

eServGlobal

Restructuring ongoing

H117 results

Slower than expected trading combined with continued restructuring of the business in H117 has resulted in a reduction in our forecasts for FY17. Management is confident that the pipeline has strengthened and should support a pick-up in revenues in H217. The HomeSend joint venture (JV) has extended its application to the cross-border bank payments market, which should support its target to break even in CY17 and drive growth in the value of the JV.

Year end	Revenue (A\$m)	EBITDA* (A\$m)	EPS* (A\$)	DPS (A\$)	P/E (x)	EV/EBITDA (x)
10/14	31.3	2.6	(0.20)	0.0	N/A	26.5
10/15	25.9	(10.4)	(5.41)	0.0	N/A	N/A
10/16	21.6	(7.0)	(3.88)	0.0	N/A	N/A
10/17e	18.2	(6.1)	(2.01)	0.0	N/A	N/A
12/17e**	22.3	(4.8)	(2.08)	0.0	N/A	N/A

Note: *PBT and EBITDA are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **14 month period to 31 December 2017

H117 trading disappoints

eServGlobal saw weaker than expected trading in H117 due to delays in a new and an existing contract, resulting in a 30% decline in revenues y-o-y. However, management is confident that it has a strong pipeline and therefore expects a material step-up in revenues in H217. Management has been restructuring the business over the past two years and continues to assess historical receivable balances – taking a more prudent approach has resulted in further WIP and receivable write-downs totalling A\$4.3m in H117. The company extended its debt by £2.5m/A\$4.2m post period end to fund working capital and further restructuring.

HomeSend expands addressable market

While current volumes processed by the HomeSend JV are predominantly for remittances, the JV has made inroads into the cross-border banking payments market. It is rolling its service out to KEB Hana and has signed several other banks to use its service. This opens up an addressable market that is multiple times larger than the remittances market. Management expects the value of the JV to grow through the year as volumes processed by the platform ramp up.

Changes to forecasts and valuation

We have revised our forecasts for FY17 to reflect the low end of management's revenue expectations and have factored in cost guidance. This results in a cut to revenues of 15.8% and a small EBITDA profit moving to an adjusted loss of A\$6.1m. While progress in the core business has been slower than hoped for, the HomeSend JV continues to make good progress and we expect adoption of the service for cross-border banking payments to drive volumes in the medium term. The current share price appears to be valuing the HomeSend JV based only on its opportunity in the remittances market, and the core business at a discount to mobile software peers. Evidence of progress in the banking sector for HomeSend as well as pipeline conversion in the core business should drive upside to the share price.

Software & comp services

5 July 2017

Price 6.63p

Market cap £42m

A\$1.69:€1.14:£1

Net debt (A\$m) at end H117 10.6

Shares in issue 640.2m

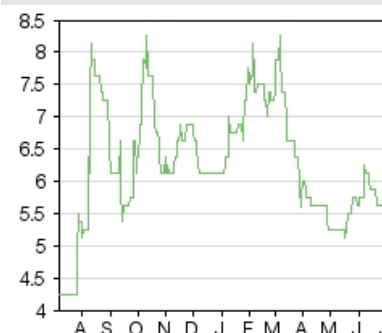
Free float 96%

Code ESG

Primary exchange AIM

Secondary exchange ASX

Share price performance



% 1m 3m 12m

Abs 15.2 15.2 51.4

Rel (local) 18.4 14.4 32.6

52-week high/low 8.2p 4.2p

Business description

eServGlobal develops mobile software solutions to support mobile financial services, with a focus on emerging markets. It also has a share in the HomeSend international remittances hub, alongside MasterCard and BICS.

