

Net Element Inc.

(NETE-NASDAQ)

NETE: LOI to Create JV for Mobile Payment Services in the Middle East, Asia and Africa

Using an industry average of EV to GM of 6.5X we believe the stock could be worth \$4.68 per share by next year if NETE could reach profitability.

Current Price (07/22/16) \$2.16
Valuation \$3.70

OUTLOOK

Net Element is a software and services company for global online and mobile payments. It operates a merchant processor in the US with an attractive merchant offering from Aptito and a mobile payment processor in primarily in Russia. It announced an LOI to create a joint venture with two companies to provide low cost money transfer services via mobile phone, and SaaS-based payroll, remittance and merchant management platform primarily targeted to customers in Middle East. The deal should close before year end.

SUMMARY DATA

52-Week High \$4.90
52-Week Low \$0.62
One-Year Return (%) 21.7
Beta 0.58
Average Daily Volume (sh) 541,228

Shares Outstanding (mil) 11.9
Market Capitalization (\$mil) \$26
Short Interest Ratio (days) N/A
Institutional Ownership (%) 29
Insider Ownership (%) 30

Annual Cash Dividend \$0.00
Dividend Yield (%) 0.00

5-Yr. Historical Growth Rates
Sales (%) 179
Earnings Per Share (%) N/A
Dividend (%) 0

P/E using TTM EPS N/M
P/E using 2015 Estimate N/M
P/E using 2016 Estimate N/M

Risk Level High
Type of Stock Small-Blend
Industry Internet Commerce

ZACKS ESTIMATES**Revenue**

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2014	4.8 A	4.9 A	6.0 A	5.4 A	21.2 A
2015	5.5 A	6.9 A	12.7 A	15.1 A	40.2 A
2016	11.3 E	12.1E	12.5 E	13.9 E	50.0 E
2017					56.0 E

Earnings per Share

(Non-GAAP EPS before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2014	-\$0.78 A	-\$0.25 A	-\$0.48 A	\$0.01 A	-\$1.86 A
2015	-\$0.36 A	-\$0.64 A	-\$0.43 A	-\$0.22 A	-\$1.54 A
2016	-\$0.11 A	-\$0.12 E	-\$0.11 E	-\$0.10 E	-\$0.49 E
2017					-\$0.35 E

Zacks Projected EPS Growth Rate - Next 5 Years **25%**

WHAT'S NEW

Net Element announced a binding letter of intent to create a joint venture with Paystar and Nexcharge to provide mobile money transfer and a comprehensive remittance and an e-wallet platform for emerging markets as well as a proprietary payment processing, fraud management and merchant management platform. [Paystar](#) was founded in 2004, is headquartered in Nevada, and has 30 employees with most in Qatar. This joint venture will provide Net Element with 51% ownership, which means it will consolidate 100% of revenues with its own, and needs to subtract off 49% of the profits as minority interest. The joint venture requires the company to contribute \$3.4 million in cash or equivalents to acquire the 51% ownership. Net Element will also have an exclusive option to buy the other 49% within 12 months. The money will not be paid out all at once, but will be contributed, as the operation requires based on business developments. There are also a series of earn out payments available to current management of these businesses should they achieve undisclosed EBITDA hurdle rates.

The main product provided by this joint venture is a service to allow the unbanked to send money to other countries with only a mobile phone, an email address, and a government ID for competitively low prices. This is targeted primarily at migrant workers seeking to send money home. Paystar's technology allows users to transfer from their payroll cards or eWallets to a global network of beneficiary banks, via SMS or the Paystar Mobile App. As seen below, Paystar's pricing can be as low as \$8.17 per transaction. According to its web site, Paystar serves Egypt, Ethiopia, Sudan, Kenya, India, Pakistan, Indonesia, Philippines, Vietnam, UAE, Jordan, Lebanon, Syria, and Yemen. Paystar aims to expand its mobile payroll and remittance services throughout the Middle East, starting with Qatar, United Arab Emirates ("UAE"), Oman, and Saudi Arabia.

