eServGlobal

Initiation of coverage

Supporting mobile money in the developing world

Software & comp services

eServGlobal's core business provides software to support domestic mobile top-up and mobile money services. Recent restructuring has materially cut the cost base and should position the business to better respond to customer demand. For international remittances, eServGlobal's participation in the HomeSend JV alongside MasterCard and BICS has the potential to generate significant upside to the share price.

Year end	Revenue (A$m)	PBT* (A$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
10/14	31.3	(0.5)	(0.20)	0.0	N/A	N/A
10/15e	31.3	(3.8)	(1.22)	0.0	N/A	N/A
10/16e	34.4	(2.5)	(0.81)	0.0	N/A	N/A
10/17e	37.7	3.7	1.05	0.0	30.4	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Core business: Mobile money in developing world

eServGlobal's core business provides software to mobile network operators and financial service providers to support recharge and mobile money services. After a period of restructuring to align the cost base with the revenue opportunity, eServGlobal is targeting revenue and margin growth from geographical expansion, growing the reseller channel and upselling mobile wallet solutions to existing recharge customers.

HomeSend JV adds upside potential

Building on this expertise, in conjunction with BICS, eServGlobal developed HomeSend, an international remittances hub. HomeSend has the potential to reduce the cost of sending smaller sums of money cross border. HomeSend was transferred into a JV with MasterCard in 2013 (MasterCard owns 55%, eServ 35%, BICS 10%) and is already benefiting from MasterCard's marketing efforts. The recent announcement that HomeSend will provide the international platform for the MasterCard Send service could accelerate adoption of the service. Currently loss-making, the joint venture is targeting break-even in FY17.

Valuation: Factoring in limited success for HomeSend

We value eServGlobal on a sum-of-the-parts basis to take account of the two different business models and ownership structures. Using peer multiples for the core software business and a DCF for the HomeSend JV, which assumes that the JV processes 2% of the international remittance market by 2024, we calculate a valuation of 30.6p per share. Varying the HomeSend market share by +/-1% results in a valuation of 38.9p/17.6p. Using book value for the JV cuts the valuation to 14.3p. To close the valuation gap, we will need to see regular operational updates for HomeSend tracking new hub members, volume growth and progress towards profitability, combined with evidence that the core business is managing to win new customers and upsell to its existing customer base.

18 August 2015

Price	**15.0p**
Market cap	**£40m**
	£1:A$2.13:€1.41
Net debt (A$m) at end H115	0.4
Shares in issue	265.8m
Free float	94%
Code	ESG
Primary exchange	AIM
Secondary exchange	ASX

Share price performance

%	1m	3m	12m
Abs	(5.6)	(2.9)	(50.7)
Rel (local)	(0.6)	3.7	(49.0)
52-week high/low		0.71p	0.26p

Business description

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

Next event

FY15 results	31 December 2015

Analysts

Katherine Thompson	+44 (0)20 3077 5730
Eric Opara	+44 (0)20 3077 5700

tech@edisongroup.com

Edison profile page

eServGlobal is a research client of Edison Investment Research Limited

Investment summary

Company description: Supporting mobile money

eServGlobal's core business sells software to mobile network operators and financial service providers to manage prepaid subscriber top-ups and mobile money wallets, with a focus on developing markets. Growth drivers include the shift to using the mobile phone for financial services, the increasing popularity of mobile peer-to-peer payments, increasing penetration of the existing customer base across additional geographies and the development of channel partners. eServGlobal has also jointly developed a hub for international remittances, which operates through its 35% stake in the HomeSend joint venture – the JV is focused on driving adoption of the hub with the aim of reaching profitability in 2017.

Financials: Restructuring paves the way for margin expansion

Our forecasts factor in relatively flat revenues and EBITDA in FY15: growth in software revenues is offset by the loss of several customers in previous years related to the move away from legacy solutions. Restructuring should have a material impact on the cost base in H215. We forecast continued growth in software sales in FY16 and FY17 and rising support revenues as customers go live. This, combined with the lower cost base, drives expansion in EBITDA margins from 8.3% in FY15e to 20.4% in FY17e. Taking into account the ramp-up of amortisation of the costs of developing PayMobile 3.0, our operating margin forecast increases from 4.1% in FY15 to 14.0% in FY17. eServGlobal's share of the HomeSend JV is equity accounted and we forecast that it will be loss-making at the net income level for FY15-17.

Valuation: HomeSend offers upside potential

Based on a sum-of-the-arts valuation, we calculate a per share value of 30.6p. We value the core business at a discount to mobile software peers to reflect its profitability profile. We assume that the HomeSend JV is successful in reaching break-even in FY17, growing its share of the international remittance market to 2% by FY24 and achieving operating margins of 30% in the long term. For the value of the JV to be reflected in the share price, investors will need to see regular operational updates tracking new hub members, live corridors, volumes transacted and progress towards profitability.

Sensitivities: Demand, competition, joint venture

Our forecasts and the share price are sensitive to the following factors. **Demand:** the core business is reliant on winning business from new customers and selling extensions and upgrades to existing customers, the timing and size of which is difficult to predict. **Competition:** eServGlobal's core business competes with other specialist mobile money software providers, as well as with larger mobile telecom-focused companies with wider service offerings. **HomeSend JV:** eServGlobal has no control over the JV and hence there is limited visibility on revenues and costs. The JV's ability to reach profitability will depend on adoption of the HomeSend platform for international remittances by money transfer organisations. eServGlobal may need to inject additional funds into the JV. **Economic and political risk:** the company's focus on developing countries exposes it to the risk of political or economic upheaval in the countries in which it has customers. **Currency:** eServGlobal's functional currency is the euro, while it reports in Australian dollars, leading to sometimes material translational currency gains or losses. In addition, as it has employees in several countries, there is some mismatch between revenues and operating costs. **Exposure to large shareholder:** the largest shareholder has a 17.5% stake in the business, has lent the company £5m and holds 2.8m options that are exercisable by 3 June 2017 at 18p per share. **Regulation:** there is the risk that regulation related to mobile money could reduce demand for eServGlobal's mobile wallet software.

