

Discovery Group

Due for a Change in Narrative in Our View: From a Negative-EV, In-Turnaround-Mode Co. to a Profitable, Leading & Growing Fintech; Reit. Buy, PT from \$7 to \$8

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Summary and Recommendation

Buy-rated UEPS (Buy, \$8 PT) reported 3Q22 earnings results AMC 5/11, beating on top and bottom: revs/adj. EBITDA of \$35.2M/(\$2.9M) versus consensus of \$29.4M/(\$3.6M). Adjusted for restructuring costs and corporate public-co costs, adj. EBITDA was \$0.34M. UEPS now breaks its business into Consumer Group (“Consumer”) and Merchant Group (“Merchant”) with Consumer at \$16.4M in revs., up 6% Y/Y and Merchant at \$18.5M up 58% Y/Y. Consumer was helped by higher lending and insurance revenues and higher account holder fees. Its EPE customers grew to 1.1M and its loan book grew 6% Y/Y to \$24.7M with loan-loss rates limited to under 1%. Merchant revenues were up significantly due to higher POS equipment sales and processing fees, much of which was pent-up demand from earlier quarters when supply chain issue impacted shipments. The Connect Group acquisition, to be classified into the Merchant segment, closed on 4/14/22 and had no contribution to 3Q22 results. Merchant had \$1.3M in segment EBITDA helped by an increase in hardware sales. UEPS highlighted segment details from all segment heads on an extensive video earnings call showing improvements in important business metrics and momentum building in its businesses. Connect’s business head also showcased stellar 5-year CAGR growth rates on value processed, devices sold, loans advanced to its formal and informal merchant businesses. We believe, Net 1’s turnaround and growth prospects remain on track with the ability to gain significantly more new accounts, improve revenues and show profitability given its reduced fixed-cost structure. The Connect Group acquisition provides positive momentum for the Merchant Group in adding ~\$90M in revenues and ~\$23M in EBITDA, both growing at least 20+% per annum. We are raising 4Q22E, and introducing FY23E, estimates to reflect the Connect Group close. With a current valuation of ~1x FY23E EV/revenue (and 7x EV/EBITDA), we believe Net1’s narrative is now due for a change from a negative-EV, in-turnaround-mode company to one that is profitable and larger, and encompassing consumers and merchants with solid 20+% organic growth prospects. We reiterate a Buy rating and we are raising our PT from \$7 to \$8, based on 2x FY23E EV/revenue.

Key Points

- **Consumer Group—putting finishing touches on the turnaround.** Overall revenues of \$35.2M were ahead of our estimates of \$29.4M while adj. EBITDA of \$0.34M, net of restructuring and public company costs, was significantly ahead of our \$(3.6M) estimate. Revenues were up 27% in rand terms and up 22% in USD terms. UEPS switched business unit reporting to Consumer and Merchant from Processing, Financial and Technology/Telecom. Consumer Group catering to processing and financial services for consumers while Merchant Group catering such services to merchants. The Consumer Group ended with Easypay (EPE) accounts of ~1.1M showing continued momentum with 38k gross adds. Consumer Group reported revenues of \$16.4M, up 6% Y/Y helped largely by higher lending and insurance revenues, partially offset by lower airtime sales. Consumer group loss improved due to cost reduction initiatives that have collectively reduced \$19.2M in annual costs. ARPU was indicated to hold steady to slightly higher than earlier quarters with growth in financial loan-book at solid loan-loss reserves of <1%. The company’s cost-cutting plan, “Project Spring,” to reduce operating costs by 300M ZAR (\$19.2M) over the next four quarters, is about half done with \$10M more to go over the next few quarters. The company ended the quarter with \$183.7M in unrestricted cash and \$114M in net cash which should result in \$126M in net debt pro forma the Connect Group close. Mgmt. insists the large opportunity to gain significant new EasyPay Everywhere (EPE) accounts is still viable as it improves its brand and relationship with South Africa Social Security Agency (SASSA). **Contd. on Page 2...**

STOCK DATA	
Market Cap (mil)	\$246.1
52-Week Range	\$3.84–\$6.97
3-Month ADTV	86,337
Shares Outstanding (mil)	57.9
Float (%)	74.9
Short Interest	644,442
Beta	1.56
Enterprise Val. (mil)	\$300.0
Fiscal Year-End	June

