

SmartPay – Investment Thesis.

CHP 1 – Company Overview.

I've touched on this prior so will only be brief

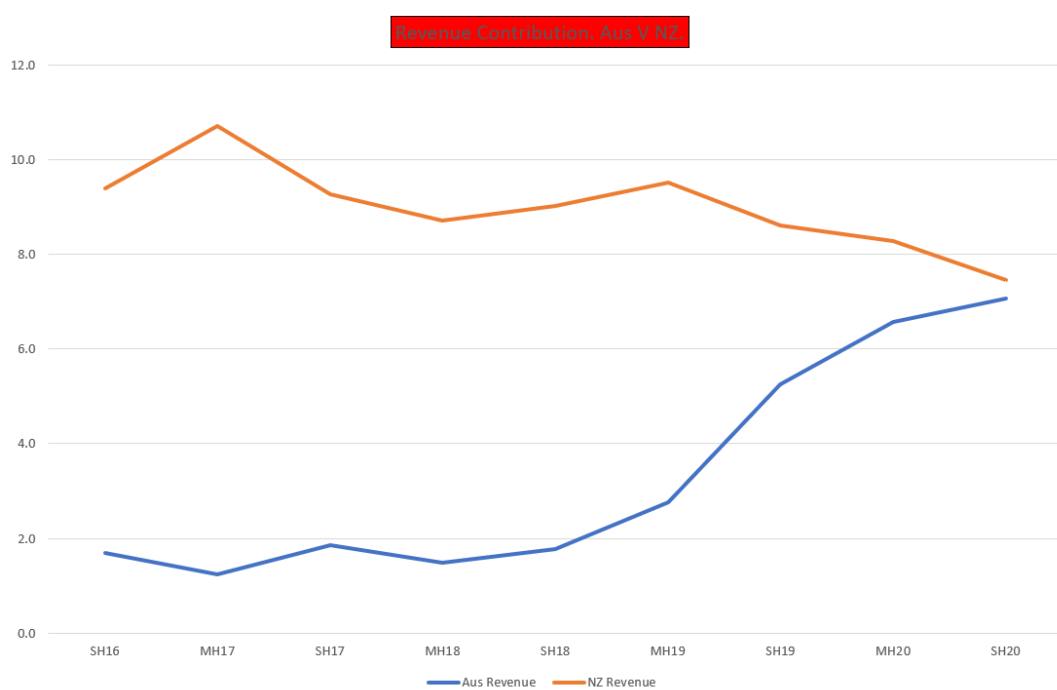
SMP Holdings are a **payments terminal** business based out of Auckland, NZ. More widely they offer payment & data management solutions for retails and merchants.

The NZ & Australian business operations differ drastically. The NZ business is profitable, mature and has been just ticking along for the last few years.

The Australian business is almost the direct opposite. Growth of terminals and thusly revenues has been phenomenal. Management have indicated that this is the part of the business they are focusing on developing. (as per the sale of the NZ side, see later).

These graphs do a better job at explaining than I can with words.

