

Company: EML Payments Limited
Title: Acquisition of Flex-e-Card conference call
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Start of Transcript

Operator: Ladies and gentlemen, thank you for standing by and welcome to the acquisition of Flex-e-Card Limited - conference call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time if you wish to ask a question, you will need to press star one on your telephone. I must advise you that this conference is being recorded today, Monday 20 May 2019.

I would now like to hand the conference over to your first speaker today, Group CEO and Managing Director of EML Payments Limited, Tom Cregan. Thank you, please go ahead.

Tom Cregan: Good morning and welcome to our investor call this morning on the acquisition of FEC. We wanted to announce today that we've entered into a definitive agreement to acquire Flex-e-Card Limited, a leading provider of gift card solutions for the shopping mall industry in the UK, Europe and the UAE. FEC, or Flex-e as we might also refer to it as, has been our closest competitor in the shopping mall segment for 10 years almost, with both companies operating in that space. I've been in ongoing talks with their co-founders for probably the last 18 months on the merits of this transaction, and it's good to get it closed.

On slide 3, moving straight into the deck, on slide 3 we've outlined the details of the transaction in which we're acquiring 100% of FEC for £21.6 million, or roughly \$40.5 million on the indicated exchange rates, and we expect to close the acquisition on June 28. The acquisition will not contribute to our financial results in FY19, and despite transaction costs incurred in closing the deal, we reaffirm our previous EBITDA guidance for FY19 of \$27 million to \$28 million, and we expect that to be very much toward the top end of that range.

FEC brings to the Group 226 shopping mall gift card programs, bringing out total shopping mall gift card programs to 800 globally, and making us clearly the largest provider of such programs in the world. FEC brings with it a significant presence in Poland and the UAE, where EML had no previous presence.

On slide 4 we outline the strategic rationale for the deal, which I think most of you will find fairly self-explanatory. So, without going through it point by point, it certainly positions us to provide a combined best of breed solution to the global shopping mall industry, combining the strengths of both companies. FEC has a strong history of growth, as indeed our UK and European business has, with three-year revenue CAGRs of just under 25%, and we expect to see that continue in the future as we target malls in markets such as Eastern Europe and the Middle East. We see them continuing to grow based on the initiatives that they currently have in place.

From a growth perspective, they have invested in kiosk technology to allow multiple points of presence for the sale of gift cards within the one mall, which is certainly useful for some mega-malls as you might call them, in Europe and the UAE. They've also invested in growing B2B sales partnerships, so effectively direct-selling mall gift cards to corporates, who in turn are providing them to their employees as staff incentives. In some cases, the ratio of B2B to sales in the mall itself is about 40%, and we believe that as we attach this across a larger portfolio of properties, we can drive additional growth in the overall segment through focusing on B2B.

They have very loyal customer relationships, as indeed do we, and have really almost zero retention issues, their churn over the last three years of a quarter of 1%, and yet growing the GDV by 94% over that same period, so I think that talks

pretty plainly to the strengths of relationship that they have in the marketplace. FEC is run by Neil Wake who along with his team will continue to run the business. Neil's run it for the last three years, I think he'll be a great addition to the team, really along with his entire team and having spent part of last week with them in Newcastle I think we're inheriting a good strong team.

Our respective teams in Birmingham and Newcastle will now focus on a plan of integrating those malls and those partnerships and implementing our strategies of product offerings off a broader expanded product offering to both their customers and ours that are in that segment. Importantly, I think we now have relationships with most, certainly many if not most of the largest mall owners in Europe and the UAE, which positions us pretty strongly.

On slide 5 the purchase price and funding details are outlined. Again, very simply the purchase price reflects a 10x multiple on their calendar year '19 EBITDA forecast, with 10% of that purchase price held in escrow. That's a common multiple paid, very similar to our previous transactions, which averaged between our original UK acquisition and our US acquisition, averaged about 9.5x. So, in the same ballpark of the previous deals that we have done.

Given our cash balance and operating cashflows, we've used approximately \$25.5 million of our cash to fund part of the transaction, and we've drawn down debt from a major Australia tier 1 bank, of approximately \$15 million. Due to confidentiality provisions, we're not at liberty to advise who that bank is, other than to say it is one of the big four. But their willingness to lend to us is a testament to their confidence in our current and future operating cashflows, which we take as a great positive.

