

## Zip Co (Z1P)

Rating: Buy | Risk: High | Price Target: \$1.60

### 1H18 Result: Record Result...With More Upside to Come as Pathway to Breakeven Clear

#### Key Information

Current Price (\$ps)	1.06
12m Target Price (\$ps)	1.60
52 Week Range (\$ps)	0.58 - 1.30
Target Price Upside (%)	50.9%
TSR (%)	50.9%
Reporting Currency	AUD
Market Cap (\$m)	256.0
Sector	Information Technology
Avg Daily Volume (m)	0.7
ASX 200 Weight (%)	0.02%

#### Fundamentals

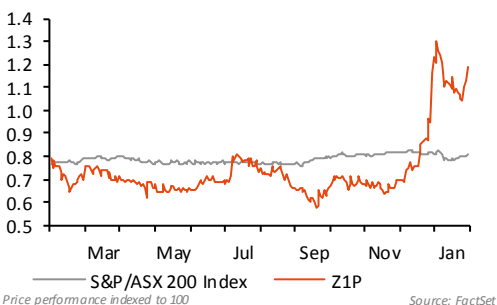
YE 30 Jun (AUD)	FY17A	FY18E	FY19E	FY20E
Sales (\$m)	17.0	35.3	69.2	106.8
NPAT (\$m)	(20.2)	(23.8)	0.8	5.9
EPS (cps)	(6.9)	(7.0)	0.2	1.7
EPS Growth (%)	(91.4%)	(1.4%)	103.3%	657.8%
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

#### Ratios

YE 30 Jun	FY17A	FY18E	FY19E	FY20E
P/E (x)	(9.4)	(15.1)	nm	60.6
EV/EBITDA (x)	(8.3)	(15.6)	89.0	26.2
Div Yield (%)	0.0%	0.0%	0.0%	0.0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

#### Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	12.4%	60.6%	49.0%	39.7%
Absolute (%)	11.6%	59.4%	49.3%	44.2%
Benchmark (%)	(0.8%)	(1.2%)	0.3%	4.5%



#### Major Shareholders

Larry Diamond (CEO & MD)	21.0%
Westpac Bank	17.1%
Peter Gray (COO & ED)	6.9%

#### Danny Younis | Senior Analyst

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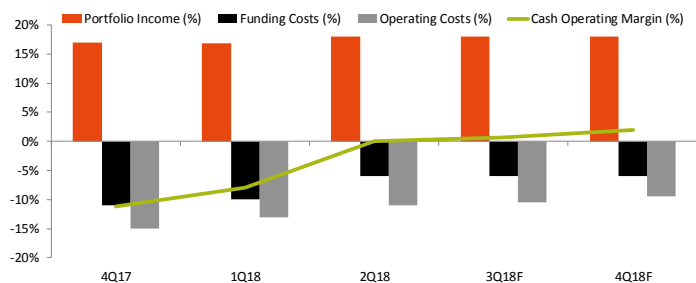
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#### Event

As expected, Z1P announced another set of very strong half-yearly numbers (1H18). Loan book growth +164% on pcp, number of merchants +255%, customers +345%, transaction volumes +183% and, most importantly, revenues +139% to \$16.0m (vs. Shaw forecast of \$15.6m). We have not made any changes to our FY18 and FY19 revenue numbers. PT and recommendation remain unchanged.

#### Highlights

- **Outlook remains for cashflow breakeven in FY18** – noting that, significantly, in 2Q18 Z1P was effectively already break-even at -\$0.1m. This pathway is highlighted below.