COMPETITIVE SERVICES & PRICING

PAGE 12

	Paystar	Moneygram		Western Union			Bank	Paypal
	Account to Account	Cash to Cash	Account to Cash	Cash to Cash	Debit Card to Cash	Debit Card to Account	Bank Wire	Account to Account
Money available within minutes during business hours?	Yes	Yes	Yes	Yes	Yes	No	No	No
Money available within minutes after business hours?	Yes	No	No	No	No	No	No	No
Transfer funds to Debit or ATM card?	Yes	No	No	No	No	Yes	Yes	Yes
Transfer Online?	Yes	No	Yes	No	Yes	Yes	No	Yes
Transfer by Phone?	Yes	No	No	No	Yes	Yes	No	No
Text Message confirmation of delivery to both parties?	Yes	No	No	No	No	No	No	No
Cost to transfer US\$300?	\$8.00	\$10.00	\$10.00	\$19.99	\$19.99	\$10.99	\$35.00 (avg)	\$9.00

*Miscellaneous voucher based systems (eg. Q-Kash) also exist. But these companies are limited to scratcher cards only. Other companies such as Luup only provide the software but not the service, their business model is locked to software sales and are not on a per transaction basis

Source: Company Presentation

Net Element believes there is great opportunity in the Middle East. Banking operations for consumers is still in its infancy and there are major technology improvements it can provide there. Also the relationships it has acquired with banks in the area will be a huge competitive advantage.

The Nexcharge acquisition brings technology that can be used throughout Net Element's worldwide card processing operations. Using Nexcharge's platform, Net Element can now bypass intermediaries like First Data and present transactions directly to Master Card and VISA and thus eliminate costs. This ability is however not unique to Net Element. Processors like Heartland can also transact directly, but it gives Net Element the chance to reap higher margins than they currently can.

The company is still working through due diligence and we estimate the deal could close by the fourth quarter. Once the deal closed we will revise forecasts to account for this new joint venture. We believes the company may be able to achieve operating synergy by eliminating redundant overhead and streamlining software development.

INVESTMENT THESIS

- Net Element is growth company in the payments industry that should benefit from the adoption of mobile and online payments in the US, Russia, the Middle East and ultimately globally.
- Its Aptito product line provides differentiation and value-added services to its generic card processing business. It recently rolled out new product for retail establishments after being heavily focused on restaurants. This business should increase margins as well as aid sales efforts by improving price/performance and customer stickiness.
- The company has an increasingly robust platform to create a global payment system complete with merchant from end and should be able to expand geographically.
- We believe the company could grow to \$50 million in revenues in 2016 through a combination of internal growth, acquisitions and change in revenue recognition. Its future addition of a Paystar and Nexcharge joint venture could add to that revenue forecast
- If NETE achieves our forecasts without further common stock dilution than that already predicted and no incremental debt, we believe its common stock could be worth \$4.68 per share based on an industry average valuation of approximately 6.5xs enterprise value to gross margin.

RISKS

- The company has new financial arrangements that are dilutive to common shareholders. It is uncertain if the company will be able to make accretive investments with these funds and shareholders may suffer further dilution.
- The company is losing money and may not be able to reach profitability or positive cash flow.
- The company is involved in a number of lawsuits with former management and business partners.

- The mobile and online payment market is still in its infancy and there is no assurance countries will adopt this method to pay for goods and services.
- The company is somewhat dependent on Russia and due to oil prices and political turmoil, and this could affect payment volumes.
- Future acquisitions may not be successfully integrated operationally or technologically. Purchased portfolios may not yield expected profits.
- The merchant acquirer market in the US is competitive and larger companies have an advantage due to economies of scale.
- Operations in Russia and the United Federation and the Middle East face considerable political risk and the company may be prohibited from certain financial transactions by governments regulation and restrictions.
- Currency, particularly the ruble, has fluctuated dramatically and could affect reported earnings and operations.

