

# Boku

## Accelerating mobile identity offering

Boku has accelerated its move into products adjacent to its carrier billing services – it had already started developing mobile identity verification services, and the acquisition of US-based Danal will add a fully formed business in this field and bring a new set of customers. Boku is paying mainly share-based initial consideration of \$37.2m, with up to a further \$64m payable in equity if ambitious revenue targets for FY19 are achieved. While initially dilutive, the deal broadens the company's product portfolio and expands the types of merchants it can serve, supporting Boku's growth prospects in the medium- to long-term.

Year end	Revenue (\$m)	EBITDA* (\$m)	EPS* (\$)	DPS (\$)	P/E (x)	EV/EBITDA (x)
12/17	24.4	(2.3)	(0.03)	0.0	N/A	N/A
12/18e	34.8	5.4	0.01	0.0	89.7	36.5
12/19e	52.0	6.7	0.01	0.0	67.7	29.7
12/20e	67.9	19.1	0.05	0.0	18.4	10.3

Note: \*EBITDA and EPS (diluted) are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

## Buying a US-based mobile ID verification business

Danal sells mobile ID verification services to a mainly US customer base, using its connections to North American mobile carriers. Danal's carrier connections could boost Boku's direct carrier billing business, which has not been particularly strong in the US. Boku can also bring to Danal its many carrier connections in Europe, the Middle East and Asia, to help it to globalise its offering. Boku will be able to broaden its merchant base from purely digital content to a range of different verticals.

## Initial consideration equates to 10.7% dilution

Boku is paying initial consideration of 26.7m shares (10.7% dilution), \$1m in cash and \$3m in warrants (at £1.41) to acquire a business generating annual revenues of c \$5m and an EBITDA loss of c \$5m. Deferred consideration of up to \$64m is payable if revenues reach at least \$10m in FY19; the maximum is only payable if revenues reach \$20m, which we believe is unlikely to happen. We have revised our forecasts to incorporate Danal from 31 December. This results in a reduction in EBITDA of 42.5% in FY19e and flat EBITDA in FY20e, with an EPS cut of 55% in FY19e and 10% in FY20e.

## Valuation: Negative reaction overdone

In the past two months, the share price has seen a significant pullback, depressed by general equity market weakness, especially for highly rated US tech stocks (many of whom are Boku customers), as well as increasing liquidity as IPO lock-ups have expired. The stock declined more than 20% on the announcement of yesterday's deal. On our new forecasts incorporating Danal, valuation multiples are forecast to fall to modest levels by FY20e, which, in our view, is not reflective of the long-term growth opportunity for Boku.

Acquisition update

Software & comp services

7 December 2018

**Price** **75.5p**

**Market cap** **£169m**

\$1.27/£1

Net cash (\$m) at end-H118 28.4

Shares in issue 223.5m

Free float 50%

Code BOKU

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (43.5) (58.3) 0.0

Rel (local) (40.4) (54.1) 9.9

52-week high/low 184.0p 71.5p

### Business description

Boku is the largest independent direct carrier billing (DCB) company. DCB uses a consumer's mobile bill (prepaid credit or post-paid monthly bill) as the means to pay for digital content or services. Boku operates a billing platform that connects merchants with mobile network operators in more than 50 countries. It has 148 employees, with its main offices in the US, the UK, Germany and India.

### Next event

FY18 trading update January 2019

### Analysts

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## Acquisition of Danal

Boku has announced that it is planning to acquire Danal Inc, a US-based provider of mobile identity verification services.

### Background on Danal

Danal was established in 2008 in San Jose, US. The company has 35 employees mostly based in San Jose. Until 2016, Danal operated a direct carrier billing business called BilltoMobile, which it sold to Bango. The remaining business provides the following services:

#### Exhibit 1: Danal products

Product	Detail
eKYC	Uses data matching/cleansing, video and biometrics capabilities to help perform online know-your-customer or anti-money laundering checks
Instant acquisition	Obtain verified profile data from Danal to sign up new customers
Phone verification	Seamlessly verify a user's phone number in an app during sign-ups, log-ins and high-value transactions
Fraud prevention	Use data matching, account baselining, phone identification and proactive monitoring to prevent fraud
TCPA	Meet Telecom Consumer Protection Act requirements by using Danal's list cleansing and maintenance service, to ensure only legitimate customer numbers are held

Source: Danal

Danal has connections to US, Canadian, UK, French and Spanish carriers.

