EDISON

Paysafe Group

FY15 results

Strong H215 drives upgrades

Software & comp services

Paysafe's results confirmed that the group generated strong growth in FY15 and that integration of Skrill is well underway. We have raised our forecasts for FY16/17 to reflect stronger growth; even with higher reinvestment into the business we also upgrade our EBITDA and EPS forecasts for both years. With net debt on track to be substantially reduced over the next two years, Paysafe has a strong position from which to fund organic and acquisitive growth and shareholder returns.

Year end	Revenue ($m)	EBITDA* ($m)	EPS* (c)	DPS (c)	P/E (x)	EV/EBITDA (x)
12/14	365.0	83.0	22.0	0.0	25.2	37.3
12/15**	613.4	152.6	25.6	0.0	21.7	20.3
12/16e	911.9	259.9	34.8	0.0	15.9	11.9
12/17e	997.4	284.1	38.1	0.0	14.6	10.9

Note: *EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Includes Skrill from 10 August 2015.

FY15 results: Growth across the board

In its inaugural set of results as a combined group, Paysafe reported FY15 revenue, EBITDA, normalised EPS and net debt ahead of our forecasts. Underlying group revenue growth of 13% confirms that both the acquired and existing businesses are performing well, and the company expects to substantially complete the integration of Skrill in Q316. Post year-end, the company made a small bolt-on acquisition in the US to complement the existing US Payment Processing business; it continues to consider other bolt-on acquisitions.

FY16 and FY17 forecast upgrades

We have revised our revenue growth forecasts for FY16 and FY17 (upgraded by +3.3% and +5.7% respectively) taking into account the pro forma growth achieved by each division in FY15. After taking into account increased investment in geographic expansion of the Pre-paid business and compliance, we upgrade our EBITDA forecasts by 3.6% in FY16 and 5.1% in FY17, resulting in normalised EPS upgrades of 0.2% and 2.0% respectively. We forecast that net debt/adjusted EBITDA will fall from 2.1x at the end of FY15 to 1.1x at the end of FY16e and 0.2x at the end of FY17e.

Valuation: Cash generation supports growth strategy

The stock trades at a discount to peers on an EV/EBITDA and P/E basis for FY16e and FY17e. The recent Skrill acquisition has expanded Paysafe's product offering and balanced out its geographical exposure, while reducing exposure to its largest merchant. In addition to those cost synergies already targeted, the enlarged group has the potential to generate additional revenue and cost synergies in excess of our forecasts. Strong cash generation should quickly reduce the group's net debt position, with the company confirming that it would consider further acquisitions as well as the return of cash to shareholders in the form of buybacks or dividends.

21 April 2016

Price	**387.80p**
Market cap	**£1,865m**
	$1.43:€1.27:£1
Net debt (£m) at end FY15	431.3
Shares in issue	481.0m
Free float	98.7%
Code	PAYS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(7.5)	(2)	33.5
Rel (local)	(10.2)	(9.5)	44.0

52-week high/low	432.4p	219.0p

Business description

Paysafe Group is a global payment solutions specialist operating in three areas: payment processing, digital wallets and prepaid services.

Next event

Trading update	July 2016

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Paysafe Group is a research client of Edison Investment Research Limited

Review of FY15 results

Exhibit 1: FY15 results highlights

$'000	FY15e est	FY15 act	Difference	Growth
Payment Processing revenues	365,102	375,077	2.7%	36.5%
Digital Wallet revenues	163,244	159,135	-2.5%	77.7%
Pre-paid revenues	72,578	76,400	5.3%	N/A
Investment income	582	2,780	377.7%	315.5%
Total revenues	**601,505**	**613,392**	**2.0%**	**68.1%**
Gross margin	*50.6%*	*48.3%*	*-2.2%*	*-3.5%*
EBITDA	**149,871**	**152,563**	**1.8%**	**83.9%**
EBITDA margin	*24.9%*	*24.9%*	*0.0%*	*2.1%*
Normalised PBT	119,511	118,783	-0.6%	71.6%
Normalised net income	107,560	108,686	1.0%	60.5%
Normalised EPS (c)	**25.1**	**25.6**	**2.0%**	**16.1%**
Reported EPS (c)	9.4	1.9	-80.2%	-91.1%
Net cash/(debt)	**(503,715)**	**(409,650)**	**-18.7%**	**N/A**

