

Zip Co

Improved medium term cost guidance

Z1P's Jun-18 qtrly update outlined a beat against our cash flow expectations, with the company having generated positive operating cash flow (after bad debts) for the Jun-18 qtr. Against our cost expectations, the qtr was also a slight beat. With our eyes on the medium term for this business, we note improved medium term guidance for both cash cost of sales and cash operating costs, helping increase our confidence in the medium term profitability of this business. Consumer and merchant demand for Zip Co's products remains strong, and we highlight recent significant merchant wins such as Super Retail Group and Officeworks as helping underpin near term growth. We maintain our ACCUMULATE rating for Z1P with a revised target price of \$1.00ps, implying a 12 mth TSR of 6%.

Jun-18 qtrly

Z1P's Jun-18 qtrly performance was broadly in line with our estimates. Transaction volume of \$171.5m was 2.6% below our \$176.1m expectations, whilst the closing receivables balance of \$316.7m was in line with our forecast. As a result, qtrly revenue of \$13.2m was in line with our expectations (OML \$13.3m). Pleasingly, net bad debts of 2.61% were lower than our estimate (2.75%), whilst the company continues to expect this number to trend towards 3% over time as the receivables book matures. Returning customer numbers have now reached 83% (for the Jun-18 qtr). Operating cash flow for the qtr was +\$2.98m, and after adjusting for bad debt write offs we estimate this was around +\$0.68m. Medium term, the company has now guided to lower costs, with cash cost of sales target of 8% (formerly 10%), and cash operating costs of 5% (formerly 5-6%) – this bodes well for medium term margins.

Valuation and earnings forecasts

Our target price of \$1.00ps is based on our DCF valuation using a WACC of 10.3% and a terminal growth rate of 3.5%. We note our FY19 and FY20 earnings forecasts have increased by \$2.8m and \$2.9m, respectively.

Key risks

The key risks to our investment thesis include: 1) credit risk, 2) growth in underlying sales / receivables, 3) competition risk, and 4) regulatory risks.

Key Financials

Year-end June (A\$)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (\$m)	2.9	16.4	39.6	72.8	101.1
EBITDA (\$m)	(4.3)	(16.2)	(16.6)	(0.1)	12.1
EBIT (\$m)	(4.8)	(18.1)	(19.9)	(4.3)	6.9
Reported NPAT (\$m)	(9.0)	(20.3)	(24.2)	(8.5)	0.1
Reported EPS (c)	(4.3)	(6.9)	(7.8)	(2.7)	0.0
Normalised NPAT (\$m)	(4.8)	(17.5)	(19.9)	(4.1)	4.8
Normalised EPS (c)	(2.6)	(6.6)	(6.7)	(1.4)	1.6
Dividend (c)	-	-	-	-	-
Net Yield (%)	-	-	-	-	-
Franking (%)	-	-	-	-	-
EV/EBITDA (X)	-	-	-	-	22.0
Normalised P/E (x)	-	-	-	-	59.9
Normalised ROE (%)	-	-	-	-	16.1

Source: OML, Iress, Zip Co

Last Price

A\$0.96

Target Price

A\$1.00 (Previously A\$0.90)

Recommendation

Accumulate

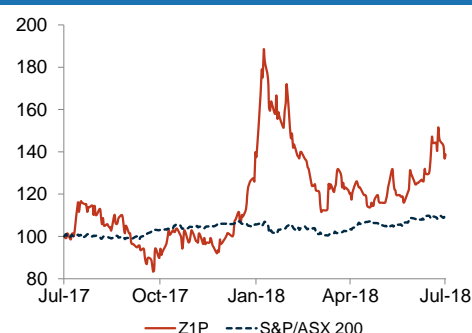
Risk

Higher

Financials

ASX Code	Z1P
52 Week Range (A\$)	0.58 - 1.30
Market Cap (\$m)	296.5
Shares Outstanding (m)	309.6
Av Daily Turnover (\$m)	0.0
3 Month Total Return (%)	15.4
12 Month Total Return (%)	38.8
Benchmark 12 Month Return (%)	9.2
NTA FY18E (¢ per share)	7.3
Net Cash FY18E (A\$m)	20.7

