

# Zip Co

## Broadening APPEal

Zip has made significant headway recently, and we highlight a number of key developments, being: a) achieving cash flow 'breakeven' in late FY18, b) significant merchant additions including a number with annualised revenues over \$1bn p.a such as Super Retail Group and Officeworks, 3) roll out of new products such as the bill payments function, which sees them move into another segment as well as broaden their customer appeal. The financial result was largely as expected, and we see the business well positioned to build significantly upon its \$750m plus annualised run rate of underlying transactions. We retain our ACCUMULATE rating on Z1P and our (unchanged) target price of \$1.00ps implies a 12 mth total shareholder return of 12%.

### Eyes forward

Zip's FY18 result was inline with our expectations, with the recent qtrly update helping to narrow our expectations. Our key takeaways were: 1) the run rate at 30-Jun-18 was ~\$750m p.a. of underlying transactions (~\$187.5m for the qtr), 2) FY19 outlook commentary was bullish as they "drive towards" \$1billion plus in annual transaction volume, and 1 million plus customers with an active Zip account, 3) Zip's beta trial of allowing consumers to pay bills with 3 months interest free opens up an opportunity for the company to expand into another segment as well as to help expand its customer base – currently, this product is reliant upon processing fees only, however with scale could see Zip earn merchant fees if they are able to demonstrate advantages to the retailer.

### Valuation

Our target price of \$1.00ps is based on our DCF valuation using a WACC of 10.6% and a terminal growth rate of 3.5%. We note our FY19 and FY20 earnings forecasts have increased by \$0.2m and \$1.2m, 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\$)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (\$m)	16.6	39.5	74.6	102.9	129.4
EBITDA (\$m)	(16.0)	(16.3)	0.3	13.4	30.1
EBIT (\$m)	(17.9)	(19.9)	(4.1)	8.6	24.9
Reported NPAT (\$m)	(20.2)	(22.5)	(8.3)	1.3	12.4
Reported EPS (c)	(6.9)	(7.3)	(2.6)	0.4	3.8
Normalised NPAT (\$m)	(17.4)	(19.9)	(3.8)	6.0	17.4
Normalised EPS (c)	(6.6)	(6.8)	(1.3)	2.0	5.7
EPS Growth (%)	-	-	-	-	184.5
Dividend (c)	-	-	-	-	-
Net Yield (%)	-	-	-	-	-
Franking (%)	-	-	-	-	-
EV/EBITDA (X)	-	-	-	17.9	7.4
Normalised P/E (x)	-	-	-	44.4	15.6
Normalised ROE (%)	-	-	-	18.5	39.4

Source: OML, Iress, Zip Co

### Last Price

**A\$0.89**

### Target Price

**A\$1.00**

### Recommendation

**Accumulate**

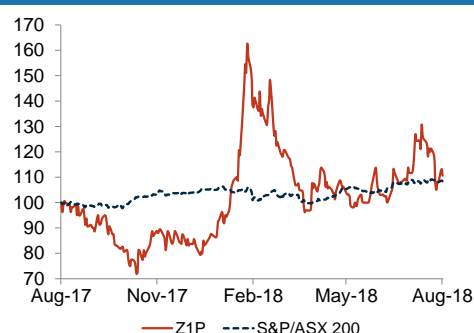
### Risk

**Higher**

### Financials

ASX Code	Z1P
52 Week Range (A\$)	0.58 - 1.30
Market Cap (\$m)	274.0
Shares Outstanding (m)	309.6
Av Daily Turnover (\$m)	1.0
3 Month Total Return (%)	6.6
12 Month Total Return (%)	10.6
Benchmark 12 Month Return (%)	8.3
NTA FY19E (¢ per share)	6.8
Net Cash FY19E (A\$m)	20.1