Source: Paysafe, Edison Investment Research

Paysafe reported FY15 revenue 2% ahead of the upwardly revised guidance from its January trading update. On a pro forma, constant currency basis revenues grew 13% y-o-y (see Exhibit 2 for definitions). Taking into account the fact that payolution revenues were included in the Payment Processing division (whereas we had included them in the Digital Wallet division), we estimate that most of the remaining upside in the Payment Processing division was due to stronger trading in the US. The Pre-paid business was ahead by 5% and investment income was significantly higher, driven by the interest earned on Skrill customer balances.

The group gross margin came in below our forecast, partly as a result of the higher contribution from Payment Processing, which has a lower gross margin than both other divisions, and partly due to a change in the accounting for Neteller gross margins (see below for further detail). As indicated in January, the company achieved integration cost synergies of $10m in H215 (earlier than originally targeted) and is on track to reach total cost synergies of $40m in 2016. The integration of Skrill should be substantially complete during Q316.

EBITDA was 2% ahead of our forecast to generate a 24.9% margin. With net interest expense higher than forecast (mainly due to the amortisation of financing fees), normalised net income was 1% higher than forecast and normalised EPS 2% ahead.

The company reduced net debt significantly below our forecast. We note that net debt per the balance sheet is slightly lower than the net debt quoted by the company of $431m – this is because the company has adjusted the net debt to reflect financing fees that are being amortised over the lives of the two loans. Looking at the cash flow in detail, the main variance was around the amount paid for Skrill: $1,097m including expenses compared to our $1,197m forecast. The difference was made up of the cash available in the business at the acquisition date ($67m), and lower than expected acquisition costs and debt offset by slightly higher cash paid.

Divisional analysis and update

Exhibit 2: Divisional growth rates and gross margins

	Payment Processing			Digital Wallet			Pre-paid		
	H115	H215	FY15	H115	H215	FY15	H115	H215	FY15
Reported revenue growth	47%	28%	37%	20%	127%	78%	N/A	N/A	N/A
Pro forma* constant currency** (cc) revenue growth	7%	25%	16%	20%	14%	17%	12%	-2%	5%
Pro forma cc revenue growth excl. major merchant	24%	33%	29%	N/A	N/A	N/A	N/A	N/A	N/A
Reported gross margin	37.1%	36.8%	36.9%	73.2%	72.8%	72.9%	N/A	51.3%	51.3%

Source: Paysafe. Note: *Pro forma includes all acquisitions as if owned for the entire comparative period (ie Skrill, Ukash, Meritus, GMA, FANS Entertainment). **Constant currency applies prior period exchange rates to H1/H2/FY15 revenues.

Payment Processing

The Payment Processing division saw a small impact from the Skrill acquisition with the addition of the payolution business. We estimate that this made a less than $5m revenue contribution in H215. On a pro forma constant currency basis, the business saw slower growth in H115, mainly reflecting the strong performance of its largest merchant in H114. Excluding the revenues generated by the largest merchant, the remainder of the business saw very strong double-digit growth. The gross margin in H215 decline slightly from H115 reflecting the higher contribution of revenues from the lower margin US business and the lower proportion of major merchant revenues. We estimate that major merchant revenues increased 17% h-o-h in H215 to $76m, but with the addition of Skrill revenues, its revenue contribution declined from 29% of group revenues in H115 to 20%.

