

MARKET UPDATE

ISX hits important milestone as XM goes live

- Isignthis Ltd (ISX) achieved a significant milestone with the announcement that its first major customer, XM.com has completed its integration and operational “cutover” process to the ISX platform. This has resulted in XM.com commencing trading using the ISX identity verification system. While this event has taken longer than expected to occur, it is nonetheless a significant achievement for ISX and marks the development as a proof of concept. In a little over two years, ISX has built a transaction, identity and e-money bank, licensed it as an EU Monetary Financial Institution, obtained a Payment Facilitator Agreement with NAB and launched services with a scale operator in the retail FX market. The Paydentity platform should allow ISX to on-board its customers at a much faster rate, whilst also increasing overall customer reach. Forecasting is likely to remain challenging for a period, and we have downgraded our FY17 earnings forecasts due to delays in the commencement of the service by XM. However, we are confident that by the end of 2017, the forward progress ISX is making should translate into meaningful revenue and earnings momentum. We retain our BUY recommendation and valuation of \$0.50 / share.**
- The UK's Joint Money Laundering Steering Group (JMLSG) and the EU's 4th AML Directive (4AMLD) requires customers to be subject to on-going and continuous due diligence, with ongoing Know Your Customer (KYC) and transactional checks for unusual or suspicious activity required on active customer accounts. ISX has embedded itself to become a critical part of this process.
- The now live Paydentity service includes: remote enhanced due diligence (EDD) to meet the KYC requirements; and payment instrument verification, including for future Strong Customer Authentication; and full cloud-based elastic computing delivering PCI DSS V3.2 Level 1 payment gateway; and risk based transaction monitoring, to mitigate fraud and monitor AML / CFT; and integration and payment processing to multiple card acquiring institutions from one Application Programme Interface (API).
- The March quarterly cash flow result was not that illuminating. Cash receipts were modest and primarily reflect transaction flows with Coinify that are growing, with fees operating on a run-rate of cEUR25 - 30k / mth. In time, we expect the leverage to high frequency transaction flows to become more apparent following a couple of quarters from XM's launch.

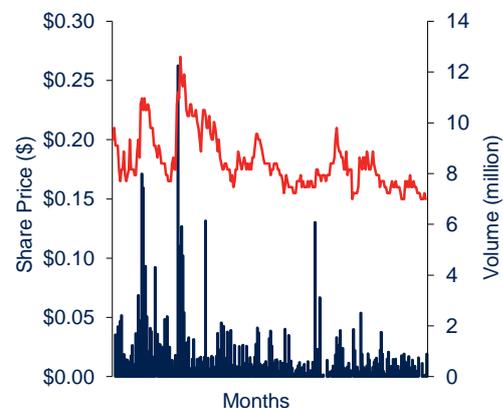
Year End June 30	2015A	2016A	2017F	2018F	2019F
Reported NPAT (\$m)	(9.6)	(9.2)	(5.0)	9.1	21.5
Recurrent NPAT (\$m)	(1.9)	(4.4)	(5.0)	9.1	21.5
Recurrent EPS (cents)	(0.6)	(0.7)	(0.6)	0.9	2.1
EPS Growth (%)	na	na	na	na	135.1
PER (x)	(25.3)	(20.5)	(24.4)	16.4	7.0
PEG	na	na	na	na	0.1
EBITDA (\$m)	(1.5)	(4.3)	(5.3)	13.0	30.5
EV/EBITDA (x)	(32.3)	(21.0)	(23.1)	11.6	4.9
Free Cashflow	0.9	(3.7)	(4.5)	3.9	17.1
FCFPS (cents)	0.3	(0.6)	(0.6)	0.4	1.7
PFCF (x)	51.4	(24.0)	(27.1)	38.5	8.8
DPS (cents)	0.0	0.0	0.0	0.5	1.2
Yield (%)	0.0	0.0	0.0	3.4	7.9
Franking (%)	0.0	100.0	100.0	100.0	100.0

27 April 2017

12mth Rating		BUY
Price	A\$	0.165
Target Price	A\$	0.50
12mth Total Return	%	212.5
RIC: ISX.AX		BBG: ISX AU
Shares o/s	m	621.8
Free Float	%	67.0
Market Cap.	A\$m	99.5
Net Debt (Cash)	A\$m	-2.3
Net Debt/Equity	%	-65.3
3mth Av. D. T'over	A\$m	0.11
52wk High/Low	A\$	0.275 / 0.145
2yr adj. beta		0.26
Valuation:		
Methodology		DCF
Value per share	A\$	0.50

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12 Month Share Price Performance