FINANCIAL DATA				
EPS Operating	2021A	2022E	2023E	
1Q	\$(0.23)	\$(0.23)A	\$0.03	
2Q	\$(0.08)	\$(0.22)A	\$0.08	
3Q	\$(0.11)	\$(0.06)A	\$0.14	
4Q	\$(0.18)	\$(0.01)	\$0.15	
FY	\$(0.60)	\$(0.51)	\$0.41	
Rev. (mil) Operating	2021A	2022E	2023E	
1Q	\$35.1	\$34.5A	\$59.0	
2Q	\$32.3	\$31.1A	\$60.9	
3Q	\$28.8	\$35.2A	\$62.9	
4Q	\$34.5	\$53.7	\$64.9	
FY	\$130.8	\$154.5	\$247.8	
EBITDA (mil)	2021A	2022E	2023E	
1Q	\$(10.8)	\$(10.1)A	\$5.7	
2Q	\$(12.8)	\$(7.1)A	\$8.8	
3Q	\$(12.8)	\$(2.9)A	\$12.2	
4Q	\$(8.2)	\$3.2	\$13.1	
FY	\$(42.9)	\$(16.9)	\$39.9	

BALANCE SHEET DATA	
	3Q22
Cash & Equivalents	\$36.0
Total Liabilities	\$163.0
Total Stockholder Equity	\$252.0

\$ in millions except for per share data.

Analyst certification and important disclosures can be found on pages 5 - 8 of this report.

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- **Connect Group to juice growth rates & profits for the company, in our view.** Merchant Group reported revenues of \$18.5M, up 58% Y/Y haled largely by sales of POS systems and by processing fees, partially offset by lower prepaid airtime sales. The Connect Group acquisition, to be classified into the Merchant group segment, closed on 4/14/22 and hence had no contribution to 3Q22 results. The acquisition of Connect Group, a leading high-growth and profitable SA fintech platform servicing merchants for ZAR ~3.7B or \$240M in market value (and an implied EV of ZAR 4.8B or \$310M). Connect provides services to 8,600 formal and 35,000 informal merchants and has grown its revenues at 30% CAGR for the last 3 years and is estimated to have recorded ZAR 375M or ~\$23M in EBITDA for its YE 2/2022, growing 24% Y/Y. At revenues and EBITDA for YE 2/2022, \$90M and \$23M respectively, Connect was acquired at an EV/revenue of 3.4x and EV/EBITDA of 12.8x. Connect's high growth comes from serving micro-, small- and medium-sized (MSME) merchants with cash management and payment solutions, bill payments, payment acceptance and merchant lending solutions. UEPS has increased its total addressable market (TAM) 3x to \$11B by acquiring Connect. Mgmt. expects to have Connect Group audited financials with pro forma figures for its YE Feb. 2022 by the end of June, after which it can lay out combined business metrics and profitability.
- **Time for a change in narrative.** Consumer headed by Lincoln Mali, Net 1's SA head, has been spearheading a strong marketing push in local markets, brand-building with various stakeholders and has raised total salesforce personnel, up-skilling them to cross-sell products. These efforts have contributed to the positive new account growth experienced in the last two quarters. UEPS' new products, EPE lite and SmartOne, targeting cost-conscious customers are also helping them add new consumer accounts. A lot of work is going into financial inclusion for its financial services customers by offering transparent, easy-to-understand, competitively priced lending products in the most underserved sections of their society. Net 1 also officially changed its name to Lesaka Group with LSAK as its new ticker effective 5/18/22 with a concerted effort to build local brand and financial inclusion. Consumer has been cutting costs and lowering operating losses to inch closer to breakeven. With Connect Group, Lesaka should end the June quarter profitable and its narrative should begin to change to a growing and profitable fintech company, likely significantly more attractive to the market, in our view. We raise our PT from \$7 to \$8, moving away from an earlier sum-of-parts valuation methodology to one treating UEPS (Lesaka) as an operating (and profitable) fintech business. UEPS now trades at a ~\$300M EV for its entire collection of businesses, when they just bought Connect for that same valuation—we believe an investor now gets the \$136M revenue Consumer Group and its Mobikwik (and other private stakes) for free.

Valuation

Our \$8 price target is based 2x FY23E EV/revenue.

Risks

Changes in economic conditions. Deteriorating economic conditions, or a prolonged economic downturn or recession, could negatively affect operating results.

Credit risk. The micro-lending loan book exposes the company to credit risk, and the allowance for doubtful finance loans may not be enough to absorb the write-offs. Additional allowances may be required; and bad loans may be difficult to recover, which could negatively impact the business.

Changes in public market valuations. The company has made multiple investments in publicly traded companies. These businesses could see their publicly traded equity valuations decline, which could negatively affect the carrying value of those investments.

Operating in emerging markets, such as South Africa and other foreign markets. Foreign markets, including South Africa, South Korea, and India, have unique regulatory requirements and operating customs. In addition, political and economic instability, elevated levels of corruption, the lack of a well-developed legal system, adverse changes to the regulatory environment, and loss due to civil strife or terrorism could negatively impact Net 1's operations.

Currency risk. Changes in currency values could negatively impact U.S. dollar-reported operating results. Elevated levels of inflation and changes in interest rates could drive changes in currency value.

