EDISON

Scale research report - Initiation

FinTech Group

Financial services

20 June 2017

Online brokerage leader

FinTech Group (FTG) is growing strongly. Management has created an integrated online broking business which can offer products across the value chain, from white labelled technology platforms to banking services. In our view, this gives it a significant advantage over its peers. The online broking sector in Germany has been consolidating and the fintech sector remains buoyant. Despite being the fastest growing major broking business in Europe, the shares trade at a discount to the sector.

Investment case

A key differentiator is that FTG owns both a bank and a software technology business, which uniquely gives it exposure to the bulk of the value chain. Management's goal is to grow the business both organically and through acquisitions so that it generates €150m of annual revenues in the mid-term along with EBITDA of €50m and net profit of €30m. Additionally, FTG is a play on a strengthening economy and subsequent rising interest rate environment as the group stands to benefit from interest income on its extensive customer deposits. With the ECB deposit rate at minus 0.4%, we believe there is more scope for rises than further declines.

Regulatory backdrop

In May, the German regulator BaFin introduced new rules that put restrictions on the provision of CFDs and spread bets in the retail market. This is good news for FTG, which predominantly offers stocks and warrants on its platform, as it shuts out the major CFD and spread betting companies from the German retail market.

FY16 results: Revenues up 27%, margin growth

FY16 revenue rose 27% to €95m while EBITDA jumped 55% to €30.6m as the margin expanded by 590bp to 32.2%. Commission income rose by 22% to €64.0m (67% of total FY16 revenues) and provision of IT services lifted 19% to €15.6m while interest income trebled to €7.8m. The company does not pay a dividend. Management's goal for FY17 is to boost client numbers by 20% y-o-y (from c 170k to 200k+) and transactions by 15% (from 7.7m in FY16 to 8.5m in FY17).

Valuation: Attractive relative to peer group

The shares trade on 12.8x FY18 consensus earnings. This looks very attractive relative to peers, given FTG's attractive growth profile and improving margins.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	75.0	19.7	(0.13)	0	N/A	0
12/16	95.0	30.6	0.73	0	24.3	0
12/17e	105.0	35.3	1.13	0	15.7	0
12/18e	115.0	41.7	1.39	0	12.8	0

Source: Bloomberg

Price	**€17.75**
Market cap	**€298m**

Share price graph

Share details

Code	FTK
Listing	Deutsche Börse Scale (Xetra)
Shares in issue	16.811m
Last reported net (debt)/cash	N/A

Business description

FinTech Group (FTG) is an integrated online brokerage business. It is divided into two business areas – a technology business and a financial services business that includes a bank and a brokerage business.

Bull

- Attractively valued against brokerage peer group.
- Favourable regulatory environment within Europe.
- Positioned to benefit from eventual upswing in interest rate cycle.

Bear

- Focused on the German market with limited geographical exposure.
- Does not offer CFDs and spread bets, which might impair its ability to grow internationally.
- Complex group structure, which is being amended.

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Company description: Leading online brokerage

Frankfurt-based FinTech Group (FTG) is a leading online brokerage business (Flatex) active in Germany (20%+ market share) and Austria (40%+ market share). FTG also has other assets in the value chain including a technology business that builds bespoke software platforms for customers, and a bank. The group's brokerage business is the nucleus of the company and generates c 70% of revenue. The balance of the business is technology & banking services to third parties (25-30%). This breakdown differs from the reported divisional breakdown as is explained elsewhere in this report (see Exhibits 2 and 3). FTG is the fastest growing major broking business in Europe, with the most active client pool in Germany (c 180k clients executing c 9m transactions which equates to more than 40 trades per client per annum). XCOM provides Flatex with all IT services expertise along with front-end trading software. biw, the group's bank, provides all regulatory service to Flatex, such as transaction processing and settlement, along with new account opening.

The company entered the online broker market in 2006 as Flatex which was floated in 2009. Flatex was the first flat fee brokerages in Germany, charging €5.90/OTC trade, no matter what the trade size. This rate has remained unchanged for 11 years. Flatex changed its name to FinTech Group in 2014 after the new management team joined, which reflected its ambition to be more than a traditional online brokerage. The group acquired a majority stake in XCOM, a technology business that also acts as Flatex's service provider, in FY15. In addition, the acquisition gave FTG control of a bank, biw (Bank for Investments and Securities). As from 12 June, biw has been renamed FinTech Group Bank AG (FTG Bank).