Company description: Mobile money

eServGlobal is a software provider specialising in mobile money solutions for mobile network operators and financial service providers. Customers tend to be in developing markets: in FY14, more than 70% of revenues were generated from the Middle East and Africa. eServGlobal has also developed a hub for international remittances, which operates through its stake in the HomeSend joint venture. After a period of restructuring, the company is focused on growing its core software business and supporting the HomeSend JV.

Background

eServGlobal was founded in 1982 and has operated several different telecom-related technology businesses. The company currently consists of two businesses: software for mobile money and recharge services and an international remittance service (HomeSend). In 2013, eServGlobal created a joint venture with MasterCard and BICS for the HomeSend service, of which it now owns 35%. eServGlobal listed on the ASX in 2003 and AIM in 2004.

The business has recently restructured the management team. The company is currently led by executive chairman John Conoley, who was previously the CEO of Psion (where he restructured the business before its sale to Motorola). John joined the board as a non-executive director in 2013 and took on the executive chairman role in April. The current COO, Stephen Blundell, will step down from 1 September but will remain on the board as a non-executive director. Paolo Gagliardi, who since 2013 has been eServGlobal's chief delivery officer, will take on the COO role from the start of September. In the medium term, the board composition will be reviewed, and may ultimately require a CEO and CFO.

Core business: Mobile Money software

The core business of eServGlobal develops, sells and installs software to manage money on a mobile phone. The software is based on eServGlobal's PayMobile platform – the latest version (3.0) was completed in H115 and provides a modular approach that allows customers to add features and services as subscriber demand allows.

Customers are mobile network operators (MNOs) – the nature of eServGlobal's products means the customer focus is more towards developing countries where subscribers tend to prepay rather than use post-pay contracts. The PayMobile platform offers:

- **Recharge solutions:** voucher management solutions (VMS) and Electronic Voucher Distribution (EVD).
- **Mobile Money:** this supports the conversion of cash to electronic value and conversion back to cash, ie a mobile wallet.

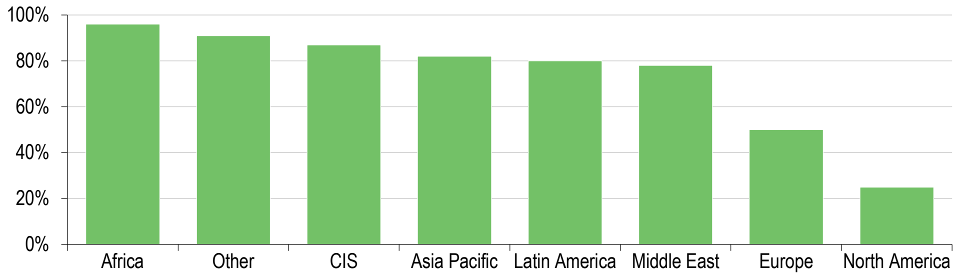
Roughly 70% of revenues are generated from Recharge (VMS and EVD), although Mobile Money is growing faster so is making up an increasing proportion of revenues. The company is looking to upgrade existing Recharge customers to its Mobile Money solution, as well as targeting new customers with the solution.

Background to the prepaid market

Prepaid subscribers are mobile phone users who buy credit for their phones in advance on an ad hoc basis, as opposed to customers on a monthly contract with an MNO. Due to lower income levels, many customers not having bank accounts and customers with little or no credit history, prepaid contracts are a prominent feature of developing markets.

The chart below shows the percentage of prepaid subscribers for different regions. As an example of the wide variance, prepaid contracts make up 26% of US and 41% of UK subscriptions compared to 97% in Kenya and Nigeria and 99% in Indonesia (source: GSMA).

Exhibit 1: Percentage of subscribers with prepaid contracts



Source: The Mobile Economy 2013 – AT Kearney & GSMA Wireless Intelligence

The crucial difference between prepaid and contract subscribers is the way that the MNO is paid for airtime/data. In developed markets prepaid subscribers tend to phone up, use an ATM or use an app to buy airtime credit – this is possible as subscribers tend to have bank accounts to which they can link, either via direct debit or by charging a debit or credit card. In some cases, subscribers may choose to go to a shop that offers this service and pay in cash. In developing markets, for the majority of users, the cash route is the only option. This means that the MNO needs a network of agents across the country that can take cash in return for issuing some kind of airtime credit – either a paper voucher in the form of a scratch card, or an electronic voucher (typically an SMS with a code that the subscriber enters into the phone). In either case, there is a network of agents that needs to be managed and vouchers for airtime that need to be created and tracked. Paper vouchers need to be designed, printed, distributed and tracked. Electronic vouchers need to be tracked from issue to redemption in real time.

eServGlobal's PayMobile platform recharge solutions offer voucher creation, distribution in an agent network, sales and fulfillment (physical or electronic), a reporting service and a promotions engine.

Moving from buying airtime to using the phone for financial services

In many developing countries, there are more mobile phone subscribers than there are adults with bank accounts. This has led to the development of services that exploit the agent network and ubiquity of phone ownership to provide mobile phone subscribers with financial services. In this case, the airtime that is acquired is treated as a store of value. So someone wanting to send cash to a relative in another part of the country where one or neither party has a bank account, or where access to a bank branch is difficult, can use the transfer of airtime as a means of transferring cash. The sender buys $10 of airtime via an agent and provides the agent with the phone number of the recipient. This is transferred via the mobile phone network and the recipient visits their closest agent with their phone to redeem the cash value of the airtime. The best known and most successful example of this is M-Pesa in Kenya, operated by Safaricom. At the end of 2014, there were 19.3 million registered users of the service out of a population of 46 million, of which 12.2 million were active users. The service generated revenues of almost £180m in 2014.

While the most basic method of transfer involves airtime, more operators are offering mobile wallets that act as a store of value that can either be cashed in or used to pay for things where wallets are accepted.

eServGlobal's Mobile Money software enables MNOs to provide their subscribers with a mobile wallet to support domestic money transfers. As well as supporting peer-to-peer payments, the software can also be used for bill payments (eg paying for water or electricity in advance without having to travel to a utility's office), G2P (government disbursements such as salaries, pensions or benefits), aid payments and P2G (payments to the government for things like tax). From a government perspective, sending or receiving money this way reduces the potential for corruption and reduces cash management expenses and complexity.