Relative Price Performance



Source: FactSet

Consensus Earnings

	FY18E	FY19E
NPAT (C) (\$m)	(23.1)	(3.7)
NPAT (OM) (\$m)	(19.9)	(4.1)
EPS (C) (c)	(7.9)	(1.3)
EPS (OM) (c)	(6.7)	(1.4)

Source: OML, Iress, Zip Co

Phillip Chippindale

Senior Research Analyst

02 8216 6346

pchippindale@ords.com.au

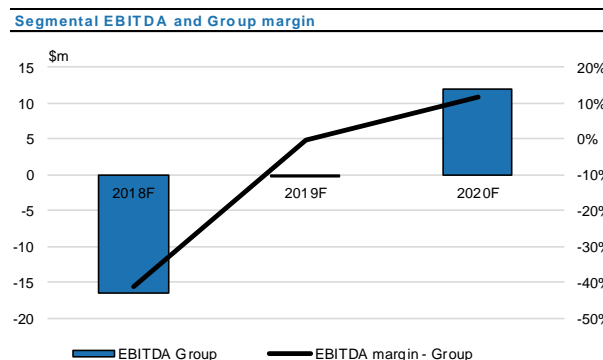
Figure 1: Z1P – Financial summary

Capital Profile			June year end (A\$m)				
Number of shares, dil (m)	310		2017A	2018F	2019F	2020F	
Market capitalisation (A\$m)	293		NPAT Reported (A\$m)	-20.3	-24.2	-8.5	0.1
Enterprise value (A\$m)	276		NPAT Normalised (A\$m)	-17.5	-19.9	-4.1	4.8
			EPS (A¢)	-6.8	-6.7	-1.4	1.6
			CFPS (US¢)	-41.0	-57.8	-48.4	-43.2
			DPS (US¢)	0.0	0.0	0.0	0.0
			DPS (A¢)	0.0	0.0	0.0	0.0
			P/E (x)	-14.0	-14.1	-68.7	59.0
			P/CF (x)	-2.3	-1.6	-2.0	-2.2
			EV/EBITDA (x)	-16.9	-16.9	-2794.7	214
			EPS Growth	nm	-1%	-80%	-216%
			Yield (%)	0.0%	0.0%	0.0%	0.0%
			Sales segmentals	2017A	2018F	2019F	2020F
			Sales - Zip	16.6	39.8	72.8	101.1
			Sales - Group	16.6	39.8	72.8	101.1
			EBITDA segmentals	2017A	2018F	2019F	2020F
			EBITDA - Zip Co	-16.0	-16.4	-0.1	12.1
			EBITDA Corporate	-3.4	-6.1	-5.9	-5.9
			EBITDA Group	-16.0	-16.4	-0.1	12.1
			EBITDA margin - Zip Co	-97%	-41%	0%	12%
			EBITDA margin - Corporate	n.a.	n.a.	n.a.	n.a.
			EBITDA margin - Group	-97%	-41%	0%	12%
			Profit & Loss (A\$m)	2017A	2018F	2019F	2020F
			Sales revenue	16.4	39.6	72.8	101.1
			Revenue	16.4	39.6	72.8	101.1
			Cost of sales	-18.0	-30.2	-42.5	-55.4
			Gross profit	-1.6	9.4	30.3	45.7
			Other revenue	0.0	0.0	0.0	0.0
			Operating costs	-14.6	-26.0	-30.4	-33.6
			EBTDA	-16.2	-16.6	-0.1	12.1
			Depreciation & Amort	-1.9	-3.2	-4.2	-5.2
			EBIT	-18.1	-19.9	-4.3	6.9
			Net interest benefit / (expense)	0.0	0.0	0.0	0.0
			Pre-tax profit	-18.1	-19.9	-4.3	6.9
			Tax benefit / (expense)	0.6	0.0	0.2	-2.1
			Profit after tax	-17.5	-19.9	-4.1	4.8
			Minorities	0.0	0.0	0.0	0.0
			NPAT (underlying)	-17.5	-19.9	-4.1	4.8
			Significant items	-2.8	-4.4	-4.5	-4.8
			NPAT (reported)	-20.3	-24.2	-8.5	0.1
			Profitability Analysis (%)	2017A	2018F	2019F	2020F
			EBIT margin	-110%	-50%	-6%	7%
			EBITDA margin	-99%	-42%	0%	12%
			Effective tax rate	-3%	0%	-5%	-30%
			ROA - EBIT / (total assets - cash)	-12%	-6%	-1%	1%
			ROE - NPAT / equity	-151%	-92%	-14%	16%
			Cashflow	2017A	2018F	2019F	2020F
			EBITDA	-16.2	-16.6	-0.1	12.1
			Operating cashflow	-7.6	0.8	16.8	32.5
			Capex	-2.5	-6.0	-3.1	-3.2
			Free cashflow (post all capex)	-10.1	-5.2	13.7	29.3
			Investing cashflow	-117.6	-176.9	-163.8	-166.3
			Financing cashflow	137.3	168.9	166.0	137.0
			Net Change in cash	12.1	-7.1	19.0	3.2
			Balance Sheet Analysis	2017A	2018F	2019F	2020F
			Debt	159.3	289.8	455.8	592.8
			Equity	11.6	31.6	27.5	32.3
			Assets	174.6	333.1	500.7	647.0
			Cash	19.2	12.7	31.7	34.9
			Net debt	-19.2	-12.7	-31.7	-34.9
			Gearing - net debt/equity	-165%	-40%	-115%	-108%
			Net debt / EBITDA (x)	12	0.8	339.1	-2.9