The group has more than 450 employees, split approximately as follows:

- 150 software developers
- 80 infrastructure experts at datacentres
- 120 bankers
- 100 management and administration

While FTG is currently listed on Scale, the goal is to move to the Prime Standard of the Frankfurt Stock Exchange over the next 12 months to increase transparency and trading volume.

Regulatory backdrop

It is important to note that FTG does not offer its own CFDs (contracts for differences), though it does offer CFDs via partners. While CFDs and spread bets are made unattractive to providers in the German retail market by BaFin regulations, the German derivative market is certainly very active and around a quarter of the group's transactions are in options and warrants. BaFin regards options and warrants as more suitable for retail investors, as they have limited risk and investors only stand to lose what they initially invest.

New strategy

The new management brought on board in 2014 sought to:

- Restructure and revitalise the group's business model from loss-making to profitability.
- Grow the market cap from €80-90m (as it stood in September 2014) by marketing the company's investment case broadly to investors.
- Resolve a historical legal dispute with its service provider XCOM/biw.

FTG agreed to acquire XCOM and its biw subsidiary in 2015 to bring technological expertise in house and give management flexibility including full control over costs. The acquisition brought the entire brokerage value chain (broking, banking and related technology) under a single roof. In addition, it enabled management to achieve considerable efficiency gains eg 16 management roles were removed, and the group is now managed by a team of six executives (the executive committee).

In March, FTG said it plans to leverage further synergies by merging its five operating companies (Fintech Group AG, flatex GmbH, biw AG, XCOM AG, and ViTrade GmbH) into just two companies - a tech entity (FinTech Group AG) and a financial services entity (FinTech Group Bank AG). The purpose was to simplify the group structure, improve transparency and to save costs (amounting to a seven-digit euro sum), mainly by simplifying the management and organisational structure.

The current focus remains on the DACH countries and the brokerage business moved into Austria two years ago. Plans are in place to target the Swiss market. The group is also looking at potential acquisitions to break into broking markets across Europe (initial target markets are France, The Netherlands, Benelux and Italy). Any acquisitions are likely to require some of the following characteristics:

- A strong client base.
- Restructuring potential where the cost per transaction or cost per client acquisition are too high, eg switching IT systems or improving marketing strategies.
- Enable the group to bring products of its existing partners on board to expand the product offerings to the acquired company's client base.

Management's goal is to grow the business both organically and through acquisitions so that it generates €150m of annual revenues within the mid-term along with EBITDA of €50m and net profit of €30m. Management's medium-term goal is to grow revenue by c 25% and EBITDA by 40%. Across business lines, the goal for B2C is 15-20% revenue growth and >50% EBITDA margins and for B2B the goal is for 15-20% revenue growth and >20% EBITDA margins.

Online brokerage (c 70% of €95m FY16 revenues)

The group's retail brokerage business, Flatex, has been growing strongly in terms of numbers of customers, transactions and assets under custody. The business rates favourably in customer surveys, and it is regarded as very transparent on its charges.

The order charge is €5.90 per OTC (over-the counter instrument, eg, options or warrants) or €5 to transact on German exchanges (plus exchange fees). The group's platform for professional traders, ViTrade, is much smaller with c 2.5k users. A major focus has been on minimising cost per trade settlement (CPT) and cost per client acquisition (CPA). CPT currently stands at €1.45 and doubling the number of transactions will reduce CPT by more than 40% to c €0.80. The company focuses on high quality customers who generate more than 40 trades per annum, and CPA current stands at c €100 compared with €300-500 at its competitors.

FTG has 19 partners (the main partners are Deutsche Bank, Commerzbank and Morgan Stanley) that offer specialist derivative products that retail investors can trade, notably exchange-traded options and warrants (exchange traded products or ETPs). FTG acts as a distributor in the ETP market and its distribution market share in German ETP products exceeds 15%. Typically, the issuing banks took a 90% cut of revenue, leaving 10% for the distributors, but in a breakthrough deal with Morgan Stanley, FTG has extracted a 50% share of revenue. Flatex has a cooperation agreement with Zinspilot, which enables Flatex traders to access overnight and fixed term deposits of a wide range of banks all across Europe from their existing account at Flatex.

There has been a new focus to drive funds under management higher and the group now has c €1.3bn in customer deposits and €6bn in securities and assets under custody that are not shown on the balance sheet. Consequently the average account has €30k in assets and €6k in cash held with Flatex/FTG Bank. Of the c €1.3bn in customer deposits, 30-40% is typically untouched during the previous 12 months. FTG has never paid interest on customer deposits and c €800m of the €1.3bn is managed in a highly diversified treasury portfolio, that consists of sovereign, municipal and corporate bonds, and yields c 0.2%.

