

MOBILE EMBRACE LIMITED (MBE)

Marketing Punch Acquisition

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We say

Price

Target

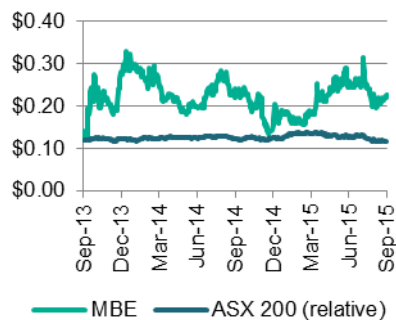
Strategic Target

BUY

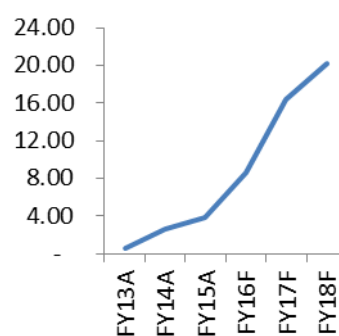
0.22 0.48 0.60

Following the Marketing Punch acquisition, MBE is now forecast to deliver ~ \$55M of revenue and ~ \$10M EBITDA in FY16. We have upgraded our forecasts and valuation for MBE off the back of the accretive acquisition, organic growth momentum and the debt funding package supplied by CBA. MBE is developing into a well-funded global technology growth story linked to the global growth of mobile advertising and mobile payments.

MBE SHARE PRICE



MBE FORECAST EBT GROWTH (\$M)



COMPANY DATA & RATIOS

Enterprise value	\$78,500,000
Market cap	\$86,000,000
Issued capital	395,869,763
Free float	~ 90%
12 month price range	\$0.13 - \$0.32
GICS sector	Application Software

ACQUISITION

Marketing Punch is a UK market leader in online performance marketing with operations in the UK and Australia. MBE paid ~ A\$5.7M for the business upfront with a 3 year performance based earn out. The acquisition was funded by a combination of a new CBA debt facility and equity (issued at \$0.26 per share). The acquisition was instantly accretive for MBE.

CBA DEBT FACILITY

MBE announced a GBP £4M (A\$8.7M) debt facility with the Commonwealth Bank of Australia (CBA), which was a strong validation point for MBE's business model and growth strategy. The funds will be used to partly fund the acquisition and to fast-track the organic growth of the company's other international operations (mobile payments in the UK).

UPGRADES

We have upgraded our earnings numbers for MBE along with the valuation. The drivers of the upgrade are due to both the acquisition though also the ongoing organic momentum in the business, specifically the international mobile payments business. We have upgraded our price target by ~ 20% to \$0.48 per share, providing 115% upside from the current share price.

MARKETING PUNCH ACQUISITION

MBE today announced the acquisition of Marketing Punch, a UK-based performance marketing business with offices in Australia, the UK and France. The acquisition brings significant scale and complements MBE's existing and growing performance marketing operations (Vizmond Media – acquired August 2015, The Performance Factory- acquired November 2014, and eggMobi – acquired December 2014). Marketing Punch is a UK market leader in online performance marketing with a growing opted-in database of over 5 million consumers. MBE now has ~ \$22M of revenue forecast in FY16 to come from the high growth mobile marketing division with encouraging industry fundamentals and has built a market leading position in Australia.

The key quantitative metrics from the Marketing Punch acquisition are as follows:

- Total upfront consideration of £2.14M (A\$5.68M) funded by cash payment of A\$4.64M as well as the issue of 4 million MBE shares at \$0.26 each (~ 30% premium to MBE share price prior to announcement);
- In addition to the upfront consideration, and subject to achieving 100% of some aggressive performance targets over the next 3 years, there will be an additional cash consideration of GDP £1.5M (\$A3.25M) for each year of successful achievement (GDP £4.5M or \$A9.77M over the 3 years). It is our understanding that the growth hurdles require EBITDA growth of greater than 30% p.a. for the performance targets to be met;
- Marketing Punch is forecast to generate FY16 revenue of £3.7M (~ A\$8M) and EBITDA of £1.2M (A\$2.6M). Based on these numbers the upfront acquisition multiple is ~ 2.2 times EBITDA and with the performance hurdles of greater than 30% growth from this figure the earn-out is self-funding and increasingly accretive.

In summary, we believe the Marketing Punch acquisition is on strategy and accretive for MBE and further strengthens the investment proposition.