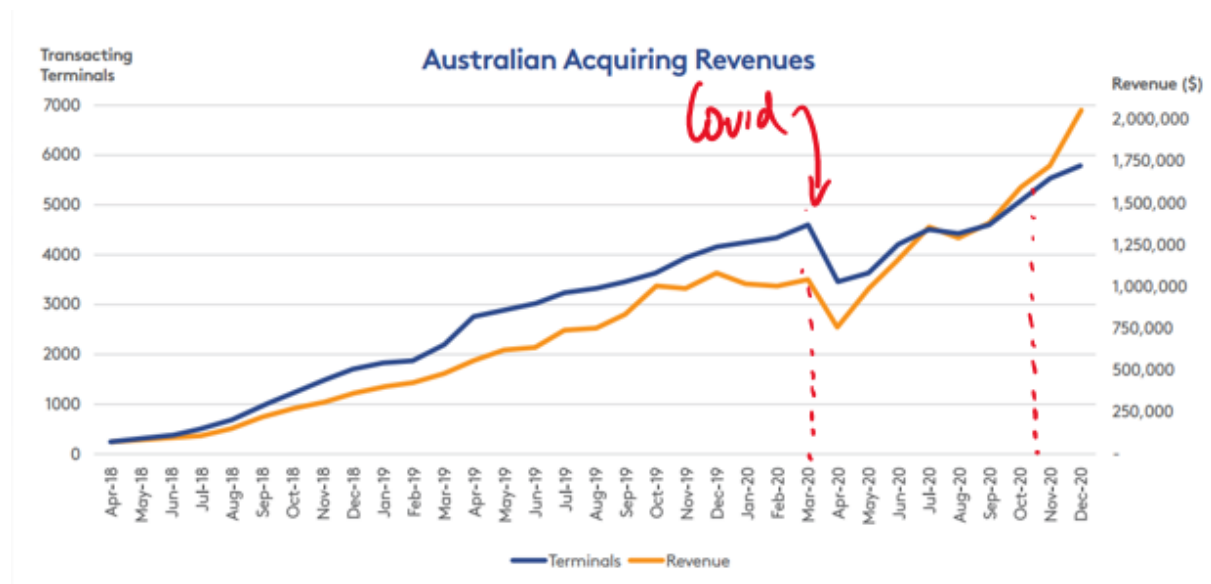
	SH16	MH17	SH17	MH18	SH18	MH19	SH19	MH20	SH20
Aus	1.7	1.24	1.9	1.5	1.8	2.8	5.3	6.6	7.1
<i>Pcp</i>			9%	20%	-4%	86%	196%	138%	34%
NZ	9.4	10.71	9.3	8.7	9.0	9.5	8.6	8.3	7.5
<i>PCP</i>			-1%	-19%	-3%	9%	-5%	-13%	-13%



This snippet taken from the annual report in 2019 shows the dedication of management to get the Aus business sustainable and on its own two feet.

We have a very solid and stable business in New Zealand with a strong presence in the New Zealand market. That business continues to underpin and support our expanding business in Australia. Our initiative to provide an end-to-end EFTPOS solution in Australia through the addition of our own acquiring capability in last year has been successfully implemented and the company is well underway in its objective to properly commercialise acquiring and other options to add value to Smartpay. To help expedite the growth opportunity for the company a capital raising of AU\$7.5million was successfully

The business regularly updates the market, and the following graph shows the growth of the deployment of the EFTPOS terminals over time.



CHP 2 – Sale of the NZ Business

In my opinion, I think the management focus on the Aus business because of the more attractive economics. This business holds an 'acquiring license' allowing for the below fee structure to be sold. (basically leads to a **'clip the ticket' revenue model where they gain from each transaction made** using a Smartpay terminal).

My understanding is that the NZ business can only gain revenue from renting and selling terminals.

Aus business

6.2 Fees. The following Fees will apply:

- (a) Initial set up Fee. A Fee (as referred to in Item 6 (Fee) of Schedule 1) to open and set up your Smartpay Customer Account.
- (b) Merchant Service Fee. Merchant Service Fees, in consideration of your use of the Smartpay Merchant Facility and any other Services nominated by you in the Application Form. You acknowledge and agree that you have received a copy of our Fees with or within the Application Form.
- (c) Monthly Rental Fee. Monthly Rental Fees, in consideration of your rental of Equipment from us (if applicable).
- (d) Cancellation Fee. Fee (as referred to in Item 6 (Fee) of Schedule 1) to cancel your Smartpay Customer Account.

November 28th – 2019. (https://cdn-api.markitdigital.com/apiman-gateway/ASX/asx-research/1.0/file/2924-02179058-2A1189719?access_token=83ff96335c2d45a094df02a206a39ff4)

)

SMP receive an offer for the NZ side of the business for **\$70m cash** from Verifone. The board of directors wanted to proceed with the deal and deploy funds as follows;

Special dividend

↑ working capital

pay off debt

The proceeds of the sale will be used to capitalise the Australian business for accelerated growth, settle all banking facilities and provide a cash distribution to shareholders.

