

# Hardman & Co

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## E-pay Asia Negotiations In China

2.38p 4.2.2008



We expect 2007 results to spring no surprises. The Indonesian operations have now been closed down, and the costs of closure are in line with management expectations. Meanwhile Malaysia, the remaining core business, is performing strongly.

- Negotiations are proceeding in China and an announcement is expected shortly. 2008 will be a year of investment in China, and though the business will be building up throughout the year, we do not expect it to do more than break even for the financial year as a whole. We have not included any contribution to profits for the year.
- We understand that total spending on the Chinese operations should not exceed AUD 600k in the current financial year.
- Malaysia is likely to continue to grow at around 15%. While the fundamentals are still secure, telcos have proven tardy to make a commitment to electronic top-up; however, existing contracts give e-pay Asia room for growth.
- The company has tightened up reporting systems internally as a result of issues identified during FY 2007.

**Share Price:** 2.38p

**12m High:** 18.5p

**12m Low:** 2.25p

**Market Cap:** £7m

**Shares in Issue:** 279m

**NAV/Share:** 1.75p

**Gearing:** AUD 1.78m net debt

**EPIC Code:** EPY

**Sector:** Technology

**Market:** AIM

**PR:** Biddick Associates

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**Nominated Advisor and Broker:**  
Seymour Pierce

**Website:** www.epay-asia.com

**Previous Research Note:**  
'Interim Results', 5.9.2007, 3.5p

**Analyst:** Andrea Kirkby

Y/E	Sales	Pretax	Net	Adjusted	P/e ratio	Divi p.	Yield
December	AUDm	Profit AUDm	Profit AUDm	Eps p.			%
2006	19.7	7.7	6.0	2.93	1.7	0.6	27.0
2007e	13.5	1.0	0.0	0.36*	14.1	-	-
2008e	13.5	2.0	0.7	0.26	19.6	0.1	2.2
2009e	15.5	3.2	1.8	0.63	8.0	0.1	5.5

At AUD = GBP .446569 \* adjusted for exceptional costs

## Breakeven Likely for 2007

EPY is likely to announce its 2007 results in early March. We do not expect any surprises in the 2007 statement. The company should close with a net breakeven position or slightly better. Indonesia is now closed, and the costs of terminating the operations are in line with previous management estimates. Meanwhile, Malaysia – the core operation - is performing reasonably well.

We forecast turnover for 2008 to be roughly flat. This comes entirely from the Malaysian business which is now the core business of the company. This is not a bad result, considering the negative impact of the closure of Indonesia and the loss of revenue from the software development business which contributed around AUD 2m of annual revenue in 2007.

## Malaysia

In the near term the company expects to make progress leveraging the Malaysian payments network and making its electronic top-up system pervasive. For instance there are possibilities in bill payment. Since the network is a largely fixed cost, further ventures have a low incremental cost and should quickly contribute to profits. Strategically, expanding the capability of the online payments system should bring benefits as consumers start to think of it as an all purpose transaction facilitator rather than purely a replacement for telco scratch cards.

## Finance and Cash Flow

The company will also focus on reducing finance costs. While the telecoms business requires EPY to buy minutes up front, and thus there is a major inventory requirement, other contracts (such as fuel cards) operate on a transaction based commission. The cash flow on these contracts is therefore positive, and

there is a strong impact on cash flow even if the P&L impact is relatively small.

EPY has also improved its financial reporting over the last year partly in response to the problems experienced in part of the business. This should help to improve cash management.

## 2008 Estimates

Our 2008 estimates assume that China will not make any contribution to profits in the year. In fact, 2008 is likely to be a year of investment in China. In terms of capital investment, EPY will need to deploy its network and provide terminals. We do not expect this cost being much over AUD 1/2m. Negotiations appear to be proceeding well and an announcement will be made in due course. Once an announcement is made we will reassess our estimates.

## China – Assessment of the Opportunity

EPY will start its Chinese operations in one of the provinces, which we assume will be 1.5 times the size of Malaysia in terms of population, though the market is likely to be less mature. We assume that if negotiations can be concluded in the next couple of months, operations could begin in the early months of Q2 2008.

By the end of the year we would expect EPY's Chinese operations to be achieving a run rate around AUD 14m a month in transaction value, and AUD 280k a month in revenue. With expected growth rates high as initial market penetration is achieved, we would expect to see the run rate increase to AUD 32m in transaction value a month by the end of FY 2009. That would indicate annual revenues in the region of AUD 5.4m, increasing total company revenues by 35%. However, the impact on earnings will be less, since the minority percentage is higher than in Malaysia.

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