### Relative Price Performance



Source: FactSet

### Consensus Earnings

	FY19E	FY20E
NPAT (C) (\$m)	(2.8)	4.1
NPAT (OM) (\$m)	(3.8)	6.0
EPS (C) (c)	(1.0)	1.4
EPS (OM) (c)	(1.3)	2.0

Source: OML, Iress, Zip Co

### Phillip Chippindale

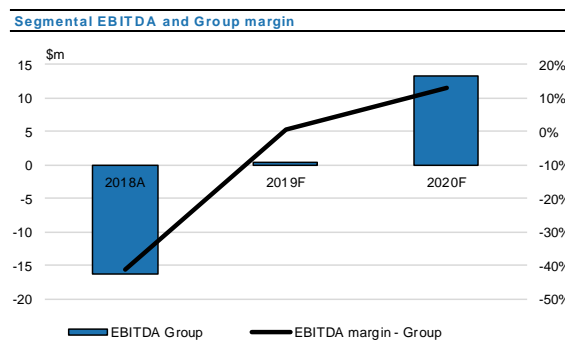
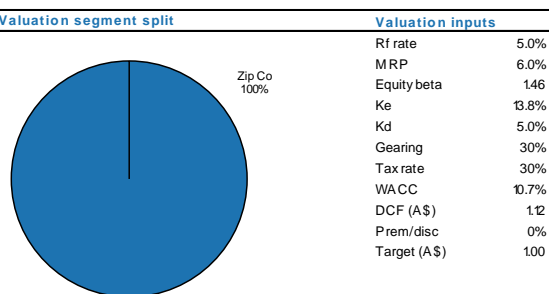
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Figure 1: Z1P – Financial summary

Capital Profile			June year end (A\$m)					
Number of shares, dil (m)	310		2017A	2018A	2019F	2020F	2021F	
Market capitalisation (A\$m)	276		NPAT Reported (A\$m)	-20.2	-22.5	-8.3	13	12.4
Enterprise value (A\$m)	259		NPAT Normalised (A\$m)	-17.4	-19.9	-3.8	6.0	17.4
			EPS (A€)	-6.8	-6.8	-13	2.0	5.7
			CFPS (US€)	-410	-57.9	-53.1	-410	-218
			DPS (US€)	0.0	0.0	0.0	0.0	0.0
			DPS (A€)	0.0	0.0	0.0	0.0	0.0
			P/E (x)	-13.1	-13.1	-67.9	44.5	15.6
			P/CF (x)	-2.2	-1.5	-17	-2.2	-4.1
			EV/EBITDA (x)	-16.0	-16.2	813.5	10.5	8.4
			EPS Growth	nm	0%	-8%	-253%	185%
			Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
DCF Valuation			Sales segmentals					
Segments	A\$m	A\$ps	2017A	2018A	2019F	2020F	2021F	
ZipCo	347	1.12	Sales - Zip	16.6	39.7	74.6	102.9	129.4
Division valuation	347	1.12	Sales - Group	16.6	39.5	74.6	102.9	129.4
Net debt	20	0.06						
Corp costs	-51	-0.17						
Valuation	316	1.02						
Premium		0%						
Target price	1.00							
P/NPV	0.79							
Current share price trading multiples			EBITDA segmentals					
PE	FY21	15.6	2017A	2018A	2019F	2020F	2021F	
EV/EBITDA	FY21	8.4	EBITDA - Zip Co	-16.0	-16.1	0.3	13.4	30.1
			EBITDA Corporate	-3.4	-6.1	-6.0	-6.0	-6.0
			EBITDA Group	-16.0	-16.3	0.3	13.4	30.1
			EBITDA margin - Zip Co	-97%	-40%	0%	13%	23%
			EBITDA margin - Corporate	n.a.	n.a.	n.a.	n.a.	n.a.
			EBITDA margin - Group	-97%	-41%	0%	13%	23%
			Profit & Loss (A\$m)					
			2017A	2018A	2019F	2020F	2021F	
			Sales revenue	16.6	39.5	74.6	102.9	129.4
			Revenue	16.6	39.5	74.6	102.9	129.4
			Cost of sales	-18.0	-30.2	-43.6	-55.7	-64.0
			Gross profit	-1.4	9.4	31.0	47.1	65.3
			Other revenue	0.0	0.0	0.0	0.0	0.0
			Operating costs	-14.6	-25.7	-30.7	-33.8	-35.2
			EBTDA	-16.0	-16.3	0.3	13.4	30.1
			Depreciation & Amort	-19	-3.6	-4.4	-4.8	-5.2
			EBIT	-17.9	-19.9	-4.1	8.6	24.9
			Net interest benefit / (expense)	0.0	0.0	0.0	0.0	0.0
			Pre-tax profit	-17.9	-19.9	-4.1	8.6	24.9
			Tax benefit / (expense)	0.6	0.0	0.2	-2.6	-7.5
			Profit after tax	-17.4	-19.9	-3.8	6.0	17.4
			Minorities	0.0	0.0	0.0	0.0	0.0
			NPAT (underlying)	-17.4	-19.9	-3.8	6.0	17.4
			Significant items	-2.8	-2.7	-4.5	-4.8	-5.1
			NPAT (reported)	-20.2	-22.5	-8.3	13	12.4
Valuation segment split			Profitability Analysis (%)					
			2017A	2018A	2019F	2020F	2021F	
			EBIT margin	-108%	-50%	-5%	8%	19%
			EBITDA margin	-97%	-41%	0%	13%	23%
			Effective tax rate	-3%	0%	-5%	-30%	-30%
			ROA - EBIT / (total assets - cash)	-12%	-6%	-1%	1%	4%
			ROE - NPAT / equity	-150%	-88%	-12%	19%	39%
Valuation inputs			Cashflow					
			2017A	2018A	2019F	2020F	2021F	
			EBITDA	-16.0	-16.3	0.3	13.4	30.1
			Operating cashflow	-7.6	14	18.1	33.7	47.4
			Capex	-2.5	-6.0	-3.1	-3.2	-3.3
			Free cashflow (post all capex)	-10.1	-4.6	15.0	30.5	44.1
			Investing cashflow	-17.6	-176.9	-179.2	-160.7	-117.6
			Financing cashflow	137.3	168.9	166.0	137.0	65.0
			Net Change in cash	12.1	-6.6	4.9	10.0	-5.2
Valuation segment split			Balance Sheet Analysis					
			2017A	2018A	2019F	2020F	2021F	
			Debt	159.3	289.7	455.7	592.7	657.7
			Equity	116	33.4	29.5	35.6	53.0
			Assets	174.6	333.1	499.3	644.9	729.3
			Cash	19.2	12.7	17.5	27.5	22.3
			Net debt	-19.2	-12.7	-17.5	-27.5	-22.3
			Gearing - net debt/equity	-165%	-38%	-59%	-77%	-42%
			Net debt / EBITDA (x)	12	0.8	-55.3	-2.1	-0.7
			Free cashflow yield	-5%	-2%	7%	14%	21%