#### Exhibit 2: Danal carrier connections

Country	Carrier
US	AT&T, T-Mobile, Sprint, Verizon
Canada	Bell, Rogers, Telus, Virgin
UK	3, EE, Telefonica, Vodafone
France	Bouygues, Orange
Spain	Orange, Telefonica, Vodafone

Source: Boku

In terms of business model, Danal charges a per-transaction fee to the merchant (its website quotes a list price of 4c per transaction, before any volume-based contracts are taken into account), and then pays away a revenue share to the carrier.

In 2017, Danal generated revenues of \$5.1m and an EBITDA loss of \$5.2m. The company commented that revenues and EBITDA were likely to be at a similar level in FY18. Gross margins are currently close to 30%; however, some carriers have minimum revenue guarantees in place so as volumes ramp this should result in gross margin expansion, with a level of 50% achievable, according to management.

### Strategic rationale – new products, new customers, new countries

Boku has previously outlined plans to develop new services that make use of its network of carrier connections, including the development of Boku Identity services. Acquiring Danal will bring Boku a fully formed mobile ID verification service with a customer base that includes MoneyGram, Square, PayPal, BNP Paribas, Western Union and USAA, and channel partners including Fiserv, Experian (also a shareholder), neustar and TransUnion. Danal has strong connections to US carriers, which Boku could leverage in its carrier billing services (the US has not traditionally been an area of strength for Boku); in addition, Boku can bring the strength of its network of carrier connections to Danal to broaden its geographic reach.

Danal's business expands the type of merchants that Boku can service, from digital content to a wide range of verticals such as general e-commerce, financial services, transportation and government.

Management noted that Danal's selling shareholders include various trade investors as well as the parent company in Korea, Danal Co, with differing objectives and views on what the company should be doing. In addition, the company has been loss-making and has not had a high level of cash with which to grow the business, which goes some way to explaining the modest level of revenues and revenue growth that the business has achieved in recent years. Management's view is that its strategic focus and ability to invest should enable it to grow Danal's business substantially from the current level.

## Deal structure

While the acquisition agreement was signed yesterday, the deal is expected to complete at the end of FY18; the deal requires approval from Danal shareholders. Boku is paying initial consideration worth c \$37.2m, on a debt-free/cash-free basis, made up of three elements:

- 26.7m shares (10.7% dilution). At Wednesday's closing price of 98p, these are worth \$33.2m. At the current level of 75.5p, they are worth \$25.6m.
- \$1m in cash.
- \$3m in warrants with a £1.41 exercise price, exercisable for five years.

The company will also pay contingent consideration of up to \$64m, in the form of shares worth \$62m and warrants worth \$2m (with an exercise price of £1.45 and five-year exercise period), subject to Danal hitting challenging revenue targets in FY19. To be eligible to earn the contingent consideration, Danal must generate revenues of at least \$10m in FY19; the consideration is stepped up according to revenue bands. The shares will be issued at a minimum/maximum price of £1.20/£1.70, equating to the potential issue of 28.7–40.7m shares (or 10.3–14.0% dilution based on the post-acquisition share count) if the maximum revenue target of \$20m is hit. The company has the option to pay the consideration in cash.

The selling shareholders have agreed to a lock-up on their Boku shares of six months for 50% and 12 months for the remaining 50%, bar \$2m-worth of shares, which are subject to an orderly market arrangement.

Based on initial consideration alone, Boku is paying 6.5x FY17 revenues based on Wednesday's closing price, or 5.8x at the 75.5p the share is now trading at. This compares to Boku trading at 10.7x FY17 and 7.5x FY18 revenues at Wednesday's closing price, or 8.1x and 5.7x, respectively, at 75.5p per share.

