

EML Payments

Storing up value

Initiation of coverage

EML Payments is a specialist payment solutions provider with a focus on the prepaid market. The group's strategy is to use acquisitions supported by organic development to establish strong positions across a diverse range of use cases and markets. EML now operates in 28 countries and has grown revenues at a five-year CAGR of 53%. While COVID-19 has slowed the pace of growth in the short term, the business is well-funded and remains profitable and cash generative. The launch of Project Accelerator is designed to keep EML at the forefront of innovation in payments technology and to support the company's aim to be 'the fintech's fintech'.

Year end	Revenue (A\$m)	PBT* (A\$m)	NPATA** (A\$m)	Dil. EPS* (c)	DPS (c)	P/E (x)	EV/EBITDA (x)
06/19	97.2	25.6	20.6	7.8	0.0	46.2	41.2
06/20	121.0	21.6	24.0	4.9	0.0	65.3	37.6
06/21e	173.4	35.3	28.2	7.6	0.0	47.2	25.2
06/22e	218.8	53.7	46.1	11.6	0.0	31.1	17.3

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

Payment solutions provider with prepaid card focus

EML Payments (EML) has developed a variety of prepaid card offerings for specialist areas such as shopping mall gift cards, salary packaging, government welfare payments and flexible lines of credit. The company can provide end-to-end solutions with technology features not available from the larger volume providers. The recent acquisition of Prepaid Financial Solutions (PFS) has diversified the customer base and product range and shifted the weighting of the business and growth prospects towards the reloadable card segment.

Resilient business, reinvesting to drive growth

The company has a strong growth track record, with a five-year CAGR of 53% for revenue and 60% for EBITDA. FY20 results reflected strong trading for the first eight months of the year, the acquisition of PFS in April and the impact of COVID-19 from March. We believe the diversification of the group and its strong cash position provide EML with good foundations on which to grow the business, and as part of Project Accelerator, we expect the company to increase its investment in new technology and strengthening its product portfolio. We forecast revenue growth of 43% in FY21, 26% in FY22 and 13% in FY23. This translates to EPS growth of 38% in FY21, 52% in FY22 and 27% in FY23.

Valuation: Scope for Accelerate to drive upside

On EV/EBITDA and P/E multiples, EML trades at a discount to global payment processing companies and at a premium to prepaid card companies, reflecting the scale and profitability of the former, and EML's better growth prospects compared to the latter. A reverse DCF analysis implies that the market is not factoring in aggressive growth or margin prospects for the company. Successful implementation of Project Accelerator should drive upside.

Software & comp services

21 October 2020

Price **A\$3.61**

Market cap **A\$1,305m**

US\$0.71/€0.60/£0.55/A\$

Net cash (A\$m) at end FY20 82.5

Shares in issue 361.6m

Free float 93%

Code EML

Primary exchange ASX

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 20.6 83.6 33.1

Rel (local) 22.5 13.3 (8.4)

52-week high/low A\$5.66 A\$1.33

Business description

EML Payments is a payment solutions company specialising in the prepaid stored value market, with mobile, physical and virtual card offerings. It provides solutions for payouts, gifts, incentives, rewards and supplier payments, managing thousands of programmes across 28 countries in Europe, North America and Australia.

Next events

EMLCON virtual event 29 October

Virtual AGM 30 October

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EML Payments is a research client of Edison Investment Research Limited

Investment summary

Specialist provider of prepaid card solutions

Over the last five years, EML has grown from being an Australia-focused prepaid card business to a global business with operations in 28 countries managing thousands of prepaid card programmes. Revenues have increased at a CAGR of 53% over the same period, helped by a number of acquisitions in the US and Europe. The group comprises three divisions: Gift & Incentive (G&I: 56% FY20 revenue, 64% FY20 gross profit), General Purpose Reloadable (GPR: 35% revenue, 28% gross profit) and Virtual Account Numbers (VANs: 9% revenue, 8% gross profit). The acquisition of Prepaid Financial Services (PFS) in April has rebalanced the group, with GPR forecast to be the key driver of revenue growth and profitability. Key investment considerations include:

- The company focuses on programmes and customers who are looking for an end-to-end solution and who are often under-served by major processor-only competitors. Using its proprietary payments platform, EML develops technology to serve these applications and aims to build a significant position in these markets with its solutions. Examples include EML's dominant position in the mall gift card market, providing programmes for the largest mall operators in North America and Europe, and its position as the main prepaid card supplier to the Australian salary packaging market.
- The company supports a range of applications with different characteristics: some are slower growth but higher margin, others are in emerging areas of fintech with high growth potential, and others generate high volume but at a lower margin. Management's strategy is to build a diversified business that is not dependent on any one application or customer.
- Customer contracts tend to be exclusive and churn is low. This allows the company to scale the business in an efficient manner, providing operational leverage.
- The business is well-funded with a cash position of A\$118m and no secured debt at the end of FY20. The business has grown by acquisition and we expect to see more acquisitions once the initial disruption from COVID-19 has abated.
- The company recently launched Project Accelerator, with the aim of remaining at the leading edge of payment solutions and providing a superior customer experience compared to its larger peers. This includes internal investment in product and infrastructure, partnering with adjacent technology providers and taking minority or controlling stakes in companies that would enable EML to expand its product and technology capabilities.

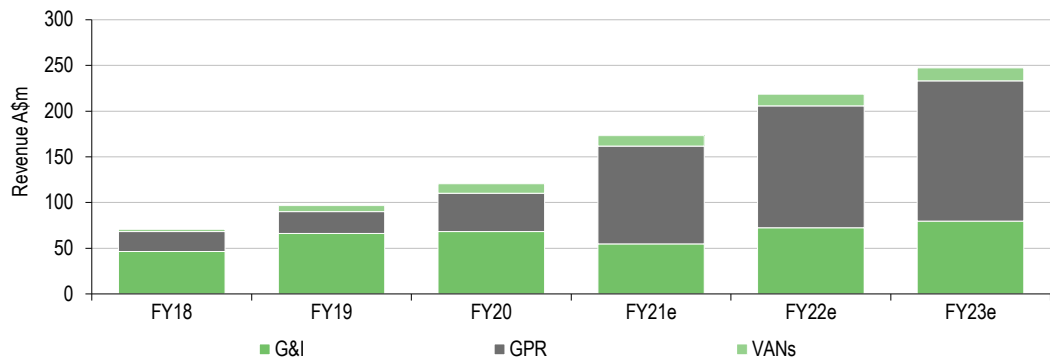
Financials: GPR to generate the majority of revenues from FY21

The company has a strong growth track record, with a five-year CAGR of 53% for revenue and 60% for EBITDA. The company recently reported FY20 results, which included the first three months of ownership of PFS. Gross debit volume (GDV) grew 54% y-o-y (40% excluding PFS) while revenue grew 24% (8% excluding PFS). After eight months of strong trading, the business slowed from March, particularly for G&I, as shops were closed during lockdown and travel came to a standstill. The Q121 trading update confirmed that all divisions saw sequential GDV and revenue growth compared to Q420 as the trading environment improved. While G&I is likely to remain depressed at least through H121, the GPR division is more resilient as it serves various non-discretionary markets such as government disbursements and banking-as-a-service. At the end of FY20, the group was generating an annualised GDV run rate of A\$17bn. The charts below show our forecasts for revenue by division, EBITDA and NPATA.¹ We note that EML has built a scalable business:

¹ Net profit after tax and adjustments for acquisitions. For a detailed reconciliation see page 21.

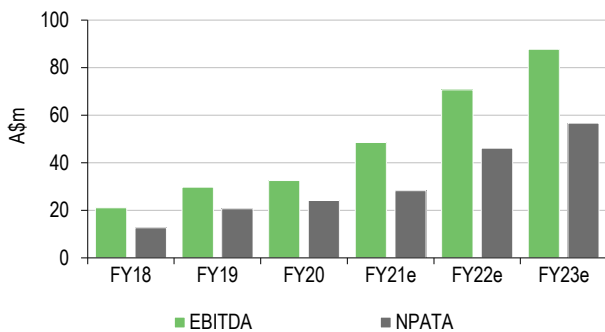
EBITDA margins expanded from 22% in FY15 to 31% in FY19 before COVID-19 depressed trading. As business recovers, we expect the company to be able to expand margins again.

Exhibit 1: Revenue by division, FY18–23e



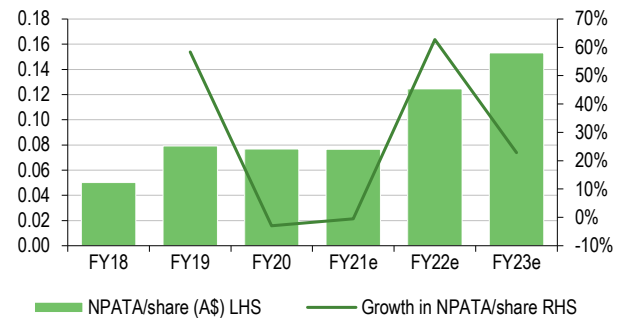
Source: EML Payments, Edison Investment Research

Exhibit 2: EBITDA and NPATA, FY18–23e



Source: EML Payments, Edison Investment Research

Exhibit 3: NPATA per share, FY18–23e



Source: EML Payments, Edison Investment Research

Valuation: Project Accelerator could provide upside

EML competes against a number of large financial services companies that offer prepaid card services, as well as privately owned large and niche prepaid card companies, with no directly comparable listed peer. We have compared EML's valuation to three groups: payment processors, companies with prepaid card activities and Australian fintechs. The payment processing and prepaid card peers generate high EBITDA margins; EML is in line with the average for prepaid card companies and slightly below the margins achieved by the much larger payment processors, although EML is forecast to grow revenues faster than both groups. The Australian fintechs are at earlier stages of development so are typically expected to grow at much faster rates but with limited profits or even losses. On an EV/EBITDA and P/E basis, EML trades at a discount to payment processors, in our view reflecting their scale and profitability compared to EML. EML trades at a premium to prepaid card companies, justified in our view because of its growth potential. It is forecast to grow EPS at a faster rate than both groups over the next two years. A reverse discounted cash flow analysis using our explicit forecasts to FY24, and a WACC of 8% and a long-term growth rate of 3%, implies that the market is pricing in revenue growth of 6.5% in FY25–30 and an EBITDA margin of 35.2% over the same period. Both appear conservative considering the group's historical performance and potential to scale. Successful execution of Project Accelerator should drive growth at faster rates than implied in the valuation.

Factors influencing growth and profitability

The company is sensitive to general factors such as competition and product development. Factors that will influence the rate of revenue growth and profitability in the short term include the pace at which malls re-open and footfall is re-established, consumer propensity to spend given the current recession, and the opening up of international travel. Changes to the regulations that EML must comply with could increase costs or reduce potential revenues. Acquisitions have been a feature of the last five years; future acquisitions will require funding and could add integration risk. With 1% of FY20 revenue generated from the interest earned on stored value balances, changes in interest rates would affect our forecasts.

