



Net Element, Inc.
(Nasdaq CM: NETE, Target Price: \$10.30)

Net Element, Inc. (Nasdaq CM: NETE, "Net Element") is a global financial technology and value-added solutions company that supports payment technology solutions, online payments and value-added transactional services in emerging countries and in the United States. The company's headquarters is located in Miami Beach, Florida.

Investment Highlights

On November 14, 2017, Net Element reported 3Q17 results, with highlights as follows:

- 3Q17 revenues grew by 6.4% YoY to reach \$14.9mn, versus \$14.0mn in the year-ago period. Revenue for the first nine months of 2017 were \$44.6mn, versus \$39.0mn in the comparable year-ago period.
- NETE benefitted from a 17.3% annual increase in its North American Transaction Solutions segment, which was attributed an increase in merchants and higher uptake of value-added services.
- Net loss to common shareholders in 3Q17 was (\$1.7mn), with a loss per share of (\$0.90), versus a loss of (\$3.5mn), or (\$2.47) per share in 3Q16.

NA Transaction revenues rise by 17.3% YoY

NETE's revenues grew by 6.4% in 3Q17 to reach \$14.9mn, as strong North American Transaction Solutions were offset by a decline in mobile solutions. NETE 's NA Transactions segment grew revenues by 17.3% YOY to \$13.1mn. This is a segment that now comprises 88.1% of total revenues. NA Transactions includes Unified Payments, a provider of comprehensive turnkey, payment processing solutions, as well as Aptito, a cloud based Software-as-a-Service ("SaaS") restaurant management solution.

NETE made several enhancements to its service offerings in the NA Transaction Solutions segment during the quarter. These included the launch of web-based, integrated same-day ACH payment processing, as well as the launch of a payment acceptance module for popular mobile instant messaging platforms, including Facebook Messenger. NETE also launched what may have the potential to become a popular new feature for its merchant customers in the new "Zero Fee" program. Zero Fee is a new program that lets merchants pass along credit card processing fees directly to its customers.

NETE maintains Nasdaq CM listing status

NETE disclosed in its 10-Q that it was able to meet continued listing requirements for the Nasdaq CM ahead of the October 20, 2017 deadline for reaching compliance. The company completed a 1:10 reverse share split on October 5, 2017, and the was able to raise \$1.1mn after the end of the quarter in order to meet the \$2.5mn shareholders' equity requirement. Funds were raised as part of the company's previously announced \$10mn stock purchase agreement with Cobblestone Capital.

New target of \$10.30 for NETE

Our price target for NETE moves to \$10.30 following the reverse split and recent results. The target suggests a fair valuation of 0.5x EV / Revenue on 2017E revenues of \$63.3mn. We continue to see NETE as an intriguing high risk / high reward growth company in the financial technology space.

Stock Details (11/19/17)

Nasdaq CM:	NETE
Sector / Industry	Financial Tech / Mobile Payments
Price target	\$10.30
Recent share price	\$4.13
Shares o/s (mn)	2.5
Market cap (in \$mn)	10.1
52-week high/low	15.40 / 2.60

Source: Thomson Reuters, SeeThruEquity Research

Key Financial (\$mn, unless specified)

	FY15A	FY16A	FY17E
Revenues	40.2	54.2	63.3
EBITDA	(7.2)	(8.7)	(4.9)
Operating Inc. (Loss)	(10.5)	(8.8)	(7.4)
Net Income	(13.3)	(13.5)	(8.7)
EPS (\$)	(23.22)	(10.33)	(4.30)

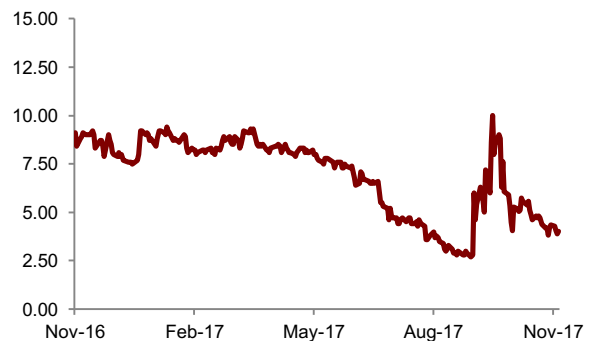
Source: SeeThruEquity Research

Key Ratios

	FY15A	FY16A	FY17E
Operating Margin (%)	(26.1)	(16.3)	(11.7)
EBITDA margin (%)	(18.0)	(16.0)	(7.7)
Net margin (%)	(32.9)	(24.8)	(13.8)
P/Revenue (x)	0.3	0.2	0.2
EV/EBITDA (x)	NM	NM	NM
EV/Revenue (x)	0.4	0.3	0.3