Supporting the unbanked

Globally there are currently c 7.5bn cellular subscriptions across c 3.7bn subscribers (source: GSMA). We note the total subscription number includes machine-to-machine connections estimated at c 3% of the total. In many countries, the number of subscriptions exceeds the size of the population. This is for several reasons:

- Subscribers may have mobile contracts on more than one device, eg phone, tablet; or
- Subscribers may have a work and personal phone; or
- Prepaid subscribers may own multiple SIM cards, which they swap around to make the best of special offers from MNOs.

It is estimated that there are two billion adults (c 38% of the adult population) who have no or very limited access to a bank account[1] (source: World Bank Findex Report 2014). Of the 62% of the population with an account, 60% or 3.16 billion adults have an account with a financial institution, 1%/53m have an account with a mobile money provider and another 1% or 53 million have a mobile money account linked to a bank account (source: World Bank Findex Report 2014). In high-income OECD economies, bank account penetration stands at 94%, whereas in the Middle East it stands at 14% and sub-Saharan African at 34%. In sub-Saharan Africa, nearly a third of adults with access to a bank account have access solely via a mobile money provider. At the beginning of 2015, the GSMA estimated that there were 259 mobile money schemes deployed across 89 countries, up from 100 deployments three years previously. Most mobile money accounts are available via multiple-access methods on the mobile: the most common is USSD (unstructured supplementary service data – the protocol for sending text across GSM networks), followed by apps, STK (SIM toolkit) and IVR (interactive voice response).

With the launch of its smartphone app, eServGlobal is able to support the growing number of smartphone owners in the developing world. Smartphone penetration currently stands at more than 50% in the EU compared to c 20% in sub-Saharan Africa and c 40% in the Middle East. This is forecast to grow to c 75%, 55% and 65% respectively by 2020 (source: GSMA 2014 State of the Industry- Mobile Financial Services for the Unbanked). 62% of current mobile money services are available on smartphone apps and we expect this proportion to grow as smartphone penetration increases.

Customer base – developing markets

eServGlobal has 61 customers with licences covering over 110 million subscribers (accounting for a minority of customers' total subscriber bases). Customers are based in the Middle East, Africa and Asia Pacific. The company has no presence in Latin America, but sees this as an area for expansion. In the table below, we show some of the customers that have been publicly announced (this list is not comprehensive). We have calculated the total numbers of subscribers served by these customers at the group level and identified, where possible, in which countries those customers have live services supported by eServGlobal. Even in the countries where services are live, operators do not always have licences covering their entire subscriber base and this is an area for potential licence extensions as subscriber adoption of services grows. At the end of H115, the company calculates that customers had reached 94% of licence subscriber thresholds.

[1] This is defined as having an account with a financial institution (bank, credit union, microfinance institution [MFI], co-operative) or through a mobile money provider.

After using eServGlobal Recharge solutions for several years, in 2013 **Zain** signed a three-year framework agreement for the provision of end-to-end mobile financial services solutions at a group level. In some of the countries in which Zain operates, more than 90% of the adult population have no access to financial services. In 2014, Zain launched pilots in Jordan and Iraq (where it is awaiting regulatory approval) and launched a live service in Saudi Arabia in 2015. We would expect to see additional licence sales as Zain rolls out the services to its affiliates.

Exhibit 2: Selected eServGlobal customers

Customer	Countries of operation	Total subs (m)	Countries with live eServ services	Est subs covered (m)
Alfa Telecom	Lebanon	2	Lebanon	2
GMT Cabo Verde	Cape Verde	0.5		
Nepal Telecom	Nepal	6	Nepal	6
Ooredoo	Qatar, Kuwait, Algeria, Tunisia, Myanmar, Maldives, Iraq, Oman, Palestine, Pakistan, Philippines, Indonesia	111	Kuwait, Algeria, Tunisia, Iraq, Indonesia (Indosat)	96.9
Sistema (MTS)	Russia, Ukraine, Armenia, Turkmenistan, Uzbekistan, Belarus	114	Armenia	2
Zain	Bahrain, Iraq, Jordan, Kuwait, Lebanon, Morocco, Saudi Arabia, South Sudan, Sudan	46	Jordan, Kuwait, Saudi Arabia	17
Total		279.5		123.9

Source: eServGlobal, company reports, Edison Investment Research

Competition

The core business competes with a variety of mobile billing software providers, most frequently with the companies in Exhibit 3.

Exhibit 3: Competitive environment

Company	Ownership	Recharge (R)/ Mobile Money (M)	Comments
Ericsson		R	Sells recharge as part of converged billing solutions
Huawei		R	Sells recharge as part of converged billing solutions
Mahindra Comviva	Tech Mahindra	R, M	Customers include Ethio Telecom, Vodafone Egypt. Claims 10% of the world's recharge is done using Comviva's PreTUPS software.
Telepin Software	Private	R, M	Canada-based; active in the Middle East, Africa & the Americas. More than 40 active deployments covering >132m subs and >1m merchants. Customers include Cable & Wireless Panama, Singtel Mobile (Singapore), Etisalat Afghanistan.
Utiba	Amdocs	R, M	Singapore-based. Customers include Digicel (Haiti), BSNL (India), True Corp (Thailand). Deployments in 36 countries covering 660m subs and >6m agents.

Source: Edison Investment Research

Sales strategy – building the channel

eServGlobal's direct sales team numbers seven employees: one in Singapore (focused on Asia Pacific), one in France (focused on French-speaking Africa) and five in the Middle East. eServGlobal previously had a reselling agreement with Nokia Siemens Networks (NSN) for its voucher management solution, from which it earned material support revenues. This relationship ended when NSN sold its business support systems (BSS) business to Redknee in 2013. eServGlobal is looking to increase the number of resellers with which it works. It also hopes to leverage its relationship with MasterCard. For example, to use the HomeSend platform for international remittances via mobile, end customers need to have a mobile wallet provided by their own MNO – MasterCard recommends eServGlobal's Mobile Money solution to customers looking for a domestic mobile wallet solution.