- **Revenue growth highlighting the leverage and critical mass being achieved, with yield of 17.5% (vs. 17.1%, vs. Shaw and Partners 17.3%)** – aided by raising the monthly fee from \$5 to \$6 on 1-Jan-18 and now trending toward the targeted 20.0%. This has been augmented on the cost side, with the cash cost of sales continuing to reduce from 16.7% to 11.4% (vs. Shaw and Partners 12.1%) owing to the exiting of expensive legacy funding costs in the half (and more competitive NAB pricing bringing weighted cost down from >10% to <6%), and cash operating costs also reducing further from 14.0% to 11.8%, due to the stabilisation of staffing costs post the ramp up in FY17.
- **Z1P ended the half with a strong cash position of \$18.3m (\$11.3m restricted in trust).**
- **Loan book/receivables up 164% in 1H18 to \$231.3m (FY16: \$40.7m; FY17: \$152.0m), a solid result above Shaw's \$228.3m estimate** – repayment profile was a robust (and improved) 14% (vs. Shaw's 12% estimate; vs. 10% a year ago), with bad debts of 2.3% and arrears of 1.9% (>60 days with write-offs >180 days). This still remains below industry averages of 3-5% and Shaw's forecast of 3.0%.
- **A standout feature was (again) the very healthy increase of +183% in transaction volumes to \$235.3m, a touch above Shaw's \$227.6m estimate** – only 12 months ago, ZML was averaging \$13m / month, it is now averaging nearly \$40m / month. We expect this monthly quantum to continue.
- **Customers on platform grew from 119,100 in pcp to 529,300 across nearly 7,800 merchant locations (2,200 in pcp)** – and we expect this to improve further. New merchants signed up during the half: Kogan, Fantastic Furniture, Spotless, Anaconda and Best & Less, all of which could potentially be significant for Z1P.

#### Recommendation

**BUY.** The share price reaction today is probably a reflection of the recent run up in share price and the company not upgrading its guidance – we do not see this as an issue, only an opportunity. None of what was in the result today should've been a surprise to the market given all the numbers were contained in last month's 2Q18 update. FY18 should be a cracker for ZML: with significant upside from the Pocketbook acquisition, lower cost NAB facility (and 17% WBC investment), further monetising the large recent wins / partnerships (i.e. Macquarie Bank, Kogan, eWays, Catch, LUX, Quest, etc.), the push into digital wallets, the (potential) rollout across Westpac, and penetrating NZ to thereby accelerate the company's growth. We believe that ZML is "best of breed" in this space - clearly enunciating a strategy of differentiating itself qualitatively, strategically and visibly vs. what we consider to be its lower quality peers like Openpay, PartPay, FuturePay, Ourpay, Oxipay etc., all offering a homogenous platform with little distinction.

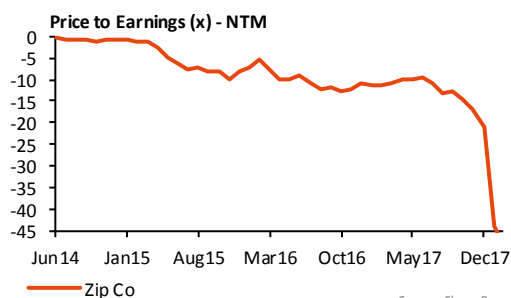
## Zip Co Information Technology

FactSet: Z1P-AU / Bloomberg: Z1P AU

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price (\$ps)	1.06
Target Price (\$ps)	1.60
52 Week Range (\$ps)	0.58 - 1.30
Shares on Issue (m)	241.6
Market Cap (\$m)	256.0
Enterprise Value (\$m)	321.0
TSR (%)	50.9%
Valuation NPV	Data
Beta	1.40
Cost of Equity (%)	13.7%
Risk Free Rate (%)	5.3%
Terminal Growth (%)	3.0%
WACC (%)	13.7%

## Company Description

Zip Co. Ltd. provides retail finance solutions. It offers point-of-sale credit and digital payment services to consumers and merchants. The company was founded on June 24, 2013 and is headquartered in Sydney, Australia.