Post year-end, the company agreed to acquire substantially all the assets of MeritCard Solutions LP for initial cash consideration of $16m, plus up to $4m in contingent consideration over the next two years. MeritCard is a Dallas-based company that specialises in building relationships with small and medium-sized independent sales organisations (ISOs), sales and bank agents and third party vendors. MeritCard is also a wholesale ISO working with Wells Fargo Bank, Deutsche Bank, Merrick Bank and TSYS. The business will retain the MeritCard brand.

Digital Wallet

This division saw strong reported revenue growth in H115, despite currency issues. The pro forma constant currency growth rate was similarly strong. The company noted that Skrill benefited from a one-off programme in H115 worth several million dollars, which partially explains the slower growth rate in H215 (albeit still double digit). The company has restated gross margins for Neteller to reflect the same cost allocation as Skrill. This reduces the H115 Digital Wallet gross margin to 73.2% compared to the previously reported 87.3%, although as it is a cost reallocation, it has no impact at the EBITDA level.

Pre-paid

The Pre-paid business was acquired with the Skrill acquisition, so reported growth analysis is not meaningful. On a pro forma basis, the business grew 12% in H115 but declined 2% in H215, resulting in growth of 5% for FY15. The pro forma H2 decline was mainly due to paysafecard's strategy to withdraw the Ukash business from certain markets as well as its issues in the Greek market. On an ongoing basis, we believe that growth should revert to levels more like those achieved in H115. The gross margin has remained stable at 51.3%.

At the end of FY15, paysafecard was available in 42 countries, in 24 languages and 23 currencies, and had 2.5 million active users/month. During the year, paysafecard started operations in New Zealand, Kuwait and Saudi Arabia, and is planning to enter new countries in 2016.

Outlook and changes to forecasts

The company noted that the positive momentum seen in 2015 has continued into 2016.

Revenue upgrades

- **Payment Processing:** within this business, we forecast moderating growth for the major merchant with much stronger growth for the remainder of the business. Overall this equates to revenue growth of 14% in FY16e and 10% in FY17e. Note that FY16e growth benefits from the inclusion of a full year of payolution revenues.
- **Digital Wallet:** management noted that Skrill's bad debt expense runs at a higher level than Neteller, and it is keen to bring this down to the Neteller level. This may slow the rate of volume growth for the Skrill wallet as the business becomes more selective. We forecast revenue growth of 12.8% for the Neteller business and 7% for the Skrill business in FY16. In FY17, for the combined business we forecast a growth rate of 7.6%.
- **Pre-paid**: for FY16, we forecast underlying euro-based revenue growth of 7% for the combined Paysafecard/Ukash business. For FY17e, we forecast growth of 10%.

Gross margin – new reporting and mix bring down margin

We forecast a small decline in the Payment Processing margin, reflecting the declining influence of higher margin business from the major merchant. We have factored in the new basis of reporting gross margin for the Neteller side of the Wallet business, but as we expect the bad-debt cost to fall for the Skrill business, we forecast overall divisional gross margin expansion. We maintain the Pre-paid margin broadly in line with the FY15 level.

EBITDA upgrades

While the company is making good progress in achieving cost synergies from the integration of Skrill, it repeated the comments it made at the November Capital Markets day that it would be increasing investment in the following areas:

- Expansion of the Paysafecard business into new territories: this involves building a network of merchants in a given country before the service can be fully launched. Expenditure around the $5m level in FY16 is unlikely to generate a return for a couple of years.
- Legal & compliance: the enlarged group has regulation to comply with in the countries in which it operates (including money laundering, KYC and gambling-related laws), has e-money, issuing and acquiring licenses to maintain, and is now a FTSE 250-listed stock. The company is investing to support this function.

We have therefore been relatively conservative in our operating expenditure assumptions. We would expect that if the company continues to beat expectations and generate strong revenue growth, it will consider reinvesting a proportion of this upside to maintain its growth trajectory.

Capex – slightly increasing R&D assumptions

We have increased our capex forecasts to take account of the company's comments regarding R&D. We assume that the company will continue to capitalise development costs at the rate of 2-3% of sales per year, with total capex including tangible assets at 4-5% of sales.