Growth strategy

Management is targeting growth in the core business from:

- shifting existing paper voucher customers to electronic voucher systems. Paper vouchers are expensive to print and distribute; electronic voucher systems improve efficiency;
- increasing the penetration of its software with existing customers (eg licence extensions for increased numbers of subscribers, rolling out the software to new geographies in an operator group);
- winning new Mobile Money customers. MNOs are keen to reduce subscriber churn – mobile wallets are attractive as subscribers are less likely to change their financial services provider as frequently as they currently swap SIM cards. eServGlobal is seeing a replacement cycle for the first wave of mobile wallets that were launched four to five years ago and hopes to win some of these. The company is also keen to support existing recharge customers as they extend the mobile wallet option to their customers;
- growing the indirect sales channel; and
- shifting projects from implementation to support – this not only allows support revenues to be earned, but also enables extensions and upgrades to be sold.

HomeSend JV

Starting in 2009, eServGlobal developed an international mobile remittance platform (HomeSend) in conjunction with BICS (Belgacom International Carrier Services). eServGlobal provided its proprietary software and BICS the payments infrastructure that it had developed for clearing and settling roaming charges. In December 2013, eServGlobal and BICS announced that they had entered into a joint venture with MasterCard to make use of the HomeSend platform. eServGlobal has a 35% stake, MasterCard 55% and BICS 10%. The joint venture went live from the beginning of April 2014 and is accounted for on an equity basis in eServGlobal's accounts. MasterCard paid eServGlobal €9m (of which €3.45m has been deferred) to transfer all HomeSend-related assets and staff to the JV, and MasterCard will contribute capital to the JV to meet its working capital requirements in the medium term. At the same time, MasterCard signed a three-year agreement where it committed to use best efforts to promote HomeSend through its sales channels. The MasterCard sales team has already signed up two customers to the platform.

In May, MasterCard announced that MasterCard Send would use HomeSend for international remittances. Through a single connection to the MasterCard Send platform businesses, merchants, governments, non-profits, issuers and other senders can send money to consumers whether they are banked or unbanked, and located domestically or abroad. Senders or recipients do not need to be MasterCard card holders.

International remittance market

The international remittance[2] market was worth $583bn in 2014 according to the World Bank, of which $436bn was sent home by migrants from developing countries. The market is made up of traditional MTOs (global and regional), banks, post offices, card networks and newer digital-only companies. The two largest players are Western Union (FY14: revenues $5.6bn, transactions processed $85bn) and MoneyGram (FY14: revenues $1.5bn).

Traditionally, an MTO would operate a network of agents in many countries. Agents can receive or pay out remittances and are able to service the segment of the market that does not have a bank account. More recently, digital-only MTOs have been established (Azimo, TransferWise, WorldRemit, Xoom) where users send and receive money via mobile or online channels, removing the need for an agent network.

[2] Person-to-person money transfers.

The World Bank has an international remittances database that it updates quarterly for 227 country corridors (consisting of 32 sending countries and 89 receiving countries), tracking the cost to send money by sending party (eg Western Union, WorldRemit), sending method, receiving method and time to access funds. The most recent data (as at June 2015) shows an average cost to send $200 (or local equivalent) of 7.68%, which has come down from the 9.67% recorded at the beginning of 2009. This cost varies by region; for example, the average cost to send to sub-Saharan Africa is 9.74% compared to 5.74% to send to South Asia. HomeSend is aiming to achieve a total cost of remittance of 4.5-6.5% (currently c 6%), of which it retains 1.5% with the remainder shared between the sending and receiving organisations.

The HomeSend hub

The HomeSend hub connects the payment systems of the different hub members and processes the individual end-user transactions. It also acts as a clearing house that manages the multilateral settlement with the connected service providers. Members of the hub can get access to all other members through a single connection and commercial relationship.

HomeSend has technical integrations with a large number of MNOs and sending organisations (MTOs, banks, post offices, etc). eServGlobal reported in June that HomeSend had 1,578 live corridors, made up of 200 sending countries and 35 receiving countries. To join the HomeSend hub, a company needs to technically integrate into the platform and then enter into commercial agreements with its opposite numbers in the corridors in which it wants to operate. This is a more efficient method than creating a commercial agreement with each necessary party and then creating the technical connections for each corridor. Customers can send and receive money via HomeSend using cash, mobile wallets, debit/credit cards or direct bank transfers. The benefit of receiving funds into a mobile wallet is that receipt is almost instantaneous.

Companies that have joined HomeSend include:

Exhibit 4: Selected partners of HomeSend

Company	Business	Company	Business
EastNets	Payments & compliance provider	Maroc Telecom	MNO - Morocco
Microfinance International Corporation	MFI - US	MTN Ghana	MNO - Ghana
SmartPay	PSP - China	Smart Communications	MNO - Philippines
Wafacash	MTO - North Africa	Ooredoo	MNO - Middle East
VNPT EPAY	PSP - Vietnam	Lycatel	MVNO
mHITs	Mobile payments - Australia	Vodafone	MNO
Tranglo	Remittance hub	Airtel Africa	MNO - Africa
Xpress Money	MTO	Telesom	MNO - Somalia
Moneytrans	MTO	Merchantrade Malaysia	MVNO - Malaysia/ MTO
WorldRemit	MTO	Indosat	MNO - Indonesia
PostFinance	FI - Switzerland	M-PAiSA (Vodafone)	MNO - Fiji
Brastel Remit	MTO - Japan	eZ Cash (Dialog Axiata)	MNO - Sri Lanka
M Lhuillier	MTO - Philippines		
MoneyGram	MTO		
eTranzact*	PSP, mobile payments		
Steward Bank*	Bank - Zimbabwe		
Azimo	MTO		

Source: eServGlobal. Note: *Signed up by the MasterCard sales team.

We expect that many MTOs will sign up to use HomeSend to supplement the networks they have already created. This enables them to access countries where they do not have an existing agent network (by working with an MNO that already has one) or to make use of mobile wallet capabilities. For example, MoneyGram signed up to use HomeSend in 2014, as it does not yet have a mobile send/receive facility. It is starting with Kenya as a receiving country, where funds can be transferred to an M-Pesa account, and we believe MoneyGram plans to expand the use of HomeSend to other corridors. Digital MTOs are also signing up – WorldRemit joined HomeSend in 2013 with an initial focus on corridors between Europe and Africa, and Azimo joined last month to launch new mobile wallet services in 10 countries. This allows MTOs to expand their networks at much lower incremental cost.