Next events

FY17 results End December 2017

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H117 results review

eServGlobal saw delays in signing new contracts in H117, resulting in a 30% year-on-year drop in revenues to A\$5.86m. Writing off A\$1.51m of WIP balances resulted in a gross loss of A\$1.35m – excluding the write-off, the company generated a gross profit of A\$0.16m (gross margin 3%). The company reported an EBITDA loss of A\$11.87m. We calculate an adjusted EBITDA that excludes the share of losses from the HomeSend JV (A\$1.92m), currency gains (A\$0.32) and write-offs of receivables (A\$2.78m) and WIP (A\$1.51m). This is lower than a year ago, despite significantly lower revenues, reflecting the results of the company's cost cutting (clean opex excluding depreciation and amortisation was A\$6.1m in H117 vs A\$7.0m in H116). The company ended H117 with cash of A\$2.86m (down from A\$9.38m at the end of FY16) and debt of A\$13.46m, resulting in net debt of A\$10.60m. Post period end, the company negotiated an additional £2.5m/A\$4.2m in debt from its existing lenders, Lombard Odier Asset Management, on the same terms as the original debt (ie due for repayment in June 2019).

Exhibit 1: Half-year results highlights

A\$m	H116	H117	y-o-y
Revenues	8.36	5.86	(29.9)
Normalised gross profit	0.45	0.16	(64.9)
Normalised gross margin (%)	5.4	2.7	(2.7)
EBITDA	(8.81)	(11.87)	25.8
EBITDA margin (%)	(105.3)	(202.6)	(97.3)
Normalised EBITDA	(6.56)	(5.92)	(10.8)
Normalised EBITDA margin (%)	(78.4)	(101.0)	(22.6)
Net income	(12.22)	(14.39)	15.1
Net debt	19.84	10.60	(46.6)

Source: eServGlobal, Edison Investment Research. *Excludes share-based payments, exceptional items and share of losses of associate.

Core business update

The shortfall in revenues in H117 was due to timing issues relating to one new contract and one existing contract. Despite this, the company is confident that it has generated an improved pipeline: the qualified pipeline was worth €39m at the end of H117 and is geographically diversified outside of the Middle East.

eServGlobal signed up an African channel partner last year; however, this relationship has not worked out as originally planned. The company has written off all revenue recognised in FY16, accounting for €1.8m/A\$2.6m of the receivables write-down. The company believes opportunities still exist in the region and intends to pursue them in due course.

Management has focused on reducing costs in the core business, reducing the total cost base by 30% compared to one year ago.

Update on HomeSend JV

The company has provided an update on the progress of the HomeSend JV. The bulk of the JV's current volumes are generated from remittances, ie person-to-person payments, usually from developed countries to developing countries. The JV also spent time over the course of 2016 integrating with Mastercard's Send network and it is now the provider of Mastercard Send Cross Border (XB)'s service. This is a service that allows Mastercard bank customers to make cross-border payments via the Send network. This reduces the banks' reliance on correspondent banks

and should reduce the cost of such payments. The provision of cross-border payment services to banks expands HomeSend's addressable market significantly: global remittances total c \$575 billion per annum (source: World Bank) compared to cross-border B2B payments in the region of \$160 trillion per annum (source: McKinsey).

In September 2016, HomeSend announced that KEB Hana, one of South Korea's largest banks, had signed up to use HomeSend for cross-border remittance services. Several corridors are now live and the remaining corridors are being added. We understand that KEB is in soft launch, with limited volumes being processed to date. Assuming the testing phase proves that the system is robust, we would expect KEB to start to ramp up volumes from H217. This underpins HomeSend's target to reach break-even during 2017. HomeSend has signed up a number of other banks to use its service and it is also exploring opportunities in the e-commerce market. Consequently, management expects the value of the JV to grow over the remainder of the year.

From a financial perspective, eServGlobal reported a share of losses of the JV of A\$1.92m for H117, which compares to A\$1.99m in H216 and A\$2.65m in H116.