Company description: Payments technology provider

EML Payments is a payment technology company with a focus on the prepaid market. Its proprietary platform supports three main product groupings: gift and incentive products, general purpose reloadable products and virtual account number products.

Background

EML Payments was founded in Australia in 2001 and was formerly known as Emerchants Limited (the company changed its name to EML Payments Limited in 2016). EML was listed on the ASX in 2011 via a reverse take-over. At that time, the business operated solely in Australia and had annual revenues of less than A\$1m. Tom Cregan, the current CEO, joined in 2012 and has led the company through a series of acquisitions to expand the product portfolio and geographic coverage. The table below summarises the acquisition history.

Exhibit 4: Acquisition history

FY	Name	Division	Location	Initial cost (A\$m)		Deferred consideration	Contingent consideration	Notes
				Cash	Equity			
FY15	Store Financial Services UK	G&I	UK & Europe	12.45	12.45	0	0	Non-reloadable mall cards: 100 programmes in 9 countries
FY16	Store Financial Services LLC (now EML North America)	G&I, VANs	US	35.085	11.46	0	0	Mall cards, B2B virtual payments
FY18	PreSend Nordic AB (now EML Payments AB)	G&I	Nordic-Baltic region	1.582	0	0	6.699	Mall cards
FY19	Perfectcard DAC (74.86%)	G&I	Ireland	4.3	0	0.387	2.922	E-money licence (Ireland), incentive and corporate expenses solutions
FY19	Flex-e-card	G&I	UK, Europe, UAE	35.936	0	3.993	0	Mall cards
FY20	Remaining 25.14% of Perfectcard	G&I	Ireland	4.679	0	0	0	As above
FY20	Prepaid Financial Services (PFS)	GPR	UK, Ireland	157.3	67.2	40.3	110.3	White-label payments and banking-as-a-service technology

Source: EML Payments

The most recent and largest acquisition, Prepaid Financial Services (PFS), completed on 1 April 2020. In November 2019, to fund the acquisition EML raised A\$242m from the issue of 69.9m shares at A\$3.55 per share. As the price for PFS was renegotiated prior to completion, the initial cash requirement reduced from the original A\$346m to A\$157m. This has left EML with a higher level of cash and no need to take out the originally planned A\$175m debt facility.

The group has 444 employees across 12 offices in Australia (HQ), Ireland, Malta, Poland, Sweden, UAE, the UK and the US.

Group strategy: remain at forefront of payment technology

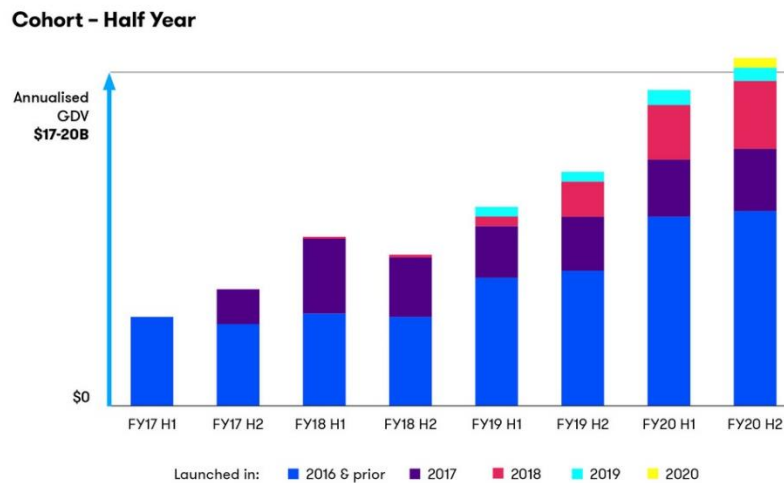
The company's mission statement is: 'We create awesome, instant and secure payment solutions that connect our customers to their customers, anytime, anywhere, wherever money is in motion'.

Practically, this means that the company supplies prepaid card solutions for specialist applications – currently shopping mall gift cards, employee and customer incentives, gambling payouts, welfare payments, salary packaging and fintechs – but would expand to other applications as they emerge. The company identifies pain points in the payments process for a given application and develops solutions to address them, commercialising the solution across the vertical where possible.

The business started with an Australia-only focus and through acquisition has grown to cover Europe and North America. The business is broadly grouped into three areas: non-reloadable cards (ie one-time use cards such as gift cards), reloadable cards and virtual account numbers (for business-to-business payments). The company is typically signed up to work on long-term contracts (three to eight years), often on an exclusive basis.

Customer churn is very low, so as new customers sign up and contribute growing levels of GDV (see Exhibit 5), EML is able to generate material revenue growth. As it is not necessary to scale costs at the same rate, the group has been able to expand profitability significantly and should be able to continue to do so as it adds new customers and verticals.

Exhibit 5: GDV contribution by customer cohort



Source: EML Payments

The chart below shows the split of GDV, revenue, yield and gross profit by division. We discuss the dynamics of each division in more detail later in the report.

Exhibit 6: Divisional summary, FY20

Division	Gift & Incentive (G&I)	General Purpose Reloadable (GPR)	Virtual Account Numbers (VANS)
Activity	Non-reloadable cards	Reloadable cards	Virtual credit card numbers
Applications	Mall & retail gift cards, incentive & reward cards	Banking-as-a-service, salary-as-a service, government/non-profit disbursements, gambling disbursements, multi-currency cards	Supplier payments
Geography	Australia, Europe, North America	Australia, Europe, North America	North America
FY20 performance			
GDV A\$bn	1.2	4.2	8.5
Revenue A\$m	68.2	41.9	10.7
Yield	5.80%	0.99%	0.13%
Gross profit A\$m	56.2	25.0	6.9
Gross margin	82.4%	59.7%	64.8%

Source: EML Payments

Pausing for breath on the M&A front

While the business has grown via acquisition over the last five years, gaining a dominant position in the mall gift card market, and rebalancing the group towards the GPR division with the most recent PFS acquisition, the company has indicated that M&A activity is likely to be quieter over the next 12 months. This gives the group time to fully embed the PFS acquisition while managing the business through COVID-19 disruption. The company currently has cash on the balance sheet and access to debt facilities so that it could be opportunistic if an attractive target emerged. However, the focus in the shorter term will be on executing Project Accelerator.

Launch of Project Accelerator

With FY20 results, the company announced that it had reviewed the group post the acquisition of PFS, and had launched a new strategy called Project Accelerator. This is designed to help the company fulfil its vision of 'offering customers a feature rich, fully embedded payment solution, via a simple, single touchpoint'. The group wants to benefit from working with companies looking to disrupt their own industries, using EML's payments technology to help them do so. In order to remain at the forefront of innovation, the group plans to focus its investment in four areas:

- **In house development of product and infrastructure:** to make it easy for customers to use EML's solutions. For example, creating a single point of integration for customers to access EML's operations in different countries or developing a tokenisation solution for Visa cards so that EML can support the customer's choice of card network.
- **Integration with adjacent technologies:** to add additional functionality that the company does not necessarily want to develop itself.
- **Partnering with disruptive fintechs:** potentially to use as a route to sell each other's products.
- **External investment:** the company has set up FinLabs to invest in minority stakes in companies with interesting and relevant technology. EML has already made its first US\$2m investment in Interchecks, a US-based disbursement tool for non-card payments. EML will also resell Interchecks technology.

The company expects to spend A\$10–15m over the next two years, some of which will be capitalised. The remainder will be funded through cost savings. Management noted that all organisational decisions will be aligned to the Project Accelerator strategy and focus on becoming the 'fintech to fintechs'.

Short-term growth drivers

For FY21, G&I revenue growth will depend on the pace at which shopping in malls recovers. The GPR division will benefit from a full 12 months of ownership of PFS (only three months were included in FY20; see page 13 for further detail) and the continuing rollout of salary packaging for recently signed contracts.

Longer-term growth drivers

In the longer term, the company should benefit from the growth of fintech companies, increasing government welfare spending and the trend to digitise cash payments. The company now has the ability to cross-sell PFS's capabilities with fintechs in the US and EML's gift card solutions to PFS' customer base.

Considering future acquisitions and product development, the company has made it clear that it is keen to diversify the business. By adding new applications and customers, it should be able to, reduce exposure to particular verticals, eg malls, to a particular customer concentration or to a particular product.

Management

The **board** is made up of managing director and CEO Tom Cregan (bio on page 28), Non-executive chairman Peter Martin (bio on page 28) and five non-executive directors: Tony Adcock (banking and consulting background), Kirstin Ferguson (consulting), George Gresham (payments), David Liddy (retail banking) and Melanie Wilson (global retail brands).

The **leadership team** is headed up by CEO Tom Cregan who joined the company in 2012 when it was called Emerchants and solely operated in Australia. He has many years' experience in leadership roles in payment-related companies including e-pay (which he sold to Euronet and then remained there to set up PaySpot in the US) and more recently NetSpend (since acquired by TSYS). CFO Rob Shore (bio on page 28) joined the company in 2016 as group financial controller and was promoted to the CFO role in 2018. Other members of the team include Richard Anderson (group chief sales and marketing officer), Andrew Betts (chief risk officer), Rachelle St. Ledger (CEO Australia), Nikki Evans (CEO EMEA), and Ailie Kofoid (CEO Americas). Key management retained from the recent PFS acquisition includes Noel Moran (CEO) and Lee Britton (commercial director).

Prepaid cards: An introduction

Prepaid cards are payment cards that must have funds loaded onto them before they can be used. They are not the same as debit or credit cards and do not pull funds from a bank account. The user can load the card with a variety of sources of funds, eg cash, direct from a bank account, or using a debit or credit card. The balance on the card represents the spending limit.

Multiple applications for prepaid cards

Cards are either reloadable or non-reloadable (ie one-time use only). Examples of **non-reloadable** cards include gift cards (the type offered by individual retailers or by shopping malls giving access to multiple retailers) and incentive cards (for example cash back cards on the purchase of a high value item). Typical uses for **reloadable** prepaid cards include travel currency, winnings payouts, payroll cards (including Australian salary packaging), welfare payments, corporate expenses and consumer banking.

Cards are either open loop or closed loop. **Open loop** cards are linked to one of the main payment networks such as Mastercard or Visa and can be used anywhere that the specific payment network debit or credit cards are accepted. **Closed loop** cards are restricted in some manner such as to a specific mall or retailer. This is attractive for mall owners and retailers as it prevents leakage, namely, it means that cardholders cannot spend the cards elsewhere.

Pre-paid cards are popular for many reasons including for the consumer:

- not having a bank account;
- not wanting to incur fees on a bank account;
- to limit/control spending (as once the funds are spent, it is not possible to go into overdraft);
- to provide a more personal gift than handing over cash;
- to get quick access to winnings when gambling;
- to convert cryptocurrency to fiat;
- to provide a more secure store of value than carrying cash eg for travel money; and
- to be able to spend online if not old enough for a credit card.