VALUATION

Due the variation in reporting of revenues of the various competitors of Net Element, we have chosen to use gross margin contribution as a more accurate way to value the companies. Using Net Element's peer group we find an average valuation of 6.5 times the enterprise value to trailing twelve-month gross margin. If we use that multiple and apply it Net Element's projected gross margin for 2016, we see that the stock could be worth \$4.68 by next year were it to achieve this forecast. We will have to revisit our forecast once the new joint venture deal closes given the uncertainty in the timing, potential revenue contribution and cash needs.

<u>Company</u>	<u>Ticker</u>	<u>Gross Margin</u>	<u>%</u>	<u>EV/GM</u>	<u>Included in Average?</u>	<u>Enterprise Value</u>
Cielo	CIOXY				n	28,260
EVERTEC	EVTC	206	54%	8.9	y	1,840
First Data	FDC	4,540	58%	6.7	y	30,410
Global Payments	GPN	1,750	61%	6.5	y	11,330
JetPay	JTPY	17	39%	2.6	y	44
PayPal	PYPL	9,250	96%	4.6	y	42,930
Qivi	QIWI	79	53%	3.1	y	244
Total System Services	TSS	924	32%	12.1	y	11,190
Vantiv	VNTV	1,680	51%	7.2	y	12,150
Average			56%	6.5		13,767
Net Element	NETE	7.89	17%			
					Market Value	55.6
					EV	51.1
					Share price	\$4.68