CBA DEBT FACILITY

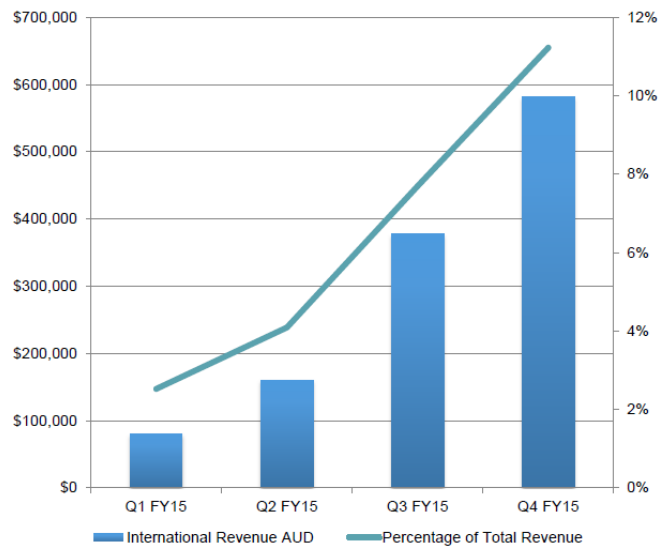
MBE has secured a £4M (A\$8.7M) debt facility with the Commonwealth Bank of Australia on what we understand to be favourable terms. £2M (A\$4.3M) will be immediately drawn down under the facility to fund the acquisition of Marketing Punch and further funds will be used to fund m-payments international growth.

We believe the CBA debt facility is a strong independent validation point for MBE's business model and growth strategy. The debt facility is also a reflection of the development of MBE as an investment proposition in light of recent execution success and an improving risk v reward equation for investors.

UNITED KINGDOM MOBILE PAYMENTS GROWTH

MBE's M-Payments Division – is the key delta in determining whether MBE can deliver global growth. MBE is not a single payment solution reliant on mass market adoption. There is a significant opportunity in the global mobile payments space for an integrated platform that can transact telco billing, credit cards, PAYPAL and Apple Pay on mobile devices. MBE has proven their ability to deliver with telco billing in the Australian market primarily with the games product and is positioned to deliver across all payment solutions. MBE delivered ~ \$22M of revenue in FY15 (+ 54%). Our investment thesis continues to be that if MBE can replicate this success in Australia with another product outside of games or more importantly in an international market, the upside is significant. Increasingly the focus is on profitable earnings growth in new markets.

An encouraging data point from the FY15 result was that international transactions had grown to 11% of MBE's total mobile payments transactions and the company points to "material growth for FY16". MBE is forecast to turn an initial profit in Singapore and Switzerland in FY16, followed by an initial profit in the large UK market in FY17. The UK market is the key delta for MBE's mobile payments growth and encouragingly MBE is now connected across all major Telcos in the UK and are now moving to a full scale market rollout in FY16. The below chart summarises the growth rate of international mobile payments revenue for MBE:



Source: MBE Investor Presentation

FY15 saw the first year of meaningful revenues for the M-Payments business from the international markets. Following over 12 months of investment in the cost base, FY16 will be a key measure of the success of this investment. The Australian market was launched in 2013 and has an addressable market of 22M mobile users. MBE delivered a ~ \$7m EBITDA result from the Australian market in FY15. The details of the 3 key international markets are broken down below:

1. **Singapore** – current serviceable market of 1.5M mobile users from the telco billing relationship with Singtel. The serviceable market has the potential to increase by bringing on rival telco M1. Revenues were first generated in June 2014, with a breakeven run rate expected in calendar year 2015.
2. **Switzerland** – current serviceable market of 6.4M. Revenues were first generated in October 2014, with a breakeven run rate expected by the first half of calendar year 2016.
3. **United Kingdom** – current serviceable market of 83M. Revenues were first generated in January 2015, with a breakeven run rate expected by the June quarter 2016. All the telco relationships are now bedded down. The UK is the significant international market opportunity for MBE, which

remains a major watch point following an encouraging start in calendar year 2015 to date

After an extended period of test and learn phase in the UK, where the customer acquisition costs, product pricing and customer retention (lifetime customer value) has been optimised, MBE has indicated that they are now ready to commit to measured growth in the UK market in the mobile payments division. The GBP debt facility also provides the funding for this initiative.

We once again emphasise the primary watch point is whether MBE can deliver profit growth in conjunction with the anticipated revenue growth in these new markets. If the losses can be stemmed from the new international markets and the \$7M EBITDA result from the Australian market replicated in the UK, the upside is significant.