Source: SeeThruEquity Research

Share Performance, LTM



Source: Thomson Reuters

QUARTERLY FINANCIAL SUMMARY

Figure 1. Income Statement Summary

Figures in \$000, unless specified	3Q17	3Q16	9 mos 2017	9 mos 2016
Total Revenue	14,901	14,010	44,604	38,964
YoY Change %	6.4%		14.5%	
Service Fees	14,901	12,874	43,263	34,356
% Revenue Mix	100.0%	91.9%	97.0%	88.2%
Branded Content	0	1,135	1,341	4,608
% Revenue Mix	0.0%	8.1%	3.0%	11.8%
Cost of Service Fees	12,757	10,684	36,232	28,286
Cost of Branded Content	0	1,011	1,303	4,279
Gross Profit	2,145	2,314	7,069	6,398
Gross Margin	14.4%	16.5%	15.8%	16.4%
General and Administrative	2,358	2,285	7,788	6,372
Non-cash compensation	111	733	836	3,108
Bad debt Provisions	320	301	1,465	678
Depreciation & Amortization	630	765	1,860	2,498
Operating Expenses	3,419	4,083	11,950	12,656
Operating Income (Loss)	(1,274)	(1,769)	(4,881)	(6,258)
Operating Margin %)	(8.6%)	(12.6%)	(10.9%)	(16.1%)
Interest & Other Items	(396)	(1,734)	(1,043)	(4,516)
Pre-Tax Income	(1,670)	(3,503)	(5,924)	(10,774)
Minority Interest	(33)	34	93	110
Net Inc. (loss) attributable to stockholders	(1,703)	(3,470)	(5,830)	(10,664)
Foreign Currency & Preferred Dividends	92	(97)	(42)	(623)
Comprehensive Income (loss)	(1,610)	(3,566)	(5,872)	(11,286)
EPS	(0.90)	(2.47)	(3.29)	(8.65)
Avg Shares outstanding in period	1,891,023	1,403,020	1,770,947	1,232,593

Source: Company Form 10Q, SeeThruEquity Research

NETE revenues rise by 6.4% in 3Q17 with 17.3% organic growth in NA Transactions segment

- **NETE reports 3Q17 revenues of \$14.9mn:** NETE reported 3Q17 revenues of \$14.9mn on November 14, 2017. Results were led by strong organic growth in North American Transaction Solutions, which grew by 17.3% YoY to reach \$13.1m.
- For the first nine months of 2017, NETE reported revenue of \$44.6mn, versus \$39.0mn in the comparable year-ago period, representing an increase of 14.5%.
- During its conference call with investors following results, management cited organic growth in its North American Transactions segment as the primary driver of the top line performance. The company also benefitted from more global merchants using its platform as well as increased uptake of value-added services.
- During the quarter, NETE made several enhancements to its service offerings. These included the launch of web-based, integrated same-day ACH payment processing, and launching a payment acceptance module for popular mobile instant messaging platforms, including Facebook Messenger. NETE also launched “Zero Fee”, a new program that lets merchants pass along credit card processing fees directly to consumers.
- **NETE Gross Margins come in to 14.4%:** NETE gross profit contracted in the quarter, which management attributed to a decline in its mobile solutions segment, which has ceased seeking new customers, the impact of storms in the US, and a lower gross margin percentage of revenue in Online Solutions. We will continue to monitor gross profit margin, which management has indicated should trend towards the high teens and eventually 20%+ range over time, considering

historical margins in the NA Transaction business in the mid-to-high teens and 30%+ historical margins in the Online Solutions business.

- **3Q17 Loss of (\$0.90) per share.** Net loss to common shareholders in 3Q17 was (\$1.7mn), with a loss per share of (\$0.90), versus a loss of (\$3.5mn), or (\$2.47) per share in 3Q16. On its call with investors, NETE noted that, on a non-GAAP basis, which eliminates noncash compensation and stock value guarantees, the company reported adjusted non-GAAP loss of \$1.6mn, as compared to \$2.7mn on the same basis in 3Q16.
- **Balance Sheet review:** NETE ended the quarter with \$0.9mn in cash, current assets of \$7.0mn, and total assets of \$20.4mn. The company had \$7.4mn in total debt and shareholders' equity of \$1.9mn.
- NETE effected a 1:10 reverse stock split on October 5, 2017. During the third quarter, the company raised \$1.1mn in share sales to Cobblestone Capital Partners LLC, which, along with the reverse split, has enabled NETE to remain in compliance for its Nasdaq CM listing states. NETE had 2.5mn shares outstanding as of November 11, 2017.
- NETE has used (\$2.6mn) in operating cash flow in the first nine months of 2017. We continue to expect NETE to require additional financing to execute its growth plan.

North American Transaction Solutions leads 3Q17 results

- The key driver of growth in 3Q17 was an increase in the number of merchants using NETE's NA Transactions Solutions segment, as well as an increase in use of value-added services. NA Transaction revenues grew by 17.3% to \$13.1mn from \$11.2mn in the year-ago period. Sequentially, NA Transaction revenues contracted due to storm disruptions Texas and Florida, which reduced activity on the platform. Management expects 4Q17 to return to historical growth trends, suggesting YoY growth could approach 30% in 4Q17.
- NA Transactions is NETE's largest operating segment, as illustrated below, at 88.1% of revenues. The segment consists of the business assets of Unified Payments, a provider of comprehensive turnkey, payment processing solutions, as well as Aptito, a cloud based Software-as-a-Service ("SaaS") restaurant management solution.
- NETE also grew its Online Solutions business, which contributed \$1.8mn in revenues during the quarter.