INCOME STATEMENT

Dollars in Millions	2014				2014				2014	2015	2016E	2017E
	Q1 2015 31-Mar	Q2 2015 30-Jun	Q3 2015 30-Sep	Q4 2015 31-Dec	Q1 2016 31-Mar	Q2 2016E 30-Jun	Q3 2016E 30-Sep	Q4 2016E 31-Dec				
North America Transaction	\$5.2	\$6.3	\$7.8	\$8.1	\$7.9	\$8.0	\$7.5	\$8.2	\$19.3	\$27.39	\$31.55	\$34.08
Yr-over-yr Growth	26.4%	37.1%	41.4%	58.3%	51.7%	27.6%	-4.2%	1.1%	30.6%	41.7%	15.2%	8.0%
Credit card cost of service	4.6	5.5	6.5	7.0	6.7	6.9	6.5	7.1	15.9	23.5	27.0	28.6
Gross margin	0.6	0.8	1.3	1.2	1.2	1.1	1.1	1.1	3.4	3.9	4.5	5.5
Gross margin %	11.1%	13.1%	17.1%	14.3%	15.3%	14.0%	14.0%	14.0%	17.6%	14.2%	14.3%	16.0%
Mobile payments	0.4	0.3	2.8	5.6	2.0	2.3	3.0	3.5	1.9	9.0	10.8	13.0
Yr-over-yr Growth	-	-2.2%	470.2%	NM	448.9%	594.8%	7.3%	-37.0%	-52.8%	385.5%	19.3%	20.0%
Cost of Service	0.0	0.0	2.8	5.3	1.8	2.1	2.8	3.2	0.0	8.1	10.0	11.9
Gross Margin	0.349	0.3	0.0	0.216	0.178	0.2	0.2	0.3	1.9	0.9	0.8	1.0
Gross margin %	96.2%	95.5%	1.3%	3.9%	8.9%	7.5%	7.5%	7.5%	100%	10.2%	7.8%	8.0%
PayOnline	-	0.3	2.1	1.4	1.4	1.8	2.0	2.2	0%	3.8	7.4	8.5
Yr-over-yr Growth	-	NA	NA	NA	NA	NA	-2.6%	52.1%	NA	NA	95.0%	15.0%
Online Solutions Cost of Service	-	0.0	1.5	0.9	0.9	1.2	1.3	1.5	0.0	2.4	4.9	5.5
Gross Margin	-	0.3	0.6	0.5	0.5	0.6	0.7	0.7	0.0	1.4	2.5	3.1
Gross margin %	-	100.0%	29.0%	37.9%	35.1%	34.0%	34.0%	34.0%	NA	38.1%	34%	36.0%
Total revenues	5.5	6.9	12.7	15.1	11.3	12.1	12.5	13.9	21.2	40.2	49.8	55.6
Yr-to-yr Growth	14.4%	40.6%	110.3%	179.3%	103.2%	75.2%	-1.4%	-8.0%	13.0%	89.8%	23.7%	11.6%
Costs and expenses:												
Cost of revenues	4.6	5.5	10.7	13.2	9.4	10.2	10.5	11.7	15.9	34.0	41.9	46.0
Gross Margin	0.9	1.4	2.0	1.9	1.9	1.9	2.0	2.2	5.3	6.3	7.9	9.6
% of Sales	16.7%	20.8%	15.5%	12.7%	16.7%	15.7%	15.6%	15.5%	25.1%	15.6%	15.9%	17.2%
G&A	2.6	3.2	2.8	5.0	2.4	2.6	2.6	2.7	11.4	13.6	10.2	11.3
Provision for loan losses	0.0	0.1	0.3	0.2	0.3	0.1	0.1	0.1	(1.2)	0.6	0.6	0.6
Depreciation and amortization	0.4	0.6	0.9	0.6	0.9	0.9	0.9	0.9	2.4	2.5	3.6	3.6
Total operating expenses	3.1	3.9	3.9	5.9	3.6	3.5	3.5	3.6	12.6	16.8	14.3	15.4
Loss from operations	(2.2)	(2.5)	(1.9)	(3.9)	(1.7)	(1.6)	(1.6)	(1.5)	(7.2)	(10.5)	(6.4)	(5.9)
Loss from operations ex-one time	(2.2)	(2.5)	(1.9)	(3.9)	(1.7)	(1.6)	(1.6)	(1.5)	(8.4)	(10.5)	(6.4)	(5.9)
Interest expense, net	(0.1)	(1.3)	(1.6)	(0.6)	(0.2)	(0.2)	(0.2)	(0.2)	(3.7)	(3.6)	(0.7)	(0.7)
Other expense	0.0	(0.0)	(0.0)	(0.0)	(0.0)	0.0	0.0	0.0	(0.2)	(0.1)	(0.0)	(0.0)
Gain on asset disposal	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gain on change in conversion derivative	0.0	2.0	(1.1)	(27.9)	0.0	0.0	0.0	0.0	0.0	(26.9)	0.0	0.0
One-time charges	0.0	0.0	0.1	27.7	0.0	0.0	0.0	0.0	1.0	27.7	0.0	0.0
Total non-operating expenses	(0.1)	0.7	(2.6)	(0.8)	(0.2)	(0.2)	(0.2)	(0.2)	(2.9)	(2.8)	(0.7)	(0.7)
Pretax operating income (loss)	(2.2)	(1.8)	(4.5)	(4.8)	(1.9)	(1.8)	(1.8)	(1.7)	(10.1)	(13.3)	(7.1)	(6.5)
Income tax provision	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Operating Loss	(2.2)	(1.8)	(4.5)	(4.8)	(1.9)	(1.8)	(1.8)	(1.7)	(10.3)	(13.3)	(7.1)	(6.5)
Minority interest	0.0	0.0	0.0	(0.1)	0.0	0.0	0.0	0.0	0.0	(0.1)	0.0	0.0
Discontinued operations:												
Loss from operations of discontinued	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loss on sale of assets of discontinued	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net loss	(2.2)	(1.8)	(4.5)	(4.9)	(1.8)	(1.8)	(1.8)	(1.7)	(10.2)	(13.4)	(7.1)	(6.5)
Preferred dividend	0.0	(0.5)	(0.6)	(0.4)	0.0	0.0	0.0	0.0	0.0	(1.6)	0.0	0.0
Net loss to common stock	(2.2)	(2.3)	(5.1)	(5.3)	(1.8)	(1.8)	(1.8)	(1.7)	(10.2)	(15.0)	(7.1)	(6.5)
Foreign currency translation gain (loss)	(0.1)	(0.1)	(0.2)	0.1	(0.0)	0.0	0.0	0.0	(1.1)	(0.3)	0.0	0.0
Comprehensive loss	(2.3)	(1.9)	(5.3)	(5.0)	(1.9)	(1.8)	(1.8)	(1.7)	(11.3)	(15.3)	(7.1)	(6.5)
Earnings ex-one time charge	(2.3)	(3.8)	(3.5)	(2.9)	(1.6)	(1.7)	(1.7)	(1.6)	(11.2)	(12.6)	(7.1)	(6.5)
Stock-based compensation	0.6	0.6	0.6	2.5	0.4	0.4	0.4	0.4	4.3	4.3	1.4	1.4
Adjusted Non-GAAP Earnings	(1.6)	(3.2)	(2.9)	(2.1)	(1.3)	(1.4)	(1.3)	(1.2)	(6.9)	(9.8)	(5.7)	(5.1)
Yr-to-yr Growth	-54%	174%	32%	-6056%	-23.1%	-57.7%	-55.5%	-41.3%	-64%	42%	-42%	-10%
GAAP EPS	(\$0.51)	(\$0.38)	(\$0.78)	(\$0.52)	(\$0.17)	(\$0.16)	(\$0.15)	(\$0.14)	(\$2.74)	(\$2.10)	(\$0.61)	(\$0.45)
Loss per share - discontinued	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Non-GAAP EPS	(\$0.36)	(\$0.64)	(\$0.43)	(\$0.22)	(\$0.11)	(\$0.12)	(\$0.11)	(\$0.10)	(\$1.86)	(\$1.54)	(\$0.49)	(\$0.35)
Yr-to-yr Growth	-	-	-	-	-69%	-82%	-74%	-54%	173%	-17%	-68%	-28%
Share outstanding (new)	4.6	5.0	6.9	9.5	11.3	11.5	11.9	12.2	3.7	6.4	11.7	14.6
Yr-to-yr Growth	0%	8%	49%	106%	145%	131%	74%	29%	31%	72%	83%	25%
Fully diluted shares (new)	6.07	6.78	9.00	12.79	12.76	13.65	14.55	15.44	4.6	8.7	14.1	16.1
Yr-to-yr Growth	0%	12%	48%	111%	110%	101%	62%	21%	24%	87%	63%	14%