Source: Company data, OML

## Financial result summary

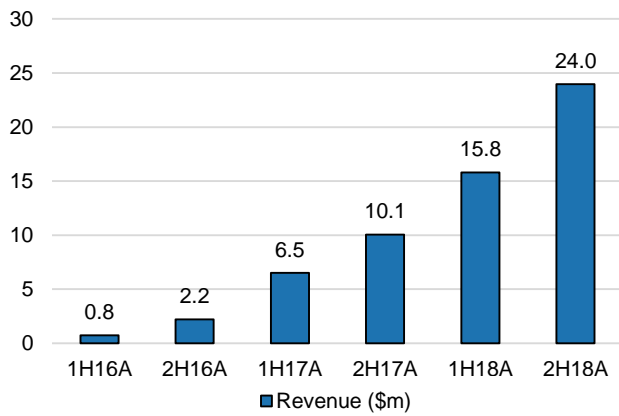
- Z1P have released their FY18 financial result. Overall, it was inline with our expectations.
- Underlying revenue for FY18 of \$39.5m was 1% below our estimate (OMLe \$39.8m).
- Underlying EBTDA of -\$16.3m was inline with our estimate (OMLe -\$16.4m).
- Underlying NPAT of -\$19.9m was 1% below our -\$19.7m estimate, due to slightly higher D&A than we had forecast.
- Commentary is that Z1P's "current run rate [is] \$750m in transaction volume per annum" (ie \$187.5m per qtr, and we had forecast \$177m in current qtr).
- FY19 priorities: to head towards \$1bn in annual transaction volume, to get 1million+ customers on the platform, and "to maintain growth whilst remaining cashflow breakeven".
- Operating cash flows of \$1.4m were known from the recent qtrly reports, as was the cash and borrowings position. We note that Z1P achieved its guidance for FY18 which was for "cash flow breakeven on a monthly basis, including bad debt writeoffs" (this was announced at the recent qtrly report).