Future plans may require additional investment

HomeSend management has presented a strategy to accelerate growth to capitalise on current demand. This includes:

- co-funded marketing initiatives with MNOs to stimulate subscriber demand;
- a new PCI-DSS[3] compliant data centre, which is necessary to connect to the MasterCard network (replacing the data centre space currently supplied by BICS); and
- acquisition of a payment institution licence.

This strategy requires additional funding from partners up to a maximum of €10m. If approved, the funding would be required in late 2015. eServGlobal's share would be €3.5m/A$5.2m. We have not factored this into our forecasts.

Sensitivities

Our forecasts and the share price are sensitive to the following factors:

- **Demand:** the core business is reliant on winning business from new customers and selling extensions and upgrades to existing customers. The timing and size of such wins is difficult to predict.
- **Competition:** eServGlobal's core business competes with other specialist mobile money software providers, as well as with larger mobile telecom-focused companies with wider service offerings.
- **HomeSend JV:** eServGlobal has no control over the joint venture and hence there is limited visibility on revenues and costs. The ability of the joint venture to reach profitability will depend on adoption of the HomeSend platform for international remittances by MTOs. eServGlobal may need to inject additional funds into the JV to support it while it works to reach break-even.
- **Economic and political risk:** the company's focus on developing countries means it is exposed to the risk of political or economic upheaval in the countries in which it has customers.
- **Currency:** eServGlobal's functional currency is the euro, while the company reports in A$, leading to sometimes material translational currency gains or losses. In addition, as the company has employees in several countries, there is some mismatch between revenues and operating costs.
- **Exposure to large shareholder:** the largest shareholder has a 17.5% stake in the business, has lent the company £5m and holds 2.8m options that are exercisable by 3 June 2017 at 18p per share.
- **Regulation:** there is the risk that regulation related to mobile money could reduce demand for eServGlobal's mobile wallet software. We note that PayMobile 3.0 is designed to be flexible enough to allow for different regulatory requirements.

[3] PCI-DSS: Payment Card Industry – Data Security Standard.

Financials

Income statement

Exhibit 5: revenue breakdown

Revenues (A$000s)	2013	2014	2015e	2016e	2017e
Hardware	1,992	977	1,000	1,000	1,000
Licences	10,689	13,631	15,335	16,408	17,721
Services	3,754	4,193	4,700	4,700	5,000
Support	12,534	9,582	7,698	9,996	11,877
SaaS & HomeSend	2,034	2,878	2,590	2,331	2,098
Total	31,003	31,261	31,321	34,436	37,696
Revenue growth					
Hardware	225.0%	-51.0%	2.4%	0.0%	0.0%
Licences	16.2%	27.5%	12.5%	7.0%	8.0%
Services	11.1%	11.7%	12.1%	0.0%	6.4%
Support	3.2%	-23.6%	-19.7%	29.9%	18.8%
SaaS & HomeSend	-25.5%	41.5%	-10.0%	-10.0%	-10.0%
Total	10.4%	0.8%	0.2%	9.9%	9.5%

Source: eServGlobal, Edison Investment Research

eServGlobal generates revenues from perpetual licence sales (recognised when a contract is signed), services (implementation fees, recognised on a percentage of completion basis), support (kicks in once the software has been implemented, charged at c 15% of the licence value pa), hardware (minimal) and SaaS (provision of a premium SMS service for one customer).

We expect continued growth in licence sales as existing customers take licence extensions and upgrades and new customers are signed up. Our FY15 services revenue forecast reflects the higher level of implementation projects currently underway (the H215 project delivery schedule is higher than in previous years). FY15 support revenues reflect the loss of two customers in the previous year. As implementation projects are finished in H215, we expect new support contracts to start in FY16. We expect SaaS revenues to decline over time as this is a legacy contract.

The company expects to achieve FY15 revenues and adjusted EBITDA at least in line with those reported in FY14. After reporting H115 revenues of A$12.8m, this implies a higher weighting in H215 (at least A$18.4m) to meet this guidance. In H115, eServ signed up several new customers and received orders worth A$16.5m, 39% higher than a year ago and 39% higher than H214. New customer contracts include the supply of an end-to-end mobile money solution to a customer in Pakistan (contract worth more than US$2.5m), supply of a mobile money solution to an ISP in Myanmar, and provision of a fully featured electronic top-up solution for a customer in the UAE.

Gross margin tends to be in the 55-60% range, with the highest margins generated by licensing and support and the lowest by hardware. H115 gross margin came in at 50% – it was lower than the range above as a high proportion of revenues were generated from services, which typically have a much lower gross margin. We forecast that as support and licence revenues grow as a proportion of the total, gross margins should tend towards 60%.

The company employs 185 people, with c 80 people in the European headquarters in France, 20-25 people in Dubai (sales, pre-sales, project managers), 60-70 people in Bucharest (development and support) and the remainder in the UK, Indonesia and Egypt. The company has undertaken various restructuring programmes over the last few years and in June announced a cost optimisation programme for legal entities, workforce and facilities that is expected to achieve annualised cost savings of A$2.9m. As at the end of June, the company had achieved A$1.2m of annualised cost savings. We forecast a decrease in operating expenses in H215 as the restructuring programme takes effect, with opex staying at a similar level in FY16 and increasing marginally in FY17.

Exhibit 6: eServGlobal profitability

A$000s	2013	2014	2015e	2016e	2017e
Revenues	31,003	31,261	31,321	34,436	37,696
Gross profit	19,214	17,902	19,538	20,404	22,994
Gross margin	62.0%	57.3%	62.4%	59.3%	61.0%
EBITDA	1,683	2,571	2,584	5,550	7,690
EBITDA margin	5.4%	8.2%	8.3%	16.1%	20.4%
Operating profit	(660)	1,987	1,294	3,140	5,280
Operating margin	-2.1%	6.4%	4.1%	9.1%	14.0%

Source: eServGlobal, Edison Investment Research

Exceptional items

In FY14, eServGlobal recognised a A$31.7m gain on the transfer of the HomeSend business into the JV. In H115, the company incurred one-off charges totalling A$2.3m, comprised of FX losses of A$0.5m and restructuring charges of A$1.8m. Restructuring is likely to result in one-off costs of A$3.2-4.2m in H215 – we have used A$3.7m in our forecast.