If the maximum revenue target of \$20m were achieved in FY19, this would equate to an EV/sales multiple of 4.9x FY19e revenues, compared to a pre-deal multiple of 6.2x for Boku.

## Integration plans

The company intends to retain all Danal employees and expects to increase investment in the business to strengthen sales and marketing and to fund engineering resources to expand carrier connections and develop higher margin products.

## Trading update – Boku trading in line year-to-date

Boku updated various KPIs for the 10 months to 31 October:

- Total payment volume (TPV) of \$2.8bn (+124% y-o-y). This compares to TPV of \$1.54bn in H118 and our forecast of \$3.55bn for FY18.

- Monthly active users of 12.2m (+83% y-o-y) at the end of October, up from 10.3m at the end of H118.

The number of Boku Account connections to merchants increased to 155, from 127 at the end of H118. We note that the Apple carrier billing website lists 17 additional carriers in 14 countries compared to the last time we wrote in September. This includes entry into new countries such as Bahrain, Cambodia and Luxembourg.

## Changes to forecasts

Based on the trading update, we make no changes to our underlying forecasts. We have revised our forecasts to incorporate the Danal acquisition from 31 December. Management expects the acquisition to be earnings-dilutive in FY19, with improving performance in FY20 and earnings accretion from FY21.

We assume that Boku is able to accelerate Danal's revenues to \$10m in FY19 and \$18m in FY20, at gross margins of 41% in FY19 and 50% in FY20. We assume a step-up in operating costs in FY19 to \$9m, remaining flat in FY20. As the company has not specified exactly how the deferred consideration is paid out between the \$10–20m revenue targets for FY19; we have not factored in any dilution. Management commented that at the \$10m revenue level, the deferred consideration would be minimal and could be paid out in cash to avoid dilution.

The table below summarises the changes to our forecasts.

**Exhibit 3: Changes to estimates**

\$m	FY18e				FY19e				FY20e			
	Old	New	Change	y-o-y	Old	New	Change	y-o-y	Old	New	Change	y-o-y
Revenues	34.8	34.8	0.0%	42.6%	42.0	52.0	23.8%	49.2%	49.9	67.9	36.1%	30.6%
Gross profit	32.2	32.2	0.0%	45.3%	39.2	43.3	10.3%	34.5%	46.9	55.9	19.2%	29.1%
Gross margin	92.4%	92.4%	0.0%	1.7%	93.5%	83.3%	-10.2%	-9.1%	94.0%	82.3%	-11.7%	-1.0%
EBITDA	5.4	5.4	0.0%	333.7%	11.6	6.7	-42.5%	23.2%	19.1	19.1	0.0%	186.7%
EBITDA margin	15.6%	15.6%	0.0%	25.1%	27.7%	12.8%	-53.6%	-2.7%	38.4%	28.2%	-26.5%	15.3%
Normalised operating profit	4.0	4.0	0.0%	199.7%	10.4	5.5	-47.5%	35.9%	18.7	18.7	0.0%	242.0%
Normalised operating profit margin	11.5%	11.5%	0.0%	28.0%	24.8%	10.5%	-14.3%	-1.0%	37.4%	27.5%	-9.9%	17.0%
Reported operating profit	-0.2	(0.2)	0.0%	97.5%	7.1	2.2	-69.5%	-1129.8%	16.0	16.0	0.0%	638.2%
Reported operating margin	-0.6%	-0.6%	0.0%	33.9%	16.9%	4.2%	-12.8%	4.8%	32.1%	23.6%	-8.5%	19.4%
Normalised PBT	3.2	3.2	0.0%	150.1%	9.8	4.9	-50.2%	51.6%	18.1	18.1	0.0%	269.7%
Reported PBT	-1.0	(1.0)	0.0%	96.4%	6.5	1.6	-75.4%	-261.6%	15.4	15.4	0.0%	860.5%
Normalised net income	2.6	2.6	0.0%	153.3%	7.8	3.9	-50.2%	50.0%	14.3	14.3	0.0%	269.7%
Reported net income	(1.1)	(1.1)	0.0%	96.1%	6.2	1.5	-75.4%	-238.9%	13.9	13.9	0.0%	809.9%
Normalised basic EPS (\$)	0.01	0.01	0.0%	137.0%	0.03	0.02	-55.5%	29.3%	0.06	0.06	-10.5%	266.2%
Normalised diluted EPS (\$)	0.01	0.01	-0.7%	133.2%	0.03	0.01	-55.1%	32.5%	0.06	0.05	-9.8%	268.6%
Reported basic EPS (\$)	(0.01)	(0.01)	0.0%	97.3%	0.03	0.01	-78.1%	-219.7%	0.06	0.05	-10.5%	801.4%
Net debt/(cash)	(20.2)	(19.2)	-5.0%	18.1%	(30.2)	(29.1)	-3.7%	52.1%	(47.6)	(47.5)	-0.2%	63.0%
TPV (\$bn)	3.55	3.55	0.0%	108.5%	4.96	4.96	0.0%	39.9%	6.39	6.39	0.0%	28.7%
Take rate	0.98%	0.98%	0.00%		0.85%	0.85%	0.00%		0.78%	0.78%	0.00%	