Our retained cash balance will be substantially more than the loan facility, and it provides us with further flexibility over other capital management decisions that would be made post the end of the year.

On slide 6 we show the three-year GDV growth of FEC, and that we expect FEC to add approximately \$4 million to \$4.1 million in incremental EBITDA at the current exchange rate, as listed in the presentation. Given there's no shares as part of this transaction, incremental EBITDA which is about 14.5%, which translates into an incremental EBITDA per share lift of about \$0.016. That 14.5% is the uplift over the midpoint of our FY19 guidance of between \$27 million and \$28 million. So, once we issue our guidance in November for FY20, obviously the number might be a little bit less than 14.5%.

But as it stands today on a common basis, it's the lift that we expect to see. We've undertaken significant due diligence and are more comfortable about their future growth goals. You'll note that their GDV revenue metrics, gross margin percentages, EBITDA margin percentages, are all in line with the existing EML business. So, for those investors that already understand our business pretty well, there's not a lot of brain surgery involved in understanding this business, it's very similar operationally and it's very similar financially and it's very similar in terms of key metrics.

Slide 7 really just graphically shows the presence we now have, and obviously expect some additional wins in the mall segments that we're now in, and you can see the brands that we're certainly working with across Europe and now the UAE. The UAE is a very interesting market and one that we looked at quite a bit. Obviously, malls themselves are big business in their own right in the UAE, but the mix of brands and programs within those malls are quite different to what you might normally see in Australia or in fact even in the UK or the EU.

So, for example, there are multiple car dealers that have their car dealerships within the malls. FEC services gift card programs for those car dealerships as well, it's quite common to buy a vehicle for X, say I'll just pick it under \$50,000, and opposed to discounting the face value of the car, they would sell a car for \$50,000 but provide a gift card to the buyer for \$1000 for example as incentives to get them to buy the vehicle. So, the programs in the UAE are not only the mall programs themselves but programs for merchants within the mall.

In summary, we see this as just a very logical deal that's in the best interests of shareholders. But financially it adds \$180 million in GDV, \$10 million in revenues, \$4 million to \$4.1 million in EBITDA, which certainly will form part of our FY20 numbers. So, whilst we won't provide formal guidance for FY20 until our AGM in November, it's logical to assume that the research analysts will increase their FY20 forecast by the same amount as we've disclosed on this deal today.

We're now seen as bankable by a major Australian bank, which is a positive in and of itself, and particularly in our ability to undertake future M&A activities should they present themselves. We're using our growing cash balances and a debt facility to fund the acquisition, so it's incremental, provides incremental EBITDA with no dilution, and we retain enough cash for other capital management considerations that we'll announce in due course. We've consolidated our leadership position in the mall gift card segment in Europe.

There's plenty of avenues for growth in that space, even with this deal done, and they are the fanatic strategies of the continued movements of malls from unregulated vouchers to regulated eMoney products like ours and theirs. All these programs will eventually be self-issued by EML. We've got growth in our mall portfolio, particularly in Eastern Europe, where FEC was putting a lot of attention. So, markets such as Hungary, Czech Republic et cetera where again we had limited presence.

We'll be focusing pretty heavily on the expansion of those B2B sales efforts across the larger portfolio as a means of driving additional growth in the space, and the use of the Pays technology, so the use of the same gift card programs but across, whether it be Apple Pay or Google Pay or Samsung Pay, implementing those across our combined mall portfolio, and then really leveraging that into broader loyalty programs for the mall industry.

I think that really sums up the basis for the transaction. Not overly complicated, and with that I'd open it up to investors for any questions they might have.

Operator: Thank you, Tom. Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. If you wish to cancel the request, please press the pound or hash key. Your first question comes from Mark Bryan from Wilsons. Please ask your question.

Mark Bryan: (Wilsons, Analyst) Hey Tom, good morning, congratulations on the deal. Just wanted to dig in if we can please Tom, to some of the growth rates that Flex-e has been achieving, and also, you've looked quite closely at the pipeline going forward, and we probably know a fair bit about that. So, really trying to understand a bit more about historic and future growth rates that we might expect out of this asset.

Tom Cregan: I think that their growth I think - on page 6 we show the growth in terms of how we see that going in this current year, which is based on their results to date. I think we would look at simpler numbers in the following two, three years, so I think we'd be looking at 20% growth rates in the next two or three years.