The cash distribution to shareholders will be finalised closer to completion of the sale and will be a function of capital structure and funding requirements for the Australian business at that time. The Board's current expectation is that this distribution is likely to be around **NZ\$0.20** / share.

However COVID hit right as SMP tried to push through with accepting the offer. As a result, **Verifone pulled out their \$70m offer with the supposed mindset that they were going to renegotiate a lower price for the sale.**

Considering SMP were cash flow negative and had rather low cash reserves, it may be a rather smart move by Verifone. The issue was that SMP management were not having a bar of it.

SMP decided to tell Verifone to do one, proceed to raise capital (approx. \$15m) and use this money to pay down its debts and continue to fund the Australian business to breakeven point.

Management have mentioned in the past that they expect the Australian side of the business to be running at breakeven when **EBITDA rises to between \$10-12m.**

The early growth phase of our Australian business and the uncertainty around the potential impact of COVID-19 presents challenges for forward revenue forecasts. We do however direct shareholders to our recent quarterly updates published on the NZX and ASX which show the recent revenue performance of the Australian business. While past performance is not necessarily an indication of future performance, the recent revenue numbers provide the best information on the current performance of the remaining business. From a cost perspective, we estimate **cash overhead cost to run the remaining business of between NZ\$10m – NZ\$12m (excludes new terminal growth capex)** and we anticipate that the remaining business will be initially operating on a negative operating cashflow basis for a period of time until the growth in revenue reaches the required level to cover these costs. However, the Board notes its intention to retain sufficient funds from the Sale proceeds to cover the expected period of this operating cash flow deficit.

O/A.

By my calculations, the Aus business runs at a EBITDA margin somewhere between **50%-65%**. Using these figures the business will break even when it reaches revenue of between **\$17.5-20m. (see below).**

I have them achieving this either late 2021, or early 2022. (also see below).

\$10m Target EBITDA						
Revenue	10	12.5	15	17.5	20	22.5
EBITDA 50% margin	5.0	6.3	7.5	8.8	10.0	11.3
EBITDA 65% margin	6.3	7.8	9.4	10.9	12.5	14.1

	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
						6711	10431	12500	15000
						2875	3875	5606	8571
						1581	3055	3200	3200
<i>Aus Rev</i>	0	0	4.5	11.8	16.1	28.9	36.69	44.0	

CHP 3 – The Investment Thesis & Presentable Case.

When it comes down to whether a business is investable, it raises points that can be simplified quite a lot.

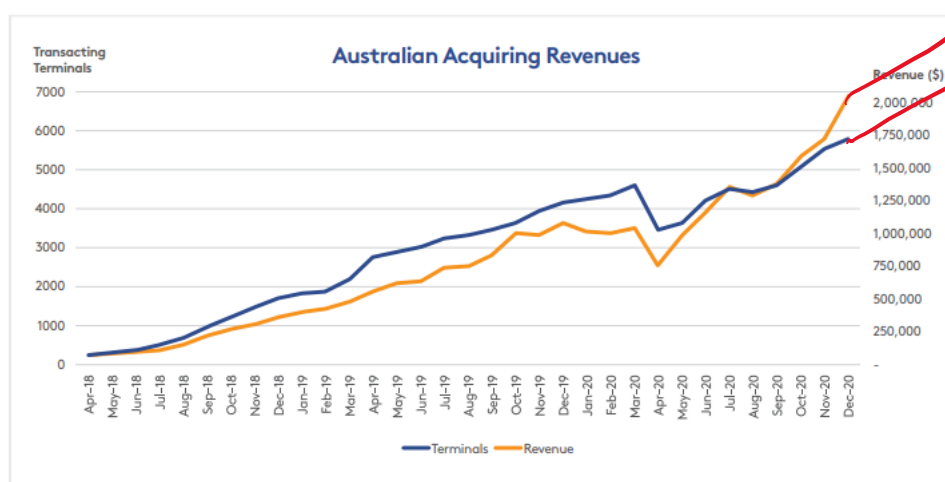
Is it an attractive business? And/or is the business commanding a high price. SMP isn't a '*shoot the lights out*' business, but we know that a bad business doesn't equal a bad investment and vice versa.