For businesses/governments:

- to encourage loyalty (staff or customers);

- to control the way funds are spent (eg for salary packaging);
- to enable citizens without bank accounts to access benefits or grants.

In the developed markets that EML operates in, the level of unbanked citizens is relatively low. For example, c 1.5 million people in the UK (2% of the population) do not have a bank account (source: Financial Inclusion Commission), although only half want one. Close to two-thirds have previously had a bank account but struggled to manage it. In the US, data from the FDIC Survey of Unbanked and Underbanked Households estimated that in 2015, 9m households were unbanked and another 20m were underbanked accounting for c 67m adults. Underbanked is defined as those with very basic bank accounts that do not provide for all financial needs. These people often resort to alternative financial services such as cheque-cashing, payday loans, international remittances and pawnshop loans, which are typically more expensive and offer less consumer protection.

Using a prepaid card can be a way of accessing the financial system without getting into difficulties, as it is not possible to become overdrawn and card issuers are regulated.

Strong growth market

In terms of market size, Applied Market Research estimates that US\$1,848bn was loaded onto prepaid cards in 2019 and expects this to grow to US\$5,511bn by 2027 (14.6% CAGR). Note that these estimates were made pre-COVID 19; while the market is likely to see lower volume growth in the short term, we believe it should not have an impact on longer-term trends. The Worldpay Global Payments Report 2018 estimated that 3% of North American e-commerce payments and 2% of North American point of sale (POS) payments were made with prepaid cards. In the US, the Federal Reserve publishes statistics on debit and credit card usage, and in 2018 calculated that 6.3% of debit card transactions were made using prepaid cards and 5.8% by value.

Data on the gift card market is not available on a global basis. In the UK, the Gift Card and Vouchers Association (GCVA) publishes regular reports on trends in the market for gift and incentive cards. In its report 'Valuing the Gift Card Industry 2020', GlobalData estimates that the UK gift card market was worth £6.9bn in 2019 and forecasts that this will grow to £8.7bn by 2025. In 2019, two-thirds of the market was from B2C sales and one-third B2B. Of the cards sold directly to consumers, c £2.8bn were for single stores and c £0.8bn were multi-store cards. Cards sold to businesses fall under the incentives and rewards category, and this is the fastest growing segment of the market. GlobalData estimates that by 2025, the B2B category would make up 50% of the market, which implies a CAGR of 11% from 2019–25.

Regulation shapes the US market

In the US, the prepaid card market splits into card issuers and programme managers. A prepaid card issuer will hold customer funds on its balance sheet, and as the US does not have an e-money regime, this can only be done by companies with FDIC² insurance. The largest issuers are Bancorp Bank, Green Dot Corporation and MetaBank.

Prepaid card schemes are typically designed and managed by programme managers; they will work with the company wishing to offer cards to consumers or businesses to design and market the cards and they will manage the movement of funds between card holder and supplier. The chart below shows key prepaid card companies in the US.

² Federal Deposit Insurance Corporation

Exhibit 7: US prepaid card companies

Company	Ownership	Issuing bank	Services offered
Blackhawk Network	Private	MetaBank	Gift cards, incentive cards
H&R Block	NYSE-listed	Axos Bank/MetaBank	GPR cards for tax refunds
InComm	Private	Amex, Bancorp, MetaBank	Gift cards, incentive cards, GPR. Sole distributor of Amex prepaid cards in the US
Mango Financial	Private	Metropolitan Commercial Bank	GPR
Netspend	Global Payments	MetaBank	GPR
PayPal	Nasdaq listed	Bancorp	GPR

Source: Edison Investment Research

In Europe, e-money regime supports self-issuance

In Europe the situation is different, as companies with an e-money licence are able to issue prepaid cards. For gift and incentive cards, Blackhawk Network and InComm are both active in Europe. PPS, a subsidiary of Edenred, issues gift cards (closed loop and Visa-branded). In the mall gift card market, EML sees competition from Belgian company Loyalttek, which has c 50 malls compared to EML's 500.

The emergence of neo banks (also known as challenger banks) and other fintechs in Europe and Australia has driven demand for GPR prepaid cards. Some of these companies have their own issuing licences (eg Revolut) but many look to third-party programme managers to do this.

Fees earned from cardholders and merchants

Prepaid cards attract a variety of different fees, with the split payable by merchant or cardholder specific to each card programme. Typical fees are as follows:

Reloadable cards: monthly service fee (often waived if more than a certain amount is loaded onto the card each month), load fees (certain types of load are usually free eg cash, direct from bank account), ATM withdrawal fee (for out of network ATMs), transaction fees if used abroad. In addition, some balance checks and customer support calls are charged for. These costs would usually be paid by the cardholder. In addition, the card issuer would earn interchange when the cardholder spends using the payment networks.

Non-reloadable: for gift cards, the fees are typically paid by the retailer or mall operator although the cardholder may be required to pay for costs such as customer support calls. Typical charges include activation fees, load fees or per transaction fees. The card issuer will earn interchange where transactions use the payment networks.

Regulation is a key cost of doing business in this market

The prepaid card market falls under regulation relating to anti-money laundering, e-money issuing and consumer protection. This covers areas such as the maximum load that can be made onto a card before AML/KYC³ checks need to be undertaken, the ability to self-issue cards, caps on interchange rates and the length of time funds remain on a non-reloadable card before the card expires.

EML has a Mastercard issuing licence in Australia and Europe. It also has two e-money licences in Ireland (through the acquisition of Perfectcard and PFS) and one in the UK (from PFS), providing the ability to service the whole of the EU after Brexit. The company also has an Australian Financial Services Licence (AFSL) issued by the Australian Securities and Investments Commission (ASIC).

EML's non-reloadable cards follow the expiry date rules for the countries in which it operates. In the UK, cards tend to have a 12-month expiry date. In Germany and Ireland, cards expire after three years. In the US, some cards expire, while others are unlimited.

³ Anti-money laundering/know your customer

Gift & Incentive (G&I)

As the name of the division suggests, G&I can be broadly grouped into gift cards and incentive schemes. All cards issued by this division are single-use only, ie can only be loaded with funds once. Pre-COVID-19, c 70% of GDV was from gift cards. For FY20, the contribution reduced to 62% of GDV (partly due to the impact of COVID-19 on mall customer programmes and partly due to faster growth in incentive programmes) and it is likely to remain lower for H121. The company noted that incentives made up c 50% of July 2020 GDV, compared to 42% a year ago.

Revenues in this division are earned from transaction fees (load fees, activation fees, interchange – these can be fixed fees or a percentage of transaction value), breakage (see page 26 for further detail), establishment fees (earned when a programme is set up) and interest earned on the stored value balances. The company issues c 11m cards per annum in this division.

The division has grown organically and through acquisition:

- FY15: Store Financial Solutions UK – more than 100 mall programmes in nine European countries including the UK.
- FY16: Store Financial Solutions LLC (SFS US) – 650 mall programmes in the US and Canada.
- FY18: PreSend Nordic AB – 90 mall programmes in eight countries (Denmark, Finland, Norway, Sweden, Estonia, Lithuania, Italy and the UK).
- FY19: Perfectcard DAC– incentive cards in the UK and Ireland; Flex-e-card – 226 mall programmes across the UK, Ireland, Poland, Italy, Finland and the UAE.

Gift cards – the largest mall card operator globally

EML runs gift card schemes for shopping malls globally. Mall operators include British Land, ECE (Germany and Eastern Europe), Unibail-Rodamco-Westfield (UK and Europe), Hammerson, Intu (UK), Land Securities and Simon Malls (US). At the end of FY20, EML was providing gift cards to more than 1,200 malls globally.

In FY20 EML launched in several Nordic malls (Nova, Tripla, Ingka) and ECE's Austrian malls. In January 2020, the company launched its programme for Simon Malls in the US. Simon Malls is not an exclusive contract; both InComm and Blackhawk Networks also manage programmes for them. EML is aiming to win share through its more advanced technology offerings such as EML Connect and PAYS (see page 11 for further detail).

The vast majority of cards are issued as plastic cards, as they can only be used in-store rather than online. Recently, in an effort to reduce the amount of plastic used in non-reloadable cards, EML launched a programme for Center Parcs in the UK using paper-based cards. The company has a stated target of reducing the issuance of plastic cards by 50% from a projected 50 million over three years (2021–2023). This would be through promoting the use of paper-based cards and digital-only cards.

Money loaded onto gift cards can fall under the remit of e-money licensing, depending on legislation in a given country or customer preference. Whether private label or e-money, gift card holders' funds are protected by similar safeguarding procedures. In Europe, EML self-issues gift and incentive cards; in the US, MetaBank issues cards for EML.

Pre-COVID-19, this part of the business generated yields of 700–800bp per annum. There is a significant seasonal impact: historically 43–46% of GDV has been generated in the eight weeks before Christmas and a large proportion of breakage recognised in the following months in H2 (see page 26 for further detail).

Trends within shopping malls, pre-COVID-19

Physical retailers have been increasingly affected by the strong growth in online retail, with the demise of the high street and large out-of-town shopping destinations a concern for governments in many countries. Some shopping mall operators are trying to halt this decline by making their malls an entertainment destination. For example, as well as having c 290 stores, including one area devoted to luxury fashion, Westfield London has 98 restaurants, cafes and bars and a 20 screen cinema. It hosts seasonal events (indoor ice rink, fashion shows) and is designed to be family friendly. Many malls are trying to help retailers with their omni-channel offerings by providing locations for click and collect. In some cases, this extends to providing changing rooms for customers to try on items ordered online, and enabling them to return goods then and there rather than having to use parcel collection services.

EML tends to work with the higher end malls to take advantage of these trends. The company has developed a software platform called **EML Connect** to help mall customers extend their gift card sales reach beyond physical stores and into online, digital and B2B sales. Key mall partners are expected to launch in the next few months.

Incentive cards: A high potential market

EML runs schemes that allow companies to offer pre-loaded incentive or reward cards to employees or customers. Examples of schemes include cash-back on purchases of high-value items (eg Fujitsu air conditioning offering an A\$400 prepaid Mastercard gift card) or bonus schemes for employees.

Cards can be branded and in most cases are issued as physical cards. EML has developed its **PAYS** technology, which means it can provide incentive cards directly to users' mobile wallets including Apple Pay, Google Pay and Samsung Pay, and even extending to wearables such as Fitbit Pay and Garmin Pay. Breakage is typically lower for these cards as they are usually open loop so the company earns a yield of c 400bp.

Customers include Allgo (Ireland), BFM Group (US), CleverGift (Ireland), Glanbia (Ireland), TCN (Australia), Vault Payment Solutions (Australia) and Virtual Commerce (US).

