

Net Element Inc. (NETE-NASDAQ)

NETE: Filing Shows PayOnline 2014 Revenues At \$6.7 million; Raising Numbers

OUTLOOK

Current Recommendation BUY
Prior Recommendation N/A
Date of Last Change 10/15/14

Current Price (08/03/15) \$0.49
Target Price \$1.40

Net Element is a software and services company, in global online payments. It operates a small merchant processor in the US and a mobile payment processor in Russia. It is closing on the acquisition of PayOnline, a market leader in the Russian Federation in online payments, that could add \$4.5m in revs this year and \$7m next. Although valuation is difficult to calculate we this puts the company at 1.3 times market cap to sales even using a future 80 million in shares outstanding.

SUMMARY DATA

52-Week High \$5.70
52-Week Low \$0.14
One-Year Return (%) -74.5
Beta 0.30
Average Daily Volume (sh) 1,731,506

Shares Outstanding (mil) 62
Market Capitalization (\$mil) \$31
Short Interest Ratio (days) 1.15
Institutional Ownership (%) 1
Insider Ownership (%) 26

Annual Cash Dividend \$0.00
Dividend Yield (%) 0.00

5-Yr. Historical Growth Rates
Sales (%) 324.8
Earnings Per Share (%) N/A
Dividend (%) 0

P/E using TTM EPS N/M
P/E using 2015 Estimate N/M
P/E using 2016 Estimate N/M

Zacks Rank 2

Risk Level High
Type of Stock Small-Growth
Industry Internet Commerce
Zacks Rank in Industry 4 of 28

ZACKS ESTIMATES

Revenue

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2013	0.9 A	5.6 A	6.5 A	5.8 A	18.7 A
2014	4.8 A	4.9 A	6.0 A	5.4 A	21.2 A
2015	5.5 A	6.7 E	8.1 E	9.9 E	30.3 E
2016					39.5 E

Earnings per Share

(Non-GAAP EPS before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2013	-\$0.10 A	-\$0.11 A	-\$0.11 A	-\$0.12 A	-\$0.44 A
2014	-\$0.11 A	-\$0.07 A	-\$0.05 A	-\$0.00 A	-\$0.19 A
2015	-\$0.04 A	-\$0.03 E	-\$0.03 E	-\$0.01 E	-\$0.10 E
2016					-\$0.10 E

Zacks Projected EPS Growth Rate - Next 5 Years **25%**

WHAT'S NEW

Raising Revenues With the Addition of PayOnline

Last night the company filed the audited numbers of PayOnline, its recent acquisition. Until now, we knew how much the company paid for it, but nothing about the company. With the release of its 2014 and 2013 annually and Q1 2015 income statements and balance sheets we now see the company generated \$6.7 million in annual revenues in 2014 and \$1.2 million in Q1. We are now raising our Net Element revenues estimates for the next three quarter and 2015 and 2016. When the company reports on approximately August 13th we will revise the full income statement and fine-tune our valuation.

For a fast first pass we are looking for the following:

	31-Mar-15	30-Jun-15 (est.)	30-Sep-15 (est.)	31-Dec-15 (est.)	2014	2015E	2016E
Credit card processing	\$5.2	\$5.4	\$5.8	7.1	\$19.4	\$23.50	\$27.03
Yr-over-yr Growth	26.5%	18.1%	4.2%	38.0%	31.0%	21.2%	15.0%
Mobile payments	0.363	0.5	0.6	0.8	1.8	2.3	5.5
Yr-over-yr Growth	-51.6%	47.8%	34.4%	226.4%	-54.4%	27.8%	139.1%
PayOnline	0.0	0.8	1.7	2.0		4.5	7.0
Total revenues	5.5	6.7	8.1	9.9	21.2	30.3	39.5
Yr-to-yr Growth	14.4%	35.4%	34.7%	83.7%	13.0%	42.7%	30.7%

Given the complicated financing, shares outstanding each quarter will vary greatly depending on share price, we can only look to the end point shares outstanding some time in March 2015. With what we know, we expect the fully diluted shares outstanding to be **approximately 80 million shares** at that time. At \$0.49 a share this is a **market capitalization of \$39 million**. So if we take the original \$27 million in revenues expected next year for the base business, and add another \$4.5 million for PayOnline revenues in 2015, we get \$30.3 million in revenues or **1.3 times market cap to sales-- an inexpensive valuation based on comparables trading at 4.6 times**. By 2016, revenues could be as high as \$40 million for another 30% increase.

If the company could reach the average valuation of its peer, its common stock could be worth \$1.40 per share twelve months from now based on an industry average valuation of approximately 4.5xs enterprise value to sales, up 186%.

Volatile Trading Compounds Risk

Net Element stock is highly volatile and price is being driven by excess supply. We believe the sellers could be SD Ventures, the former owners of PayOnline. While we have no idea what its particular cash needs are, we can hypothesize that they have been eager to change ownership in a Russian entity to US dollars by selling the stock it received in the acquisition. Since it receives stock monthly when the dividend is paid, we believe there could be monthly events to driving down the stock until the monthly payments stop early next year.