Capitalised R&D

The company is capitalising the costs of developing PayMobile 3.0. Total costs of A$8.3m were capitalised over H114-H115, with amortisation starting in H115 and covering a three-year period.

Interest expense

The company took out a loan from its largest shareholder in June 2015. The loan principal was £5m/A$9.7m and is fully repayable after two years. The loan incurs interest at a rate of 0.8% per month with interest paid at the end of the term. An arrangement fee of 2.5% was paid at the outset of the loan.

Contribution from JV

We have modelled the joint venture by making assumptions on HomeSend's ability to penetrate the international remittances market. eServGlobal reported that the JV had seen transaction volumes increase 388% y-o-y from May 2014. We estimate that HomeSend earns 1.5% of the value of each transaction that passes through the platform and we apply an 80% gross margin to revenues. We factor in increasing operating expenses as HomeSend adds headcount to support the growth of the business. We forecast break-even at the operating profit level in FY17, before amortisation of acquired intangibles.

Exhibit 7: HomeSend JV P&L

A$000s	FY14	FY15e	FY16e	FY17e
Revenue (reported)	924	4,614	10,266	26,758
Gross profit @ 80%	739	3,692	8,213	21,406
Opex	(4,012)	(12,358)	(15,899)	(18,517)
Clean op profit	(3,272)	(8,667)	(7,687)	2,889
Amortisation	(3,229)	(4,000)	(4,771)	(4,771)
Operating profit	(6,501)	(12,667)	(12,458)	(1,882)
Tax	0	0	0	0
Profit from continuing ops (reported)	(6,501)	(12,667)	(12,458)	(1,882)
eServ's share @ 35%	**(2,275)**	**(4,433)**	**(4,360)**	**(659)**

Source: eServGlobal, Edison Investment Research

Cash flow and balance sheet

- The company is due a final payment of €3.45m/A$4.8m from MasterCard for the creation of the HomeSend JV in 2014. This is sitting in an escrow account and will be released on 3 April 2016.

- For H215, we expect the company to capitalise an additional A$1.25m of development costs. For FY16 and FY17, we forecast minimal tangible capex and a small amount on intangibles, totalling A$0.6m in both years.
- The company raised A$5.2m (net) from the issue of 10m shares at A$0.55 in December 2014.
- We forecast a net debt position of A$8.0m by the end of FY15 shifting to net cash of A$1.4m by the end of FY16 (boosted by the final payment for HomeSend) and rising to A$6.0m by the end of FY17.

Valuation

As eServGlobal is made up of two separate businesses, one of which is not controlled by eServGlobal management, we have used a sum-of-the-parts valuation. We look at the core business on a peer multiple and DCF basis. We use a DCF to calculate potential values for eServGlobal's share of the HomeSend JV.

Core business

In the table below, we show financial and valuation metrics for a selection of companies that specialise in selling mobile-related software. Median EBITDA margins are forecast to reach 18% this year and 21% next year, compared to our forecast for eServGlobal achieving an EBITDA margin of 8.3% in FY15e and 16.1% in FY16e. We apply an EV/Sales multiple of 1.5x FY16e revenues (a discount of 25% to peers to reflect the profitability profile), which is equivalent to an EV/EBITDA multiple of 9.3x FY16e and results in an enterprise value of A$51.7m (9.1p per share).

Exhibit 8: Mobile software companies: valuation & financial performance

	EV/Sales			EV/EBITDA			P/E			EBITDA margin			Rev growth		
	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e
Comptel	1.4	1.3		8.4	7.5		23.3	19.5		16.3%	17.4%		9.2%	5.2%	
Evolving Systems	2.8	2.5	2.2	12.3	8.5	6.9	16.9	12.5	9.2	22.8%	29.1%	31.7%	-12.0%	13.9%	12.3%
Redknee	1.1	0.9	0.9	6.4	4.9	3.9	68.7	14.5	9.5	16.9%	19.0%	23.6%	-14.1%	15.9%	0.1%
Synchronoss	3.4	3.0	2.5	9.7	8.2	6.2	20.9	18.0	14.9	35.3%	36.1%	40.3%	26.7%	16.7%	18.4%
Verifone Systems	2.1	2.0	1.8	11.8	9.9	9.5	17.1	14.0	12.2	18.0%	19.6%	19.1%	6.9%	8.8%	7.4%
Average	**2.2**	**1.9**	**1.9**	**9.7**	**7.8**	**6.6**	**29.4**	**15.7**	**11.4**	**21.9%**	**24.2%**	**28.7%**	**3.3%**	**12.1%**	**9.5%**
Median	**2.1**	**2.0**	**2.0**	**9.7**	**8.2**	**6.5**	**20.9**	**14.5**	**10.8**	**18.0%**	**19.6%**	**27.6%**	**6.9%**	**13.9%**	**9.8%**

Source: Thomson. Note: Priced as at 12 August 2015.

Cross-checking this valuation, we have performed a reverse DCF on the core business, based on our forecasts up to FY17. To arrive at the same valuation requires a CAGR for revenues of 5.5% from FY18-24 (fading down to 3%), EBITDA margins averaging 19.5% over 10 years and peaking at 22.4%, capex/sales of 2%, working capital/sales of 4%, WACC of 10% and long-term growth of 3%. Assuming that eServGlobal continues to sell upgrade and extension licences to its existing customer base, as well as win new customers for its mobile money solutions, with associated support contracts, this revenue growth appears reasonable.

HomeSend

MasterCard paid a total consideration of A$13.3m (of which $4.8m is deferred until April 2016). At the time the JV was created, eServGlobal's 35% stake was considered to have a fair value of A$31.1m, implying a valuation for the JV of A$89m. At the end of H115 the book value of eServGlobal's stake was A$25.5m, reflecting the losses generated by the JV to that point.

There is very limited data available on the financial performance of the JV to date. In Exhibit 7, we show the revenues and net profit generated from the JV in FY14 (period 3 April - 31 October 2014). We have constructed a DCF that assumes that HomeSend grows its share to 2% of the global remittance market over the next 10 years. We assume that it moves to profitability in FY17 (preacquired intangibles amortisation) and ultimately achieves operating margins of 30%. Based on working capital/sales reducing down to 3% and capex/sales to 5% over the period, and using a WACC of 10% with a long-term growth rate of 3%, we value the JV at A$336m, of which eServGlobal's share would be worth A$118m. This assumes that sufficient working capital is available until break-even is reached. At such an early stage in the life of the JV, there are obviously many assumptions underlying this calculation. In the table below, we provide a sensitivity analysis that shows how this value changes depending on market share assumptions and long-term operating margins.