COVID-19 impact: Gift cards see bigger effect than incentives

As shops have been closed during lockdown, gift card sales have declined as has the usage of previously purchased gift cards. This has had a negative effect on transaction fees (due to lower card usage) and breakage (due to lower volumes of new card sales). New programme launches have been delayed so establishment fees are also down. In most countries, retail stores have re-opened, although footfall is lower due to restrictions in store and because not all consumers are willing to venture out to crowded places yet. In addition, not all customer service staff who would be responsible for selling gift cards have returned to work. Unibail-Westfield-Rodamco (UWR) noted in its H120 results (published 29 July) that footfall and sales were recovering faster than expected where malls had reopened. For those malls that re-opened 11–12 weeks ago, trading is at c 80–90% of prior year levels, although in the UK, which reopened more recently, year-to-date footfall is at more like 50% of prior year. Simon Property Group (the parent company of Simon Malls) reported in its Q220 results (published 10 August) that 91% of tenants were open and operating as at 7 August, although we understand it only recently re-opened the kiosks that sell gift cards. In May, tenants reported volumes down 50% y-o-y, reducing to 20% down in June.

For EML, Christmas is always the key shopping period for gift cards, and it remains to be seen how likely consumers will be to buy them. The purchase of incentive and reward cards is likely to be less affected by the closure of malls. However, as many of the recipients of the cards will want to use them in shops, a certain proportion of fees will be delayed until retail stores are fully open again.

Financial performance and forecasts

Exhibit 8: Gift & Incentive divisional performance							
		FY18	FY19	FY20	FY21e	FY22e	FY23e
GDV	A\$bn	0.7	1.1	1.2	1.1	1.2	1.3
Revenue	A\$m	46.6	66.4	68.2	54.9	72.5	79.8
Yield	%	6.33%	6.26%	5.80%	5.00%	6.00%	6.00%
Cost of sales	A\$m	(10.0)	(14.0)	(12.0)	(11.6)	(15.3)	(16.8)
Gross profit	A\$m	36.6	52.4	56.2	43.3	57.2	62.9
Gross margin	%	78.5%	78.9%	82.4%	78.9%	78.9%	78.9%
Transaction revenues	A\$m	14.82	26.68	32.56			
Service revenues	A\$m	26.43	31.89	25.70			
Establishment fees	A\$m	3.91	6.03	8.70			
Interest income	A\$m	1.46	1.77	1.21			
Total revenue	A\$m	46.63	66.37	42.47			
GDV – growth y-o-y		N/A	43.8%	10.8%	-6.5%	10.0%	10.0%
Revenue – growth y-o-y		N/A	42.3%	2.7%	-19.4%	32.0%	10.0%

Source: EML Payments, Edison Investment Research

The table above details the division's historical performance and our forecasts. FY19 GDV and revenue benefited from the inclusion of PreSend Nordic for a full year (acquired 1 February 2018) and Perfectcard (acquired 4 July 2018). Similarly, FY20 benefited from a full year's ownership of Flex-e-card (acquired 28 June 2019; contribution in FY20 not disclosed). Trading for the first eight months of the year was strong: November/December GDV was 17% higher y-o-y, January/February was 26% higher. In March, GDV started to decline bottoming out in April at A\$31m (-53% y-o-y), with gift card GDV down 90% y-o-y. June mall gift card volumes had recovered to 76% of February volumes and 73% of June 2019 volumes. GDV in March to June declined 32% y-o-y in total. In this division, A\$100m of GDV translates to c A\$6m revenues and c A\$4.9m gross profit; the company estimates it lost c A\$200m in GDV due to COVID-19, which translates to a loss in gross profit of close to A\$10m in FY20.

We forecast a decline in GDV in FY21, as we expect it will take some time for trading to revert back to normal in the mall card market. We expect faster growth from incentives, as these are less dependent on physical stores being open. As we expect lower breakage revenues in FY21, this brings down the yield and the gross margin; the company expects yield will be closer to 500bp.

General Purpose Reloadable (GPR)

In FY19, prior to the acquisition of PFS, the GPR division made up 30% of group GDV and 25% of group revenue. With all of PFS's activities falling into the GPR category, this boosts the GPR division's contribution to the group. Based on the June 2020 run rate, GPR now contributes c 55% of revenue. The acquisition of PFS strengthened some of the areas that EML was already operating in (such as government and fintech) and has added new areas such as banking-as-a-service and multi-currency travel cards. Exhibit 9 shows the key areas of operation for PFS as well as the estimated financial performance prior to acquisition (note the deal was announced in November 2019 and completed on 1 April 2020).

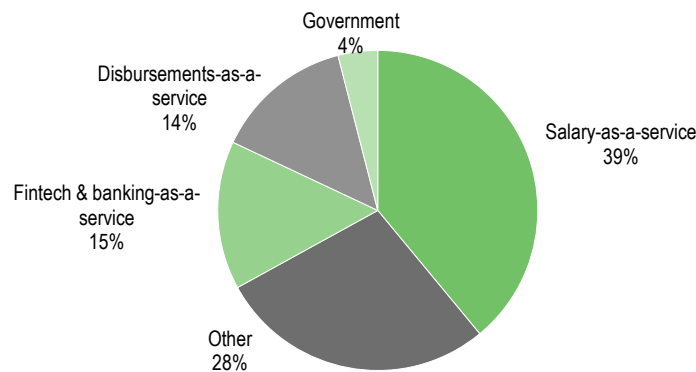
Exhibit 9: Prepaid Financial Services – lines of business and financial summary

Application	% CY18 GDV	Details	Customers
Digital banking & current accounts	43	Online/mobile banking & real-time payments, issuance of IBANs, partial current a/c switching services	Correos, PCS, NLB, Rebellion
Government, local authority & NGO	42	Issuance to unbanked & underbanked individuals, online banking & real-time payments, real-time secure funds distribution and bulk payments	UNHCR, HM Government, CarerCard, Finnish Immigration Service
Corporate solutions & incentive schemes	7	Customised e-money and digital banking solutions, end-to-end payment services, full programme design & management, reward & loyalty programmes	3, Centrip
Multi-currency travel cards	6	Multi-currency cards or e-wallets, direct integration with numerous FX providers, single/multi-use virtual cards, P2P/youth-centric products	Veritas, sgm-FX
Instant issue & GPR	1	Full programme design & management, white-labelled end-user interfacing, card issuing, GPR (B2B, B2C)	iKort
CY19e GDV			£2.5bn/A\$4.6bn
CY19e revenue			£40m/A\$73m
CY19e adjusted EBITDA			£12m/A\$22m (30% margin)
CY19e yield			160bp

Source: EML Payments

The chart below shows the main applications supported by the GPR division and the split of GDV in FY20. We discuss the main applications in more detail below.

Exhibit 10: GPR GDV split, FY20



Source: EML Payments

Salary-as-a-service: Leader in Australian salary packaging

This business line has until recently operated solely in Australia. Employees that work for non-profit organisations, such as charities and hospitals, can elect to take advantage of salary sacrifice rules that allow them to allocate a percentage of salary pre-tax to Australian Taxation Office-authorized expenditure categories. The two categories that EML Payments provides prepaid cards for are Meals & Entertainment and Living Expenses. Each category is capped: Meals & Entertainment at A\$2,650 per annum/A\$221 per month and Living Expenses at A\$9,010 per annum/A\$751 per month. As well as reducing their overall income tax bill, employees may also be able to benefit from discounts or loyalty schemes offered by participating merchants.

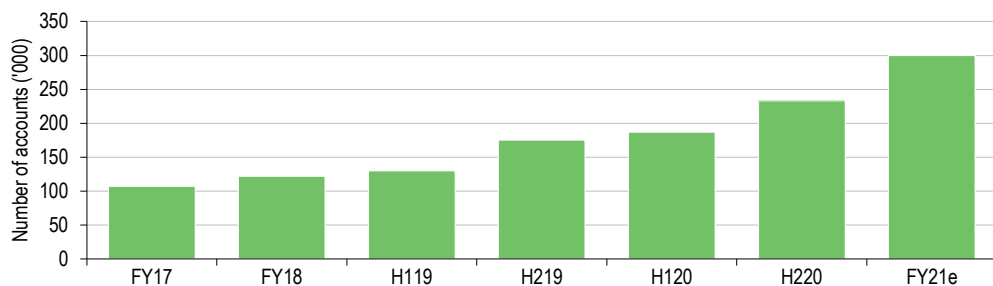
EML provides the prepaid cards in physical form or via a mobile wallet. In the case of employees taking advantage of both categories, the mobile wallet allows them to manage all expenditure in the same place rather than using two plastic cards. EML will make the decision on whether to authorise payments from either category based on merchant codes. EML earns a monthly fee per account plus interchange every time an account-holder spends from the card. The company earns revenue of c A\$60 per card per annum.

The main providers of Australian salary packaging services are Eziway, McMillan Shakespeare, paywise and Smartgroup – all customers of EML. EML also has a direct contract with NSW Health.

EML entered the market after changes to interchange regulations and the cost to develop compliant product prompted the exit of ANZ Banking Group and National Australia Bank. Since then, Westpac has been the only other material prepaid card supplier to this market, but as it exited the market this year this leaves EML as the main supplier.

EML launched its first salary packaging solution in FY17 servicing six providers and was supporting 107,000 accounts by the end of FY17. The chart below shows progress since then and includes the company's target to be supporting 300,000 accounts by the end of FY21. This compares to an estimated addressable market of 350,000 accounts. The company estimates that once it hits its 300,000 account target, it will be generating an annualised GDV of more than A\$2bn and annual revenue of c A\$18m. For FY20, salary packaging generated GDV of c A\$1.65bn. Growth in FY21 and FY22 will mainly come from the rollout to the 300,000 accounts. After that, growth will move in line with headcount in the healthcare industry and any changes to the tax rules or limits.

Exhibit 11: Salary packaging progress



Source: EML Payments

EML is working towards self-issuing all cards. Currently, c 25% of cards are still issued by Heritage Bank but the company is aiming to be at 100% self-issuance by the end of H121.

The company is keen to expand to providing services outside of Australia and has signed up customers for payroll-related applications in Spain and Germany.