HISTORICAL STOCK PRICE



DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research (“Zacks SCR”), a division of Zacks Investment Research (“ZIR”), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Lisa Thompson, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESTMENT BANKING AND FEES FOR SERVICES

Zacks SCR does not provide investment banking services nor has it received compensation for investment banking services from the issuers of the securities covered in this report or article.

Zacks SCR has received compensation from the issuer directly or from an investor relations consulting firm engaged by the issuer for providing non-investment banking services to this issuer and expects to receive additional compensation for such non-investment banking services provided to this issuer. The non-investment banking services provided to the issuer includes the preparation of this report, investor relations services, investment software, financial database analysis, organization of non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per-client basis and are subject to the number and types of services contracted. Fees typically range between ten thousand and fifty thousand dollars per annum. Details of fees paid by this issuer are available upon request.

POLICY DISCLOSURES

This report provides an objective valuation of the issuer today and expected valuations of the issuer at various future dates based on applying standard investment valuation methodologies to the revenue and EPS forecasts made by the SCR Analyst of the issuer’s business. SCR Analysts are restricted from holding or trading securities in the issuers that they cover. ZIR and Zacks SCR do not make a market in any security followed by SCR nor do they act as dealers in these securities. Each Zacks SCR Analyst has full discretion over the valuation of the issuer included in this report based on his or her own due diligence. SCR Analysts are paid based on the number of companies they cover. SCR Analyst compensation is not, was not, nor will be, directly or indirectly, related to the specific valuations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports and articles are based on data obtained from sources that it believes to be reliable, but are not guaranteed to be accurate nor do they purport to be complete. Because of individual financial or investment objectives and/or financial circumstances, this report or article should not be construed as advice designed to meet the particular investment needs of any investor. Investing involves risk. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports or articles or tweets are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.