MBE Management have guided to the fact that the investment in the corporate and technology cost base has now largely occurred and has put in place the required platform to deliver profitable growth. We will closely monitor this metric in determining the ultimate valuation for the MBE business.

The acceleration of the UK mobile payments business is expected to generate a financial loss in FY16 of up to \$2M as the company ramps up the customer acquisition strategy. A breakeven run rate is still expected by June 2016 and a profit contribution for FY17. This scenario is reflected in our forecast.

Our divisional forecasts are outlined below:

	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Revenue by Division (\$A)						
Mobile Payments (Convey)	9,147,458	14,161,911	21,837,249	32,755,874	42,582,636	48,970,031
Mobile Advertising (4th Screen)	3,080,933	5,018,819	10,927,372	22,391,058	33,586,587	40,303,904
other	-	-	-	-	-	-
Total Revenue	12,228,391	19,180,730	32,764,621	55,146,932	76,169,223	89,273,935
% Revenue Growth		57%	71%	68%	38%	17%
Mobile Payments (Convey)	839,000	4,864,365	6,274,952	8,741,042	14,131,226	18,209,711
Mobile Advertising (4th Screen)	- 384,000	72,750	676,497	3,358,659	6,424,283	8,060,781
corporate costs	-	- 1,797,136	- 1,919,449	- 2,100,000	- 2,310,000	- 2,541,000
EBITDA	1,034,348	3,139,979	4,780,834	9,999,701	18,245,509	23,729,492
EBITDA margin	8.5%	16.4%	14.6%	18.1%	24.0%	26.6%

Source: BOEQ

The key points relating to our forecasts are outlined below:

- We have upgraded our forecasts for the Mobile Advertising division to reflect the Marketing Punch acquisition. We have assumed the FY16 numbers are delivered consistent with the guidance statement for the business in FY16 and have growth in this business consistent with the performance hurdles (i.e. ~ 30% EBITDA growth per annum). Equally we have assumed the earn-out payments being achieved in our cash flow forecast;
- We have marginally increased our revenue forecast for FY16 in the mobile payments division to reflect the ramp up in the growth of the UK market. We have slightly reduced our EBITDA forecast for this division to reflect the forecast losses in the UK market. In FY17 we assume the UK market returns a modest profit and by FY18 divisional EBITDA margins are restored; and
- The net result of the changes to our forecast are a slight EBITDA upgrade for FY16 with the additional earnings from the acquisition largely offset by losses in the UK market for mobile payments. FY17 sees a 20%+ upgrade to our EBITDA forecast with a full year contribution from the acquisition along with a modest profit from the UK market for mobile payments.

VALUATION AND RECOMMENDATION

In the near term, we value MBE at \$0.48 per share using a blended valuation approach. FY17 earnings are used for the PE based approach applying a 15 times PE multiple. FY17 is used as we believe this is reflective of the earnings potential for MBE with the visible pipeline ahead for the business. We combine this with a DCF based valuation approach using a beta of 1.5 and WACC of 12.5%

The recent upgrade of our price target from \$0.41 per share to \$0.48 per share is driven by an upgrade in our forecast numbers as outlined above.

Applying a longer term approach and the ability for MBE to secure its position as a global player in the mobile payments industry with multiple products successfully implemented in multiple regions, we apply a strategic value of \$0.60 per share.

We retain our BUY recommendation.

SUMMARY FINANCIALS

Stock Details

Recommendation:	Buy								
Valuation	\$0.48		52 Week High	\$0.32				Market Capitalisation	\$86m
Share price	\$0.225		52 Week Low	\$0.13				Free Float	90%
Upside/downside	115%								

Profit & Loss Analysis

(A\$m)	FY14A	FY15A	1H16F	2H16F	FY16F	FY17F	FY18F
Total Revenue	19.2	32.8	23.1	32.0	55.1	76.2	89.3
Expenses	-16.0	-28.0	-19.3	-25.9	-45.1	-57.9	-65.5
EBITDA	3.1	4.8	3.8	6.2	10.0	18.2	23.7
D&A	-0.5	-1.0	-0.5	-0.8	-1.4	-1.9	-3.5
EBIT	2.7	3.8	3.3	5.3	8.6	16.3	20.2
Tax	0.0	-1.0	-0.7	-1.2	-1.9	-3.7	-4.5
NPAT (pre abnormal)	2.7	3.0	2.6	4.1	6.7	12.6	15.8
Net profit after tax	2.6	3.0	2.6	4.1	6.7	12.6	15.8
Basic EPS (cents)	0.8	0.8	0.6	1.0	1.7	3.2	4.0
Diluted EPS (cents)	0.8	0.7	0.6	1.0	1.6	3.0	3.7
DPS (cents)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Ratio Analysis