Fintech and banking-as-a-service: A fast-growing, innovative sector

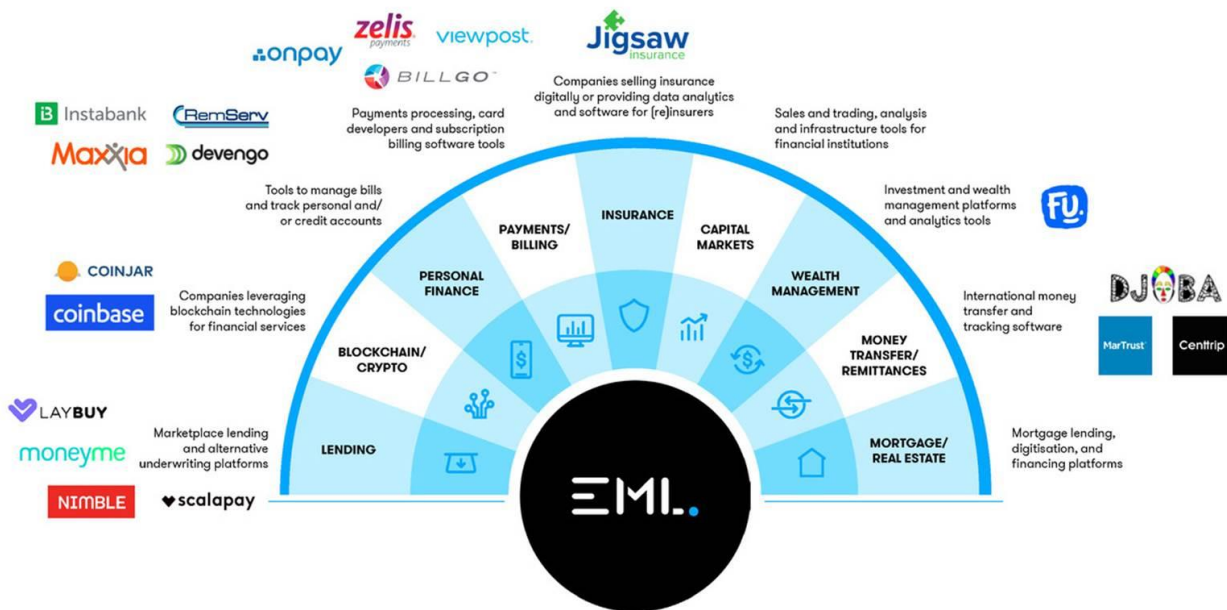
The emergence of innovative fintech companies in Europe and Australia has generated demand for EML's prepaid card technology. In the banking-as-a-service market, EML provides general purpose prepaid cards as a debit card alternative, and sometimes as an alternative to a bank account. Customers include QPay (Australian neo bank targeting university students), Fundsfy (Spanish neo bank with an investment marketplace), eCREDO (Spanish neo bank), Correos (bank account offered by the Spanish Post Office), PayGoo (the largest reloadable prepaid company in the Nordics), Rebellion Pay (Spain), PCS (France) and NLB (Slovenia).

Exhibit 12 shows the broad range of applications that make up the fintech sector and the company logos show where EML already has customers.

EML has developed a delegated authority solution called **EML ControlPay**. This allows EML's customer to control the spending on a card. For example, in the case of a consumer applying for an on-demand loan using a virtual card, EML passes the request for a loan to the prospective lender. The lender will assess the request against the relevant criteria, such as merchant, merchant category, type of transaction and available funds. If accepted, the lender will authorise cash to be loaded onto the prepaid virtual card. This technology allows the lender to make real-time approval decisions on a transaction by transaction basis, with EML bearing no credit risk. Using EML ControlPay, Instabank in Norway offers the drawdown of a flexible line of credit on a prepaid card.

More recently MoneyMe launched a similar service in Australia for what it calls ‘freestyle lending’ and in May Nimble launched Nimble Anytime to provide a revolving line of credit.

Exhibit 12: EML’s current and potential fintech markets



Source: EML Payments

COVID-19 had a short-term impact on transaction volumes at the beginning of lockdown, particularly in France and Spain, as consumers had less opportunity to spend money. However, the effect was relatively short lived and this end market is proving resilient. The availability of digital solutions is helpful when consumers are keen to avoid face-to-face contact.

Disbursements-as-a-service

This covers a variety of applications, including gambling payouts, sales commission and welfare-related payments.

Government/welfare payments – seeing COVID-19 boost

EML has always been active in this area, supporting government and local authorities that want to pay benefits or grants to citizens who may not have a bank account. This category also includes NGOs and charities making payments to beneficiaries. The acquisition of PFS has added materially to this category, bringing 30 local authorities in the UK as well as the Red Cross and the UNHCR.

During the pandemic, there has been increased demand for digital solutions that enable governments and charities to target funds at the most needy in a safe way. Examples include EML supporting a long-time customer, Epipoli, to supply prepaid Mastercard cards funded by the Italian government for the financially insecure to buy essential items in store or online. In the UK, PFS has created the ‘Emergency Card’ for local authorities who want to support vulnerable citizens such as those suffering from mental illness or victims of domestic abuse but want to reduce face-to-face contact when providing the funds. PFS is also the exclusive provider of prepaid cards to NHS Volunteer Responders (managed by the Royal Voluntary Service).

Gambling payouts – sports betting opportunity

EML works with a number of betting operators to offer a prepaid card onto which winnings can be loaded. These branded cards serve as a loyalty tool for the gaming operators. The prepaid card

enables the user to access winnings immediately, rather than having to wait for them to be sent to a bank account. The user can use the prepaid card to fund their gambling account with the operator and can also top up the prepaid card using other sources of funds. The company is aiming to take advantage of the legalisation of sports betting in the US, which is taking place on a state-by-state basis. We detail below the customers signed up in this market.

- **FY15–FY17:** EML started by serving the Australian sports betting market and over this period, it launched services with bet365, BetEasy, Ladbrokes, NEDS, Sportsbet and William Hill. In FY17 it launched its first reloadable gaming product with bet365 in the UK.
- **FY18:** EML signed contracts with Betsson, Fortuna and GVC in Europe and exited the year with an annualised GDV of A\$0.5bn.
- **FY19:** EML launched a programme with its first sports betting operator in the US (PointsBet in New Jersey), signed a contract with bet365 for the US and launched a programme with Betsson in Sweden. FY19 exit GDV was A\$0.7bn.
- **FY20:** the US programmes with PointsBet and bet365 were expanded and the company launched new programmes with StarCasino in Italy (a Betsson subsidiary), SuperSport in Croatia and RoundPeak in the US (lottery operator). In H2, contracts were signed in the US with VGW (poker-focused), Potent Systems (horse-racing) and Spoker (fantasy sports/poker).

The lack of sporting events during lockdown reduced sports betting, but consumers switched to betting on horse racing or e-sports, so GDV was relatively resilient during FY20. As bricks and mortar betting shops have been closed in Europe due to COVID-19, the company believes this could accelerate the shift by gambling operators to digital solutions.

Sales commission – reducing contribution

In FY17, EML started working with **LuLaRoe**, a US-based multi-level marketing company that sells women's clothing. People who want to become an independent distributor of LuLaRoe merchandise are required to use a prepaid card onto which they load the funds to buy the stock wholesale. As the distributor sells clothing, the sale proceeds are loaded onto the card. If the distributor decides to buy more merchandise, they use the funds already on the card. They can also use the prepaid card in the same way as any other reloadable card to buy items or withdraw cash anywhere that Mastercard is accepted. EML earns fees whenever funds are spent outside of LuLaRoe. The company saw rapid growth in GDV in FY17 and FY18 (GDV c A\$1.6bn) as distributors joined the scheme. As unsuccessful distributors gave up, the GDV started to decline (FY19 c A\$0.7bn, down more than 50%). However, the remaining distributors are now more likely to be successful and therefore have excess funds on their cards to spend, generating fees for EML. As GDV is measured as the total amount loaded onto the card but fees are not earned on every transaction, the yield is optically much lower than for the rest of the division (c 20–30bp). We estimate that in FY20, GDV was c A\$0.5bn.

Travel currency

PFS runs card programmes for multi-currency prepaid cards. With the halt in international travel during lockdown, revenues from this market will be reduced.

Financial performance and forecasts

The table below shows the historical performance of the division and our forecasts. The acquisition of PFS in April 2020 boosted GDV by A\$1.25bn and revenue by A\$15.8m for FY20. Underlying GDV grew 9% and revenue 9% y-o-y. The company noted that PFS generated a yield of 124bp in Q420, down from its pre-acquisition level of c 160bp due to lower multi-currency card volumes, which attract a high yield. As the PFS yield is higher than the underlying GPR yield, this helped boost the divisional yield compared to FY19 and will boost forecast yield. The gross margin

declined in the year due to the addition of PFS, which generates a gross margin of c 57%. PFS currently uses a third-party payment processor; the main cost synergy that EML highlighted when the acquisition was announced was the ability to bring processing in-house. This will be undertaken over the next 18–24 months and when complete should boost PFS gross margin by c 5–6pp. Our FY21 GDV forecast splits roughly 63/37 PFS/EML and revenues split roughly 71/29, with organic revenue growth of c 17%.

Exhibit 13: GPR divisional performance

GPR		FY18	FY19	FY20	FY21e	FY22e	FY23e
GDV	A\$bn	3.3	2.7	4.2	9.5	11.9	13.7
Revenue	A\$m	21.6	23.9	41.9*	106.7	133.4	153.4
Yield	%	0.65%	0.87%	0.99%	1.12%	1.12%	1.12%
Cost of sales	A\$m	(7.4)	(8.1)	(16.9)	(40.5)	(48.7)	(53.7)
Gross profit	A\$m	14.2	15.8	25.0	66.2	84.7	99.7
Gross margin	%	65.6%	66.0%	59.7%	62.0%	63.5%	65.0%
Recurring revenue	A\$m	18.7	19.7	34.6			
Establishment fees	A\$m	2.0	3.7	5.0			
Interest income	A\$m	0.9	0.5	1.5			
Total revenue	A\$m	21.6	23.9	41.2			
GDV – growth y-o-y			-18.2%	54.6%	125.0%	25.0%	15.0%
Revenue – growth y-o-y			10.8%	74.9%	154.9%	25.0%	15.0%

Source: EML Payments, Edison Investment Research. Note: *Before A\$0.7m amortisation of fair value of bonds on acquisition of PFS.

Virtual Account Numbers (VANs)

The VANs division is focused solely on the US, providing single-use virtual credit card numbers to enable corporates to make payments to their suppliers. The opportunity for this service arises because of the still high prevalence of payment by cheque in the US, compared to the successful use of SEPA payments in Europe. Inherited with the acquisition of SFS US in FY15, the company had originally planned to provide a full service offering whereby it would work with all of a company's suppliers to on-board them to receive payment in this way. However, this was a very people-intensive service, which went contra to the group's strategy of using technology to scale the business. The decision was made to focus on the processing side; while the yield is low at c 13bp, the volumes processed give the group credibility with Visa and Mastercard and help reduce scheme fees across all North American programmes. VANs is the largest division by GDV, but with the lowest yield it is the smallest in revenue terms.

As well as targeting payment aggregators (customers include BillGO and Viewpost), the division has started working with buy now pay later (BNPL) companies. EML recently signed contracts with ScalaPay in Italy and LayBuy in multiple geographies.

Financial performance and forecasts

VANs generated 62% GDV growth and 67% revenue growth in FY20. The business saw strong performance in H120, with revenue growth of 106% y-o-y. In H220 growth slowed to 32%, mainly due to the timing of new customer launches in Q419, but also because COVID-19 had an impact on volumes as healthcare customers (29% of GDV) saw slower rates of spending.