DCF Valuation		
Segments	A\$m	A\$ps
ZipCo	344	1.11
Division valuation	344	1.11
Net debt	17	0.05
Corp costs	-53	-0.17
Valuation	308	0.99
Premium		0%
Target price		1.00
P/NPV		0.85

Current share price trading multiples		
PE	FY21	18.6
EV/EBITDA	FY21	9.3

Valuation segment split		Valuation inputs	
Zip Co 100%		Rf rate	5.0%
		MRP	6.0%
		Equity beta	1.38
		Ke	13.3%
		Kd	5.0%
		Gearing	30%
		Tax rate	30%
		WACC	10.3%
		DCF (A\$)	1.11
		Prem/disc	0%
		Target (A\$)	1.00



Source: Company data, OML

Z1P Jun-18 quarterly update - Summary

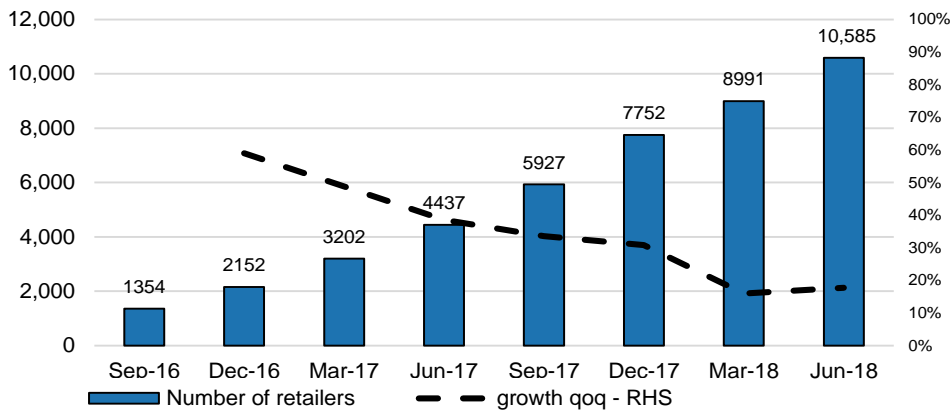
- Underlying sales volume for the qtr of \$171.5m was 2.6% below our estimate (OMLe \$176.1m).
- Guidance achieved in relation to “cash flow breakeven on a mthly basis” within FY18. Underlying operating cash flows of \$2.98m for the qtr, resulted in Underlying operating cash flows post bad debts write-off of +\$0.68m (versus OMLe of negative US\$0.3m) for the Jun-18 qtr.
- Z1P’s number of integrated merchants is now ~10,585, ahead of our 10,441 estimate, adding 1,594 merchants in the qtr.
- Z1P’s customer base is now over 738k, adding over 110k in the Jun-18 qtr.
- Z1P’s receivables balance stands at \$316.7m as at qtr end, in line with our expectations.
- Revenue of \$13.2m was inline with our expectations (OMLe \$13.3m), and up 18% qoq (owing to the growth in the receivables balance).
- Revenue yield of 17.6% was below our 18.3% estimate. This was somewhat offset by total costs of 18.6% which was better than our 19.0% estimate.
- Net bad debts were 2.61% for the qtr, slightly below our 2.75% estimate.
- Repeat customers have now reached 83% of all underlying transactions (by value) in the Jun-18 qtr (up from 61% in Mar-18 qtr).
- Funding: At the end of the qtr the company had \$90m of funding headroom.
- Pocketbook: User base has grown to >530k users (adding 40k in the Jun-18 qtr).

