualified Liquid Assets held for Members	83,612	107,027	106,092	118,091	127,974	127,974	127,974
Receivable from Members & Merchants	354	647	608	796	1,126	1,516	1,954
Trade and other debtors	3,348	2,830	5,254	12,683	12,787	17,213	22,187
Current Liabilities	99,980	119,253	143,957	192,104	241,047	287,521	252,521
Creditors	23,595	23,023	44,234	81,639	107,524	127,524	122,524
Payable to Members	76,385	96,230	97,741	110,248	123,413	123,413	123,413
Short term borrowings	0	0	1,982	217	10,110	36,584	6,584
Long Term Liabilities	0	0	31,340	9,394	801	145,801	130,801
Long term borrowings	0	0	8,440	9,394	801	100,801	100,801
Other long term liabilities	0	0	22,900	0	0	45,000	30,000
Net Assets	93,457	90,948	70,118	85,062	131,605	185,400	269,875
CASH FLOW							
Operating Cash Flow	5,217	8,211	36,319	31,869	94,542	70,967	96,674
Net Interest	0	0	0	0	(158)	(1,864)	(3,795)
Tax	503	(242)	424	(932)	(1,191)	(3,982)	(9,933)
Capex	(18,794)	(13,763)	(11,222)	(6,467)	(13,567)	(22,200)	(18,000)
Acquisitions/disposals	(17)	0	(25,833)	(1,667)	(5,281)	(160,000)	(5,000)
Financing	0	(3,449)	(2,755)	3,294	1,188	0	0
Dividends	0	0	0	0	0	0	0
Net Cash Flow	(13,091)	(9,243)	(3,067)	26,097	75,533	(117,079)	59,945
Opening net (debt)/cash	86,540	73,449	64,207	58,718	85,829	159,665	42,586
HP finance leases initiated	0	0	0	0	0	0	0
Other	0	1	(2,422)	1,014	(1,697)	0	0
Closing net (debt)/cash	73,449	64,207	58,718	85,829	159,665	42,586	102,531

Source: Company accounts, Edison Investment Research

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