Performance %	1mth	3mth	12mth
Absolute	-3.2	-14.3	-25.0
Rel. S&P/ASX 300	-5.1	-17.9	-36.8

E-MONEY LICENSE

Earlier this month, ISX announced that it had been awarded an e-Money Institution (EMI) license #115.1.3.17 by the Central Bank of Cyprus (CBC). This license allows ISX to provide the following services within the European Economic Area (EEA):

- Execute payment transactions (including credit transfers, direct debits, through payment cards)
- Issuing and / or acquiring of payment instruments, including credit / debit / virtual cards
- Issuance of e-Money, being digital cash stored on an electronic device, virtual card or remotely at a server
- Money remittance; FX services; Credit for a maximum of 12 months; and Ancillary services

ISX expects to focus on the first three services initially.

In parallel with finalising commercial arrangements with Visa Inc., MasterCard Worldwide, JCB and other card schemes, ISX is aiming to conclude the technical integration to each of these card schemes, with integration expected to take around six months. The technical integration programme of work has already been scoped and agreed.

As an interim measure, ISX has already identified partnership opportunities where it may use the technical and payment settlement infrastructure of other EEA based payment service providers, while contracting and servicing merchants under its own license. Merchants can therefore be contracted directly with ISXPay to enable faster access to settlement fees.

The E-Money licence is the last significant hurdle in the execution of ISX's strategy and allows it to offer its full range of services including: Paydentity, payment gateway, card acquiring and card issuing services in the EU. This will also complement the partnership that ISX has with NAB for card acquiring services in Australia and New Zealand.

WHAT CAN INVESTORS EXPECT FROM XM

XM is a retail FX market operator that generates c\$12bn in daily turnover. It is the second largest operator in this sector next to Saxo Bank. It is gargantuan in size and the commencement of operations on the ISX platform is a significant endorsement of ISX's technology and approach to identity verification for high volume highly regulated online merchants, as well as a faster cheaper payment processing and fund settlement system.

This relationship was first announced in July 2016, and it has taken longer than expected for operations to commence, but the size and strategic importance of the relationship has meant that achieving proof of concept was of paramount importance, irrespective of the elongated time line to delivery. However, achieving this milestone should have benefits for future customer agreements where tighter time lines and specific "go live" dates could be enshrined in the contractual terms.

Even though ISX has achieved lift-off, the roll-out of the platform will still take some time to progress through all of XM's jurisdictions, as well as build penetration into the payment processing and settlement functions. We expect that it may take up to six months for XM to adopt the full range of ISX services across all of its jurisdictions. Even though the platform has been rigorously tested, one can understand that a large high frequency financial market operation cannot afford to have any small disruption to its service. Performance on the ISX platform will be critical for the roll-out to be successful.

In Figure 1, we show our view of the value of the XM business to ISX. When we previously showed this table, we assumed a customer base of 0.5m, as reported by XM in 2014. Two years on and this has doubled to 1.0m, which highlights the growth in the XM business. We also assume c75% of the actual turnover generated by XM, so by definition these estimates are conservative.

The roll-out of the XM business commences in the UK, and EU residents gain access via the UK website. Progressively, XM is expected to roll-out the platform to the EU directly and then other jurisdictions. At present, the UK represents a small part of the overall XM business, but we understand that the EU business is to be shifted out of the Cyprus domicile to the UK domicile. Depending on when this occurs, it could accelerate the transaction flows accessible to ISX.

Even on our assumptions which are now proving to be more conservative, once ISX is being fully utilised, which we expect to be within a six month time frame, the annual revenue flows should make ISX profitable on its own, given the annualised cost base of c\$6m, as per the latest Appendix 4C.

At this point it is not clear what portion of XM's 1m users have been through KYC verification through existing means, but c50% seems reasonable from our understanding. However, we do expect all re-verifications to be conducted through the ISX platform due to its speed and lower cost relative to other established mechanisms. We also assume that 100% of the verification business will translate into transaction processing business, given the extreme cost competitiveness of the ISX service.

Both KYC and processing revenue lines would be attractive to investors in their own right, but we think the primary driver of value will be the card acquiring or settlement services. In the model below, we assume that ISX will only gain access to c5% of the total value transacted. Even this small allocation would contribute about half of the potential revenue to ISX from this one relationship. Settlement services provide significant operating and earnings leverage, which should become apparent over the next twelve months.

We think that merchants will be interested in diversifying the number of financial institutions currently used for settlement services. Anecdotal evidence indicates there has been significant interest in accessing ISX's settlement capability since the E-Money Institution (EMI) license was announced earlier this month. This interest also seems to be separate from the KYC offering, so it will be interesting to see how this develops.