Figure 2: Z1P – Jun-18 qtrly business update – Snapshot of key stats

Z1P Qtrly snapshot	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Ords	QoQ	vs pcq	v Ords
	QTR	QTR	QTR	QTR	Actuals	Estimate			
Sales volume									
Transaction volume (\$m)	86.4	95.1	140.2	136.1	171.5	176.1	26%	98%	-2.6%
Net increase qoq	25.4	8.7	45.1	4.1	35.4				
Receivables									
Receivables balance (\$m)	152.0	176.4	231.3	265.5	316.7	317.7	19%	108%	-0.3%
Net increase qoq	37.3	24.4	54.9	34.2	51.2				
Merchants									
Merchants	4,437	5,927	7,752	8,991	10,585	10,441	18%	139%	1.4%
Net increase qoq	1,235.0	1,490.0	1,825.0	1,239.0	1,594.0				
Customers									
Customers	300,882	403,964	529,326	627,843	738,129	756,051	18%	145%	-2.4%
Net increase qoq	102,769	103,082	125,362	98,517	110,286				
Financials									
Portfolio income									
Revenue Yield	0.0%	16.6%	17.5%	18.0%	17.6%	18.3%	-2%	#DIV/0!	-3.8%
Net increase qoq	-18.2%	16.6%	0.9%	0.5%	-0.4%	0.2			
Revenue									
Revenue (\$m)	5.5	6.8	8.9	11.2	13.2	13.3	18%	142%	-1.1%
Net increase qoq	0.9	1.4	2.1	2.3	2.1	2			
Bad debts									
Bad debts (%)	1.28%	1.98%	2.28%	2.62%	2.61%	2.75%	-0%	104%	-5.1%
Net increase qoq	0.33%	0.70%	0.30%	0.34%	-0.01%				