**Figure 2: Z1P's FY18 Financial result – a snapshot**

Fin result snapshot	2016	1H17	2H17	2017	1H18	2H18	2018	Ords	B'berg cons	vs Ords	vs B'berg cons	YoY
							<b>ACTUAL</b>	<b>Estimate</b>				
<b>Profit &amp; Loss statement</b>												
Revenue	3.0	6.5	10.1	16.6	15.8	23.7	39.5	39.8	37.7	-0.6%	5%	138%
Costs	-7.2	-11.0	-21.6	-32.6	-26.9	-28.9	-55.8	-56.2		-0.7%		71%
EBTDA	-4.2	-4.5	-11.5	-16.0	-11.1	-5.1	-16.3	-16.4	-18.9	-0.9%	-14%	1%
D&A	-0.6	-0.5	-1.4	-1.9	-1.5	-2.0	-3.6	-3.2		10.0%		89%
EBT	-4.8	-5.1	-12.9	-17.9	-12.7	-7.2	-19.9	-19.7	-22.1	0.9%	-10%	11%
PBT	-4.8	-5.1	-12.9	-17.9	-12.7	-7.2	-19.9	-19.7		0.9%		11%
Tax expense	0.0	0.0	0.6	0.6	0.0	0.0	0.0	0.0		n.a		-100%
<b>Underlying NPAT</b>	<b>-4.8</b>	<b>-5.1</b>	<b>-12.3</b>	<b>-17.4</b>	<b>-12.7</b>	<b>-7.2</b>	<b>-19.9</b>	<b>-19.7</b>	<b>-22.9</b>	0.9%	-13%	14%
EPS	-2.6	-2.1	-4.6	-6.6	-4.3	-2.4	-6.8	-6.7	-7.8	0.9%	-13%	3%
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.00	n.a	n.a	n.a
<b>Cashflows</b>												
Operating cashflow s	-0.5	-0.9	-6.7	-7.6	-2.8	4.2	1.4	1.4		1.8%		-119%
Investing cashflow s	-8.4	-52.3	-65.3	-117.6	-88.4	-88.5	-176.9	-176.9		0.0%		50%
Financing cashflow s	14.9	58.3	79.0	137.3	90.3	78.6	168.9	168.9		0.0%		23%
<b>Balance sheet</b>												
Debt	31.0	80.4	159.3	159.3	211.0	289.7	289.7	289.7		0.0%		82%
Cash	7.1	12.2	19.2	19.2	18.3	12.7	12.7	12.7		0.0%		-34%
Net debt	-24.0	-68.2	-140.1	-140.1	-192.7	-277.1	-277.1	-277.0		0.0%		98%