Source: Edison Investment Research

**Exhibit 4: Financial summary**

\$m	2014	2015	2016	2017	2018e	2019e	2020e	2021e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>								
Revenue	18.3	19.2	17.2	24.4	34.8	52.0	67.9	79.1
Cost of Sales	(4.1)	(4.0)	(3.2)	(2.3)	(2.6)	(8.7)	(12.0)	(14.6)
Gross Profit	14.2	15.2	14.0	22.1	32.2	43.3	55.9	64.4
EBITDA	(9.6)	(11.4)	(12.3)	(2.3)	5.4	6.7	19.1	26.9
Normalised operating profit	(9.8)	(12.4)	(13.8)	(4.0)	4.0	5.5	18.7	26.4
Amortisation of acquired intangibles	(0.8)	(1.9)	(1.7)	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)
Exceptionals	(2.1)	(0.1)	(2.4)	(2.2)	(0.5)	0.0	0.0	0.0
Share-based payments	(1.7)	(1.8)	(2.1)	(0.9)	(2.4)	(2.0)	(1.4)	(1.4)
Reported operating profit	(14.4)	(16.2)	(19.9)	(8.4)	(0.2)	2.2	16.0	23.7
Net Interest	(0.6)	(0.4)	(1.2)	(2.4)	(0.8)	(0.6)	(0.6)	(0.6)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	(17.1)	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	(10.4)	(12.8)	(15.0)	(6.4)	3.2	4.9	18.1	25.8
Profit Before Tax (reported)	(15.0)	(16.6)	(21.1)	(28.0)	(1.0)	1.6	15.4	23.2
Reported tax	(0.4)	(0.4)	0.5	(0.1)	(0.1)	(0.1)	(1.5)	(3.5)
Profit After Tax (norm)	(7.8)	(9.6)	(11.2)	(4.8)	2.6	3.9	14.3	20.4
Profit After Tax (reported)	(15.4)	(17.0)	(20.6)	(28.1)	(1.1)	1.5	13.9	19.7
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	(7.8)	(9.6)	(11.2)	(4.8)	2.6	3.9	14.3	20.4
Net income (reported)	(15.4)	(17.0)	(20.6)	(28.1)	(1.1)	1.5	13.9	19.7
Basic average number of shares outstanding (m)	21.3	27.4	140.1	150.3	216.5	251.2	253.5	254.3
EPS - basic normalised (\$)	(0.36)	(0.35)	(0.08)	(0.03)	0.01	0.02	0.06	0.08
EPS - diluted normalised (\$)	(0.36)	(0.35)	(0.08)	(0.03)	0.01	0.01	0.05	0.07
EPS - basic reported (\$)	(0.72)	(0.62)	(0.15)	(0.19)	(0.01)	0.01	0.05	0.08
Dividend (\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	#DIV/0!	4.7	(10.4)	42.0	42.6	49.2	30.6	16.5
Gross Margin (%)	77.6	79.1	81.4	90.7	92.4	83.3	82.3	81.5
EBITDA Margin (%)	(52.5)	(59.2)	(71.4)	(9.5)	15.6	12.8	28.2	34.0
Normalised Operating Margin	(53.2)	(64.4)	(80.0)	(16.5)	11.5	10.5	27.5	33.4
<b>BALANCE SHEET</b>								
Fixed Assets	32.7	30.8	26.8	26.9	62.3	60.7	58.7	55.1
Intangible Assets	32.5	30.1	25.7	25.8	60.8	58.8	57.6	56.3