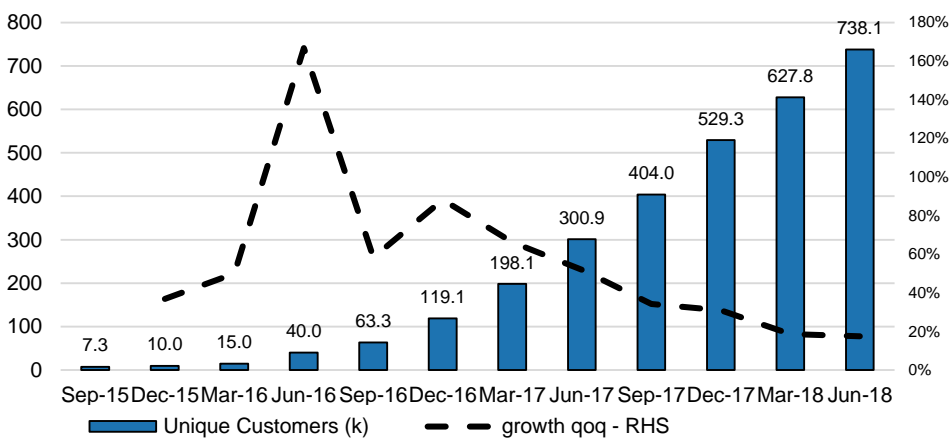
Source: Company data, OML

Figure 3: Z1P's Retail merchants



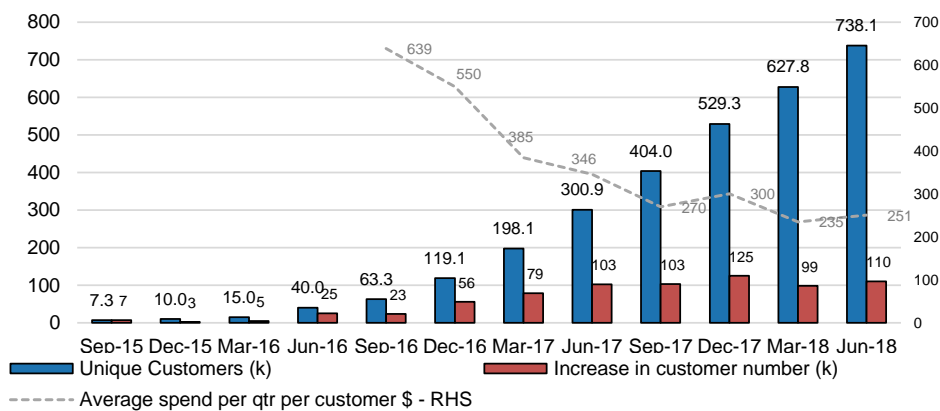
Source: Company data, OML

Figure 4: Z1P's Customers



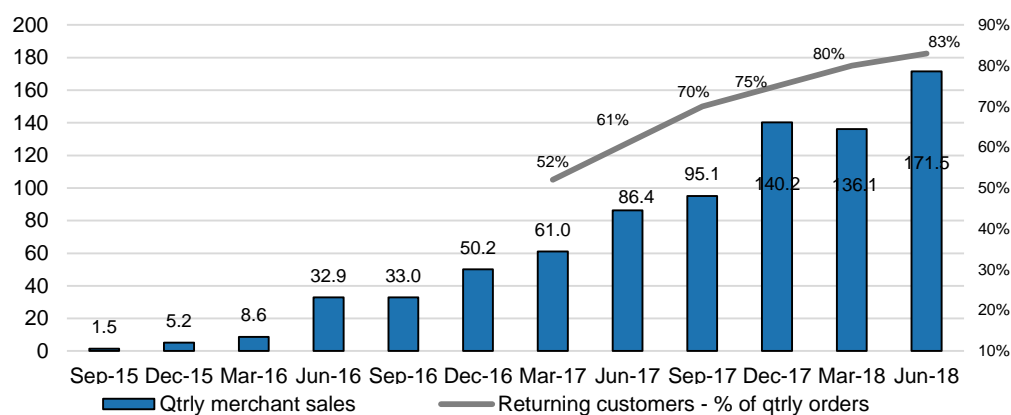
Source: Company data, OML

Figure 5: Z1P's customer growth, and per customer spend



Source: Company data, OML

Figure 6: Z1P's underlying retail sales vs returning customers



Source: Company data, OML

Changes to our forecasts

We have made slight revisions to our earnings forecasts in FY18-20, on the back of the recent qtrly report. Our valuation and target price have both increased ~10%, after rolling forward our DCF valuation and after adjusting our medium term and long term cost forecasts.

Figure 7: Changes to our earnings forecasts and valuation

Changes to	2018A	2019A	2020A	Val (\$ ps)	Target price (\$ ps)
Normalised NPAT (A\$m) - revised	-19.9	-4.1	4.8	0.99	1.00
Normalised NPAT (A\$m) - previous	-20.5	-6.8	2.0	0.90	0.90
Change (A\$m)	0.7	2.7	2.8	0.1	0.10
Change (%)	-3%	-40%	144%	10%	11%