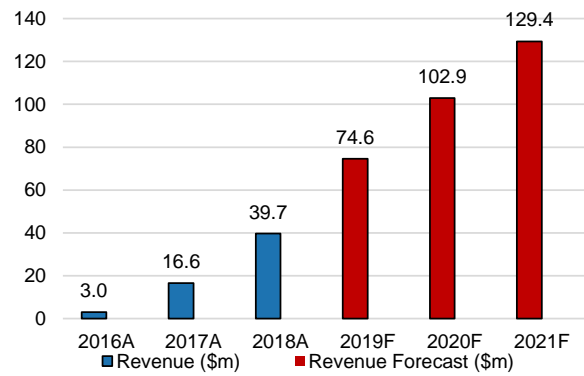
Source: OML, company data

Figure 3: Z1P's Revenue – half years



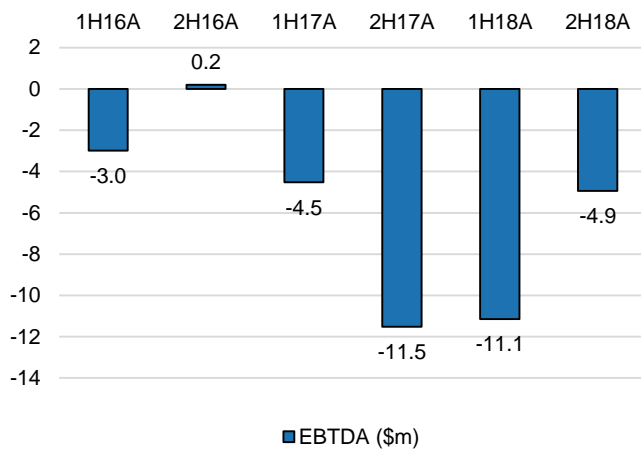
Source: Company data, OML

Figure 4: Z1P's Revenue profile



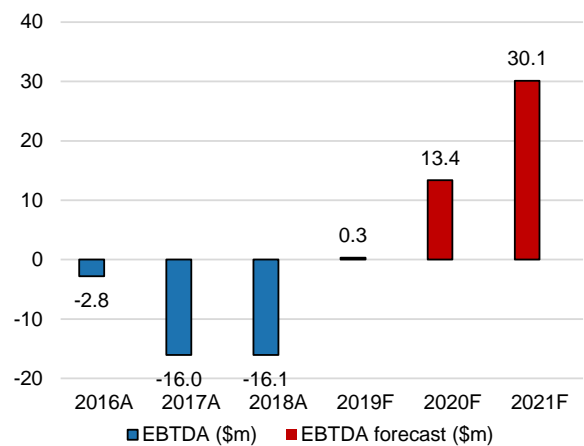
Source: Company data, OML

Figure 5: Z1P's EBITDA – half years



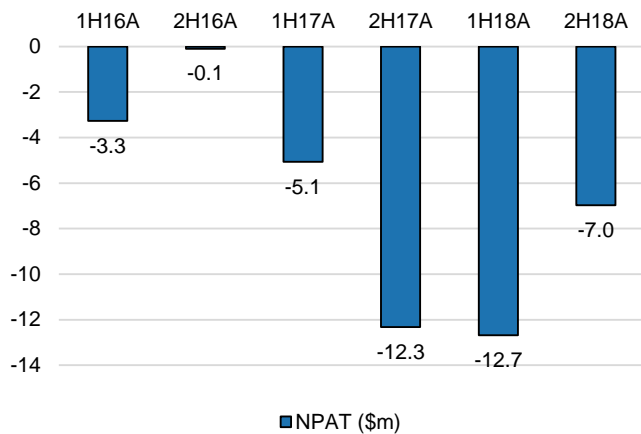
Source: Company data, OML

Figure 6: Z1P's EBITDA profile



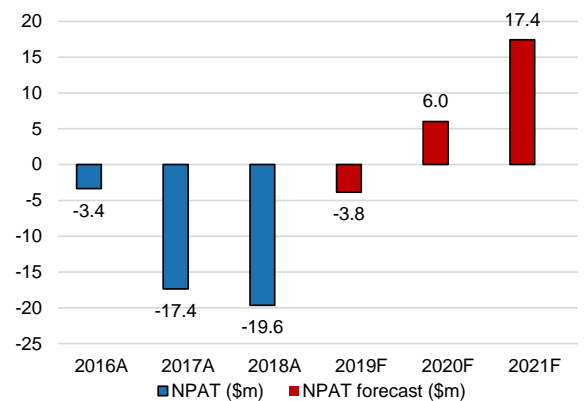
Source: Company data, OML

Figure 7: Z1P's NPAT – half years



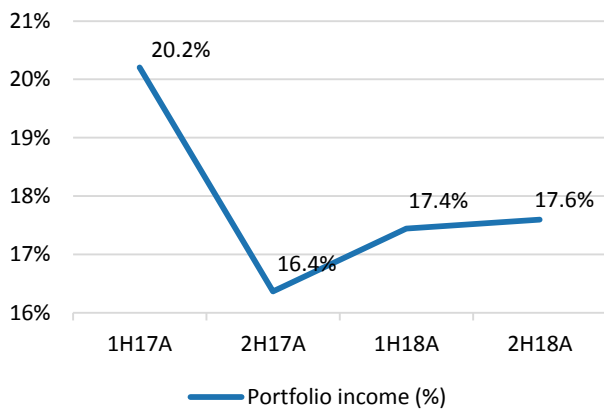
Source: Company data, OML

Figure 8: Z1P's NPAT profile



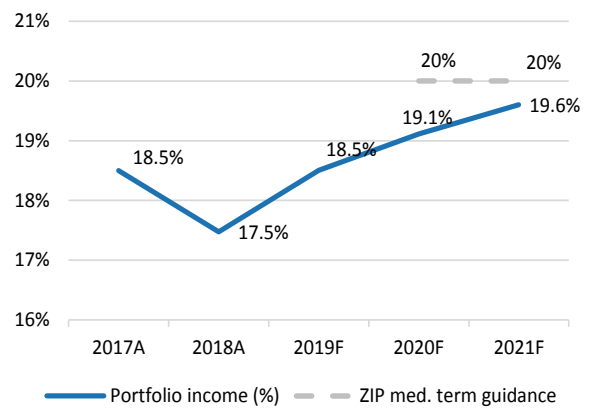
Source: Company data, OML

Figure 9: Z1P's Portfolio income - half years



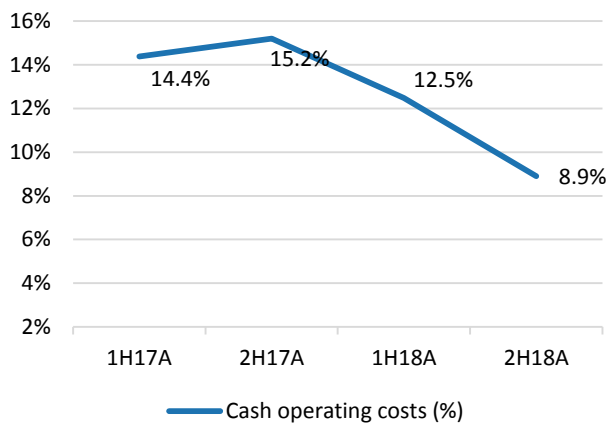
Source: Company data, OML

Figure 10: Z1P's Portfolio income profile



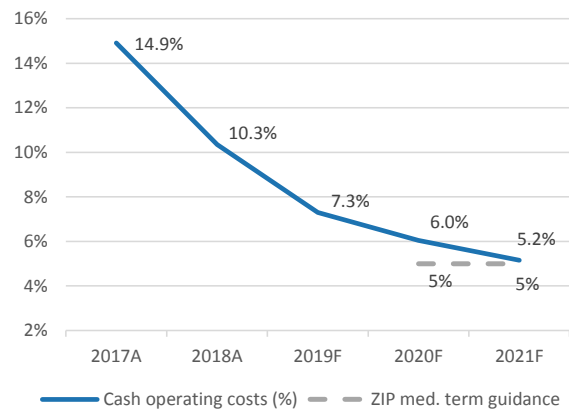
Source: Company data, OML

Figure 11: Z1P's Cash operating costs – half years



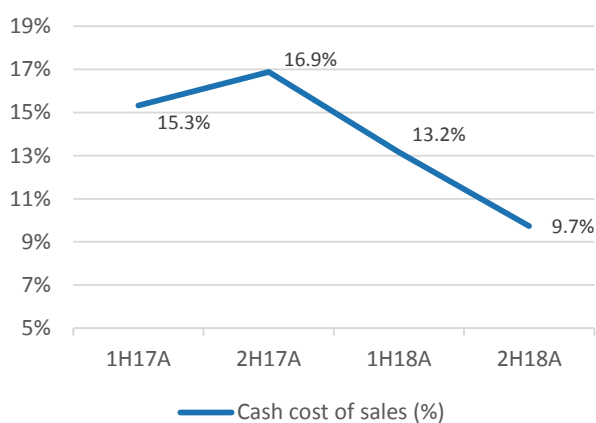
Source: Company data, OML

Figure 12: Z1P's Cash operating cost profile