Exhibit 1: Key performance indicators

	FY12	FY13	FY14	FY15	FY16
Transactions executed	6,625,418	5,486,715	6,023,210	10,143,219	10,462,477
Number of retail customers	118,170	126,111	134,403	176,600	212,040
Transactions per customer per year	56.1	43.5	44.8	57.4	49.3
Customer assets under management (€m)	2,810	3,527	4,043	5,770	10,855
of which: securities account volume	2,272	2,795	3,236	4,784	9,512
of which: deposits account volume	538	732	807	986	1,343

Source: Company accounts

Credit book

To generate a return from the c €1.3bn deposits, FTG has taken advantage of its position as a bank to establish a diversified and fully collateralised credit book. This is technically an overdraft facility at 3.9% that enables investors to borrow against (typically 25%) blue chip shares such as VW. This loan book is €80m+, generating interest income of c €3.3m. Additionally, FTG offers True Sale Factoring. The strategy here is to seek niche intermediaries who can source the business. The main focus is on the supermarkets and also some large corporations. The factoring book is approximately €40m generating 3.5% interest after fees. The total credit book is greater than €150m, generating c 4% interest, and FTG seeks to grow it to €250m by the end of the year.

Technology and banking services to third parties (c 30% of FY16 revenues)

FTG has c 250 technology experts. This includes 150 software developers who build and maintain the IT backbone of FinTech Group AG, which is also white labelled for third-party customers, and they work on projects for customers. Additionally there are c 80 infrastructure experts who look after the group's datacentre hosting activities. We note the group is ISO 27001 accredited, which is a necessity for hosting activities.

The group has c 100 B2B customers of which the 20 largest generate c 80% of revenue. FTG is able to onboard three to five new customers per year each delivering €1m in new revenue with a client lifetime value of €5-10m.

The typical business model for a technology sale involves a one off set-up fee, ongoing licence fees and project fees to work on changes to the systems.

Success stories include the following:

- The backbone for retail banking, eg, FTG Bank runs and manages the online retail banking business for pbb direct (Deutsche Pfandbriefbank), on pbb's balance sheet.
- Transaction system for the OTC business at both Commerzbank and Deutsche Bank, utilising LOX, the group's OTC market making technology platform.
- Setting up 250k accounts in one month for Equatex, a leading stock option plan administrator.

Reporting segments

FTG provides statutory segmental reporting according to the so-called management approach, as shown in Exhibit 3, which differs to the breakdown in Exhibit 2. We note that c 70-80% of broking revenues are back-office trade processing, which is reflected in the second, larger division. These trade processing revenues were not recorded in the consolidated accounts until after XCOM was consolidated from 31 March 2015.

There are two business segments.

Securities Trading & Financial Services: responsible for the provision of front-end online brokerage products and services and retail banking services. The revenues of this segment originate from the sale of the corresponding products and services.

Transaction Processing & White Label Banking Services: responsible for the company's electronic securities settlement and deposit management activities, the provision of IT services, and research and development activities, with its revenues resulting from the provision of the corresponding services.

Exhibit 2: Revenues breakdown

€000s	FY14	FY15	FY16
Commission income	13,742	52,384	64,031
Provision of IT services	3,392	13,102	15,583
Interest income	6	2,666	7,799
Other operating income	0	7,039	7,439
Value adjustments to financial assets	0	(167)	169
Total revenue	**17,140**	**75,024**	**95,021**

Source: FinTech Group

Exhibit 3: Statutory segmental reporting

€000s	FY14	FY15	FY16
Revenue			
Securities Trading & Financial Services	17,140	28,478	19,381
Transaction Processing & White Label Banking Services	0	45,221	70,767
Other and consolidation	0	1,325	4,873
Total	17,140	75,024	95,021
EBITDA			
Securities Trading & Financial Services	3,624	19,637	11,891
Transaction Processing & White Label Banking Services	0	8,389	28,329
Other and consolidation	0	(8,288)	(9,596)
Total	3,624	19,738	30,624
EBITDA margins			
Securities Trading & Financial Services	21.1%	69.0%	61.4%
Transaction Processing & White Label Banking Services	0	18.6%	40.0%
Other and consolidation	0	(625.5)%	(196.9)%
Total	21.1%	26.3%	32.2%
Depreciation and amortisation	(404)	(2,499)	(5,159)
Earnings before interest and income tax (EBIT)	3,220	17,239	25,465
Financial result	(116)	(2,670)	(1,226)
Earnings before income tax (EBT)	3,104	14,569	24,239
Income tax expense	2,488	(971)	(3,956)
Earnings from continuing activities	5,592	13,598	20,283

Source: FinTech Group

Acquisition of XCOM

FTG acquired 51.12% of XCOM in FY15, partly funded by a €13.1m capital increase in December 2014. The direct shareholding was increased to 63.65% in December 2015 and to 73.77% in 2016. The shareholding has recently been increased to more than 99%.