Mark Bryan: (Wilsons, Analyst) Okay, excellent thank you. In terms of the size of the business, I think you said that the business has about just over 50 employees. Can you remind me how many employees you have in the European arena purely looking at gift cards?

Tom Cregan: This takes it to roughly 100 in Europe, so between our team in Birmingham and Perfectcard, they're roughly 48 to 50, so we've got, well have 100 people now in Europe. Perfectcard as a group is obviously our regulated - is money issuer, so a fair chunk of our headcount is regulatory headcount, they're the issuer of our programs. Whilst we own them, they are still a regulated entity, which means they would put us under the same scrutiny as anyone else would.

So, whether we're issuing product [unclear] for Bet365 or ECE or whoever it might be, they're managing that aspect. Then what they sell from that part of the world is incentive cash back cards, so more like what Edge Loyalty do in Australia with consumer cash back and promotional products. The Newcastle guys, FEC are virtually all malls, and our Birmingham business is a mix because we've got malls obviously in that portfolio but we've got distribution partners in that portfolio, we've got gaming in that portfolio.

So, I think if we looked it up long-term, I would see that more of our incentive business would probably be centred out of Ireland and more of our mall business would be centred out of Newcastle with FEC, and more of our GPR business would end up coming out of Birmingham, and that's how I think the teams will avoid tripping over each other going after similar kind of opportunities.

Mark Bryan: (Wilsons, Analyst) Understood, sometimes difficult this early on for cultural reasons, but if there is a bit of overlap, is there presumably some cost-out potential here as well?

Tom Cregan: No, not really, in fact I spoke to - I was in Newcastle last week and we were clear with the team there that it's not a cost-out business. In fact, really salaries in Newcastle are, they're an extreme at the opposite end of the spectrum to London for example. A customer service role in London might cost you £40,000, in Newcastle it might cost you £17,000. We're not really that fussed in trying to exit two or three people to prop up a number, because you'd have to get rid of a lot of people to actually make a material lift on the number, because just having those people work on new business and sales, so that's really the driver.

Mark Bryan: (Wilsons, Analyst) Excellent, thanks for the questions, appreciate it.

Operator: Your next question comes from Nic Caley from Baillieu. Please ask your question.

Nicholas Caley: (Baillieu Holst, Analyst) Hi, Tom. Can you just tell me what kiosk technology means?

Tom Cregan: Yes, sure I mean really, it's just a self- service ability to buy a card. So, walking up to something that would look like an ATM but you could just put your card into, buy a gift card and move on. So, not having to be at the physical counter for example, the gift card counter, to buy one. You don't need one in every place by and large because not a lot of malls are big enough. But if you've got malls in the UAE, we just signed a Mall of America in the US which is the largest single property in the world in terms of size.

Having these at different parts of the mall, just helps sell more because the person doesn't need to walk one mile to the counter to buy one. So, that's technology that they had invested in and they own that technology, and we'll be able to deploy that where it makes sense.

Nicholas Caley: (Baillieu Holst, Analyst) Great, thanks.

Operator: Your next question comes from Owen Humphries from Canaccord. Please ask your question.

Owen Humphries: (Canaccord Genuity, Analyst) Giddy, Tom.

Tom Cregan: Giddy, how you doing?

Owen Humphries: (Canaccord Genuity, Analyst) Good, well done on the transaction. I remember going back a couple of years now, Flex-e-Card was one of the major competitors in the UK market, in fact they're one of your only competitors from my understanding, and you guys were incrementally taking market share, which you can see that in the UK GDV growth numbers, but surprisingly around that European growth. Can you just go through what's driving that growth there? It sounds like it's coming out of Poland. Do they have any large customers? I know that you

mentioned Intu, but did they have Westfield as well across Europe, UK and obviously Unibail transaction there. Have you guys secured that contract with this acquisition? Can you just go through the growth rate of what's driving the European numbers?

Tom Cregan: Yes, that's a good point. A lot of it is just more malls really, more physical points of presence. I think in the UK market it was not dissimilar to the US in terms of large property owners, the Westfield, the Intu's, the British land, the Hammerson's, that we respectively had. Now they're on long-term contracts, they come up for renewal rarely, and they're often won by the incumbent. So, I think Intu for example, have been an FEC customer for over 10 years.