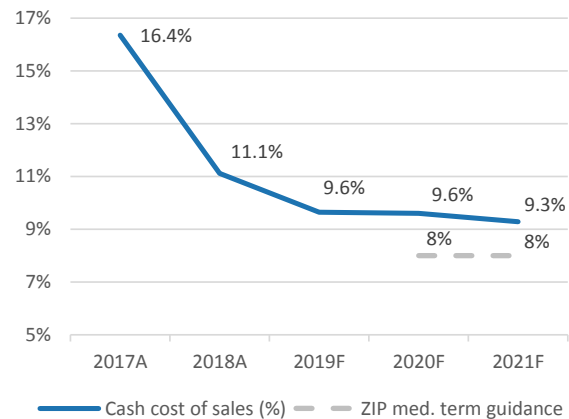
Source: Company data, OML

Figure 13: Z1P's cash cost of sales – half years



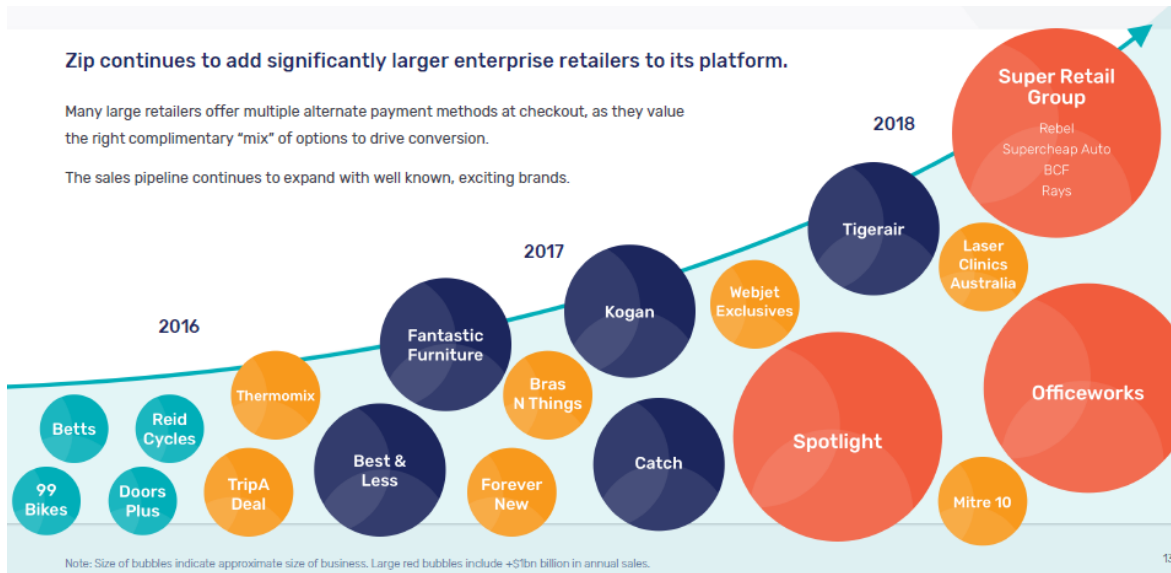
Source: Company data, OML

Figure 14: Z1P's cash cost of sales profile



Source: Company data, OML

**Figure 15: Z1P's recent retailer additions have been at the large end of town...**



Source: Company presentation

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**Changes to our forecasts**

We have made slight revisions to our NPAT forecasts, after slight changes to our underlying transaction volume assumptions. As a result, our valuation has increased slightly, however our target price of \$1.00ps is unchanged.

**Figure 16: Changes to our earnings forecasts and valuation**

Changes to	2019F	2020F	2021F	Val (\$ ps)	Target price (\$ ps)
<b>Normalised NPAT (A\$m) - revised</b>	<b>-3.8</b>	<b>6.0</b>	<b>17.4</b>	<b>1.02</b>	<b>1.00</b>
Normalised NPAT (A\$m) - previous	-4.1	4.8	15.5	0.99	1.00
Change (A\$m)	0.2	12	19	0.0	0.00
Change (%)	-5%	25%	12%	3%	0%

Source: Company data, OML

