EML Payments

Q3 trading update

Weaker European business drives downgrades

Software & comp services

With its Q322 trading update, EML Payments downgraded its guidance for FY22. A number of factors have combined to weigh on revenue and increase overheads. We have revised our forecasts to reflect lower revenue growth and a higher cost base, cutting our EBITDA and NPATA forecasts for FY22–24. In our view, resolution of the Irish regulatory issue and rising interest rates are the two main factors that could provide earnings and share price upside.

Year end	Revenue (A$m)	PBT* (A$m)	NPATA** (A$m)	Diluted EPS* (c)	DPS (c)	P/E (x)	EV/EBITDA (x)
06/20	121.0	21.6	21.0	5.5	0	28.8	16.8
06/21	192.2	30.2	21.0	6.6	0	24.0	13.0
06/22e	229.1	20.1	15.5	4.3	0	37.1	14.7
06/23e	268.4	45.5	38.9	9.6	0	16.5	8.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **NPATA = net profit after tax, excluding acquisition-related costs.

European performance behind expectations

EML's Q322 trading update confirmed gross debit volume (GDV) growth of 408% y-o-y (we estimate 11% organic) and revenue growth of 21% to A$59.8m. Underlying EBITDA and NPATA were down 14% and 22% respectively. While the Australian and North American parts of the business traded in line with expectations, the European business was behind, mainly due to the focus on the Central Bank of Ireland (CBI) remediation project. This has delayed some operational improvement programmes and reduced the level of establishment fees in the General Purpose Reloadable (GPR) division. As EML expects some of these issues to continue into Q422, it has reduced its full-year guidance.

FY22 guidance reduced; revising estimates down

The company has revised down its guidance for FY22 GDV, revenue and underlying EBITDA. The underlying NPATA range has been tightened, but the lower end of the range is unchanged. We have reduced our FY22 revenue forecast by 2.6%, underlying EBITDA by 10.8% and underlying NPATA by 5.9%. We have also reduced our FY23 and FY24 forecasts, reflecting lower revenue and higher operating costs in FY22. Management has several initiatives underway to accelerate revenue growth and reduce the cost base and expects to benefit as interest rates rise globally.

Valuation: Lacking confidence

On FY23 estimates (when we expect more normalised EBITDA profitability), EML is trading at a discount to global payment processor peers on all metrics and at a discount to prepaid card peers on an EV/Sales and EV/EBITDA basis. The share price was already depressed because of the CBI issue and it has declined a further 41% since the Q3 update. If the regulatory issue is successfully resolved without imposing material growth constraints on the European business and the delayed operational improvement programmes start to benefit margins, a return to an upgrade cycle should improve confidence and drive a re-rating of the stock.

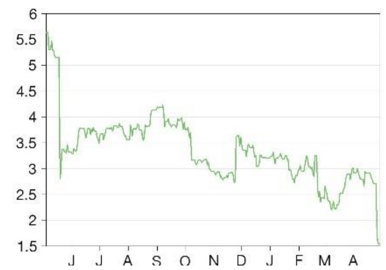
3 May 2022

Price	**A$1.58**
Market cap	**A$590m**

$0.72: €0.67: £0.57: A$1

Net cash (A$m) at end H122	0.2
Shares in issue	373.4m
Free float	93%
Code	EML
Primary exchange	ASX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(47.1)	(49.7)	(73.2)
Rel (local)	(46.0)	(51.2)	(74.4)
52-week high/low		A$5.75	53

Business description

EML Payments is a payment solutions company managing thousands of programmes across 27 countries in Europe, North America and Australia. It provides payment solutions for banking, credit and disbursement services, earned wage access, gifts, incentives and rewards, and open banking and FX.

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Q3 trading update

On 26 April, EML Payments issued a Q3 trading update and reduced its guidance for FY22. The table below shows the performance for Q322.

Exhibit 1: Q322 performance

	Q322	Q321	y-o-y
GDV (A$bn)	**23.9**	**4.7**	**408%**
Gift & Incentive (G&I)	0.20	0.16	24%
General Purpose Reloadable (GPR)	2.82	2.38	18%
Digital Payments (DP)	20.9	2.16	868%
Revenue (A$m)	**59.8**	**49.7**	**21%**
G&I*	20.8	19.7	6%
GPR*	32.7	25.9	26%
DP*	6.3	2.6	142%
Yield (bp)	**106**	**25**	**-76%**
G&I*	1,041	1,231	-15%
GPR	116	109	6%
DP	3	12	-75%
Gross margin	70.5%	72.7%	-2.2%
Underlying EBITDA	13.6	15.8	-14%
Underlying EBITDA margin	22.7%	31.8%	-9.0%
Underlying NPATA	8.1	10.5	-22%

Source: EML Payments. Note: *Edison estimate.