Tangible Assets	0.2	0.7	0.5	0.4	0.5	0.5	0.7	0.8
Investments & other	0.0	0.0	0.6	0.7	1.0	1.3	0.5	(2.0)
Current Assets	72.5	53.0	48.9	79.3	87.9	111.0	142.6	178.1
Stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debtors	59.7	43.3	37.1	59.1	64.8	77.9	91.2	100.7
Cash & cash equivalents	12.0	9.0	11.3	18.7	21.7	31.6	50.0	75.9
Other	0.7	0.6	0.5	1.4	1.4	1.4	1.4	1.4
Current Liabilities	(69.6)	(65.5)	(61.0)	(77.5)	(85.0)	(103.7)	(118.4)	(129.2)
Creditors	(64.6)	(60.4)	(54.9)	(75.0)	(82.5)	(101.2)	(115.9)	(126.7)
Tax and social security	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short term borrowings	(5.0)	(5.1)	(6.1)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Other	0.0	0.0	0.0	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Long Term Liabilities	0.0	(0.3)	(15.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Long term borrowings	0.0	(0.2)	(15.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Other long term liabilities	0.0	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Net Assets	35.5	18.0	(0.4)	28.6	65.0	67.9	82.8	103.9
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	35.5	18.0	(0.4)	28.6	65.0	67.9	82.8	103.9
<b>CASH FLOW</b>								
Op Cash Flow before WC and tax	(9.6)	(11.4)	(12.3)	(2.3)	5.4	6.7	19.1	26.9
Working capital	9.3	11.6	(3.4)	1.0	1.9	5.5	1.4	1.3
Exceptional & other	(1.6)	1.1	4.2	(5.5)	(1.6)	(0.7)	(0.4)	0.0
Tax	(0.0)	(0.0)	(0.0)	0.0	(0.4)	(0.4)	(0.7)	(1.0)
Net operating cash flow	(1.9)	1.3	(11.5)	(6.8)	5.3	11.1	19.5	27.1
Capex	(1.1)	(3.6)	(1.5)	(0.3)	(0.5)	(0.6)	(0.6)	(0.6)
Acquisitions/disposals	5.9	0.3	0.0	0.0	(1.0)	0.0	0.0	0.0
Net interest	(0.3)	(0.3)	(0.3)	(0.9)	(0.8)	(0.6)	(0.6)	(0.6)
Equity financing	0.2	0.1	0.1	19.8	0.0	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.6	(0.0)	0.1	(1.1)	0.0	0.0	0.0	0.0
Net Cash Flow	3.3	(2.2)	(13.1)	10.6	2.9	10.0	18.3	26.0
Opening net debt/(cash)	(4.9)	(7.0)	(3.6)	9.9	(16.2)	(19.2)	(29.1)	(47.5)
FX	(1.2)	(0.8)	(0.4)	0.4	0.0	0.0	0.0	0.0
Other non-cash movements	0.0	(0.4)	(0.0)	15.1	0.0	0.0	0.0	0.0
Closing net debt/(cash)	(7.0)	(3.6)	9.9	(16.2)	(19.2)	(29.1)	(47.5)	(73.4)

Source: Boku, Edison Investment Research

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