If we take SMP's Australian business growth and extrapolate this forward a few years, a presentable case is made. We want to be in a position whereby **heads, we win a lot. Tails, I don't lose much.**

For simplicities sake, we are going to assume in this case that the NZ business is not sold, and stays at a flat rate of revenue.

[illegible]

Here is a snapshot of my forecasts for the next 4 reporting half years. (Please keep in mind the NZ reporting season dates).



Currently both revenue & terminal numbers have been growing at a steady & commendable rate. I am anticipating for this to continue. Terminal deployment rate is estimated at around **320 new terminals per month.**

Revenue per terminal is estimated to grow from \$3200 to \$3500 by SH22. (As we come out of the covid impacted economy).

I have made a table of possible outcomes for the Australian business to hit breakeven point, based on the \$10m of EBITDA required to reach breakeven.

Incremental(s) per terminal						
Revenue per year		2800	3000	3200	3500	3800
Cost of deployment		900	900	900	900	900
EBITDA (margin of 40%)		1120	1200	1280	1400	1520
EBITDA (Margin of 50%)		1400	1500	1600	1750	1900
EBITDA (margin of 60%)		1680	1800	1920	2100	2280
(40% margin)	No. Terminals to break even	8929	8333	7813	7143	6579
(50% margin)	No. Terminals to break even	7143	6667	6250	5714	5263
(60% margin)	No. Terminals to break even	5952	5556	5208	4762	4386

So in the worst case scenario (*highlighted in purple*), with the lowest EBITDA margin (40%), they will require close to 9000 terminals to hit breakeven.

In the best case scenario (*highlighted in blue*), with the highest EBITDA margin (60%), they will require ~4300 terminals to breakeven.

	SH16	MH17	SH17	MH18	SH18	MH19	SH19	Full	Half	Half	MH21(f)	SH21(f)	MH22(f)	SH22(f)
No. terminals (aus)														
Period end			0	500	1500	3000	4000	4500	4611		6711	8631	10431	12231
Period average!					1000	2250	3500	4250	4556		5661	7671	9531	11331

Given by my estimates of hitting 9000 terminals by the March half, 2022, the worst case for break even is then. (unless something is fundamentally flawed in my forecasts).



Transitioning from fixed rental to transactional

Legacy:

- Predominantly fixed rental
- Ave RPU = AU\$43 / month
- Terminal payback period:
6 – 8 months

New:

- Predominantly "clip of ticket"
- Target RPU AU\$100 + / month
(variable by customer size)
- Terminal payback period: 3 – 4
months (variable)

ental revenue / EBITDA

~\$1m + incremental revenue / EBITDA

Another positive I have not quantified for is the payback of terminals over say 4 months. Each terminal brings producing incremental earnings to EBITDA after this time.

FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	
0	0	500	3000	4500	6711	10431	12500	15000	
			2875	3875	5606	8571	11466	13750	
			1581	3055	3200	3200	3200	3200	
	0	0	4.5	11.8	16.1	28.9	36.69	44.0	Aus revenue
	0	0	4.5	11.8	16.1	28.9	36.7	44.0	
				1.60405	36%	79%	27%	20%	
	20.1	18.0	18.5	16.9	15.5	16.0	16	15.0	
		-11%	3%	-9%	-8%	3%	0%	-6%	
	20.9	20.3	21.1	28.3	31.6	44.9	52.7	59.0	Total Revenue
		-3%	4%	34%	12%	42%	17%	0.1	
	0.9	0.0	0	0	0	0	0	0.0	
	21.8	20.4	21.1	28.3	31.6	44.9	52.7	59.0	
	-0.4	-0.9	-2.2	-7.2	-9.0	-12.7	-11.9	-13.7	
	-0.9	-0.4	-0.8	-1.0	-0.6	-0.8	-0.9	-1.0	
	-1.7	-1.3	-2.2	-2.8	-3.3	-3.5	-3.6	-3.7	
	-7.1	-6.4	-8.2	-8.7	-9.3	-9.7	-9.9	-10.1	
	-0.9	-0.6	-0.2	-0.2	-0.1	-0.2	-0.2	-0.2	
	-0.8	-0.9	-0.7	-0.7	-0.7	-0.7	-0.8	-0.8	
	-0.3	-0.4	-0.4	-0.3	0.0	0.0	0.0	0.0	
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
	-0.1	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	
	-12.2	-11.0	-14.7	-20.9	-23.1	-27.5	-27.3	-29.5	OPEX
	8.7	9.3	6.4	7.3	8.5	17.3	25.4	29.5	
	0.0	0.0	0.0	0.0	0	0	0	0.0	
	8.6	9.3	6.4	7.3	8.5	17.3	25.4	29.5	EBITDA
	-5.9	-5.9	-6.5	-7.4	-6.0	-5.6	-5.71	-5.82	
	2.7	3.5	-0.1	0.0	2.5	11.7	19.7	23.7	
	-1.4	-1.3	-1.8	-4.3	-1.0	0	0	0.0	
	1.3	2.2	-1.9	-4.3	1.5	11.7	19.7	23.7	
	0.3	-0.3	0.4	0.5	-0.7	-3.5	-3.94	-4.7	
	1.5	1.8	-1.5	-3.8	0.8	8.2	15.8	18.9	NPAT

Here are my forecasts for EBITDA, NPAT & Revenue for the next 3 years. (these are obviously needed for valuations sake).

Intrinsic value, if discounted @ 12%	1.00							
Price		0.9	0.9	0.9	1	1.4		
S.O		209.4	240.4	240.4	240.4	240.4		
mkt cap (aud)		188.5	216.3	216.3	240.4	336.5		
aud/nzd		1.065	1.065	1.065	1.065	1.065		
mkt cap (nzd)		200.7	230.4	230.4	256.0	358.4		
Net Debt		19.0	-6.0	-16.0	-30.0	-50.0		
EV		219.7	224.4	214.4	226.0	308.4		
P/E				26.3	15.2	17.8		
EV/EBITDA		30.0	26.3	12.4	8.9	10.5		
EV/EBIT			88.3	18.3	11.5	13.0		
FCF Yield								
Return at 0.9				0%	0%	11%	56%	

I think its fair to say that the market would be willing to pay an **EV to EBITDA multiple of around 9-12x** for the business, or a P/E around the market average of **18 times**.

If we take the Australian business, it is low OPEX and only requires upfront cash flow on the physical machines. Once deployed SMP are able to just keep on on 'clipping the ticket' allowing for great revenue margins moving forward without the need for continuous spending on operations. Hence, I have applied a nice 9-12x range EBITDA multiple and 18x P/E multiple. Nothing too demanding here.

If we reverse extrapolate the price in 2024 with the multiples previously described, we get a share price around **\$1.40**. (Currently representing a 56% return over 3 years).

If we discount that price back to today at a 12% rate, we get intrinsic value at \$1.00 (currently implying a discount of price to value of 10%).

Nothing major here, but I feel my forecasts are fairly conservative also.

If say, you wanted to apply a **15x EV/EBITDA multiple** (which I would never do for this type of business) we end up with the following results.

- **\$1.95** share price in 3 years' time
- **\$1.39** implied intrinsic value
- A current discount to price of 54%, presenting a very attractive opportunity.

Intrinsic value, if discounted @ 12%	1.39					
Discount of price to value	54%					
Price		0.9	0.9	0.9	1	1.95
S.O		209.4	240.4	240.4	240.4	240.4
mkt cap (aud)		188.5	216.3	216.3	240.4	468.7
aud/nzd		1.065	1.065	1.065	1.065	1.065
mkt cap (nzd)		200.7	230.4	230.4	256.0	499.2
Net Debt		19.0	-6.0	-16.0	-30.0	-50.0
EV		219.7	224.4	214.4	226.0	449.2
P/E				26.3	15.2	24.7
EV/EBITDA		30.0	26.3	12.4	8.9	15.2
EV/EBIT			88.3	18.3	11.5	19.0
FCF Yield						
Return at 0.9			0%	0%	11%	117%

In today's market who knows what the market will value a business like Smartpay.