Not dissimilar to what we see in the US where we have our portfolio of larger key clients and our competitors have theirs and often never the twain shall meet so to speak. In Europe though, as we found with ECE, that the general market is moving just towards the removal of unregulated products and moving them into regulated products. So, I think with an inability for them to significantly grab share in the UK, they've just spent more time focusing on other markets. So, they've got a fair chunk of malls in Italy, Poland, some in Scandinavia, in some of those countries, ECE for example is one of their customers in Poland.

So, it brings together those other relationships that we have, but a lot of their growth has been driven by expansion of malls and expansion of programs. So that as I said in the UAE, they've got 13 centres but they've got 27 different programs at the moment supporting malls, retailers, car dealerships, all sorts of stuff. I would put their growth down to sales grunt, if I could be that blunt.

Owen Humphries: (Canaccord Genuity, Analyst) Okay, got you. Just obviously we talked about the kiosk product, is there anything inside their portfolio that you'll be rolling out across your mall portfolio? Is there any revenue upside to your current portfolio?

Tom Cregan: We were both working on the Pays, so we both had similar plans there. But really, it's their B2B, so what they have invested, time and money and resources given they've got headcount allocated for it is around that. I think we look at - I mean we don't have Westfield for example as a client in Australia, but the ratio of B2B sales as a percentage of their total sales is about 40%.

So, they do a really good job of marketing their gift card programs to corporates, so that core employee incentive or employee awards or whatever, you are given a Westfield card. They've invested a bit more than us in that, they've got some better interfaces, some better technology to support that kind of business. It's something we could have built ourselves really, but you can't do everything, we've got many competing priorities at the moment. So, what they've got is good for that, they're certainly rolling it out and pursuing that across their base, and we'll be using that technology to do that across ours as well.

Owen Humphries: (Canaccord Genuity, Analyst) Okay, good one, well done, I'll step back in the queue.

Tom Cregan: Thanks.

Operator: Your next question comes from Killian Murphy from Petra Capital. Please ask your question.

Killian Murphy: (Petra Capital, Analyst) Thanks very much. Morning, Tom. Just two quick questions from me please. Just with the B2B selling, does that affect the seasonality of the business, or is it still like your mall business and largely weighted towards Christmas?

Tom Cregan: That's a good question. With B2B it's less seasonal because typically it's employee incentives and employee rewards and those type of programs that are run continuously across the year. We think that that will help our cause because Westfield for example in London have one mall at the moment and the other one's under refurbishment.

It doesn't really work to go to an employer and say we'd like to sell you these cards and if you give them to your employee, they can use them in Westfield. But there's only one place they could use it at, whereas now we cover every large property owner in the country.

So, we think that helps our case to get out to corporates and sell more into the corporate market. So, it tends to be less seasonal, and then the UAE for obvious reasons is very non-seasonal. I mean obviously they don't have any peak seasonality around Christmas, so their GDV is pretty spread across the year.

Killian Murphy: (Petra Capital, Analyst) Okay, cool thanks. Just on issuing, you mentioned that you were going to use your eMoney licence to issue these cards. It's doing about 76% GP margin, when you get to issue all those cards, which I imagine would take about a year or so, what should we be thinking in terms of GP margins?

Tom Cregan: It probably will take us a year to get those programs just converted to us as the issuer, because again, rather than spending millions going out and replacing cards in market, we'll wait for those cards to expire and then we will start issuing new ones from that point. At which point we obviously get rid of the issuing bank costs and so on. So, our aspirational number is we think we end up getting to 80% gross margin just through that, and I think we'll be on our way to doing that within that 12 to 18-month mark.

Killian Murphy: (Petra Capital, Analyst) Fantastic, and just finally from me, in terms of there's still a decent amount of cash in the balance sheet and obviously you're generating a lot of cash. In terms of further acquisition pipeline, is Europe your focus and these kinds of businesses which you've done well in the past, are the US more of a focus for acquisitions in the short-term?

Tom Cregan: Really, we don't really have a plan per se in terms of we want to buy a company, a certain geography or a company with a certain product, our product portfolio - most of our, I think I said at our last results, most of our M&A interest is opportunistic, it's opportunities have come up. But in this case, it's one that I've worked on for quite a while with the owners of that business, but the timing was right to re-institute that. So, there's no agenda or there's no particular strategy to buy a business in the US versus anywhere else for that matter.

The point is just really to keep our options open. I think, we had a lot of discussion post the last roadshow around what to do with cash, and obviously there were different options there. No decisions have been made at this point, but certainly special dividends were not really perceived by anyone as something of interest given the minute they're paid that the shareholder departs.