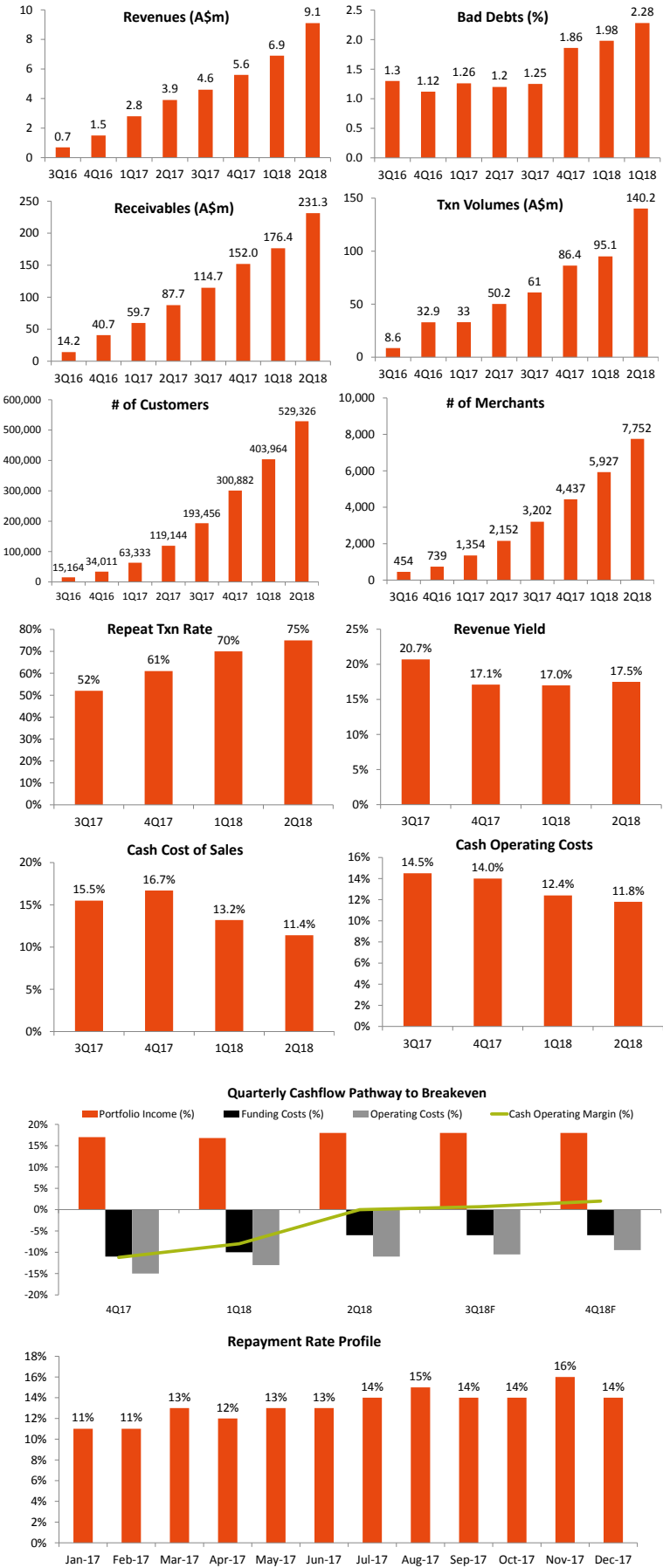


## Financial Year End: 30 June

Investment Summary (AUD)	FY16A	FY17A	FY18E	FY19E	FY20E
EPS (Reported) (cps)	(3.6)	(6.9)	(7.0)	0.2	1.7
EPS (Underlying) (cps)	(3.6)	(6.9)	(7.0)	0.2	1.7
EPS (Underlying) Growth (%)	82.8%	(91.4%)	(1.4%)	103.3%	657.8%
PE (Underlying) (x)	(17.2)	(9.4)	(15.1)	nm	60.6
EV / EBIT (x)	(15.8)	(7.5)	(13.7)	195.8	31.5
EV / EBITDA (x)	(16.9)	(8.3)	(15.6)	89.0	26.2
DPS (cps) (AUD)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	100%	0%	0%	0%	0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Free Cash Flow Yield (%)	(2.2%)	(6.1%)	(1.1%)	0.2%	1.3%
Profit and Loss (AUD) (m)	FY16A	FY17A	FY18E	FY19E	FY20E
Sales	3.2	17.0	35.3	69.2	106.8
Sales Growth (%)	675.7%	436.3%	107.8%	95.9%	54.3%
EBITDA	(8.4)	(19.0)	(20.5)	3.6	10.9
EBITDA Margin (%)	nm	nm	(58.1%)	5.2%	10.3%
Depreciation & Amortisation	(0.6)	(1.9)	(2.9)	(2.0)	(1.8)
EBIT	(9.0)	(20.9)	(23.4)	1.6	9.1
EBIT Margin (%)	nm	nm	(66.3%)	2.4%	8.5%
Net Interest	0.0	0.1	(0.4)	(0.5)	(0.6)
Pretax Profit	(9.0)	(20.7)	(23.8)	1.1	8.5
Tax	0.0	0.6	0.0	(0.3)	(2.5)
Tax Rate (%)	0.0%	(2.7%)	0.0%	(30.0%)	(30.0%)
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	(9.0)	(20.2)	(23.8)	0.8	5.9
Significant Items	0.0	0.0	0.0	0.0	0.0
NPAT Reported	(9.0)	(20.2)	(23.8)	0.8	5.9
Cashflow (AUD) (m)	FY16A	FY17A	FY18E	FY19E	FY20E
EBIT	(9.0)	(20.9)	(23.4)	1.6	9.1
Tax Paid	0.0	0.6	0.0	(0.3)	(2.5)
Net Interest	0.0	0.1	(0.4)	(0.5)	(0.6)
Change in Working Capital	(2.4)	11.1	8.6	2.3	3.2
Depreciation & Amortisation	0.6	1.9	2.9	2.0	1.8
Other	9.0	(0.4)	12.4	(2.4)	(3.5)
Operating Cashflow	(1.9)	(7.6)	0.2	2.6	7.5
Capex	(1.4)	(3.3)	(3.9)	(2.1)	(2.9)
Acquisitions and Investments	0.0	(1.9)	0.0	0.0	0.0
Disposal of Fixed Assets/Investments	0.2	0.0	0.0	0.0	0.0
Other	(35.0)	(112.5)	(159.5)	(167.4)	(141.7)
Investing Cashflow	(36.1)	(117.6)	(163.4)	(169.5)	(144.7)
Free Cashflow	(3.2)	(10.9)	(3.8)	0.5	4.5