## Zip Co

PROFIT & LOSS (A\$m)	2017A	2018A	2019E	2020E	2021E
Revenue	16.6	39.5	74.6	102.9	129.4
Operating costs	(32.6)	(55.8)	(74.3)	(89.5)	(99.3)
<b>Operating EBITDA</b>	<b>(16.0)</b>	<b>(16.3)</b>	<b>0.3</b>	<b>13.4</b>	<b>30.1</b>
D&A	(1.9)	(3.6)	(4.4)	(4.8)	(5.2)
<b>EBIT</b>	<b>(17.9)</b>	<b>(19.9)</b>	<b>(4.1)</b>	<b>8.6</b>	<b>24.9</b>
Net interest	-	-	-	-	-
<b>Pre-tax profit</b>	<b>(20.7)</b>	<b>(22.5)</b>	<b>(8.5)</b>	<b>3.8</b>	<b>19.9</b>
Net tax (expense) / benefit	0.6	-	0.2	(2.6)	(7.5)
Significant items/Adj.	(2.8)	(2.7)	(4.5)	(4.8)	(5.1)
Associate NPAT	-	-	-	-	-
<b>Normalised NPAT</b>	<b>(17.4)</b>	<b>(19.9)</b>	<b>(3.8)</b>	<b>6.0</b>	<b>17.4</b>
<b>Reported NPAT</b>	<b>(20.2)</b>	<b>(22.5)</b>	<b>(8.3)</b>	<b>1.3</b>	<b>12.4</b>
Normalised dil. EPS (cps)	(6.6)	(6.8)	(1.3)	2.0	5.7
Reported EPS (cps)	(6.9)	(7.3)	(2.6)	0.4	3.8
Effective tax rate (%)	3.1	-	5.0	30.0	30.0
DPS (cps)	-	-	-	-	-
DPS (cps)	-	-	-	-	-
Dividend yield (%)	-	-	-	-	-
Payout ratio (%)	-	-	-	-	-
Franking (%)	-	-	-	-	-
Diluted # of shares (m)	292.8	309.6	316.7	321.9	327.4