Recent newsflow

German regulatory ruling

In May, the German regulator, BaFin, announced significant restrictions to CFD trading in Germany. The new regulations had originally been outlined in December. This was very positive news for FTG since the group does not have its own CFD business (though it does offer CFDs through its partners). The move by BaFin to protect retail investors discourages competition from CFD players such as UK-based IG Index and CMC Markets which have been seeking to break into the German market. BaFin's General Administrative Act restricts the marketing, distribution and sale of financial contracts for difference (CFDs). Contracts with an additional payments obligation (ie potential margin calls) can no longer be offered to retail clients. This could shift trades away from CFDs to exchange traded products (ETPs) and FinTech Group would significantly benefit from a shift to ETPs.

Market overview

There are four major players in the German online brokerage market - Comdirect, ING DIBA, BNP Cortal Consors and FTG. Comdirect (c 81% owned by Commerzbank) has 1.4m customers who execute c 14m trades per annum. That equates to 10 trades per annum, compared to 40+ for FTG. The sector has undergone consolidation over the last three years. This includes the acquisition of DAB Bank by BNP Paribas in 2014 while Onvista was acquired by Comdirect in December.

On the international market, FTG's main quoted peers are Avanza (STO:AZA) in Sweden, Swissquote (SWX:SQN) in Switzerland, Binckbank (AMS:BINCK) in the Netherlands and Interactive Brokers (NASDAQ:IBKR) in the US.

Management

Supervisory board and management board

The executive board consists of Mr Frank Niehage as chair of the group and the bank and Mr Muhamad Said Chahrour as chief financial officer. The executive committee consists of the executive board and four divisional executives – head of IT, head of B2B, head of B2C and deputy CEO of FinTech Group Bank. The three-person supervisory board is chaired by Martin Korbmacher.

Frank Niehage, CEO

Frank Niehage was appointed CEO in September 2014. Prior to joining FTG, Mr Niehage was a managing director at Goldman Sachs where he oversaw the bank's German wealth management business. Previously he was with Bank Sarasin where he held the role of CEO in Germany. Before that he served in various senior positions at Commerzbank, Credit Suisse, UBS and international law firm Beiten Burkhardt, both in Germany and internationally, especially in Asia. Mr Niehage is an attorney at law in Germany and has received his Master of Law majoring in international economics from the University of Houston Law Center.

Muhamad Chahrour, CFO

Mr Chahrour joined FTG as head of finance in July 2015 and he joined the executive board as CFO on 1 January 2017. He was previously head of global finance at Lamudi, and prior to that he worked in Transactions - Corporate & Real Estate at PwC and M&A at UBS.

Martin Korbmacher, Chairman of the supervisory board

Mr Korbmacher was appointed chairman of the supervisory board in September 2014. He has extensive experience in traditional banking as well as in financial services technologies. After being global head of equities at Dresdner Kleinwort, he became investment banking head of Germany and Austria for Credit Suisse in 2005. In mid-2011 Mr Korbmacher decided to pursue entrepreneurial activities and started Event Horizon Capital & Advisory GmbH, an advisory and investment boutique focused on alternative asset management and VC investments in various sectors including financial services technologies.

Shareholders and free float

FTG's major shareholder GfBk is a vehicle of Flatex founder Bernd Förtsch. Heliad Equity Partners (Heliad) is a DACH-focused closed-ended fund investing in technology, e-commerce and lifestyle sectors. We recently initiated on Heliad.

- GfBk Gesellschaft für Börsenkommunikation mbH 39.8 %
- Heliad Equity Partners 15.1%
- Free float 45.1%

Financials

The structure of the business changed significantly in FY15 after the group acquired XCOM, which included XCOM's bank subsidiary, biw. Prior to FY15, the accounts were prepared under HGB accounting standards. From FY15 (including restated FY14 numbers), the group has reported under IFRS.

