

## Zip Co (Z1P)

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

### Tigerair a Huge Milestone Win. Opportunity Beckons at Cheaper Price. BUY.

#### Key Information

Current Price (\$ps)	0.78
12m Target Price (\$ps)	1.60
52 Week Range (\$ps)	0.58 - 1.30
Target Price Upside (%)	106.5%
TSR (%)	106.5%
Reporting Currency	AUD
Market Cap (\$m)	187.2
Sector	Information Technology
Avg Daily Volume (m)	0.4
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)	(11.1)	nm	44.3
EV/EBITDA (x)	(8.3)	(11.1)	63.1	17.7
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 (%)	(20.6%)	(28.5%)	15.2%	12.1%
Absolute (%)	(24.4%)	(33.2%)	10.7%	10.7%
Benchmark (%)	(3.8%)	(4.7%)	(4.5%)	(1.4%)



#### Major Shareholders

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

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#### Event

We reiterate our BUY recommendation on Z1P despite the share price falling 22% over the past month.

#### Highlights

- Z1P's share price has been caught in the crossfire of the 'broker wars'** relating to the 'buy now, pay later' space and Afterpay Touch (APT) in particular, and any implications re: upcoming ASIC review (mostly based on *ad hoc* innuendo, misinformation and false extrapolation).
- Z1P is well prepared for any ASIC investigation into the space, welcoming any review:**
  - How does Z1P make money?** Predominantly from merchant fees and customer fees, and to a much smaller extent, establishment fees and interest. Late fees are a long distant #5 source of revenue.
  - What are Z1P's credit approval processes?** Z1P's credit approval processes are the tightest in the industry. Why? Bad debts remain well below industry benchmarks at <3% despite having over 530,000 customers transacting \$140m in volumes in 1H18. Z1P is fully compliant with two ASIC issued licences: (1) Australian Credit Licence (for the provision of credit); and (2) AFLS (for the provision of non-consumer related products). No breaches to date have been recorded. It is also salient to note that Z1P now has strong strategic and operational relationships with two major banks (NAB/WBC) who have given the tick of approval post rigorous due diligence and painstaking reviews of Z1P's credit policies, systems, people and processes. Z1P not only credit checks every single applicant, but also declines a large number of applicants.
  - How important are late payment fees to Z1P?** Insignificant. Most of Z1P's revenues are derived from merchant and customer fees (e.g. monthly account fees). **Shaw and Partners estimates late fees as 1-2% of Z1P's revenues at best. In comparison, APT derives a much higher 20% of its revenues in late fees.**
- Tigerair partnership a significant win (a top 3 merchant by revenue now for Z1P) and comes on the back of a record last 2Q18** – and goes live on 16 April 2018. According to public releases, Tigerair generates over \$540m in annual revenue, and Shaw and Partners estimate Tigerair books ~100,000+ seats each week. This continues Z1P's penetration into the high ATV and lucrative travel and leisure sector.
- Outlook remains for cashflow breakeven in FY18 and this is a key catalyst for the company** – noting that, significantly, in 2Q18 Z1P was effectively already break-even.
- A standout feature in 1H18 was (again) the very healthy increase of +183% in transaction volumes to \$235.3m** – only 12 months ago, Z1P was averaging \$13m / month, it is now averaging nearly \$40m / month. We expect this monthly quantum to continue as it signs on larger and larger merchants like Tigerair.
- 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.

#### Recommendation

BUY. The share price reaction over the past month has been grossly overdone. Nothing has changed – if anything, there has been more positive news with the Tigerair announcement. FY18 should be a cracker for Z1P: 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, Tigerair, 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 Z1P 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.

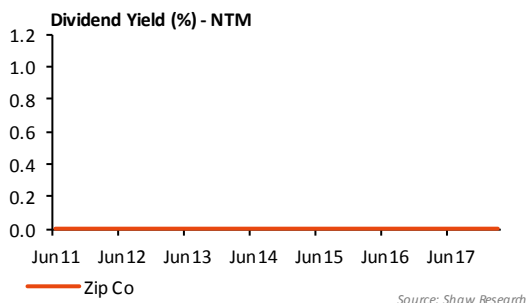
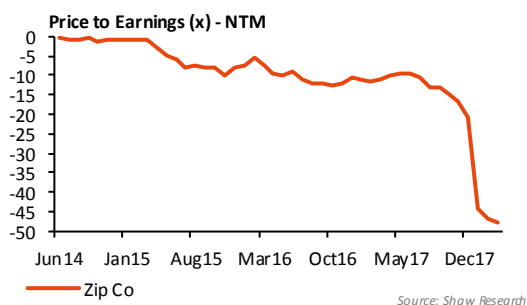
## Zip Co Information Technology

FactSet: Z1P-AU / Bloomberg: Z1P AU

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price (\$ps)	0.78
Target Price (\$ps)	1.60
52 Week Range (\$ps)	0.58 - 1.30
Shares on Issue (m)	241.6
Market Cap (\$m)	187.2
Enterprise Value (\$m)	228.1
TSR (%)	106.5%
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)	(11.1)	nm	44.3
EV / EBIT (x)	(15.8)	(7.5)	(9.7)	138.7	21.3
EV / EBITDA (x)	(16.9)	(8.3)	(11.1)	63.1	17.7
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%)	(1.5%)	0.2%	1.8%
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

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## Rating Classification

<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

**RISK STATEMENT:** Where a company is designated as ‘High’ risk, this means that the analyst has determined that the risk profile for this company is significantly higher than for the market as a whole, and so may not suit all investors. Clients should make an assessment as to whether this stock and its potential price volatility is compatible with their financial objectives. Clients should discuss this stock with their Shaw adviser before making any investment decision.

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