Source: Company data, OML

Zip Co

PROFIT & LOSS (A\$m)	2016A	2017A	2018E	2019E	2020E
Revenue	2.9	16.4	39.6	72.8	101.1
Operating costs	(7.2)	(32.6)	(56.2)	(72.9)	(89.0)
Operating EBITDA	(4.3)	(16.2)	(16.6)	(0.1)	12.1
D&A	(0.6)	(1.9)	(3.2)	(4.2)	(5.2)
EBIT	(4.8)	(18.1)	(19.9)	(4.3)	6.9
Net interest	-	-	-	-	-
Pre-tax profit	(9.0)	(20.9)	(24.2)	(8.7)	2.1
Net tax (expense) / benefit	-	0.6	-	0.2	(2.1)
Significant items/Adj.	(4.2)	(2.8)	(4.4)	(4.5)	(4.8)
Associate NPAT	-	-	-	-	-
Normalised NPAT	(4.8)	(17.5)	(19.9)	(4.1)	4.8
Reported NPAT	(9.0)	(20.3)	(24.2)	(8.5)	0.1
Normalised dil. EPS (cps)	(2.6)	(6.6)	(6.7)	(1.4)	1.6
Reported EPS (cps)	(4.3)	(6.9)	(7.8)	(2.7)	0.0
Effective tax rate (%)	-	3.1	-	5.0	30.0
DPS (cps)	-	-	-	-	-
DPS (cps)	-	-	-	-	-
Dividend yield (%)	-	-	-	-	-
Payout ratio (%)	-	-	-	-	-
Franking (%)	-	-	-	-	-
Diluted # of shares (m)	208.2	292.8	309.6	316.7	321.9
CASH FLOW (A\$m)	2016A	2017A	2018E	2019E	2020E
EBITDA incl. adjustments	(4.3)	(10.9)	(3.4)	17.5	34.0
Income tax paid	0.3	-	-	(0.2)	(0.5)
Operating Cash Flow	(0.5)	(7.6)	0.8	16.8	32.5
Capex	(1.4)	(0.6)	(6.0)	(3.1)	(3.2)
Acquisitions	29.1	(2.7)	-	-	-
Other investing items	(36.1)	(114.3)	(170.9)	(160.7)	(163.1)
Investing Cash Flow	(8.4)	(117.6)	(176.9)	(163.8)	(166.3)
Inc/(Dec) in equity	15.9	10.9	41.0	-	-
Inc/(Dec) in borrowings	(0.7)	126.4	128.7	166.0	137.0
Dividends paid	(0.3)	-	-	-	-
Other financing items	-	-	(0.8)	-	-
Financing Cash Flow	14.9	137.3	168.9	166.0	137.0
FX adjustment	-	-	(0.8)	-	-
Net Inc/(Dec) in Cash	6.1	12.1	(7.1)	19.0	3.2
BALANCE SHEET (A\$m)	2016A	2017A	2018E	2019E	2020E
Cash	7.1	19.2	12.7	31.7	34.9
Receivables	38.2	144.2	307.0	456.2	602.9
Inventory	-	-	-	-	-
Other current assets	-	-	-	-	-
PP & E	0.1	0.5	3.7	4.2	4.8
Intangibles	1.5	10.6	10.3	8.7	6.2
Other non-current assets	-	-	-	-	-
Total Assets	46.9	174.6	333.1	500.7	647.0
Short term debt	-	-	-	-	-
Payables	3.9	2.6	10.1	15.7	20.2
Other current liabilities	0.2	0.9	1.1	1.1	1.1
Long term debt	-	-	-	-	-
Other non-current liabilities	31.0	159.3	289.8	455.8	592.8
Total Liabilities	35.4	162.9	301.5	473.1	614.7
Total Equity	11.5	11.6	31.6	27.5	32.3
Net debt (cash)	(14.3)	(3.7)	(20.7)	(16.8)	(24.1)

Accumulate

DIVISIONS	2016A	2017A	2018E	2019E	2020E
Zip	(2.8)	(16.0)	(16.4)	(0.1)	12.1
Corporate	(1.2)	(3.4)	(6.1)	(5.9)	(5.9)
Total -	(3.9)	(19.4)	(22.6)	(6.0)	6.2

KEY METRICS (%)	2016A	2017A	2018E	2019E	2020E
Revenue growth	-	462.7	140.8	84.0	38.8
EBITDA margin	-	-	-	-	11.9
EBIT margin	-	-	-	-	6.8
Return on assets	-	-	-	-	0.8
Return on equity	-	-	-	-	16.1

VALUATION RATIOS (x)	2016A	2017A	2018E	2019E	2020E
Reported P/E	-	-	-	-	5,874.2
Normalised P/E	-	-	-	-	59.9
Price To Free Cash Flow	-	-	-	20.7	9.9
Price To NTA	19.9	275.6	13.2	15.2	11.1
EV / EBITDA	-	-	-	-	22.0
EV / EBIT	-	-	-	-	38.5