Revenue growth	7.6%	70.8%			72.1%	38.1%	17.2%
EBITDA margin	16.4%	14.6%			18.1%	24.0%	26.6%
EBIT margin	13.9%	11.6%			15.7%	21.4%	22.6%
EBIT growth	349.3%	42.8%			126.7%	89.1%	23.8%
NPAT growth	311.7%	13.7%			118.9%	89.5%	24.9%
EPS growth	497.4%	-7.1%			116.7%	89.5%	24.9%
DPS growth	-	-			-	-	-
Tax rate	0.0%	26.6%			22.5%	22.5%	22.5%

Cash Flow Analysis

(A\$m)	FY14A	FY15A	1H16F	2H16F	FY16F	FY17F	FY18F
EBITDA	3.1	4.8	3.8	6.2	10.0	18.2	23.7
Increase in working capital	0.3	-1.4	-3.4	1.1	-2.3	-2.2	-1.3
Capital expenditure	-0.5	-0.2	0.0	-0.1	-1.4	-1.7	-1.9
Income taxes paid	0.0	0.0	-0.7	-1.2	-1.9	-3.7	-4.5
Proceeds from issue of shares	11.4	0.1	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	-2.3	-6.0	-0.9	-0.2	0.2	-5.9	-3.0
Net increase in cash	12.1	-2.7	-1.3	5.9	4.6	4.8	12.9
Operating Cash Flow (\$M)	3.2	5.3	0.6	6.0	6.6	12.4	18.0
Cash Flow Per Share (cps)	1.2	1.6	0.2	1.5	1.7	3.1	4.5
Free Cash Flow (\$M)	2.7	5.0	0.5	6.0	5.2	10.7	16.1
Free Cash Flow Per Share (cps)	0.8	1.3	0.1	1.5	1.3	2.7	4.1
Free Cash Flow Yield (%)	3.7%	5.7%	0.6%	6.7%	5.9%	12.0%	18.0%

Balance Sheet Analysis

(A\$m)	FY14A	FY15A	FY16F	FY17F	FY18F
Trade and other receivables	3.8	9.0	10.8	14.9	17.5
Earned & Unbilled Revenue	0.0	0.0	0.0	0.0	0.0
Trade and other payables	1.8	4.7	5.2	7.1	8.3
Working Capital	2.0	4.3	5.7	7.8	9.2
Property, plant and equipment	0.1	0.2	0.9	2.5	2.8
Intangibles	2.3	10.2	15.1	18.5	21.4
Other assets	13.0	12.6	17.1	21.5	32.7
Total assets	19.1	32.0	43.9	57.5	74.5
Net debt (- net cash)	-12.3	-9.5	-7.5	-12.3	-25.2
Total liabilities	2.3	9.4	14.7	15.6	16.8
Contributed equity	30.6	32.8	32.8	32.8	32.8
Reserves	0.2	0.6	0.6	0.6	0.6
Retained profits	-	13.9	10.9	4.2	8.4
Other	-	-	-	-	-
Total equity	16.8	22.5	29.2	41.8	57.6

Ratio Analysis

	FY14A	FY15A	FY16F	FY17F	FY18F
P/E ratio	26.9x	29.0x	13.4x	7.1x	5.6x
P/E ratio (valuation)	57.7x	62.1x	28.7x	15.1x	12.1x
Enterprise value	73.7m	76.5m	78.5m	73.7m	60.8m
EV/EBITDA	23.5x	16.0x	7.9x	4.0x	2.6x
EV/EBIT	27.6x	20.1x	9.1x	4.5x	3.0x
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Payout ratio	0%	0%	0%	0%	0%
Franking	0%	0%	0%	0%	0%
Net Debt / Equity	-73%	-42%	-26%	-29%	-44%
Net Debt / (Debt + Equity)	-268%	-73%	-34%	-42%	-78%
EBIT / Net Interest	-32.1x	-15.2x	349.6x	987.0x	-169.6x
R&D / Sales	55%	67%	64%	58%	55%
Return on Assets	14.0%	12.8%	15.2%	22.0%	21.2%
Return on Equity	15.9%	18.2%	22.8%	30.2%	27.4%

Source: BOEQ

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