CHP4 – Analysing Management

Subset 1 – Who are the BOD?

Board of Directors



Gregor John Barclay

Chairman and Independent Director – LLB, Dip. Bus

Greg joined the board of Smartpay in 2010 and was appointed Chairman in 2016. He is an experienced company director having held various directorships and advisory roles across a number of New Zealand and off-shore entities. Currently he is also chairman of the Pacific Forest Products group (an international log export and marketing company), Franchised Businesses Limited (by number the largest franchise company in New Zealand) and Boffa Miskell Limited. He is an approved Chartered Member of the NZ Institute of Directors.

Having graduated from Canterbury University in 1985 Greg practises as a commercial lawyer. He was a founder partner of Claymore Partners in 1997 and still continues to act as a consultant to the firm at present. His practice area includes mergers/acquisitions, project commercialisation, new ventures and structured financing. Greg has also had an extensive involvement in the business of sport as an advisor to sports entities and as an owner of a national sports event and management company. He is currently the chairman of New Zealand Cricket, a member of the board of the International Cricket Council and was a board member of Cricket World Cup 2015 Limited.

In addition to being on the Board, Greg serves on the Board's Audit and Finance Committee.

Greg Resides in Auckland, NZ.

- Ex-lawyer
- Practice area – M&A, projecting, structured financing.
- Based in NZ
- Interests involve cricket, he is the chairman of the ICC.



Carlos Gil

Non-Executive Director - BEc, GradDipAppFin SIA, MAppFin FSIA

Carlos Gil is the founder and current CEO of ASX listed Microequities Asset Management, Smartpay's largest shareholder. He has extensive experience in stockbroking, funds management, and investment research gained over a career spanning more than 20 years. He has held various senior management positions in Europe, including roles as Head of International Securities at BM Securities, and at Banesto Bank (Santander Group).

Carlos holds a Bachelor of Economics from Sydney University, a Graduate Diploma in Applied Finance and Investment Analysis from the Australian Securities Institute and a Master in Applied Finance and Investment Analysis from the Financial Services Institute of Australia.

In addition to being on the Board, Carlos serves on the Board's Audit and Finance Committee.

Carlos resides in Sydney, Australia.

- CEO of a LIC.
- Chief investment officer of Microequities Investment Management.
- SMP largest holder. (as of June 2020)
- Experience in fund management, capital allocation etc.
- Based in Syd, Aus.

Digger deeper the performance of Microequities Asset Management (MAM.AX).

Note, they were only publicly listed in 2018, however been funning a few funds for over 10 years.



FUND HIGHLIGHTS*

Unit Price
\$4.7717

1 Year Return
+68.31%

Total Return since inception in 2009
+733.15%

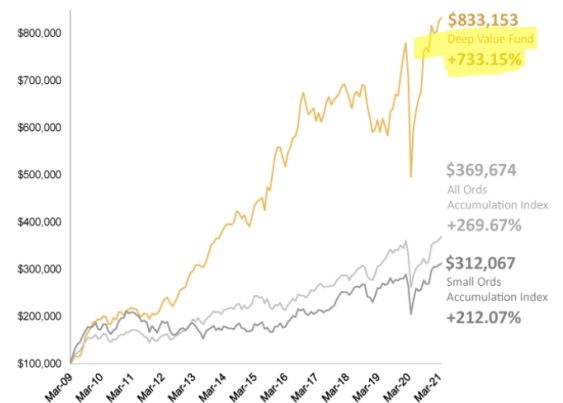
Compound pa since inception in 2009
+19.18%

Recommended Investment Term
5+ Years

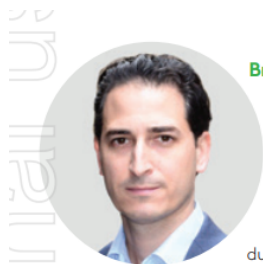
Fund Status
OPEN

* as at 31/03/2021

Value of \$100,000 invested at inception**



In summary, very strong performance over a long period shows this guy knows his stuff. Keep in mind, he is the **largest holder of SMP shares.**



Bradley Gavin Gerdis

Managing Director B.Bus (Hons), MCom

Bradley joined Smartpay in **December 2011** bringing to the company expertise and experience in managing high growth payments businesses. He joined the **Smartpay Board in July 2012**.