LEVERAGE	2016A	2017A	2018E	2019E	2020E
ND / (ND + Equity) (%)	519.7	(47.1)	(189.7)	(156.2)	(293.6)
Net Debt / EBITDA (%)	336.1	23.0	124.4	17,969.3	(200.0)

SUBSTANTIAL HOLDERS	m	%
Larry Diamond, CEO and MD	61.1	19.7%
Westpac	49.4	15.9%
Peter Gray, COO	20.0	6.5%

VALUATION	
Target Price Method	DCF
Target Price (\$)	1.00
Valuation disc. / (prem.) to share price (%)	4.4

Institutional Research

Nicholas McGarrigle	Head of Institutional Research	+61 2 8216 6345	nmcgarrigle@ords.com.au
Jules Cooper	Senior Research Analyst	+61 3 9608 4117	julescooper@ords.com.au
John O'Shea	Senior Research Analyst	+61 3 9608 4146	joshea@ords.com.au
Phillip Chippindale	Senior Research Analyst	+61 2 8216 6346	pchippindale@ords.com.au
William MacDiarmid	Research Analyst	+61 2 8216 6514	wmacdiarmid@ords.com.au
Jason Korchinski	Research Associate	+61 2 8216 6348	jkorchinski@ords.com.au
Joshua Goodwill	Research Associate	+61 3 9608 4121	jgoodwill@ords.com.au

Institutional Sales (Australia)

Nick Burmester	Head of Institutional Equities	+61 2 8216 6363	nburmester@ords.com.au
Duncan Adam	Institutional Equity Sales	+61 2 8216 6423	dadam@ords.com.au
Matt White	Institutional Equity Sales	+61 3 9608 4133	mwhite@ords.com.au
Richard Wolff	Institutional Equity Sales	+61 2 8216 6429	rwoff@ords.com.au
Stephen Jolly	Institutional Equity Sales	+61 2 8216 6424	sjolly@ords.com.au
Frida Bohlenius	Institutional Equity Sales Support	+61 2 8216 6365	fbohlenius@ords.com.au
Brendan Sweeney	Operator	+61 2 8216 6781	bsweeney@ords.com.au

Institutional Sales (Hong Kong)

Timothy Last	Institutional Equity Sales	+852 2912 8988 +61 8 8203 2526	tlast@ords.com.hk
Christopher Chappel	Institutional Equity Sales	+852 2912 8985	cchappel@ords.com.hk
Sam Phillips	Institutional Equity Sales	+852 2912 8986	sphillips@ords.com.hk

Ord Minnett Offices

Adelaide
Level 5
100 Pirie Street
Adelaide SA 5000
Tel: (08) 8203 2500
Fax: (08) 8203 2525

Brisbane
Level 31
10 Eagle St
Brisbane QLD 4000
Tel: (07) 3214 5555
Fax: (07) 3214 5550

Buderim
Sunshine Coast
1/99 Burnett Street
Buderim QLD 4556
Tel: (07) 5430 4444
Fax: (07) 5430 4400

Caloundra, Sunshine Coast
79-81 Bulcock Street
Caloundra QLD 4551
Tel: (07) 5491 3100
Fax: (07) 5491 3222

Canberra
101 Northbourne Avenue
Canberra ACT 2600
Tel: (02) 6206 1700
Fax: (02) 6206 1720

Gold Coast
Level 7, 50 Appel Street
Surfers Paradise QLD 4217
Tel: (07) 5557 3333
Fax: (07) 5557 3377

Mackay
45 Gordon Street
Mackay QLD 4740
Tel: (07) 4969 4888
Fax: (07) 4969 4800

Melbourne
Level 7
161 Collins Street
Melbourne VIC 3000
Tel: (03) 9608 4111
Fax: (03) 9608 4142

Newcastle
426 King Street
Newcastle NSW 2300
Tel: (02) 4910 2400
Fax: (02) 4910 2424

Head Office

Sydney
Level 8, NAB House
255 George Street
Sydney NSW 2000
Tel: (02) 8216 6300
Fax: (02) 8216 6311
www.ords.com.au

International

Hong Kong
1801 Ruttonjee House
11 Duddell Street
Central, Hong Kong
Tel: +852 2912 8980
Fax: +852 2813 7212
www.ords.com.hk

Guide to Ord Minnett Recommendations

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historic volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

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