June 2020 GDV of A\$685m saw a pickup from the levels in April and May and implies an annualised run rate of A\$8.2bn. We assume that volumes pick up through the course of the year as businesses return to more normal activity and new customers signed in Q420 start to build volume. Our forecasts reflect modest growth in GDV of 10% per annum with a stable yield. As the yield in this division is so low, if growth were double this rate, it would only add another A\$1.1m revenue in FY21, c 0.7% of group revenue.

Exhibit 14: Virtual Account Numbers (VANs) divisional performance

		FY18	FY19	FY20	FY21e	FY22e	FY23e
GDV	A\$bn	2.7	5.2	8.5	9.3	10.2	11.3
Revenue	A\$m	2.4	6.4	10.7	11.5	12.7	14.0
Yield	%	0.09%	0.12%	0.13%	0.12%	0.12%	0.12%
Cost of sales	A\$m	(.4)	(2.0)	(3.7)	(4.1)	(4.5)	(4.9)
Gross profit	A\$m	2.1	4.4	6.9	7.5	8.2	9.1
Gross margin	%	85.3%	68.1%	64.8%	64.8%	64.8%	64.8%
Recurring revenue	A\$m	2.4	6.4	10.7	11.7	12.7	14.0
GDV – growth y-o-y			96.2%	61.8%	10.0%	10.0%	10.0%
Revenue – growth y-o-y			164.5%	66.2%	8.3%	10.0%	10.0%

Source: EML Payments, Edison Investment Research

Sensitivities

EML's financial performance and share price are sensitive to the following factors:

- Regulation:** EML is subject to a number of different regulatory regimes (see page 9), which it needs to comply with on a country-by-country basis. If legislation around breakage and card expiry dates were to change, this could significantly reduce revenue and profitability. However, we would expect EML to counter this by raising the other fees it charges. We note that the diversification of the group has reduced the proportion of revenue generated from breakage (FY18: 37%; FY20: 21%; H220: 17%) and we expect it to decrease further in FY21 due to the full year inclusion of PFS. Changes to e-money licensing could add additional compliance costs. While not currently regulated, the buy now, pay later market could attract scrutiny, and this may reduce demand for EML's services. We note, however, that this business falls within the low-yielding VANs division so would see limited revenue impact. The gambling market is heavily regulated, although in the US, this is acting as an opportunity for EML to enter a market that was previously closed. Regulators have put caps on the level of interchange that can be earned – if caps were reduced further, this would have a negative impact on EML revenues. The company considers its experience of managing the regulatory landscape to be a competitive advantage - as regulation increases, it becomes more costly for new entrants
- Competition:** this could take the form of competing prepaid card services or substitution by other services. For example, there is the risk that as more consumers are able to open bank accounts, demand for prepaid cards could diminish. In the US, for example, JP Morgan Chase has stopped issuing its Chase Liquid prepaid card and shifted customers instead to a Chase Secure Banking account. Fintechs may decide to apply for their own issuing licences. The growth in online retail could reduce demand for mall gift cards. EML counters the natural decline in certain applications by constantly seeking out new verticals and developing its technology to provide value-added services.
- Pace of economic growth:** consumer propensity to spend during the current recession and willingness to enter bricks and mortar stores will influence the pace at which shopping malls return to normal trading. The speed at which international travel markets open up will influence the growth of the multi-currency prepaid card market. The health of corporates will influence the rate of spending on incentive and reward cards.
- Interest rates:** just over 1% of revenue in FY20 came from the interest earned on stored value. Interest rates globally are at historic lows; EML would benefit from any future rate rises. It is possible that interest rates in the UK could turn negative which would increase the cost to manage treasury.

- **Acquisitions:** the company has been highly acquisitive and the recent PFS acquisition has yet to be fully integrated. Future acquisitions would require funding (we note that EML had cash of A\$118m at the end of FY20 and no secured debt) and could bring integration risk.

Financials

Income statement

EML earns revenues in four ways:

- Recurring revenues – transaction-based (64% of FY20 revenue): EML earns either a percentage of the transaction value, a fixed fee per transaction or a fixed monthly fee.
- Recurring revenues - service-based (21% of FY20 revenue): this mainly includes breakage but can also include dormant account fees. Breakage is the value left on a non-reloadable card that is never used. See Appendix 1 for more detail on the accounting for breakage revenue and cash.
- Establishment fees (11% of FY20 revenue): when setting up a card programme, EML may charge a fixed fee upfront. Establishment income also includes revenue from the resale of plastic cards.
- Interest income (4% of FY20 revenue): for those cards that EML self-issues, it holds the load value in segregated bank accounts and is entitled to the interest earned on these accounts. Separately it earns interest income on the group's own cash.

Yield is measured as total revenue from all four sources above divided by the GDV in a given period. We have discussed our forecasts at a divisional level in the earlier sections and in the table below we summarise our forecasts at a group level. Cost of goods sold comprises plastic card costs, card scheme fees and banking connections. We forecast group gross margin to decline in FY21 due to the inclusion of lower-margin PFS. As it brings processing in house and other parts of the business self-issue more cards, the margin should grow.

In FY20, G&I revenue was affected by COVID-19 lockdown restrictions and, as it is the highest yielding division, this resulted in a dip in the EBITDA margin compared to FY19. Included within operating costs for FY20 are one-off costs of A\$0.6m related to restructuring in June; this should provide cost savings of c A\$1.6m in FY21. The company also decided to close the UAE mall gift card operation (GDV A\$32m), as it earned a substantially lower yield (c 220bp) and would cost too much to scale. This should provide an A\$0.5m benefit to EBITDA.

Review of Q121 trading update

EML released a trading update on 21 October. The table below summarises divisional performance in Q121 – trading improved compared to Q420 for all divisions. Compared to the prior quarter, group GDV increased 20%, revenue increased 20% and EBITDA increased 67%.

- **G&I:** GDV increased 41% q-o-q as malls saw better trading, with GDV 11% below the prior year period. Yield of 598bp was 17bp higher than Q420 and 16bp below Q120. This resulted in Q121 revenue 45% higher q-o-q and 13% lower y-o-y.
- **GPR:** the company noted that the original EML GPR business saw GDV growth of 16% y-o-y and 2% q-o-q. PFS saw GDV growth of 24% q-o-q. Yield of 110bp was flat q-o-q and 21bp higher y-o-y, reflecting the higher yield of PFS. Q121 revenue was 16% higher q-o-q and 313% higher y-o-y.
- **VANS:** Q121 GDV grew 23% q-o-q and was flat y-o-y. Yield of 12.4% was flat compared to both periods. This resulted in Q121 revenue growth of 23% q-o-q and flat y-o-y.

Exhibit 15: Quarterly divisional performance

	Q121	Q420	Q120	q-o-q	y-o-y
GDV (A\$m)					
G&I	0.199	0.141	0.223	41.1%	-10.8%
GPR	2.389	2.067	0.715	15.6%	234.1%
VANS	2.267	1.840	2.276	23.2%	-0.4%
Group GDV	4.855	4.048	3.214	19.9%	51.1%
Yield (bp)					
G&I	598	581	614	17	-16
GPR	110	110	89	0	21
VANS	12.4	12.4	12.4	0	0
Revenue (A\$m)					
G&I	11.9	8.2	13.7	45.3%	-13.1%
GPR	26.3	22.7	6.4	15.6%	313.0%
VANS	2.8	2.3	2.8	23.2%	-0.4%
Net interest contribution	(0.4)	0.7	0.3		
Group revenue	40.6	33.9	23.2	19.8%	75.0%
EBITDA (A\$m)	10.0	6.0	3.2	66.7%	212.5%
EBITDA margin	24.6%	17.7%	13.8%		

Source: EML Payments

We expect G&I weakness will continue to weigh on margins in FY21 before improving in FY22. We note that in February, prior to COVID-19 disruption, the company had provided guidance (excluding PFS) for revenues of A\$120–129m and EBITDA of A\$39.5–42.5m (c 33% margin) in FY20, which illustrates the operational leverage of the business once volumes start to recover in G&I. The company expects to incur group cash operating costs of A\$64–72m in FY21; we are forecasting A\$68.5m.

Exhibit 16: Group forecasts

		FY18	FY19	FY20	FY21e	FY22e	FY23e
GDV	A\$bn	6.8	9.0	13.9	19.9	23.4	26.3
Revenue	A\$m	71.0	97.2	121.0	173.4	218.8	247.4
Yield		1.05%	1.08%	0.88%	0.87%	0.94%	0.94%
Gross profit	A\$m	53.3	73.0	88.1	117.2	150.4	171.9
Gross margin		75.1%	75.1%	72.8%	67.6%	68.7%	69.5%
EBITDA	A\$m	21.0	29.7	32.5	48.4	70.6	87.7
EBITDA margin		29.6%	30.6%	26.9%	27.9%	32.3%	35.5%

Source: EML Payments, Edison Investment Research

NPATA: The company's preferred profit measure

EML provides detailed financial metrics on a divisional basis and tracks EBITDA. However, as EBITDA has become less meaningful due to the introduction of the new lease accounting standard as well as the different treatments of share-based payments by analysts and investors, the company uses net profit after tax excluding acquisition-related items (NPATA) as its preferred earnings measure. This provides a measure of the underlying profitability of the business, once accounting adjustments and one-off costs relating to acquisitions are excluded. The table below shows the reconciliation of NPATA to reported net income.

Exhibit 17: Reconciliation of net income to NPATA

A\$m	FY18	FY19	FY20	FY21e	FY22e	FY23e
Net income	2.2	8.5	(5.9)	4.2	24.6	36.1
Fair value adjustment on bonds	0.0	0.0	0.7	2.0	1.0	0.0
Amortisation of acquired intangibles	7.2	7.5	10.6	15.5	14.0	14.0
Acquisition-related share-based payments	2.8	2.3	2.5	0.0	0.0	0.0
Interest on unwind of contingent consideration	0.5	1.8	3.3	6.5	6.5	6.5
Gain on cash flow hedge for acquisition	0.0	0.0	(3.0)	0.0	0.0	0.0
Acquisition-related expenses	0.0	0.6	15.8	0.0	0.0	0.0
NPATA	12.7	20.6	24.0	28.2	46.1	56.6
<i>Growth in NPATA</i>		62.5%	16.9%	17.3%	63.3%	22.9%
NPATA/share (c)	5.0	7.9	7.7	7.6	12.5	15.3
<i>Growth in NPATA/share</i>		58.3%	-3.0%	-0.5%	62.8%	22.9%

Source: EML Payments, Edison Investment Research

The company has no plans to pay a dividend yet, instead planning to preserve cash for investment in technology and acquisitions.

Balance sheet and cash flow

See page 25 for financial summary table. EML capitalises a proportion of development costs; in FY20, it capitalised A\$8m. With Project Accelerate, we expect this to step up to at least A\$12m per annum.

We discuss in the Appendix how the **contract asset** on the balance sheet is accounted for. We assume that it grows in line with the growth in G&I GDV.

For those programmes that are self-issued, EML will report the customer funds held under 'Segregated funds and bond investments' with a corresponding liability called 'Liabilities to stored value account holders'. We forecast that this will grow in line with the movement in GDV for G&I and GPR combined.