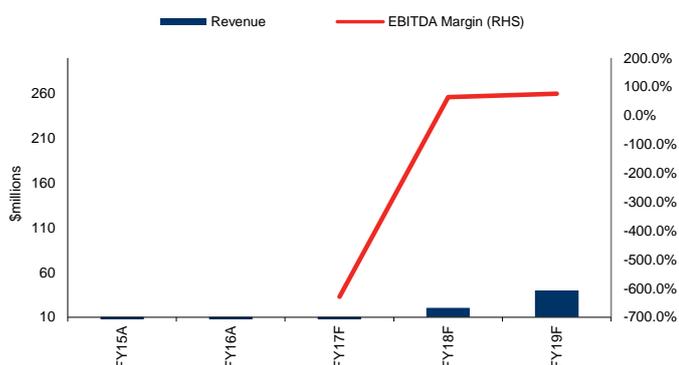
Figure 1: XM Financial Model - Estimated

XM	
Backlog KYC	
Existing Customers to Verify	500,000
Average Verifications per Person per annum	1.0
Price per Verification - EUR cents	2.0
Verification Revenue - EUR dollars	1,000,000
AUD / EUR rate	0.70
Verification Revenue - AUD	1,428,571
New KYC	
New Customers per week	5,000
Customers per year	260,000
Average Verifications per person	1.0
Price per Verification - EUR	4.5
Verification Revenue - EUR	1,170,000
AUD / EUR rate	0.70
Verification Revenue - AUD	1,671,429
Processing - Not Acquiring	
Transactions per Customer per year	12
Total Transaction per annum	9,120,000
Fee per Transaction - EUR	0.08
Transaction Processing Revenue - Not Acquiring	729,600
AUD / EUR	0.70
Transaction Processing Revenue - Not Acquiring	1,042,286
Settlement	
Number of Transactions per year	9,120,000
Average Price per Transaction - EUR	1000
Transaction Value per year - EUR	9,120,000,000
Net Fee to ISX	0.50%
Settlement Revenue @ 100% of Transactions - EUR	45,600,000
AUD / EUR	0.70
Settlement Revenue @ 100% of Transactions - AUD	65,142,857
% of Settlement Volume Allocated to ISX	5.0%
Settlement Revenue to ISX - AUD	3,257,143
Total ISX Revenue from XM - AUD	7,399,429

Source: Patersons Securities Ltd

iSignthis (ISX)				\$0.17
Cash Flow (\$m)	2016A	2017F	2018F	2019F
Adj. Operating Cashflow	-3.9	-3.2	4.9	18.5
Capex	-0.1	-1.0	-1.0	-1.0
Capitalised R&D	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0
Earn-out Payments	0.0	0.0	0.0	0.0
Investing Cashflow	-0.1	-1.0	-1.0	-1.0
Equity Raised	10.7	0.0	0.0	0.0
Increase (Repay) Debt	0.0	0.0	0.0	0.0
Distributions Paid	0.0	0.0	-1.2	-8.7
Other	0.0	0.0	0.0	0.0
Financing Cashflow	10.7	0.0	-1.2	-8.7
Change in Cash Held	6.8	-4.2	2.6	8.8
Closing Cash Balance	9.0	4.8	7.4	16.2

Revenue & Margins



Valuation	2017F	FY18F	FY19F
DCF			
Beta			2.0x
WACC			18.0%
DCF per share			\$0.50
Capitalisation of future earnings	2017F	2018F	2019F
EBITDA	-5.3	13.0	30.5
EV / EBITDA multiple	15.0x	15.0x	15.0x
Enterprise value	-79.2	195.0	457.4
Net cash / (debt)	4.8	7.4	16.2
Equity value	-74.4	202.4	473.6
Equity value per share	-\$0.09	\$0.20	\$0.47

Directors & substantial shareholders

Name	Position
Timothy Joseph Hart	Independent Chairman
Nickolas John Karantzis	Managing Director
Barnaby Ian Robert Egerton-Warburton	Independent Non Exec Director
Scott William Minehane	Independent Non Exec Director

Shareholder	No. shares	%
iSignthis Ltd	311.7	50.1
Deutsche Bank	31.9	5.1
Total substantial	343.6	55.2