Prior to joining Smartpay, Bradley was a founding executive of Customers Ltd, an ASX listed ATM and payments company which grew from start-up to become Australia's largest ATM operator during his time with the business. Bradley also played a leading role as a founding director in the development of Strategic Payments Services Pty Ltd, a payments processing business in joint venture with Customers Limited, Bendigo Bank Ltd and MasterCard International. Bradley's experience includes direct investment roles with ANZ Private Equity and Gresham Private Equity.

He has held executive and non-executive director positions in both publicly listed and private companies.

Bradley resides in Sydney, Australia.

(EX) MD & CEO, Brad Gerdis.

Both his Linked-in & twitter pages had literally zero activity, so not much to report.

Had over 10 years' experience within the payments industry and been on the SMP Board since 2012. Good level of experience and tenure.

Bradley Gerdis has resigned from being the Managing Director of Smartpay Holdings Limited but through his directorship of Haymaker Investments Pty Limited which retains a shareholding at 30 September 2020 of 6,515,422 shares (31 March 2020: 6,515,422) in Smartpay Holdings Limited he remains a related party. A secured loan of A\$1,500,000 (NZ\$1,621,000) was provided to Haymaker Trust on 6 July 2020 for a term of 18 months at 3% interest and 4,500,000 ordinary shares are held as security against the loan. Interest is capitalised into the loan and paid at maturity.

Equates to a 2.7% stake.

After writing this, I realised that Brad had resigned in September 2020, however was still helping the business transition to new leadership.

5 August 2020

The board of Smartpay wishes to advise that Bradley Gerdis has resigned from his role of CEO and Managing Director and will be stepping down effective 1st September 2020. Post 1st September, Bradley will remain engaged in the business in a transition capacity for a further 3 months.

The board is pleased to advise that it has appointed current COO and Executive Director Marty Pomeroy to the position of CEO and Managing Director to replace Bradley. Marty has played a pivotal leadership role within the business for the past 7 years, working closely with Bradley on every aspect of the business throughout this time.

Martyn Richard Pomeroy

Executive Director

Marty joined Smartpay in January 2013 post the acquisition of Viaduct Limited. Marty joined the Smartpay Board in April 2014.

Prior to joining Smartpay Marty was one of the two founding Directors of Viaduct Limited. Marty was instrumental in the development and success of the Viaduct business from a startup in 2001, through a period of growth to it becoming the third largest provider of EFTPOS terminals in New Zealand with an annual turnover of \$7 million and employing 36 staff. Prior to Viaduct Marty held managerial roles in sales and service with EFTPOS New Zealand. He brings over 13 years of experience in the NZ Payments industry to the Board.

Marty has a detailed understanding of the operational, sales and commercial elements of the Smartpay business and is also driving the strategy and build of the opportunity in Australia.

Marty resides in Auckland, New Zealand.

Its promising to see someone at the helm with over 13 years' experience in this niche industry.

Marty was successful in growing Viaduct from a start-up to a 7m turnover company, showing his leadership qualities.

He attended Scots College in NZ, a prestigious school with a good reputation.

Subset 2 – How are management aligned with shareholders?