Reducing net debt at pace

On our forecasts, the company should be able to pay down debt at a rapid pace. The net debt (reported)/adjusted EBITDA at the end of FY15 stood at 2.1x and we calculate that this will reduce to 1.1x by the end of FY16 and 0.2x by the end of FY17. We would expect the company to consider several uses for excess cash: share buybacks, a dividend, or further M&A. In fact, the company has said it will continue to consider bolt-on acquisition opportunities.

Exhibit 3: Changes to forecasts

$'000	FY16e old	FY16e new	Change	Growth	FY17e old	FY17e new	Change	Growth
Payment Processing revenues	402,584	428,654	6.5%	14.3%	431,258	472,680	9.6%	10.3%
Digital Wallet revenues	277,833	265,654	-4.4%	66.9%	293,479	285,903	-2.6%	7.6%
Pre-paid revenues	201,608	212,543	5.4%	178.2%	217,736	233,797	7.4%	10.0%
Total revenues	**882,725**	**911,851**	**3.3%**	**48.7%**	**943,173**	**997,380**	**5.7%**	**9.4%**
Gross margin	52.1%	50.8%	-1.3%	2.5%	51.8%	50.6%	-1.2%	-0.2%
EBITDA	**250,861**	**259,872**	**3.6%**	**70.3%**	**270,214**	**284,098**	**5.1%**	**9.3%**
EBITDA margin	28.4%	28.5%	0.1%	3.6%	28.6%	28.5%	-0.2%	0.0%
Normalised PBT	206,879	207,620	0.4%	74.8%	222,698	229,744	3.2%	10.7%
Normalised net income	175,847	176,477	0.4%	62.4%	189,293	195,283	3.2%	10.7%
Normalised EPS (c)	**34.7**	**34.8**	**0.2%**	**36.2%**	**37.4**	**38.1**	**2.0%**	**9.6%**
Reported EPS (c)	30.4	22.5	-26.0%	1116.1%	34.1	29.3	-14.1%	30.0%
Net cash/(debt)	**(336,026)**	**(260,543)**	**-22.5%**		**(134,726)**	**(53,974)**	**-59.9%**	

Source: Edison Investment Research

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Exhibit 4: Financial summary