A Recap on PayOnline—A Major Mobile Payment Company in Russia

On March 17, 2015, the company announced it entered into a binding offer letter to purchase PayOnline based in Moscow from SD Ventures, for \$3.6 million in cash, \$3.6 million in restricted stock, plus the possibility of another \$1.28 million in stock based on earn-out hurdles. The deal is expected to close once all assets have been transferred to Net Element, but financials are expected to be consolidated as of the May 20, 2015 date. The earn-out is based on PayOnline reaching a certain EBITDA for certain post-closing periods, multiplied by 1.35, and will be paid in March 2016 based on 2015 results. The cash will be funded by the sale of stock from Net Elements' current shelf registration backed up with \$7 million of its \$10 million line of credit. There are a number of synergies between the two companies and each hopes to expand geographically into each other's current business territories.

PayOnline is a processor of online payments and works with four or five major banks in Commonwealth of Independent States, Europe and Asia. It has 10 million active customers and more than 3,000 merchants. It has a high level of fraud protection, works with MasterCard and Visa and is integrated into travel platforms such as SABER, Galileo and GDS. In addition to online web-based payments the company also has a mobile app that provides a wallet that can be used for person-to-person payments.

INVESTMENT THESIS

- Net Element is growth company in the payments industry that should benefit from the adoption of mobile and online payments in the US and Russia and ultimately globally.
- The new CEO took his former company, Unified Payments, from 0 to \$67 million in revenues in two years. We believe he has the experience and drive to replicate this success with Net Element.
- Management has been restructuring operations and finances and with a lower cost structure and far less debt, the company should now be positioned to accelerate sales in 2015 and beyond.
- The company has an increasingly robust platform to create a global payment system complete with merchant from end and should be able to expand geographically.
- We believe the company could grow to \$30 million in revenues in 2015 through a combination of internal growth as well as acquisitions and partnerships and reach cash flow breakeven for 2016.
- If NETE achieves our forecasts, we believe its common stock could be worth \$1.40 per share twelve months from now based on an industry average valuation of approximately 4.5xs enterprise value to sales, up 186%.

VALUATION

There are a number of public companies in the merchant acquiring/processing business. The largest is Cielo with a \$27 B enterprise value located in Brazil. The smallest is we are using is Qiwi, who runs payment systems in the Russian Federation and is based in Moscow and has a \$1 billion enterprise value. The rest are located in the US. All are profitable and we expect that NETE will have to meet that hurdle in order to be awarded a comparable value. If we take the average enterprise value to sales of this group of companies of 4.5 times sales and apply it to the revenues we expect Net Element to generate next year, and its fully diluted share count next year, and turn that back to price per share we get a conservative share value of \$1.38. With greater clarity on PayOnline's contribution, estimates will be adjusted accordingly.

Net Element

Merchant Acquiring/Processing

Company	Ticker	Revenue		EBIDTA Margin	Enterprise Value / Sales		Included in Average?	Enterprise Value
		2015E	LTM		2015E	LTM		
Cielo	CIOXY	NA	\$2,510	48%	NA	11.0x	n	27,670
Vantiv	VNTV	\$1,640	\$2,750	24%	5.4x	3.2x	y	8,780
Total System Services	TSS	\$2,710	\$2,520	29%	3.5x	3.7x	y	9,360
Global Payments	GPN	\$2,357	\$2,740	21%	3.6x	3.1x	y	8,390
EVERTEC	EVTC	\$373	\$365	45%	5.6x	5.7x	y	2,090
Heartland Payment System	HPY	\$796	\$2,390	13%	3.2x	1.1x	y	2,560
Qivi	QIWI	\$183	\$169	32%	6.0x	6.4x	y	1,090
Average				28%	4.5x	3.9x		\$5,378

Net Element YoY growth	Projected Revenue		EBIDTA Margin	Enterprise Value / Sales		valuation Range	
	2015E	LTM		2015E	LTM	Low	High
	\$32	\$21	NM	4.5x	3.9x	\$82	\$145

Conclusion of Enterprise Value	\$113,435,860
Market Value	\$110,624,203
Shares Outstanding	80,000,000
Price per Share	\$1.38