Exhibit 9: Sensitivity analysis

Scenario	Value of eServGlobal's share (A$m)	Per share (p)
Base case	117.6	20.78
Gain 1% of market	44.1	7.80
Gain 3% of market	164.4	29.04
Operating margin 20%	67.6	11.95
Operating margin 40%	162.9	28.77

Source: Edison Investment Research

As a cross-check, we have looked at the financial and valuation metrics for companies involved in the remittances market. Western Union and MoneyGram are well established MTOs with large agent networks and wide geographic coverage. Xoom is a digital MTO still in a strong growth phase, which has recently been bid for by PayPal. Earthport has developed a bulk cross-border remittances platform and is yet to break even. PayPoint operates bill payment and other payment-related services across its network of retailers. Using the base case valuation, by FY17 the JV valuation equates to an EV/Sales multiple of 12.6x and EV/EBITDA of 68.7x. Assuming that the JV's profitability ramps up from FY18, these multiples fall to 2.6x and 7.9x respectively by FY20, much more in line with the peer group's multiples for FY17.

Exhibit 10: Remittance companies: valuation & financial performance

	EV/Sales			EV/EBITDA			P/E			EBITDA margin			Rev growth		
	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e
Earthport	9.8	6.2	3.9		20.6	14.3	-52.2	27.8	24.6	0.0%	30.0%	27.1%	75.6%	57.9%	60.0%
Moneygram Intl	0.4	0.3	0.3	2.1	1.9	1.8	12.8	9.9	8.8	17.1%	17.5%	17.8%	-2.0%	7.5%	6.3%
Paypoint	4.9	4.8	4.0	11.0	10.3	9.6	16.2	15.0	14.1	44.8%	46.5%	42.0%	3.2%	3.1%	19.2%
Western Union	2.2	2.2	2.1	8.8	8.6	8.6	12.3	11.7	11.4	25.2%	25.3%	24.7%	-1.9%	2.2%	2.3%
Xoom	4.3	3.6	2.9	40.4	23.9	16.7	65.3	40.7	27.3	10.7%	14.9%	17.7%	20.3%	21.2%	20.7%
Average	**4.3**	**3.4**	**2.7**	**15.6**	**13.1**	**10.2**	**10.9**	**21.1**	**17.2**	**19.6%**	**26.8%**	**25.8%**	**19.0%**	**18.4%**	**21.7%**
Median	**4.3**	**3.6**	**2.9**	**9.9**	**10.3**	**9.6**	**12.8**	**15.0**	**14.1**	**17.1%**	**25.3%**	**24.7%**	**3.2%**	**7.5%**	**19.2%**

Source: Thomson. Note: Priced as at 12 August 2015.

Sum-of-the-parts valuation

In the table below, we show the range of valuations for the group based on using peer multiples for the core business and DCF for HomeSend. We also show the impact on the valuation of using HomeSend's book value.

Exhibit 11: Sum-of-the-parts valuation

Core business	FY15e	FY16e	FY17e	
Revenues (A$m)	31.3	34.4	37.7	
EBITDA (A$m)	2.6	5.6	7.7	
EBITDA margin	8.3%	16.1%	20.4%	
EV/Sales multiple (x)	1.6	**1.5**	1.4	
EV/EBITDA multiple (x)	20.0	9.3	6.7	
EV (A$m)		**51.7**		
HomeSend	**DCF valuation**	**Per share (p)**	**Book value**	**Per share (p)**
eServ share of JV (A$m/p)	117.6	20.78	25.5	4.50
Group EV (A$m)	**169.3**		**77.2**	
Net debt at end H115 (A$m)	-0.4		-0.4	
Deferred consideration (A$m)	4.4		4.4	
Group equity value (A$m)	**173.2**		**81.1**	
Group equity value (£m/p)	**81.3**	**30.60**	**38.1**	**14.33**
Current share price		15.50		15.50
Upside/(downside)		92%		-8%

Source: Edison Investment Research

Clearly, if the HomeSend JV manages to achieve growth in market share to 2%, the share is undervalued. To close this valuation gap, it will be crucial to see operational metrics from the joint venture to monitor its progress.

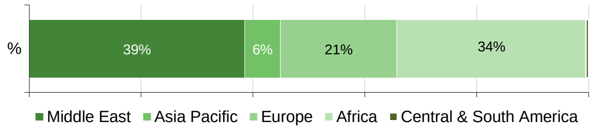
Based on our sensitivity analysis in Exhibit 9, achieving a 1% higher or lower share of the international remittances market over a 10-year period (keeping the long-term operating margin at 30%) would change the valuation to 38.9p or 17.6p. Keeping market share at 2% but varying the long-term operating margin up or down by 10 percentage points would take the valuation up to 38.6p or down to 21.8p.

In our model, we have not taken into account eServGlobal investing further funds in the joint venture. If it does this, we would expect the company to use the proceeds sitting in the escrow account that are due for release in April 2016. This reduces the upside by c 5%.