At the end of FY20, **contingent consideration** of A\$73.6m was recognised on the balance sheet. This consists of A\$4.3m for the Perfectcard acquisition (due to be paid in December 2020 in a mix of cash and shares) and A\$69.3m for the PFS acquisition. The maximum contingent consideration payable for PFS is £55m (which was A\$110m at the date of acquisition) and is based on EBITDA targets for FY21–23, equivalent to growth of c 20% per annum. It is payable in cash in August 2021, 2022 and 2023. The discounted fair value on the balance sheet is unwound each year, with the amount unwound being treated as an exceptional finance cost in the income statement.

There is also an additional A\$35.8m in **deferred consideration** due for PFS, payable in cash 50% in June 2024 and 50% in June 2025 earning 2% interest per annum. We have treated the deferred consideration as debt in our net cash calculation.

We forecast that the cash balance will increase from A\$118m at the end of FY20 to A\$188m by the end of FY23, absent any new acquisitions.

Valuation

EML competes against a number of large financial services companies that offer prepaid card services, as well as privately owned large and niche prepaid card companies. When considering peers from a valuation perspective, we have grouped together three types of companies:

- Payment processing companies – these companies earn revenues by charging on a per transaction basis.
- Prepaid card companies – this includes companies focused on the corporate expenses market: Edenred, Fleetcor and Wex provide prepaid fuel cards for fleet management. Edenred also

provides employee incentive and reward cards as well as corporate expense management and Ticket Restaurant cards; its subsidiary PPS competes with EML in the digital banking space, particularly in the UK. Appreciate provides multi-retailer gift cards; Greendot is a GPR card issuer; Euronet's subsidiary ePay provides prepaid services as well as payment processing services.

- Australian fintech companies – all three are active in the consumer credit space, offering BNPL services.

Exhibit 18: Peer group financial performance

	Currency	Market cap (m)	Sales growth		EBITDA margin		EBIT margin		EPS growth	
			CY	NY	CY	NY	CY	NY	CY	NY
EML Payments	A\$	1,305	43.4%	26.2%	27.9%	32.3%	20.4%	24.7%	38.3%	51.8%
<u>Payment processors</u>										
Adyen	€	49,245	30.3%	42.0%	53.9%	56.4%	49.4%	52.9%	15.6%	64.0%
FIS	US\$	89,149	22.2%	8.4%	41.9%	45.3%	34.3%	38.7%	-2.2%	22.0%
Fiserv	US\$	67,782	-2.7%	7.0%	38.9%	41.9%	31.0%	34.2%	9.9%	22.5%
Global Payments	US\$	52,984	47.8%	12.7%	44.9%	47.0%	39.7%	42.6%	2.1%	25.5%
Ingenico Group	€	8,624	-12.9%	9.2%	20.6%	21.1%	15.7%	16.5%	-0.1%	12.5%
PayPal Holdings	US\$	240,021	20.4%	19.3%	28.8%	29.0%	24.9%	25.6%	20.4%	22.1%
Square	US\$	82,652	227.6%	27.3%	4.2%	7.2%	4.5%	7.1%	-29.6%	113.6%
Worldline	€	13,176	-1.5%	8.4%	23.9%	26.1%	16.1%	19.6%	-1.6%	26.6%
Average			41.4%	16.8%	32.1%	34.2%	26.9%	29.6%	1.8%	38.6%
Average excl Square			14.8%	15.3%	36.1%	38.1%	30.2%	32.9%	6.3%	27.9%
<u>Prepaid card companies</u>										
Appreciate Group	£	49	-21.4%	11.4%	6.4%	8.6%	4.8%	6.9%	-61.6%	59.7%
Edenred	€	10,124	-11.4%	10.2%	39.2%	40.7%	30.5%	32.9%	-15.8%	20.7%
Euronet Worldwide	US\$	4,884	-13.5%	17.2%	10.3%	18.6%	0.0%	0.0%	-73.0%	192.9%
Fleetcor Technologies	US\$	20,979	-9.3%	12.9%	52.1%	56.8%	49.8%	50.6%	-8.1%	17.7%
Green Dot Corp	US\$	3,258	7.4%	5.1%	16.1%	18.3%			-34.9%	22.7%
WEX	US\$	6,607	-8.4%	10.8%	41.7%	44.7%	31.3%	35.9%	-27.6%	28.7%
Average			-9.4%	11.3%	27.6%	31.3%	23.3%	25.3%	-36.8%	57.1%
<u>Australian fintechs</u>										
Afterpay Ltd	A\$	27,736	73.5%	54.6%	8.9%	15.6%	4.7%	12.5%	-260%	379.2%
FlexiGroup Ltd	A\$	555	-8.8%	6.5%			23.7%	28.0%	47.7%	24.1%
Zip Co Ltd	A\$	3,710	104.1%	56.2%	-8.2%	2.1%	-14.0%	-1.8%	11.9%	-61.6%
Average			56.3%	39.1%	0.3%	8.8%	4.8%	12.9%	-66.8%	113.9%

Source: Edison Investment Research, Refinitiv (as at 19 October)

Exhibit 19: Peer group valuation metrics

	EV/sales		EV/EBITDA		P/E		Div yield	
	CY	NY	CY	NY	CY	NY	CY	NY
EML Payments	7.1	5.6	25.2	17.3	47.2	31.1	0.0%	0.0%
<u>Payment processors</u>								
Adyen	73.1	51.5	135.7	91.3	210.2	128.2	0.0%	0.0%
FIS	8.3	7.7	19.9	17.0	26.2	21.5	1.0%	1.1%
Fiserv	6.4	6.0	16.6	14.4	23.0	18.8	0.0%	0.0%
Global Payments	9.0	8.0	20.1	17.0	27.9	22.2	0.4%	0.4%
Ingenico Group	3.5	3.2	16.9	15.1	27.7	24.6	0.8%	1.0%
PayPal Holdings	11.0	9.2	38.3	31.9	54.8	44.9	0.0%	0.0%
Square	11.0	8.7	263.5	119.7	330.9	155.0	0.0%	0.0%
Worldline	5.9	5.4	24.7	20.9	44.8	35.4	0.0%	0.1%
Average	16.0	12.5	67.0	40.9	93.2	56.3	0.3%	0.3%
Average excl Square	16.8	13.0	38.9	29.7	59.2	42.2	0.3%	0.4%
<u>Prepaid card companies</u>								
Appreciate Group	0.3	0.2	4.2	2.8	14.0	8.8	4.2%	5.9%
Edenred	8.2	7.4	20.8	18.2	37.8	31.4	1.8%	1.9%
Euronet Worldwide	2.4	2.0	22.9	10.8	49.3	16.8	0.0%	0.0%
Fleetcor Technologies	10.3	9.1	19.7	16.0	23.0	19.6	0.0%	0.0%
Green Dot Corp	2.9	2.8	18.2	15.2	33.6	27.4	0.0%	0.0%
WEX	5.2	4.7	12.5	10.5	22.5	17.5	0.0%	0.0%
Average	4.9	4.4	16.4	12.3	30.0	20.2	1.0%	1.3%
<u>Australian fintechs</u>								
Afterpay Ltd	30.4	19.6	342.1	126.1	1128.2	235.4	0.0%	0.0%
FlexiGroup Ltd	6.6	6.2	N/A	N/A	10.6	8.5	2.4%	5.0%
Zip Co Ltd	14.4	9.2	N/A	449.4	N/A	N/A	0.0%	0.0%
Average	17.1	11.7	82.9	287.7	357.5	23.9	0.8%	1.7%

Source: Edison Investment Research, Refinitiv (as at 19 October)

The payment processing and prepaid card peers generate high EBITDA margins; EML is in line with the average for prepaid card companies and slightly below the margins achieved by the much larger payment processors, although EML is forecast to grow revenues at a much faster rate than both groups. The Australian fintech companies are at earlier stages of development so are typically expected to grow at much faster rates but with limited profits or even losses.

On an EV/EBITDA and P/E basis, EML trades at a discount to payment processors, in our view reflecting their scale and profitability compared to EML. EML trades at a premium to prepaid card companies, justified in our view because of its growth potential. It is forecast to grow EPS at a faster rate than both groups over the next two years.

We have performed a discounted cash flow analysis to estimate the growth rates and margin assumptions factored into the current share price after the explicit forecast period. Using a WACC of 8% and a long-term growth rate of 3%, we estimate that the market is pricing in revenue growth of 6.5% in FY25–30 with an EBITDA margin of 35.2%. Both look conservative considering the group's historical performance and potential to scale. Exhibit 20 shows the sensitivity of the share price to the WACC and long-term growth rate. Exhibit 21 shows the sensitivity to the revenue growth rate and EBITDA margin for FY25–30.

Exhibit 20: Sensitivity of valuation to WACC and terminal growth rate (A\$/share)

	Terminal growth rate					
	1.00%	2.00%	3.00%	4.00%	5.00%	
WACC	11.00%	1.95	2.06	2.20	2.37	2.60
	10.50%	2.07	2.19	2.35	2.56	2.85
	10.00%	2.20	2.34	2.53	2.78	3.14
	9.50%	2.34	2.51	2.74	3.05	3.49
	9.00%	2.50	2.71	2.98	3.36	3.94
	8.50%	2.69	2.93	3.27	3.75	4.51
	8.00%	2.90	3.20	3.61	4.24	5.28
	7.50%	3.14	3.51	4.03	4.86	6.35
	7.00%	3.43	3.88	4.56	5.69	7.95
	6.50%	3.77	4.34	5.24	6.86	10.63

Source: Edison Investment Research

Exhibit 21: Sensitivity of valuation to EBITDA margin and revenue growth, FY25–30 (A\$/share)

	EBITDA margin								
	26.0%	28.0%	30.0%	32.0%	34.0%	36.0%	38.0%	40.0%	
Revenue growth	4.0%	2.34	2.54	2.73	2.92	3.12	3.31	3.50	3.69
	5.0%	2.44	2.65	2.85	3.05	3.26	3.46	3.66	3.87
	6.0%	2.55	2.76	2.98	3.19	3.40	3.62	3.83	4.05
	7.0%	2.66	2.88	3.11	3.33	3.56	3.78	4.01	4.23
	8.0%	2.77	3.01	3.25	3.48	3.72	3.96	4.19	4.43
	9.0%	2.89	3.14	3.39	3.64	3.89	4.14	4.39	4.63
	10.0%	3.02	3.28	3.54	3.80	4.06	4.33	4.59	4.85
	11.0%	3.15	3.42	3.70	3.97	4.25	4.52	4.80	5.07
	12.0%	3.29	3.58	3.86	4.15	4.44	4.73	5.02	5.30