Outlook and changes to forecasts

The company had been targeting a reduction in costs to below €18m/A\$26m in FY17, at which point it expected to break even. We were forecasting revenues of A\$27.6m for the year with a small positive EBITDA of A\$0.8m. Management now estimates that revenues could be in the range of €15-19m (A\$22-28m) for the 14 months to 31 December.¹ Management continues to target further cost reductions and expects costs for FY17 to be around €16.5m (A\$24.3m) and for the 14 months to 31 December, around €18.5m (A\$27.2m), with the potential to break even by the end of CY17.

We are resetting our forecasts based on the lower end of guidance. We have assumed that revenues are spread equally across the eight-month period to 31 December 2017, so we are forecasting H217 revenues of A\$12.3m. While this is 115% higher than in H117, it is 7% below the same period a year ago. We now forecast an EBITDA loss of A\$6.1m for FY17 (the year to 31 October 2017) and expect net debt to reach A\$9.9m by the end of FY17. We have also introduced forecasts for the 14 month period to 31 December 2017.

Exhibit 2: Changes to forecasts

A\$'000	FY17e old	FY17e new	Change	y-o-y	14 months to end CY17
Revenues	27,629	18,163	(34.3%)	(15.8%)	22,264
Gross profit	12,713	5,081	(60.0%)	(16.5%)	6,721
Gross margin	46.0%	28.0%	(18.0%)	(0.2%)	30.2%
Normalised EBITDA	791	(6,071)	(867.1%)	(13.0%)	(4,769)
Normalised EBITDA margin	2.9%	(33.4%)	(36.3%)	(1.1%)	(21.4%)
Normalised EBIT	(2,599)	(9,461)	264.1%	5.8%	(8,724)
Normalised EBIT margin	(9.4%)	(52.1%)	(42.7%)	(5.6%)	(39.2%)
Reported EBIT	(2,799)	(13,621)	386.7%	(45.0%)	(12,918)
Normalised PBT	(7,272)	(15,830)	117.7%	9.7%	(16,334)
Reported PBT	(7,472)	(19,990)	167.5%	5.5%	(20,528)
Normalised net income	(6,018)	(12,864)	113.8%	9.6%	(13,301)
Reported net income	(6,178)	(20,290)	228.4%	7.5%	(20,861)
Normalised EPS	(0.94)	(2.01)	113.8%	48.2%	(2.08)
Net debt/(cash)	4,105	9,912	141.5%	315.8%	9,542

Source: Edison Investment Research.

¹ The company is changing its year-end to 31 December. It will report results for the 12 months to 31 October in December as well as results for the 14 months to 31 December in March 2018.