Exhibit 12: Financial summary

A$'000s	2011	2012	2013	2014	2015e	2016e	2017e
Year end 31 October	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	7,017	28,070	31,003	31,261	31,321	34,436	37,696
Cost of Sales	(4,234)	(12,267)	(11,789)	(13,359)	(11,783)	(14,032)	(14,701)
Gross Profit	2,783	15,803	19,214	17,902	19,538	20,404	22,994
EBITDA	(6,694)	(1,936)	1,683	2,571	2,584	5,550	7,690
Operating Profit (before amort acq intang, SBP and except.)	(8,601)	(7,277)	(660)	1,987	1,294	3,140	5,280
Amortisation of acquired intangibles	0	0	0	0	0	0	0
Exceptionals	0	(6,485)	5,997	28,735	(6,006)	0	0
Share-based payments	(261)	(624)	(456)	(438)	(400)	(400)	(400)
Operating Profit	(8,862)	(14,386)	4,881	30,284	(5,112)	2,740	4,880
Income from associate	0	0	0	(2,275)	(4,433)	(4,360)	(659)
Net Interest	164	(1,016)	(386)	(254)	(680)	(1,313)	(895)
Profit Before Tax (norm)	(8,437)	(8,293)	(1,046)	(542)	(3,819)	(2,533)	3,726
Profit Before Tax (FRS 3)	(8,698)	(15,402)	4,495	27,755	(10,225)	(2,933)	3,326
Tax	(560)	(187)	5,879	(13,515)	2,045	587	(665)
Profit After Tax (norm)	(8,997)	(5,805)	(732)	(379)	(3,055)	(2,026)	2,981
Profit After Tax (FRS3)	(9,258)	(15,589)	10,374	14,240	(8,180)	(2,346)	2,661
Average Number of Shares Outstanding (m)	196.8	196.8	241.1	253.1	260.4	265.8	265.8
EPS - normalised (c)	(4.59)	(3.01)	(0.36)	(0.20)	(1.22)	(0.81)	1.05
EPS - FRS 3 (c)	(4.73)	(7.98)	4.25	5.57	(3.19)	(0.93)	0.95
DPS (c)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	39.7%	56.3%	62.0%	57.3%	62.4%	59.3%	61.0%
EBITDA Margin (%)	(95.4%)	(6.9%)	5.4%	8.2%	8.3%	16.1%	20.4%
Operating Margin (before am and except.) (%)	(122.6%)	(25.9%)	(2.1%)	6.4%	4.1%	9.1%	14.0%
BALANCE SHEET							
Fixed Assets	20,090	16,303	14,330	43,431	36,927	30,756	28,288
Intangible Assets	13,190	9,386	3,523	9,011	11,879	10,069	8,259
Tangible Assets	1,541	912	482	3	3	3	3
Other Fixed Assets	5,359	6,005	10,325	34,417	25,045	20,684	20,026
Current Assets	50,814	18,136	38,855	31,554	39,574	46,022	42,276
Stock	170	158	74	173	173	173	173
Debtors	40,425	14,094	21,846	27,604	29,262	30,190	33,048
Cash	10,129	3,794	4,909	3,679	5,049	15,489	8,956
Other	90	90	12,026	98	5,090	169	98
Current Liabilities	(40,856)	(12,934)	(15,082)	(18,826)	(14,630)	(26,836)	(16,935)
Creditors	(19,952)	(11,665)	(11,932)	(13,803)	(11,330)	(12,456)	(13,635)
Taxation & social security	(6,904)	(69)	(150)	(2,023)	(300)	(300)	(300)
Short term borrowings	(14,000)	(1,200)	(3,000)	(3,000)	(3,000)	(14,080)	(3,000)
Long Term Liabilities	(1,175)	(6,431)	(749)	(865)	(10,953)	(865)	(865)
Long term borrowings	0	(6,000)	0	0	(10,088)	0	0
Other long term liabilities	(1,175)	(431)	(749)	(865)	(865)	(865)	(865)
Net Assets	28,803	14,989	37,154	55,070	50,564	48,593	52,149
CASH FLOW							
Operating Cash Flow	(8,060)	(11,901)	(7,207)	(5,810)	(7,553)	5,748	6,012
Net Interest	1,486	(974)	(580)	(271)	(484)	(200)	(200)
Tax	(448)	(7,813)	(1,088)	2,018	(2,023)	(300)	(665)
Capex	(529)	(1,966)	(1,950)	(6,403)	(4,158)	(600)	(600)
Acquisitions/disposals	0	23,307	0	5,418	0	4,800	0
Financing	(33,230)	(77)	16,140	3,964	5,500	0	0
Dividends	(23,910)	(111)	0	(146)	0	0	0
Net Cash Flow	(64,691)	465	5,315	(1,230)	(8,718)	9,448	4,546
Opening net debt/(cash)	(60,820)	3,871	3,406	(1,909)	(679)	8,039	(1,410)
HP finance leases initiated	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0
Closing net debt/(cash)	3,871	3,406	(1,909)	(679)	8,039	(1,410)	(5,956)

Source: eServGlobal, Edison Investment Research

Contact details	Revenue by geography
eServGlobal SAS 244, Avenue Pierre Brossolette 92245 MALAKOFF Cedex France +33 1 46 12 58 85 www.eservglobal.com	

Management team

Executive Chairman: John Conoley	COO: Paolo Gagliardi (from 1 September 2015)
John began his career in the IT industry with IBM in 1983, and worked in a range of industries in technical, sales and marketing roles. Since then, he has held general management and director-level roles in small and medium-sized private and public companies. His most recent roles include non-executive director with IT security company Vistorm, head of the £1.6bn B2B Energy Division at Eon and, most recently, CEO of mobile device company Psion, an international company listed in the UK.	Paolo has been chief delivery officer of eServGlobal since 2013, and was appointed COO with effect from the start of September 2015. He has more than 20 years' international experience in directing complex, multi-million euro, end-to-end projects in the ICT industry. Paolo was regional director of technology for Vodafone and VP of Managed Services for Bharti, delivering managed VAS solutions to Bharti Group mobile operators in emerging markets.
COO (until 1 September 2015): Stephen Blundell	**CTO: James Hume**
With nearly 20 years of experience in finance and operations, Stephen took over the role of eServGlobal's CFO in 2009 and was appointed to the Board in 2013. In 2014 he was appointed COO to support the company's growth strategy. He will step down as COO on 1 September, but remain as a non-executive director. He has held various senior roles with leading multi-national software companies, including EMEA Director of Finance at Adobe Systems and EMEA Vice President Commercial Operations at Siemens PLM..	James has more than 15 years' extensive experience in developing and delivering commercial enterprise software for the telco and financial services worlds. His background includes customer-facing roles in various international markets, working closely with multiple stakeholders to deliver strategic and dynamic technology solutions.

Principal shareholders	(%)
Henderson Global Investors	17.5
Legal & General Investment Management	17.0
Acorn Capital	12.8
Hargreave Hale	8.1
Investec	4.7
Renaissance	4.1
Herald Investment Management	2.4

Companies named in this report

Earthport (LON: EPO), Moneygram International (NASDAQ: MGI), PayPoint (LON: PAY), Western Union (NYSE: WU), Xoom (NASDAQ: XOOM)