Profit & Loss (\$m)	2016A	2017F	FY18F	FY19F
Sales Revenue	0.4	0.8	20.2	40.0
COGS	0.0	0.0	-1.0	-2.0
Gross Profit	0.4	0.8	19.2	38.0
Operating Expenses	-4.7	-6.1	-6.2	-7.5
Associates	0.0	0.0	0.0	0.0
EBITDA	-4.3	-5.3	13.0	30.5
Depn & Amort	-0.1	-0.1	-0.1	-0.1
EBIT	-4.4	-5.4	12.9	30.3
Net Interest	0.0	0.3	0.2	0.4
PBT	-4.4	-5.0	13.1	30.7
Tax expense	0.0	0.0	-3.9	-9.2
NPAT (Underlying)	-4.4	-5.0	9.1	21.5
Adjustment	-4.9	0.0	0.0	0.0
Statutory NPAT	-9.2	-5.0	9.1	21.5
NPAT (Adjusted)	-4.4	-5.0	9.1	21.5

Segment Revenue (\$m)	2017F	FY18F	FY19F
Average User No. (m)	1.0	2.8	3.8
Average Transactions Processed (m)	0.5	12.5	28.2

Verification Catch-Up Revenue	0.2	3.0	1.4
Verification Annuity Revenue	0.4	9.4	19.8
Transaction Processing Revenue	0.2	5.5	7.9
Settlement Revenue	0.0	2.3	10.9
Total Revenues	0.8	20.2	40.0

Balance Sheet (\$m)	2016A	2017F	FY18F	FY19F
Cash	9.0	4.8	7.4	16.2
PP&E	0.2	1.1	2.0	2.8
Intangibles	1.2	1.2	1.2	1.2
Other	0.1	1.1	4.3	8.0
Assets	10.4	8.2	14.9	28.2
Payables	0.5	2.5	1.2	1.8
Borrowings	0.0	0.0	0.0	0.0
Other liabilities	0.1	0.1	0.1	0.1
Liabilities	0.7	2.6	1.4	1.9
Shareholders Funds	9.7	5.7	13.6	26.4

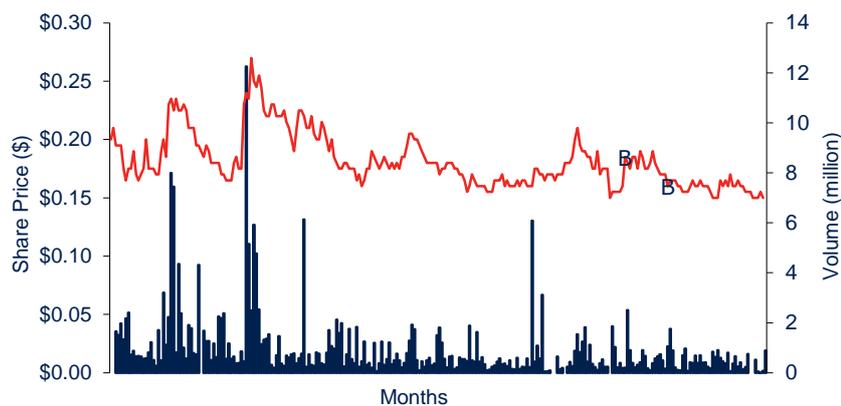
EPS & DPS	2016A	2017F	FY18F	FY19F
EPS (Reported)	-1.5	-0.6	0.9	2.1
EPS (Adjusted)	-0.7	-0.6	0.9	2.1
EPS growth (%)	na	na	na	135.1
DPS	0.0	0.0	0.5	1.2
Payout Ratio (%)	0.0	0.0	56.5	55.6
Dividend Yield (%)	0.0	0.0	3.1	7.2

Ratios	2016A	2017F	FY18F	FY19F
Profitability				
NPAT Growth (%)	na	na	na	135.1
Sales Growth (%)	1432.6	89.1	2311.4	97.8
EBITDA Margin (%)	na	na	64.2	76.2
ROIC (%)	na	na	145.6	208.2
ROE (%)	na	na	67.3	81.5
ROA (%)	na	na	87.2	107.9
Tax Rate (%)	0.0	0.0	30.0	30.0

Valuation	2016A	2017F	FY18F	FY19F
Price / Earnings (x)	-22.6	-26.9	18.1	7.7
EV / EBITDA (x)	-22.0	-30.4	12.2	4.9
Price / FCF (x)	-24.0	-29.8	45.1	9.7
Price / NTA (x)	11.5	30.2	13.4	6.6

Balance Sheet	2016A	2017F	FY18F	FY19F
Net Debt / Equity (%)	na	na	na	na
Net Debt / Assets (%)	na	na	na	na
Interest Cover (x)	na	na	na	na
NTA (\$/share)	0.0	0.0	0.0	0.0
Shares (m)	621.8	1002.8	1002.8	1002.8

Recommendation History



Date	Type	Target Price	Share Price	Recommendation	Return
06 Feb 17	Research Note	0.50	0.16	B	
01 Mar 17	Research Note	0.50	0.17	B	6.3%
	Current Share Price		0.17		

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