Equity Raised / Bought Back	15.2	8.2	37.9	37.9	37.9
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Change in Debt	(4.0)	0.0	0.0	0.0	0.0
Other	32.8	129.1	130.8	131.1	131.1
Financing Cashflow	44.0	137.3	168.7	169.0	169.0
Exchange Rate Effect	0.0	0.0	0.0	0.0	0.0
Net Change in Cash	6.1	12.1	5.4	2.1	31.8
Balance Sheet (AUD) (m)	FY16A	FY17A	FY18E	FY19E	FY20E
Cash	7.1	19.2	24.7	26.8	58.6
Accounts Receivable	0.1	0.4	6.3	8.9	12.4
Other Current Assets	0.0	0.0	0.0	0.0	0.0
PPE	0.1	0.5	3.4	3.4	3.4
Goodwill & Intangibles	1.5	10.6	10.5	10.5	10.5
Investments	0.0	0.0	0.0	0.0	0.0
Other Non Current Assets	38.1	143.8	302.0	468.2	608.6
Total Assets	46.9	174.6	346.9	517.7	693.5
Accounts Payable	3.9	2.6	2.7	2.9	3.2
Short Term Debt	0.0	0.0	0.0	0.0	0.0
Long Term Debt	0.0	0.0	0.0	0.0	0.0
Income Taxes Payable	0.0	0.0	0.0	0.0	0.0
Other	31.4	160.3	304.1	425.1	562.2
Total Liabilities	35.4	162.9	306.8	428.1	565.5
Total Shareholder Equity	11.5	11.6	40.1	89.6	128.1
Ratios	FY16A	FY17A	FY18E	FY19E	FY20E
ROE (%)	(158.2%)	(174.4%)	(92.0%)	1.2%	5.5%
ROIC (%)	(77.7%)	(173.7%)	(59.3%)	0.9%	4.6%
Gearing (%)	(159.5%)	253.2%	(159.5%)	(42.6%)	(84.5%)
Net Debt / EBITDA (x)	0.8	1.0	1.2	(7.5)	(5.4)
Price to Book (x)	nm	nm	nm	nm	nm

## Z1P Summary ... in Charts

Figures 1 - 12: Z1P Operational Metrics by Chart



Source: Shaw and Partners, Z1P

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<b>Buy</b>	Expected to outperform the overall market
<b>Hold</b>	Expected to perform in line with the overall market
<b>Sell</b>	Expected to underperform the overall market
<b>Not Rated</b>	Shaw has issued a factual note on the company but does not have a recommendation

## Risk Rating

<b>High</b>	Higher risk than the overall market – investors should be aware this stock may be speculative
<b>Medium</b>	Risk broadly in line with the overall market
<b>Low</b>	Lower risk than the overall market

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