Terrorist attacks, other acts of violence, and natural disasters. A substantial portion of the business is concentrated in emerging markets. Terrorist attacks or natural disasters in these areas or elsewhere could severely affect operating results.

Key personnel. Given the tenure and expertise of the current management team, a departure could have a material, adverse effect on the company's ability to achieve its investment objectives.

Pandemic. A global health crisis could potentially slow demand for the company's products and services leading to a deterioration of financial results.

General industry risks. The company could miss our estimates and/or its financial guidance.

Net 1 UEPS Technologies, Inc. Model -- UEPS
B. Riley Securities
(\$000's)

	2020	1Q21 Sep	2Q21 Dec	3Q21 Mar	4Q21 Jun	2021	1Q22 Sep	2Q22 Dec	3Q22 Mar	4Q22E Jun	2022E	1Q23E Sep	2Q23E Dec	3Q23E Mar	4Q23E Jun	2023E
Revenue																
Processing	98,484	24,483	19,990	18,747	21,192	82,435	21,356	16,686	15,608							
IPG		1,209	478			1,693										
All Other	95,174	23,274	19,512	18,747	21,192	80,742	21,356	16,686	15,608							
Financial Services	46,870	8,265	9,709	10,192	10,830	38,996	10,626	9,297	9,217							
Technology	18,071	6,211	4,609	2,026	4,905	17,751	4,824	5,131	9,779							
Other									598							
Subtotal Operating Segments	163,425	38,959	34,308	30,965	36,927	139,182	36,806	31,114	35,202							
Intersegment Eliminations	(12,428)	(1,846)	(2,003)	(2,137)	(2,410)	(8,396)	(2,302)									
Revenue - Total	150,997	37,113	32,305	28,828	34,517	130,786	34,504	31,114	35,202	53,697	154,517	59,052	60,942	62,904	64,943	247,841
Consumer			16,259	16,236			17,164	16,639	16,429	17,086	67,318	17,428	17,776	18,132	18,495	71,831
Merchant - Existing			15,206	12,171			17,072	14,102	18,478	17,554	67,206	17,905	18,263	18,629	19,001	73,798
Merchant - Connect										18,750	18,750	23,400	24,570	25,799	27,088	100,857
Other			878	421			427	396	397	413	1,633	429	447	464	483	1,823
Subtotal			32,343	28,828			34,663	31,137	35,304	53,803	154,907	59,162	61,056	63,023	65,067	248,309
Intersegment Eliminations			(38)	0			(159)	(23)	(102)	(106)	(890)	(110)	(115)	(119)	(124)	(468)
Revenue - Total	150,997	37,113	32,305	28,828	34,517	130,786	34,504	31,114	35,202	53,697	154,517	59,052	60,942	62,904	64,943	247,841
Operating Expenses																
Cost of Goods Sold, IT Processing, Servicing and Support	109,006	26,460	24,339	23,096	22,353	96,248	24,207	20,580	23,008	23,928	91,723	26,051	26,616	26,924	27,241	106,832
Selling, General and Administration	75,256	18,528	22,097	18,892	24,546	84,063	20,627	17,746	15,184	12,678	66,235	10,178	7,678	5,178	5,282	28,316
Depreciation and Amortization	4,647	923	1,074	1,132	1,218	4,347	895	726	463	463	2,547	477	491	506	521	1,995
Transactions Costs/ Impairment Loss	6,336								5,852		5,852					-
Transactions Costs/ Impairment Loss	6,336							1,489	116		1,605					-
Operating Expenses - Connect										14,208	14,208					-
Operating Expenses - Total	201,581	45,911	47,510	43,120	48,117	184,658	45,729	40,541	44,623	51,278	160,505	54,126	52,902	51,449	52,638	211,116
Operating Income	(44,248)	(10,775)	(15,205)	(14,292)	(13,600)	(53,872)	(11,225)	(9,427)	(9,421)	2,419	(27,654)	4,926	8,039	11,455	12,305	36,725
Operating Margin	-29.3%	-29.0%	-47.1%	-49.6%	-39.4%	-41.2%	-32.5%	-30.3%	-26.8%	4.5%	-17.9%	8.3%	13.2%	18.2%	18.9%	14.8%
Change in Value of Securities			15,128	10,814	23,362	49,304		(2,429)	6,494							
EBITDA	(30,949)	(9,852)	(14,131)	(13,160)	(12,382)	(49,525)	(10,330)	(6,272)	(8,958)	3,182	(22,378)	5,703	8,831	12,261	13,126	39,920
Transaction Costs		30		174		1,879	243	1,642	5,968		7,853					