Overall, EML saw Australian and North American businesses trading in line with expectations. Due to the impact of remediation activities in Europe, the European prepaid business operating performance was significantly behind management expectations.

While **G&I** GDV was 24% higher y-o-y, reflecting more normal trading post COVID-19, we estimate that revenue was only 6% higher, as Q321 benefited from higher levels of breakage.

GPR GDV was 18% higher y-o-y, benefiting from growth in European programmes with PCS, Correos and the Home Office. Revenue yield improved from 109bp to 116bp, as the business recorded A$9.8m in new dormant account fees. This was partially offset by lower establishment fees and negative interest rates in Europe.

DP GDV grew 868% y-o-y reflecting the inclusion of Sentenial volumes (A$18.5bn); we estimate organic growth was 11% y-o-y. Revenue increased 142% y-o-y, with yield falling to 3bp as lower-yielding Sentenial revenues were included.

The lower gross margin (mainly due to negative interest rates and reduced establishment fees) and higher level of overheads resulted in underlying EBITDA and NPATA declining y-o-y. The company noted that underlying measures excluded A$13.6m in CBI-related costs.

The company signed 23 contracts in Q322, versus 26 in Q222 and launched 46 programmes in the quarter. It signed new contracts in the European employee benefits market (Up Spain) and the open banking market (Praxis Tech).

The CBI remediation programme is ongoing and the company continues to expect it to complete by the end of FY22, subject to independent review.

Exhibit 2 summarises the changes to guidance.

Exhibit 2: Changes to FY22 guidance

A$m	Old	New	Change
GDV (A$bn)	81–88	79–84	down 2–4
Revenue	230–250	225–235	down 5–15; mid-point now at bottom of previous range
Overheads	103–112	106–109	narrowed range
Underlying EBITDA	58–65	52–55	down 6–10
Underlying NPATA	27–34	27–30	range reduced, lower end unchanged
Gross margin	c 69%	c 69%	no change
Operating cashflow	80–90%	50–60%	reduced

Source: EML Payments

We discuss the main reasons for this downgrade:

- **Lower establishment fees in GPR**: the company had previously flagged that these have been reduced due to restrictions on business within PFS relating to the CBI issue. EML expects continued challenges with launching new programmes in Q422 and estimates that in H222, establishment fees will be c A$4m lower than in H221.
- **Delay in approval for new bonds**: EML is seeking to improve the returns on the cash it holds by investing some of it in bonds; regulatory approval for these bonds has taken longer than expected. This mainly affects interest income in the GPR division and is expected to have a A$1–2m impact in H222.
- **Currency**: The Australian dollar has strengthened against the euro and sterling. The company estimates that this will reduce revenue by c A$1.5m in FY22.
- **Overheads spend in H2 towards upper end of expectations**: the company has several projects underway to reduce operating costs. As the team in Europe has been focused on concluding the remediation project relating to the CBI issue, some of these projects are taking longer to deliver. Combined with increased headcount and IT spend in Europe to strengthen the compliance function, this results in overheads at the higher end of the original range.

Changes to forecasts

We have revised our forecasts to reflect the company's new expectations. In particular, we have reduced our forecasts for DP, as volumes year-to-date have been lower than we had expected. We have increased our forecast for CBI-related costs to A$15.0m from A$12.7m, although these are excluded from underlying profit measures.

The company noted that several operational initiatives are underway which should help growth in revenue and margins in FY23:

- GPR: launching new core programmes in Europe, including Up Spain and Banco Sabadell. The division should also continue to benefit from inactivity fees.
- DP: improved open banking revenue as investment in the Nuapay side of the Sentential business starts to take effect.
- Operational improvement projects: four projects delayed from H222 should contribute an incremental $4–5m cost saving.
- Identification of efficiency opportunities: during FY22, the company invested heavily to manage the remediation plan, enhance the European executive team and strengthen the compliance function. A project is now underway to identify areas where cost efficiencies could be made.
- Interest income: assuming the EUR bonds receive regulatory approval, rising rates globally should add an incremental $6–10m in interest income in FY23 (which is recorded as revenue).