Figure 2. FY 3Q17 Operating Segment Performance and Business Mix

Revenue by Segment	3Q17	3Q16	YoY		
			Change	3Q17 Mix	3Q16 Mix
NA Transaction Solutions	\$13,123.2	\$11,186.3	17.3%	88.1%	79.8%
Mobile Solutions	\$0.0	\$1,226.2	(100.0%)	0.0%	8.8%
Online Solutions	\$1,777.9	\$1,597.1	11.3%	11.9%	11.4%
Total Revenue	\$14,901.1	\$14,009.7	6.4%	100.0%	100.0%

Gross Profit by Segment	2Q17	2Q16	Change
NA Transaction Solutions	\$1,844.1	\$1,600.3	15.2%
Mobile Solutions	\$0.0	\$180.4	(100.0%)
Online Solutions	\$300.4	\$533.7	(43.7%)
Total Revenue	\$2,144.5	\$2,314.5	(7.3%)

Source: Company Earnings Release, SeeThruEquity Research

- The Mobile Solutions continues to decline as the company is not investing new resources into this business.
- The Online Solutions gross profit declined due to decrease in gross margin as a percentage of revenues.

Updating price target, estimates following reverse split and results

- **Updating Estimates:** We are updating our estimates following 3Q17 results. We now expect 2017E revenues to come in at \$63.3mn, with FY2018E revenues expected to be \$76.9mn. We do not expect NETE to begin generating adjusted profitability until the end of 2019E at the earliest. The company is focused on building enterprise value through growth and is more likely to seek external financing as needed, rather than to make sharp cost cuts.
- **Compelling valuation:** At the recent price of \$4.13, NETE trades at a market capitalization of approximately \$10mn and an Enterprise Value of \$16.6mn. Although we acknowledge that likely dilution from the company's financing needs should warrant a discount to peers in the space, recent prices suggest a valuation of just 0.3x EV/2017 revenues of \$63.3mn. We see this as representing a steep discount to fair value, especially in light of the strong annual growth in NETE's core NA Transactions segment.
- We attribute the depressed valuation to concerns over the company's balance sheet and potential dilution that could occur with new capital raising activities. We note, however, that if NETE is able to show robust growth, or if it is able to demonstrate that it is approaching a pathway toward generating recurring positive cash flows, sentiment could improve on the company. Indeed, there would potentially be substantial opportunity for upside if the valuation gap between NETE versus peers were to close.

Company	Mkt cap (\$ mn)	EV/Revenue(x)		P/E Ratio	
		TY	NY	TY	NY
Global Payments Inc	15,949	5.4x	4.7x	25.1x	21.3x
Vantiv	11,431	6.9x	6.3x	21.0x	18.6x
Net 1	536	0.5x	0.4x	5.7x	5.1x
PayPal Holdings	93,240	6.5x	5.4x	41.6x	34.2x
WEX	5,190	6.1x	5.4x	22.6x	19.1x
Bottomline Technologies	1,352	3.5x	3.2x	30.7x	26.0x
EuroNet Worldwide	4,687	2.0x	1.8x	19.5x	16.9x
VeriFone Systems	1,922	1.5x	1.4x	13.2x	10.8x
Planet Playment	222	3.7x	3.4x	26.4x	20.4x
Average		4.0x	3.6x	22.9x	19.2x
Net Element Inc	10.	0.4x	0.3x	N/A	N/A
Premium (discount)		(89.7%)	(92.6%)	N/A	N/A

* STE Research, Yahoo!Finance estimates for peer companies as of 10/16/17

- **\$10.30 Price target:** We are updating our price target to \$10.30 at this time. NETE trades at a steep discount to peers on an EV / Revenue basis. NETE is not yet profitable, which accounts for the discount in the target versus the peer group average.
- If achieved, the target price of \$10.30 would imply an EV/Revenue multiple of 0.5x 2017E revenues of \$63.3mn, versus an average of 4.0x for the peer group.
- We continue to see NETE as an intriguing high risk / high reward growth company in the financial technology space. We would look to revisit the target following company guidance for 2018E and/or evidence of NETE approaching recurring free cash flow – which would potentially justify a narrowing valuation gap versus peers in the industry.

About Net Element, Inc.

Net Element, Inc. (NASDAQ: NETE) operates a payments-as-a-service transactional and value-added services platform for small to medium enterprise ("SME") in the US and selected emerging markets. In the US it aims to grow transactional revenue by innovating SME productivity services such as its cloud based, restaurant and retail point-of-sale solution Aptito. Internationally, Net Element's strategy is to leverage its omni-channel platform to deliver flexible offerings to emerging markets with diverse banking, regulatory and demographic conditions such as UAE, Kazakhstan, Kyrgyzstan and Azerbaijan where initiatives have been recently launched. Net Element was named in 2016 by South Florida Business Journal as one of the fastest growing technology companies. Further information is available at www.netelement.com.

Contact

Ajay Tandon
SeeThruEquity
www.seethruequity.com
(646) 495-0939
info@seethruequity.com

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