CASH FLOW (A\$m)	2017A	2018A	2019E	2020E	2021E
EBITDA incl. adjustments	(16.0)	(16.3)	0.3	13.4	30.1
Change in working capital	2.5	3.3	(0.5)	(1.0)	(1.0)
Net Interest (paid)/received	(9.6)	(13.0)	(18.7)	(25.1)	(30.1)
Income tax paid	-	1.2	(0.2)	(0.8)	(5.1)
Other operating items	15.6	26.2	37.2	47.1	53.5
<b>Operating Cash Flow</b>	<b>(7.6)</b>	<b>1.4</b>	<b>18.1</b>	<b>33.7</b>	<b>47.4</b>
Capex	(0.6)	(6.0)	(3.1)	(3.2)	(3.3)
Acquisitions	(2.7)	-	-	-	-
Other investing items	(114.3)	(170.9)	(176.1)	(157.5)	(114.3)
<b>Investing Cash Flow</b>	<b>(117.6)</b>	<b>(176.9)</b>	<b>(179.2)</b>	<b>(160.7)</b>	<b>(117.6)</b>
Inc/(Dec) in equity	10.9	41.0	-	-	-
Inc/(Dec) in borrowings	126.4	127.9	166.0	137.0	65.0
Dividends paid	-	-	-	-	-
Other financing items	-	-	-	-	-
<b>Financing Cash Flow</b>	<b>137.3</b>	<b>168.9</b>	<b>166.0</b>	<b>137.0</b>	<b>65.0</b>
FX adjustment	-	-	-	-	-
Net Inc/(Dec) in Cash	12.1	(6.6)	4.9	10.0	(5.2)

BALANCE SHEET (A\$m)	2017A	2018A	2019E	2020E	2021E
Cash	19.2	12.7	17.5	27.5	22.3
Receivables	144.2	306.8	469.0	608.0	701.9
Inventory	-	-	-	-	-
Other current assets	-	-	-	-	-
PP & E	0.5	3.2	3.0	2.8	2.9
Intangibles	10.6	10.3	9.3	7.9	6.0
Other non-current assets	-	-	-	-	-
<b>Total Assets</b>	<b>174.6</b>	<b>333.1</b>	<b>499.3</b>	<b>644.9</b>	<b>729.3</b>
Short term debt	-	-	-	-	-
Payables	2.6	8.0	12.1	14.7	16.7
Other current liabilities	0.9	1.2	1.2	1.2	1.2
Long term debt	-	-	-	-	-
Other non-current liabilities	159.3	289.7	455.7	592.7	657.7
<b>Total Liabilities</b>	<b>162.9</b>	<b>299.7</b>	<b>469.8</b>	<b>609.3</b>	<b>676.3</b>
<b>Total Equity</b>	<b>11.6</b>	<b>33.4</b>	<b>29.5</b>	<b>35.6</b>	<b>53.0</b>
Net debt (cash)	(3.7)	(23.5)	(20.1)	(28.5)	(49.1)

## Accumulate

DIVISIONS	2017A	2018A	2019E	2020E	2021E
Zip	(16.0)	(16.1)	0.3	13.4	30.1
Corporate	(3.4)	(6.1)	(6.0)	(6.0)	(6.0)
<b>Total -</b>	<b>(19.4)</b>	<b>(22.2)</b>	<b>(5.7)</b>	<b>7.4</b>	<b>24.1</b>
Zip EBITDA margin	(96.8)	(40.7)	0.4	13.0	23.3
<b>Total -</b>	<b>(96.8)</b>	<b>(40.7)</b>	<b>0.4</b>	<b>13.0</b>	<b>23.3</b>

KEY METRICS (%)	2017A	2018A	2019E	2020E	2021E
Revenue growth	458.6	138.4	88.7	38.0	25.7
EBITDA growth	-	-	-	4,119.2	124.9
EBIT growth	-	-	-	-	189.4
Normalised EPS growth	-	-	-	-	184.5
EBITDA margin	-	-	0.4	13.0	23.3
OCF / EBITDA	0.0	0.0	0.0	0.0	0.0
EBIT margin	-	-	-	8.4	19.3
Return on assets	-	-	-	1.1	2.5
Return on equity	-	-	-	18.5	39.4

VALUATION RATIOS (x)	2017A	2018A	2019E	2020E	2021E
Reported P/E	-	-	-	227.0	23.4
Normalised P/E	-	-	-	44.4	15.6
Price To Free Cash Flow	-	-	17.5	8.8	6.2
Price To NTA	254.7	11.2	13.0	9.7	5.8
EV / EBITDA	-	-	-	17.9	7.4
EV / EBIT	-	-	-	27.7	8.9

LEVERAGE	2017A	2018A	2019E	2020E	2021E
ND / (ND + Equity) (%)	(47.1)	(239.1)	(211.6)	(401.0)	(1,273.3)
Net Debt / EBITDA (%)	23.2	144.6	(6,322.6)	(212.7)	(163.3)

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 (%)	13.0

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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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