Exhibit 3: Changes to forecasts

		FY22e	FY22e			FY23e	FY23e			FY24e	FY24e		
		Old	New	Change	y-o-y	Old	New	Change	y-o-y	Old	New	Change	y-o-y
Revenues	**A$m**	**235.1**	**229.1**	**-2.6%**	**19.2%**	**286.1**	**268.4**	**-6.2%**	**17.2%**	**320.5**	**305.4**	**-4.7%**	**13.8%**
Gross profit	A$m	162.5	158.2	-2.7%	23.2%	203.8	189.4	-7.1%	19.7%	231.3	218.9	-5.4%	15.6%
Gross margin		69.1%	69.0%	-0.1%	2.2%	71.2%	70.6%	-0.7%	1.5%	72.2%	71.7%	-0.5%	1.1%
EBITDA	**A$m**	**45.7**	**37.1**	**-18.8%**	**-12.0%**	**83.5**	**67.7**	**-18.9%**	**82.4%**	**100.5**	**86.9**	**-13.5%**	**28.2%**
EBITDA margin		19.4%	16.2%	-3.2%	-5.7%	29.2%	25.2%	-3.9%	9.0%	31.4%	28.4%	-2.9%	3.2%
Add back CBI costs	A$m	12.7	15.0			0.0	0.0			0.0	0.0		
Underlying EBITDA	**A$m**	**58.4**	**52.1**	**-10.8%**	**-2.6%**	**83.5**	**67.7**	**-18.9%**	**29.9%**	**100.5**	**86.9**	**-13.5%**	**28.2%**
Underlying EBITDA margin		24.8%	22.8%	-2.1%	-5.1%	29.2%	25.2%	-3.9%	2.5%	31.4%	28.4%	-2.9%	3.2%
Normalised operating profit	A$m	31.8	23.2	-26.9%	-26.4%	64.9	49.2	-24.2%	111.7%	78.3	64.7	-17.3%	31.6%
Normalised operating margin		13.5%	10.1%	-3.4%	-6.3%	22.7%	18.3%	-4.4%	8.2%	24.4%	21.2%	-3.2%	2.9%
Reported operating profit	A$m	(2.9)	(7.5)	157.6%	55.3%	42.4	26.7	-37.0%	-457.5%	55.8	42.2	-24.2%	58.2%
Reported operating margin		-1.2%	-3.3%	-2.0%	-0.8%	14.8%	9.9%	-4.9%	13.2%	17.4%	13.8%	-3.6%	3.9%
Normalised PBT	A$m	28.7	20.1	-29.9%	-33.4%	61.1	45.5	-25.7%	126.3%	74.5	61.0	-18.1%	34.2%
Reported PBT	A$m	(10.3)	(14.9)	44.4%	-36.2%	35.8	20.1	-43.9%	-235.0%	49.9	36.4	-27.1%	81.2%
Normalised net income	A$m	22.9	16.1	-29.9%	-33.4%	48.9	36.4	-25.7%	126.3%	59.6	48.8	-18.1%	34.2%
NPATA	**A$m**	**20.1**	**15.5**	**-22.7%**	**-26.2%**	**51.5**	**38.9**	**-24.4%**	**151.0%**	**62.1**	**51.2**	**-17.4%**	**31.5%**
Add back CBI costs	A$m	9.1	12.0			0.0	0.0			0.0	0.0		