$'000s	2011	2012	2013	2014	2015	2016e	2017e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	127,972	179,072	253,367	364,954	613,392	911,851	997,380
Cost of Sales	(53,868)	(89,648)	(121,484)	(187,298)	(316,922)	(448,246)	(492,548)
Gross Profit	74,104	89,424	131,883	177,656	296,470	463,606	504,832
EBITDA	18,738	28,275	53,106	82,946	152,563	259,872	284,098
Company EBITDA	17,453	27,563	52,213	85,965	152,563	259,872	284,098
Operating Profit (before amort acq intang, SBP and except.)	6,698	20,599	42,888	71,257	133,201	230,780	252,007
Amortisation of acquired intangibles	(4,700)	(4,100)	(3,300)	(9,200)	(31,900)	(48,000)	(48,000)
Exceptionals	(25,675)	(7,123)	(1,368)	7,219	(60,986)	(18,000)	0
Share-based payments	(1,007)	(3,931)	(4,512)	(8,274)	(14,089)	(14,000)	(14,000)
Operating Profit	(24,684)	5,445	33,708	61,002	26,226	150,780	190,007
Net Interest	(1,540)	(1,800)	(995)	(2,024)	(14,418)	(23,160)	(22,262)
Profit Before Tax (norm)	5,158	18,799	41,893	69,233	118,783	207,620	229,744
Profit Before Tax (FRS 3)	(26,224)	3,645	32,713	58,978	11,808	127,620	167,744
Tax	27	(2,461)	(1,235)	(1,303)	(4,405)	(19,143)	(25,162)
Profit After Tax (norm)	5,185	16,338	40,311	67,703	108,686	176,477	195,283
Profit After Tax (FRS3)	(26,197)	1,184	31,478	57,675	7,403	108,477	142,583
Average Number of Shares Outstanding (m)	216.8	221.6	252.2	277.7	399.8	481.7	486.9
EPS - normalised (c)	2.4	7.0	15.1	22.0	25.6	34.8	38.1
EPS - FRS 3 (c)	(12.1)	0.5	12.5	20.8	1.9	22.5	29.3
DPS (c)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	57.9%	49.9%	52.1%	48.7%	48.3%	50.8%	50.6%
EBITDA Margin (%)	14.6%	15.8%	21.0%	22.7%	24.9%	28.5%	28.5%
Company EBITDA Margin (%)	13.6%	15.4%	20.6%	23.6%	24.9%	28.5%	28.5%
Operating Margin (before am and except.) (%)	5.2%	11.5%	16.9%	19.5%	21.7%	25.3%	25.3%
BALANCE SHEET							
Fixed Assets	72,672	67,393	65,551	295,955	1,569,269	1,546,396	1,507,223
Intangible Assets	63,337	58,526	53,231	284,723	1,548,253	1,520,471	1,478,390
Tangible Assets	9,335	8,867	12,320	10,114	18,492	23,400	26,309
Other Fixed Assets	0	0	0	1,118	2,524	2,524	2,524
Current Assets	172,743	219,167	184,490	177,275	259,045	384,134	569,375
Cash & cash equivalents	57,956	82,174	164,379	109,893	117,875	238,759	419,313
Restricted NETELLER cash	108,925	123,514	6,198	8,777	29,070	29,070	29,070
Cash held as reserves & settlement assets	0	0	0	38,607	66,341	66,341	66,341
Receivable from Members & Merchants	608	796	0	0	0	0	0
Trade and other debtors	5,254	12,683	13,913	19,998	45,759	49,964	54,651
Current Liabilities	143,957	192,104	117,634	114,410	170,943	174,232	185,060
Creditors	44,234	81,639	107,524	58,240	121,070	126,567	137,395
Payable to Members/Merchant liability	97,741	110,248	0	30,591	16,758	16,758	16,758
Short term borrowings	1,982	217	10,110	25,579	33,115	30,907	30,907
Long Term Liabilities	31,340	9,394	801	150,498	582,804	536,789	490,774
Long term borrowings	8,440	9,394	801	107,205	494,410	468,395	442,380
Other long term liabilities	22,900	0	0	43,293	88,394	68,394	48,394
Net Assets	70,118	85,062	131,606	208,322	1,074,567	1,219,509	1,400,764
CASH FLOW							
Operating Cash Flow	36,319	31,869	94,542	42,699	91,654	243,163	290,239
Net Interest	0	0	(158)	(1,873)	(8,403)	(18,487)	(17,590)
Tax	424	(932)	(1,191)	(1,564)	(4,929)	(19,143)	(25,162)
Capex	(11,222)	(6,467)	(13,567)	(11,094)	(23,721)	(38,267)	(40,919)
Acquisitions/disposals	(25,833)	(1,667)	(5,281)	(169,192)	(1,102,070)	(18,159)	0
Financing	(2,755)	3,294	1,188	(4,939)	670,173	0	0
Dividends	0	0	0	0	0	0	0
Net Cash Flow	(3,067)	26,097	75,533	(145,963)	(377,296)	149,107	206,569
Opening net (debt)/cash	64,207	58,718	85,829	118,389*	(22,891)	(409,650)	(260,543)
HP finance leases initiated	0	0	0	0	0	0	0
Other	(2,422)	1,014	(1,697)	4,683	(9,463)	0	0
Closing net (debt)/cash	58,718	85,829	159,665*	(22,891)	(409,650)	(260,543)	(53,974)

Source: Paysafe, Edison Investment Research. Note: *Difference due to new basis for reporting cash.

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