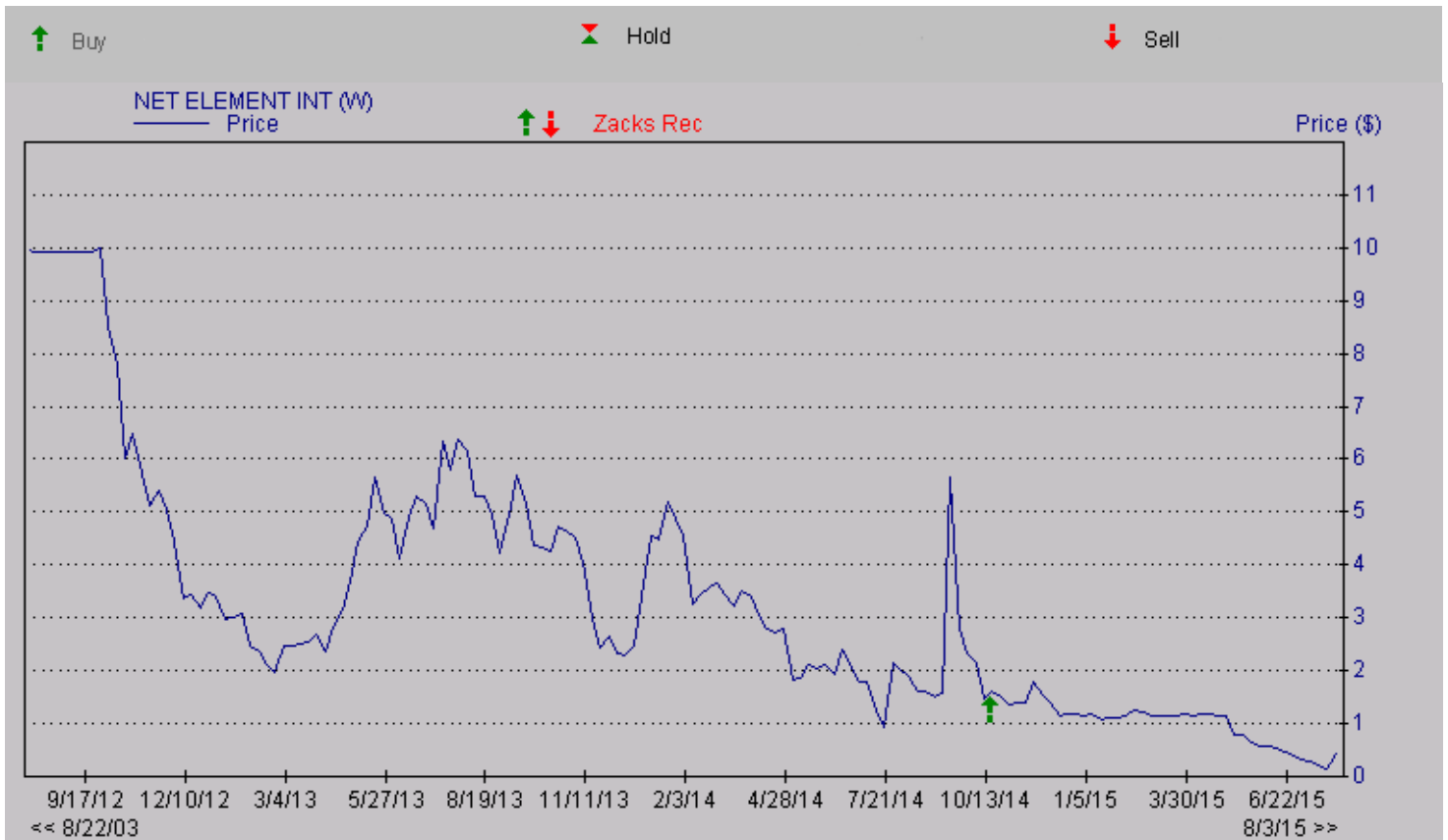
RISKS

- The company is losing money and may not be able to reach profitability or maintain positive cash flow.
- The company is involved in a number of lawsuits with former management.
- The Russian mobile and online payment market is still in its infancy and there is no assurance the country will adopt this method to pay for goods and services.
- Future acquisitions may not be successfully integrated operationally or technologically. Purchased portfolios may not yield expected profits.
- The merchant acquirer market in the US is competitive and larger companies have an advantage due to economies of scale.
- Operations in Russia and the United Federation face considerable political risk and may be prohibited from certain transactions by governments.
- Currency, particularly the ruble, has fluctuated dramatically and could affect reported earnings and operations.

PAYONLINE HISTORICAL INCOME STATEMENT

		2014	2013	Q1 2015	Q1 2014
Net Revenues	\$	6,729,228	5,997,495	1,202,878	1,390,235
Yr-to-yr		12.2%		-13.5%	
Direct expenses:					
Bank commissions		4,595,623	4,047,877	802,092	947,362
Employee salaries and related benefits		814,121	966,162	139,276	249,875
Technology consulting and maintenance		86,475	46,586	19,817	22,431
Professional fees and other consulting expenses		225,598	96,101	42,300	17,171
Marketing expenses		201,176	306,613	44,048	9,411
Lease expenses		216,876	298,651	34,019	68,050
Communications		38,938	49,165	6,191	8,996
Depreciation expenses		20,112	16,528	3,908	5,416
Amortization expenses		65,714	37,506	14,729	12,522
Other direct expenses		36,075	54,151	22,024	58,305
Total direct expenses		6,300,709	5,919,340	1,128,404	1,399,539
Yr-to-yr		6.4%		-19.4%	
Net Revenues less Direct Expenses	\$	428,520	58,155	74,474	9,304
Yr-to-yr		636.9%		700.5%	

HISTORICAL ZACKS RECOMMENDATIONS



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