Other (Allowance for doubtful loans recv. from equity inv)	(15,932)		13	360	4,000	4,739										
Adj. EBITDA	(46,881)	(10,800)	(12,792)	(12,800)	(8,208)	(42,907)	(10,087)	(7,059)	(2,990)	3,182	(16,954)	5,703	8,831	12,261	13,126	39,920
Other																
Interest Income	2,805	611	717	606	482	2,416	389	313	761	761	2,224	761	761	761	761	3,044
Interest Expense	7,641	747	677	744	814	2,982	816	765	691	3,668	5,940	3,668	3,668	3,668	3,668	14,670
Gain on Sale/Other	(15,932)			472												
Total Other Expense	(20,768)	(136)	40	(610)	(332)	(1,038)	(427)	(452)	70	(2,907)	(3,716)	(2,907)	(2,907)	(2,907)	(2,907)	(11,626)
Income Before Income Tax Expense	(65,016)	(10,911)	(117)	(4,088)	9,430	(5,619)	(11,652)	(12,308)	(2,857)	(487)	(27,304)	2,019	5,133	8,548	9,398	25,099
Income Tax Expense	2,656	(1,090)	3,468	2,171	3,011	7,560	186	98	470	(80)	674	50	127	211	232	619
Net (Loss) Income Before Earnings from Equity Accounted I	(67,672)	(9,821)	(3,518)	(6,259)	6,419	(13,179)	(11,838)	(12,406)	(3,327)	(407)	(27,978)	1,969	5,006	8,337	9,166	24,479
Earnings from Equity Accounted Investments	(29,542)	(19,137)	(1,016)	55	(4,780)	(24,878)	(1,156)	0	0	0	(1,156)	0	0	0	0	0
Net(Loss) Income Attributable to NET1	(78,358)	(28,958)	(4,534)	(6,204)	1,639	(38,057)	(12,994)	(12,406)	(3,327)	(407)	(29,134)	1,969	5,006	8,337	9,166	24,479
Diluted EPS - Consolidated	(\$1.37)	(\$0.51)	(\$0.08)	(\$0.11)	\$0.03	(\$0.67)	(\$0.23)	(\$0.22)	(\$0.06)	(\$0.01)	(\$0.51)	\$0.03	\$0.09	\$0.15	\$0.16	\$0.43
Average Shares Outstanding (Diluted)	57,119	56,638	56,568	56,921	56,937	56,898	56,809	56,608	56,626	56,698	56,898	56,959	57,109	57,259	57,409	57,409
Key Metrics																
Operating Cash Flow	(46,045)	(28,035)	(11,979)	(8,254)	(8,258)	(58,371)	(12,099)	(13,785)	(8,775)	356	(34,303)	2,746	5,797	9,143	9,987	27,674
Free Cash Flow	(51,983)	(29,535)	(15,002)	(8,903)	(8,596)	(62,656)	(12,797)	(13,974)	(9,609)	(444)	(36,824)	1,946	4,997	8,343	9,187	24,474
Revenue Growth - (YoY)	-9.2%	-22.6%	-20.4%	-21.0%	32.9%	-13.4%	-7.0%	-3.7%	22.1%	55.6%	18.1%	71.1%	95.9%	78.7%	20.9%	60.4%
Price	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31	\$4.31
Market Capitalization (\$ Millions)	246,182	244,110	243,808	245,330	245,398	245,398	244,847	243,980	244,058	244,367	244,367	245,493	246,140	246,786	247,433	247,433
Cash & CE (\$ Millions)	217,160	209,200	206,251	208,000	198,572	198,572	188,495	182,356	183,712	36,268	36,268	38,214	43,212	51,555	60,742	60,742
Total Debt (\$ Millions)	60,000	70,000	55,000	78,304	78,304	78,304	77,916	77,916	77,916	77,916	163,000	163,000	163,000	163,000	163,000	163,000
Private Investments (\$ Millions)	(30,978)	(35,090)	(43,843)	(52,374)	(42,878)	(42,878)	(25,464)	(20,192)	(17,570)	293,183	293,183	292,363	288,012	280,315	271,774	271,774
Current Enterprise Value of Operating Businesses	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF
Price-to-Earnings (TTM)	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF
EV to Revenue (TTM)	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF
EV to Adj. EBITDA (TTM)	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF
Net 1 Shareholders Equity	290,213	269,542	285,261	274,405	275,980	275,980	256,747	240,267	252,980	252,573	252,573	254,542	259,549	267,886	277,052	277,052
Book Value per Share	\$5.08	\$4.76	\$5.04	\$4.82	\$4.85	\$4.85	\$4.52	\$4.24	\$4.47	\$4.45	\$4.45	\$4.47	\$4.54	\$4.68	\$4.83	\$4.83

Source: B. Riley Securities, Research, Company Filings

*Closing price of last trading day immediately prior to the date of this publication unless otherwise indicated.

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