As of June, 2020

- Greg Barclay, Chairman. Nil shares owned.
- Brad Gervis, *Now EX-MD & CEO*. **3.18% ownership**.
- Martyn Pomeroy, MD & CEO. **1.66% ownership**.
- Will Pulver, N.E.D. **1.04% ownership**.
- Carlos Gill, N.E.D. **1.32% ownership**. (*through his Listed investment company*)

Carlos Gill was appointed a director of the company on 5 December 2018. He is a director of Microequities Asset Management Pty Ltd and they hold directly and indirectly 33,127,406 (2019: 33,127,406) ordinary shares in the Company. He received \$53,000 (2019: \$17,000) directors fees in 2020.

I did find this relating to the indirect ownership to 33m shares, even though they only own 2.7m. I can only conclude that this is either a typo, or that Carlos **owns the convertible notes** that are live for SMP.***

** see below. They do not own the notes.

	Number of Securities	% of Capital
Microequities Asset Management Pty Limited	34,317,882	16.76
Anacacia Pty Limited*	8,295,445	4.05
Milford Asset Management	17,238,131	9.92
Allan Walker Tattersfield	10,242,051	6.07
Jencay Capital Pty Limited	8,709,237	5.07
Regal Funds Management Pty Limited	12,017,852	5.87

* Anacacia Pty Limited also holds Convertible Notes, in the event that all the convertible notes on issue become convertible and are converted Anacacia will hold 30,507,734 shares, being 13.09% of the issued share capital of the Company of 232,974,845 that will then be on issue.

Overall, **not a huge amount of insider ownership**, particularly given that Brad has since resigned. Inside ownership is not the 'be-all and end-all' kind of result that defined whether a company is investable, but it is important.

Subset 3 – How is the BOD compensated?

can be made until shareholder approval is obtained. The current limit available for directors fees, as approved by the shareholders at the 2018 Annual Meeting is \$300,000 per annum. The actual remuneration paid to the non-executive directors is set out on page 65 of the Annual Report.

Under current shareholder approval, the BOD is allocated a portion of \$300,000.

CEO compensation is as follows;

Chief Executive Officer

	Base Salary	Other benefits including superannuation contributions	Subtotal	At Risk Incentive STI*	% STI against maximum	Total Remuneration
FY20	418,000	20,000	438,000	45,500	22.75%	483,500
FY19	418,000	20,000	438,000	137,500	68.75%	575,500

*STI (Short Term Incentive) is based on payments made in the period but relates to assessment of performance in the prior period.

This was the compensation as at June 2020 (the last annual report). Brad Gervis has since been replaced by Marty & we are assuming he takes on the same remuneration, considering it is titled "Chief Executive Officer"

With 20% stake forming an STI, I think this compensation is reasonable. To be able to fully analyse this, one would need to compare compensation across the industry. (I do know that the Tyro CEO, Rob Cooke, is paid around ~\$2m).

Subset 3 – sentiment on market (buying/selling by insiders)

- SELL – Anacacia Pty - \$6.2m shares – **June 2020.**
- SELL – Regal Funds Management - 2.2m shares – **July 2020.**
- BUY – Milford Asset Management - 6.5m shares – **November 2020.**
- BUY – MOELIS Australia – 11.1m shares – **between June & December 2020.**
- *** Anacacia – I literally cannot tell if they are buying or selling. Will leave the announcement here for someone to explain it to me. (https://cdn-api.markitdigital.com/apiman-gateway/ASX/asx-research/1.0/file/2924-02326956-2A1272593?access_token=83ff96335c2d45a094df02a206a39ff4)
- BUY – Carlos Girl/Microequities AM – 0.3k – **Dec 2020.**
- ***Exercision of convertible notes**, at a price of 0.25c. (resulting in the issue of 22.6m new shares. Note I have accounted this in my model).

Overall, rather flat movement in recent past. Good to see Carlos buying on the inside, even though a small amount its better than zero.

CHP 5 – Major risks.

- Competition – the banks and other payment providers.

Tyro is a major competitor of SMP whom also offer an EFTPOS platform here in Australia. I see them all the time at Café's and smaller merchants. TYR differ in the sense that they own a banking license and have a more diversified revenue stream.

Below is a case on why TYR is mockery of a business.

<https://arichlife.com.au/tyro-asx-tyr-share-price-looking-beyond-the-bricking/>.