Exhibit 3: Financial summary

	A\$'000s	2012	2013	2014	2015	2016	2017e	2017e*
Year end 31 October		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue		28,070	31,003	31,261	25,866	21,577	18,163	22,264
Cost of Sales		(12,267)	(11,789)	(13,359)	(20,608)	(15,490)	(13,082)	(15,543)
Gross Profit		15,803	19,214	17,902	5,258	6,087	5,081	6,721
EBITDA		(1,936)	1,683	2,571	(10,449)	(6,982)	(6,071)	(4,769)
Operating Profit (before amort acq intang, SBP and except.)		(7,277)	(660)	1,987	(12,469)	(10,039)	(9,461)	(8,724)
Amortisation of acquired intangibles		0	0	0	0	0	0	0
Exceptionals		(6,485)	5,997	28,735	(12,539)	(3,533)	(3,971)	(3,971)
Share-based payments		(624)	(456)	(438)	(54)	(75)	(189)	(222)
Operating Profit		(14,386)	4,881	30,284	(25,062)	(13,647)	(13,621)	(12,918)
Income from associate		0	0	(2,275)	(3,831)	(4,638)	(4,597)	(5,490)
Net Interest		(1,016)	(386)	(254)	(1,356)	(2,861)	(1,772)	(2,120)
Profit Before Tax (norm)		(8,293)	(1,046)	(542)	(17,656)	(17,538)	(15,830)	(16,334)
Profit Before Tax (FRS 3)		(15,402)	4,495	27,755	(30,249)	(21,146)	(19,990)	(20,528)
Tax		(187)	5,879	(13,515)	(2,125)	(596)	(100)	(100)
Profit After Tax (norm)		(5,805)	(732)	(379)	(14,125)	(14,030)	(12,664)	(13,067)
Profit After Tax (FRS3)		(15,589)	10,374	14,240	(32,374)	(21,742)	(20,090)	(20,628)
Average Number of Shares Outstanding (m)		196.8	241.1	253.1	264.0	366.6	640.2	640.2
EPS - normalised (c)		(3.01)	(0.36)	(0.20)	(5.41)	(3.88)	(2.01)	(2.08)
EPS - FRS 3 (c)		(7.98)	4.25	5.57	(12.33)	(5.98)	(3.17)	(3.26)
DPS (c)		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)		56.3%	62.0%	57.3%	20.3%	28.2%	28.0%	30.2%
EBITDA Margin (%)		(6.9%)	5.4%	8.2%	(40.4%)	(32.4%)	(33.4%)	(21.4%)
Operating Margin (before am and except.) (%)		(25.9%)	(2.1%)	6.4%	(48.2%)	(46.5%)	(52.1%)	(39.2%)
BALANCE SHEET								
Fixed Assets		16,303	14,330	43,431	42,928	33,274	26,876	25,683
Intangible Assets		9,386	3,523	9,011	6,939	5,598	3,797	3,497
Tangible Assets		912	482	3	84	32	32	32
Other Fixed Assets		6,005	10,325	34,417	35,905	27,644	23,047	22,154
Current Assets		18,136	38,855	30,761	34,895	28,240	23,970	28,002
Stock		158	74	173	66	72	72	72
Debtors		14,094	21,846	26,811	24,403	17,976	14,680	17,994
Cash		3,794	4,909	3,679	4,976	9,375	8,401	9,118
Other		90	12,026	98	5,450	817	817	817
Current Liabilities		(12,934)	(15,082)	(18,033)	(25,520)	(14,469)	(12,224)	(14,921)
Creditors		(11,665)	(11,932)	(13,010)	(22,285)	(14,189)	(11,944)	(14,641)
Taxation & social security		(69)	(150)	(2,023)	(235)	(280)	(280)	(280)
Short term borrowings		(1,200)	(3,000)	(3,000)	(3,000)	0	0	0
Long Term Liabilities		(6,431)	(749)	(865)	(19,532)	(12,649)	(19,203)	(19,551)
Long term borrowings		(6,000)	0	0	(16,531)	(11,759)	(18,313)	(18,661)
Other long term liabilities		(431)	(749)	(865)	(3,001)	(890)	(890)	(890)
Net Assets		14,989	37,154	55,070	32,359	33,823	19,067	18,827
CASH FLOW								
Operating Cash Flow		(11,901)	(7,207)	(5,810)	(12,130)	(10,712)	(5,020)	(4,336)
Net Interest		(974)	(580)	(271)	(423)	(175)	(148)	(148)
Tax		(7,813)	(1,088)	2,018	(3,148)	(1,159)	(300)	(350)
Capex		(1,966)	(1,950)	(6,403)	(2,921)	(1,583)	(1,590)	(1,855)
Acquisitions/disposals		23,307	0	5,418	0	5,133	0	0
Financing		(77)	16,140	3,964	4,365	15,929	0	0
Dividends		(111)	0	(146)	0	0	(421)	(421)
Net Cash Flow		465	5,315	(1,230)	(14,257)	7,433	(7,480)	(7,110)
Opening net debt/(cash)		3,871	3,406	(1,909)	(679)	14,555	2,432	2,432
HP finance leases initiated		0	0	0	0	0	0	0
Other		0	0	0	977	(4,690)	(0)	(0)
Closing net debt/(cash)		3,406	(1,909)	(679)	14,555	2,432	9,912	9,542

Source: eServGlobal, Edison Investment Research *14 month period to 31 December 2017

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