Underlying NPATA	**A$m**	**29.2**	**27.5**	**-5.9%**	**-15.0%**	**51.5**	**38.9**	**-24.4%**	**41.5%**	**62.1**	**51.2**	**-17.4%**	**31.5%**
Reported net income	A$m	(10.3)	(14.9)	44.4%	-48.2%	28.6	16.1	-43.9%	-208.0%	39.9	29.1	-27.1%	81.2%
Normalised basic EPS	A$	0.06	0.04	-29.9%	-35.2%	0.13	0.10	-25.7%	124.5%	0.16	0.13	-18.1%	34.2%
Normalised diluted EPS	A$	0.06	0.043	-29.9%	-35.2%	0.13	0.10	-25.7%	124.6%	0.16	0.13	-18.1%	34.2%
Reported basic EPS	A$	(0.03)	(0.04)	44.4%	-49.6%	0.08	0.04	-43.9%	-207.2%	0.11	0.08	-27.1%	81.2%
NPATA/share	A$	0.05	0.04	-22.7%	-28.2%	0.14	0.10	-24.4%	149.1%	0.16	0.13	-17.4%	31.5%
Dividend per share	A$	0.00	0.00	N/A	N/A	0.00	0.00	N/A	N/A	0.00	0.00	N/A	N/A
Net debt/(cash)	**A$m**	**(50.0)**	**(42.6)**	**-14.6%**	**-58.6%**	**(82.3)**	**(62.0)**	**-24.7%**	**45.4%**	**(102.6)**	**(71.3)**	**-30.5%**	**15.0%**
GDV	**A$bn**	**83.7**	**80.6**	**-3.8%**	**309.4%**	**121.0**	**106.6**	**-11.9%**	**32.4%**	**133.3**	**120.6**	**-9.5%**	**13.1%**
Yield	**bp**	**28**	**28**	**0**	**-70**	**24**	**25**	**2**	**-3**	**24**	**25**	**1**	**0**
Divisional data													
GDV													
G&I	A$bn	1.3	1.35	2%		1.5	1.5	2%		1.6	1.6	2%	
GPR	A$bn	12.3	12.1	-2%		14.1	13.9	-2%		15.5	15.3	-2%	
Digital Payments	A$bn	70.1	67.1	-4%		105.4	91.3	-13%		116.2	103.7	-11%	
Revenue													
G&I	A$m	77.6	77.6	0%		87.2	88.7	2%		95.9	97.5	2%	
GPR	A$m	136.3	134.0	-2%		155.3	152.8	-2%		170.8	168.0	-2%	
Digital Payments	A$m	21.0	17.2	-18%		43.3	26.7	-38%		53.5	39.6	-26%	
Gross profit													
G&I	A$m	62.1	62.1	0%		69.8	70.9	2%		76.7	78.0	2%	
GPR	A$m	83.1	81.8	-2%		98.6	96.2	-2%		111.0	108.4	-2%	
Digital Payments	A$m	17.0	14.1	-17%		35.2	22.0	-38%		43.3	32.2	-26%	
Gross margin													
G&I		80.0%	80.0%			80.0%	80.0%			80.0%	80.0%		
GPR		61.0%	61.0%			63.5%	63.0%			65.0%	64.5%		
Digital Payments		81.2%	81.9%			81.2%	82.1%			81.0%	81.4%		