So, that wasn't seen to be conducive to building a register, but there was some interest in buy-back, there was some interest in dividends, all of those things that we can still discuss as a Board at the end of the year. If there is an acquisition opportunity between now and then, then it gives us the cash to use on that too. So, it was really just optionality, Killian, just keeping the powder dry.

Killian Murphy: (Petra Capital, Analyst) Okay great, thanks, Tom.

Tom Cregan: Thanks.

Operator: Your next question comes from Ed Prendergast from Pengana. Please ask your question.

Ed Prendergast: (Pengana, Analyst) Giddy, Tom, just a quick one.

Tom Cregan: Morning, Ed.

Ed Prendergast: (Pengana, Analyst) Who were the vendors of the business and why were they in a position or wanting to sell?

Tom Cregan: The two guys, it's owned by two individuals who are very accomplished FinTech entrepreneurs in the payments space. FEC is one of four business I think that they've set up and some have exited, so they're professional build, develop and sell guys. So, that's why they're not part of the transaction in terms of being retained by us. One of the companies that they founded, and the reason we've been talking to them for a while, it just took a long time to get it done, is that they have another, a FinTech business that they set up called GPS, which is a transaction processing business that they sold down 40% of last year to American private equity group.

So, most of their last nine months was taken up with that deal. Tony Kerr and Craig Dewar are their names, they're pretty accomplished serial entrepreneurs in the payments space. The question as to why was we really had an agreement to this in February a year ago, but then the sale of their minority stake in GPS took precedence. I think from memory, and it's public, it'd be on the internet, but I think 40% was worth £50 million or thereabouts.

So, their priority was to sell down a stake in a much larger asset that took priority and we picked up discussions when that transaction was completed last year.

Ed Prendergast: (Pengana, Analyst) Yes, that's fine.

Operator: Your next question comes from Ron Shamgar from TAMIM Asset Management. Please ask your question.

Ron Shamgar: (TAMIM Asset Management, Analyst) Hi, Tom, congrats on the deal.

Tom Cregan: Hi Ron. Thanks very much.

Ron Shamgar: (TAMIM Asset Management, Analyst) Most of my questions were answered, just a quick one. With the acquisition costs that's included in the guidance, can you quantify those?

Tom Cregan: Say again sorry, I just want to make sure I get it right.

Ron Shamgar: (TAMIM Asset Management, Analyst) The acquisition costs are included in the guidance, can you quantify those costs?

Tom Cregan: I might defer that one to Rob, it'd probably be \$300,000 I would think, Ron, something like that, \$300,00 or \$400,000 maybe. Rob, have we got a final number on that? We haven't got the legal bills in yet.

Rob Shore: No, we haven't got the legal bills but that's in that order of magnitude. We did most of the due diligence ourselves in-house, so we managed to keep the transaction costs down. But legals and tax are specialisms that we go and get external advice on where the majority of the cost goes, as well as travel on this one obviously because it's based in the UK.

Ron Shamgar: (TAMIM Asset Management, Analyst) Okay yes, that's it from me, thanks.

Operator: Your next question, it's a follow-up question from Owen Humphries from Canaccord. Please ask your question.

Owen Humphries: (Canaccord Genuity, Analyst) That's okay, guys, Ron just asked my question, he snuck in.

Tom Cregan: It's in that order, hard to know what the total bill is, but despite that we'll still be looking as I said on towards the high end of that previously, a firm guidance anyway.

Operator: Your next question comes from Advait Joshi from Bombora. Please ask your question.

Advait Joshi: (Bombora Investment Management) Congrats on the acquisition, guys. I was just wondering if you have any commentary around the cost of debt, the [unclear] cost of debt that you've gotten, if you can quantify that as well?

Tom Cregan: Rob, might flip that one to you.

Rob Shore: [Unclear] in terms of the cost we're not at liberty to disclose the pricing, but it's pretty competitive, it's a fairly small cost for us at the moment and we're pretty comfortable with taking on a small debt facility, leverage the balance sheet. But we haven't disclosed that.

Advait Joshi: (Bombora Investment Management) Cool, thanks.

Operator: There are no further questions at this time. Tom, please continue.

Tom Cregan: Thanks guys, thanks for everyone's attendance this morning, and look forward to seeing everyone in the coming months.

Operator: Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.

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