Source: Edison Investment Research

Exhibit 22: Financial summary

	A\$m	2017	2018	2019	2020	2021e	2022e	2023e
30-June		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT								
Revenue		58.0	71.0	97.2	121.0	173.4	218.8	247.4
Cost of Sales		(13.7)	(17.7)	(24.2)	(32.9)	(56.2)	(68.4)	(75.4)
Gross Profit		44.2	53.3	73.0	88.1	117.2	150.4	171.9
EBITDA		14.5	21.0	29.7	32.5	48.4	70.6	87.7
Normalised operating profit		11.9	18.1	25.6	22.4	35.4	54.0	68.4
Amortisation of acquired intangibles		(8.9)	(7.2)	(7.5)	(10.6)	(15.5)	(14.0)	(14.0)
Exceptionals		0.2	(0.3)	(3.0)	(11.2)	0.0	0.0	0.0
Share-based payments		(5.3)	(5.0)	(4.2)	(6.1)	(8.0)	(2.5)	(2.5)
Reported operating profit		(2.1)	5.6	10.9	(5.6)	11.9	37.5	51.9
Net Interest		0.0	(0.1)	(0.0)	(0.7)	(0.2)	(0.3)	(0.3)
Joint ventures & associates (post tax)		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals		0.0	(0.5)	(1.8)	(0.2)	(6.5)	(6.5)	(6.5)
Profit Before Tax (norm)		11.9	17.9	25.6	21.6	35.3	53.7	68.2
Profit Before Tax (reported)		(2.1)	5.0	9.0	(6.6)	5.3	30.7	45.2
Reported tax		2.1	(2.8)	(0.6)	0.7	(1.1)	(6.1)	(9.0)
Profit After Tax (norm)		8.9	14.4	20.5	17.3	28.2	43.0	54.5
Profit After Tax (reported)		0.0	2.2	8.5	(5.9)	4.2	24.6	36.1
Minority interests		0.0	0.0	(0.2)	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)		8.9	14.4	20.3	17.3	28.2	43.0	54.5
Net income (reported)		0.0	2.2	8.3	(5.9)	4.2	24.6	36.1
Basic ave. number of shares outstanding (m)		245	246	249	304	361	362	362
EPS - basic normalised (A\$)		0.036	0.058	0.081	0.057	0.078	0.119	0.151
EPS - diluted normalised (A\$)		0.036	0.057	0.078	0.055	0.076	0.116	0.147
EPS - basic reported (A\$)		0.000	0.009	0.033	(0.019)	0.012	0.068	0.100
Dividend (A\$)		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)		148.6	22.5	36.9	24.4	43.4	26.2	13.0
Gross Margin (%)		76.3	75.1	75.1	72.8	67.6	68.7	69.5
EBITDA Margin (%)		25.1	29.6	30.6	26.9	27.9	32.3	35.5
Normalised Operating Margin		20.5	25.4	26.4	18.5	20.4	24.7	27.7
BALANCE SHEET								
Fixed Assets		90.6	108.0	162.9	905.2	1,318.9	1,509.0	1,649.2
Intangible Assets		60.1	65.8	104.6	404.7	393.6	381.1	366.7
Tangible Assets		2.8	3.5	5.4	14.6	12.6	10.2	7.7
Investments & other		27.6	38.7	53.0	485.8	912.6	1,117.6	1,274.9
Current Assets		96.9	131.6	313.8	1,001.1	1,842.1	2,250.3	2,576.6
Stocks		10.3	12.6	18.2	22.3	20.9	23.0	25.3
Debtors		6.3	8.9	14.4	21.7	30.8	38.6	43.6
Cash & cash equivalents		39.9	39.0	33.1	118.4	148.0	162.4	187.6
Other		40.4	71.1	248.2	838.7	1,642.4	2,026.3	2,320.1
Current Liabilities		(62.8)	(90.5)	(299.0)	(1,326.3)	(2,563.1)	(3,161.6)	(3,616.8)
Creditors		(23.8)	(21.2)	(33.9)	(47.5)	(56.8)	(67.3)	(72.4)
Tax and social security		(0.0)	0.0	(0.8)	(0.2)	(0.2)	(0.2)	(0.2)
Short term borrowings		0.0	0.0	(15.0)	0.0	0.0	0.0	0.0
Other		(39.0)	(69.3)	(249.4)	(1,278.6)	(2,506.1)	(3,094.1)	(3,544.2)
Long Term Liabilities		(4.2)	(19.3)	(33.5)	(139.0)	(143.7)	(116.4)	(89.1)
Long term borrowings		0.0	0.0	0.0	(35.8)	(35.8)	(35.8)	(35.8)
Other long term liabilities		(4.2)	(19.3)	(33.5)	(103.2)	(107.9)	(80.6)	(53.3)
Net Assets		120.6	129.8	144.2	441.0	454.2	481.3	519.9
Minority interests		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity		120.6	129.8	144.2	441.0	454.2	481.3	519.9
CASH FLOW								
Op Cash Flow before WC and tax		13.1	19.7	28.4	31.2	47.1	69.2	86.4
Working capital		4.9	(9.2)	2.0	3.6	2.3	(0.4)	(3.1)
Exceptional & other		(0.8)	(1.2)	(0.7)	(12.7)	0.7	0.0	0.0
Tax		2.1	(2.8)	(0.6)	0.7	(1.1)	(6.1)	(9.0)
Net operating cash flow		19.3	6.5	29.2	22.8	49.0	62.7	74.3
Capex		(2.9)	(5.3)	(5.8)	(11.0)	(13.6)	(14.3)	(15.0)
Acquisitions/disposals		0.0	(0.7)	(44.0)	(142.5)	(3.8)	(32.0)	(32.0)
Net interest		0.0	(0.1)	(0.0)	(0.7)	(0.2)	(0.3)	(0.3)
Equity financing		0.2	0.0	0.4	240.8	0.0	0.0	0.0
Dividends		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other		(3.6)	(0.6)	(0.4)	(7.0)	(1.8)	(1.8)	(1.8)
Net Cash Flow		13.0	(0.2)	(20.6)	102.3	29.6	14.4	25.2
Opening net debt/(cash)		(26.9)	(39.9)	(39.0)	(18.1)	(82.5)	(112.2)	(126.6)
FX		(0.0)	(0.6)	(0.3)	(2.0)	0.0	0.0	0.0
Other non-cash movements		0.0	0.0	0.0	(35.8)	0.0	0.0	0.0
Closing net debt/(cash)		(39.9)	(39.0)	(18.1)	(82.5)	(112.2)	(126.6)	(151.8)

Source: EML Payments, Edison Investment Research

Appendix 1: Breakage accounting – the basics

Gift cards can be issued with an expiry date (typically 12 or 24 months) or can last indefinitely. In the UK, EML tends to issue cards with a 12-month limit. In Germany and Ireland, cards have a three-year expiry. In the case of cards that have no expiry date, EML may apply dormant account fees after a certain amount of time (usually called account management fees (AMF)) – these are charged monthly either until the card is used or until there are no funds remaining.

Revenue recognition – relies on actuarial analysis

In the case of cards with funds remaining at expiry, EML may be entitled to keep the cash; this is known as breakage. For each card programme, EML will agree with its customer how much breakage it will be entitled to. EML bases its accounting for breakage revenue on IFRS 15 which states that revenue should be recognised as performance obligations are satisfied. In practice, rather than waiting until the card expires to recognise the revenue, this calls for breakage revenue to be recognised over the same period of time as transactions are undertaken with the card.

Consumers tend to spend the vast majority of card value in the first four months after they receive it. So as many cards are received as Christmas presents, a large proportion of gift card load is spent in the following January to April. At this point, EML will not know the precise amount of breakage that will be left on the card. In North America, the company uses a third-party consultant to estimate the likely breakage, based on the historical activity on millions of previously expired cards. Every month EML sends data to the consultant who uses actuarial methods to calculate a breakage percentage for each programme, which EML will then use for revenue recognition purposes.

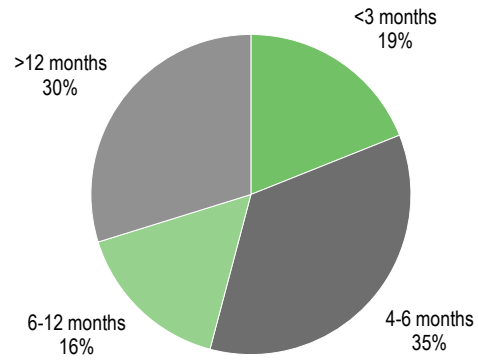
So as an example, if the actuarial consultant estimates that breakage on a particular card programme is likely to run at 5%, and EML is entitled to keep half of this, for a A\$100 gift card, EML will earn A\$2.50 of breakage. EML will recognise this revenue over a set period of time, typically four months from the date of activation, with a set percentage recognised each month that reflects the typical spending pattern (ie not equally over the four months).

For cards with no expiry date but subject to AMFs, a similar exercise is carried out, and the expected AMFs recognised in proportion to the expenditure on the card. For those with no expiry and no AMFs, the exercise is known as ‘de-recognition of liability’, as unless some form of breakage and cash receipt is recognised, a liability to the cardholder will remain on the balance sheet indefinitely.

Cash receipts – delayed compared to revenues

As EML recognises breakage revenues, it accrues for the cash that it will be entitled to and records this as a contract asset. For cards with a fixed expiry date, EML is entitled to the cash when the card expires. For cards with no expiry in North America, EML’s actuarial consultant determines the timing of when EML is entitled to receive the cash from the banks holding it. On a half-yearly basis EML reports the expected timing of the receipt of cash from the contract asset. The chart below shows the expected timing of cash receipts from the A\$31.8m contract asset on the balance sheet at the end of FY20.

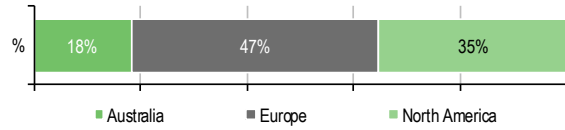
Exhibit 23: Timing of cash conversion for contract asset at end FY20



Source: EML Payments

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Revenue by geography (FY20)

Management team
Managing director & CEO: Tom Cregan

Tom Cregan joined EML as CEO in 2012 when it was Emerchants. Tom leads the team in managing the growth of EML. Tom brings more than 16 years of experience in the electronic payments industry including leadership with corporate expense management.

CFO: Rob Shore

Rob Shore joined EML in 2016 and was appointed to the role of CFO in 2018. He has over 15 years of experience as a chartered accountant working with Australian, UK and US listed businesses and leading international finance teams in varied industry sectors.

Non-executive chairman: Peter Martin

Peter Martin was appointed chairman in 2015. He was formerly the CEO of Rothschild Australia Asset Management (Rothschild) and was a director of a number of Rothschild boards in Australia and overseas. He was instrumental in the sale of Rothschild to Westpac Banking Corporation.

Principal shareholders

	(%)
Greencape Capital	6.3
Tom Cregan	5.1
The Vanguard Group	3.9
Peter Martin	2.0
Pengana Capital	1.2
BlackRock	1.1
Dimensional Fund Advisors	0.5

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