Source: Edison Investment Research

Exhibit 4: Financial summary

A$'m	2018	2019	2020	2021	2022e	2023e	2024e
30-June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue	71.0	97.2	121.0	192.2	229.1	268.4	305.4
Cost of Sales	(17.7)	(24.2)	(32.9)	(63.8)	(70.9)	(79.0)	(86.5)
Gross Profit	53.3	73.0	88.1	128.4	158.2	189.4	218.9
EBITDA	21.0	29.7	32.5	42.2	37.1	67.7	86.9
Normalised operating profit	18.1	25.6	22.4	31.6	23.2	49.2	64.7
Amortisation of acquired intangibles	(7.2)	(7.5)	(11.1)	(20.2)	(20.0)	(20.0)	(20.0)
Exceptionals	(0.3)	(3.0)	(13.6)	(11.2)	(4.7)	0.0	0.0
Share-based payments	(5.0)	(4.2)	(6.1)	(5.0)	(6.0)	(2.5)	(2.5)
Reported operating profit	5.6	10.9	(8.5)	(4.8)	(7.5)	26.7	42.2
Net Interest	(0.1)	(0.0)	(0.7)	(1.4)	(3.2)	(3.7)	(3.7)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	(0.5)	(1.8)	1.3	(17.1)	(4.2)	(2.9)	(2.1)
Profit Before Tax (norm)	17.9	25.6	21.6	30.2	20.1	45.5	61.0
Profit Before Tax (reported)	5.0	9.0	(7.9)	(23.3)	(14.9)	20.1	36.4
Reported tax	(2.8)	(0.6)	0.7	(5.4)	0.0	(4.0)	(7.3)
Profit After Tax (norm)	14.4	20.5	17.2	24.1	16.1	36.4	48.8
Profit After Tax (reported)	2.2	8.5	(7.1)	(28.7)	(14.9)	16.1	29.1
Minority interests	0.0	(0.2)	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	14.4	20.3	17.2	24.1	16.1	36.4	48.8
Net income (reported)	2.2	8.3	(7.1)	(28.7)	(14.9)	16.1	29.1
Basic ave. number of shares outstanding (m)	246	249	304	360	371	373	373
EPS - basic normalised (A$)	0.058	0.081	0.056	0.067	0.043	0.097	0.13
EPS - diluted normalised (A$)	0.057	0.078	0.055	0.066	0.043	0.096	0.13
EPS - basic reported (A$)	0.009	0.033	(0.023)	(0.080)	(0.040)	0.043	0.08
Dividend (A$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	22.5	36.9	24.4	58.9	19.2	17.2	13.8
Gross Margin (%)	75.1	75.1	72.8	66.8	69.0	70.6	71.7
EBITDA Margin (%)	29.6	30.6	26.9	21.9	16.2	25.2	28.4
Normalised Operating Margin	25.4	26.4	18.5	16.4	10.1	18.3	21.2
BALANCE SHEET							
Fixed Assets	108.0	162.9	872.1	685.3	943.8	980.0	1,010.8
Intangible Assets	65.8	104.6	371.7	350.1	461.7	443.9	425.0
Tangible Assets	3.5	5.4	14.6	11.2	7.7	3.9	4.9
Investments & other	38.7	53.0	485.8	323.9	474.5	532.2	580.8
Current Assets	131.6	313.8	1,008.6	1,603.5	1,854.5	2,106.8	2,243.6
Stocks	12.6	18.2	22.3	16.4	20.0	21.9	24.0
Debtors	8.9	14.4	21.7	22.0	28.3	33.2	37.7
Cash & cash equivalents	39.0	33.1	118.4	141.2	129.1	148.4	89.6
Other	71.1	248.2	846.2	1,424.0	1,677.1	1,903.4	2,092.3
Current Liabilities	(90.5)	(299.0)	(1,357.8)	(1,792.8)	(2,188.4)	(2,465.6)	(2,695.2)
Creditors	(21.2)	(33.9)	(47.5)	(62.9)	(79.2)	(81.7)	(89.0)
Tax and social security	0.0	(0.8)	(2.6)	(6.0)	(6.0)	(6.0)	(6.0)
Short term borrowings	0.0	(15.0)	0.0	(1.4)	(1.4)	(1.4)	(1.4)
Other	(69.3)	(249.4)	(1,307.7)	(1,722.5)	(2,101.9)	(2,376.5)	(2,598.8)
Long Term Liabilities	(19.3)	(33.5)	(82.6)	(81.1)	(149.0)	(141.9)	(48.2)
Long term borrowings	0.0	0.0	(35.8)	(36.9)	(85.0)	(85.0)	(16.9)
Other long term liabilities	(19.3)	(33.5)	(46.8)	(44.2)	(64.0)	(56.9)	(31.4)
Net Assets	129.8	144.2	440.2	414.9	460.9	479.4	511.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	129.8	144.2	440.2	414.9	460.9	479.4	511.0
CASH FLOW							
Op Cash Flow before WC and tax	19.7	28.4	31.2	41.2	37.1	67.7	86.9
Working capital	(9.2)	2.0	3.6	31.7	9.6	(14.4)	(5.8)
Exceptional & other	(1.2)	(0.7)	(12.7)	(17.3)	(32.9)	0.0	0.0
Tax	(2.8)	(0.6)	0.7	(5.4)	0.0	(4.0)	(7.3)
Net operating cash flow	6.5	29.2	22.8	50.2	13.9	49.3	73.8
Capex	(5.3)	(5.8)	(11.0)	(12.6)	(14.0)	(17.0)	(19.3)
Acquisitions/disposals	(0.7)	(44.0)	(142.5)	(3.5)	(55.9)	(8.0)	(40.3)
Net interest	(0.1)	(0.0)	(0.7)	(1.4)	(3.2)	(3.7)	(3.7)
Equity financing	0.0	0.4	240.8	0.6	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	(0.6)	(0.4)	(7.0)	(11.0)	(1.2)	(1.2)	(1.2)
Net Cash Flow	(0.2)	(20.6)	102.3	22.2	(60.3)	19.4	9.3
Opening net debt/(cash)	(39.9)	(39.0)	(18.1)	(82.5)	(103.0)	(42.6)	(62.0)
FX	(0.6)	(0.3)	(2.0)	0.6	0.0	0.0	0.0
Other non-cash movements	0.0	0.0	(35.8)	(2.4)	0.0	0.0	0.0
Closing net debt/(cash)	(39.0)	(18.1)	(82.5)	(103.0)	(42.6)	(62.0)	(71.3)

Source: EML Payments, Edison Investment Research

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