Exhibit 4: Financial summary

(€000s)	FY14	FY15	FY16
Year ended 31 December	IFRS	IFRS	IFRS
Income statement			
Revenue	17,140	75,024	95,021
EBITDA	3,624	19,738	30,624
EBITDA margin	21.1%	26.3%	32.2%
EBIT	3,220	17,239	25,465
EPS from continuing operations (€)	(0.58)	0.86	1.21
EPS from discontinued operations (€)	0.00	(0.99)	(0.47)
DPS (€)	0.00	0.00	0.00
Balance sheet			
Total non-current assets	9,354	64,999	70,236
Total current assets	85,927	1,142,067	1,463,300
Assets from discontinued operations	0	1,174	459
Total assets	95,281	1,208,240	1,533,995
Total non-current liabilities	(36)	(16,324)	(14,808)
Total current liabilities	(45,163)	(1,106,059)	(1,428,557)
Total liabilities	(45,199)	(1,122,383)	(1,443,365)
Net Assets	50,082	85,857	90,630
Cash flow			
Cash flow from operations	23,240	(58,705)	(143,956)
Cash flow from investments	(331)	(47,237)	(9,192)
Cash flow from financing	21,838	26,296	1,078
Net Cash Flow	44,747	(79,646)	(152,070)
Cash & cash equivalent end of year	61,482	541,273	389,202

Source: Company accounts

Income statement

As shown in Exhibit 4, the group has reported strong profits growth over the last two years along with significant margin expansion. The company does not pay a dividend, and does not intend to in the foreseeable future, as the focus is on investing for growth.

Balance sheet and cash flow

The group balance sheet changed significantly due to the acquisition of XCOM, which included the biw bank. The group's net debt position is difficult to calculate for two reasons: 1) the ownership of a bank which is consolidated in the accounts; and 2) the fiduciary client funds (and related liabilities) on the balance sheet. The cash flow statement has been rendered relatively meaningless since biw was consolidated, due to the volatile nature of banking cash flows.

Sensitivities

We highlight the following risks:

- **Economic slowdown:** An economic slowdown will likely reduce the wealth of investors and therefore reduce customer deposits and transactions.
- **Banking risks:** Credit risk and default risk relating to the activities of the group's bank.
- **Regulatory changes:** A relaxation of regulations in favour of CFD and spread betting could elevate competition, as FTG is focused on stock and warrants trading. Recent rulings at BaFin

have been in favour of FTG, to the detriment of CFD and spread betting providers. The implementation and subsequent increase of trading taxes could reduce customer transactions.

- **Interest rates:** FTG has extensive customer deposits, which remain relatively stable over time. Based on the group's c €1.3bn customer deposits, a 10bp increase in short-term interest rates would increase profits by c €1.3m (though, in reality the overall relationship is more complex due to the group's ownership of a bank).
- **Investment risks.** There is some low but inherent credit and duration risk in the actively managed treasury portfolio.

Valuation: Attractive given the sector consolidation and anticipated continuing fintech M&A

The shares trade on 12.8x FY18 consensus earnings. This looks very attractive relative to peers, albeit for Binckbank which has been struggling, with weaker margins and a slower growth profile.

FTG is clearly an attractive takeover target as its business combines a traditional online brokerage with fintech elements. According to a recent survey by Simmons & Simmons, the international law firm, 31% of banks and asset managers expect to acquire a fintech firm within the next 12 to 18 months as a way to improve their digital innovation. An additional 31% said they are delaying acquisitions while they seek greater certainty about which firms to target.

Exhibit 5: Peer group comparison

	Share price	Market cap		Revenue, local curr (m)			Revenue	Operating profit		Operating margin (%)		P/E (x)	
	local curr	local curr (m)	Currency	Year 0	Year 1	Year 2	CAGR	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
FinTech Group	**17.75**	**298**	**EUR**	**95.0**	**105.0**	**115.0**	**10.0%**	**29.8**	**35.5**	**28.3%**	**30.9%**	**15.7**	**12.8**
Avanza	368.7	11,002	SEK	919.0	1004.0	1094.2	9.1%	484.5	519.0	48.3%	47.4%	26.6	23.8
Swissquote	25.95	398	CHF	150.2	165.0	174.5	7.8%	97.7	102.7	59.2%	58.9%	16.4	15.9
Binckbank	4.367	310	EUR	147.7	155.8	161.3	4.5%	12.4	37.5	8.0%	23.3%	8.6	10.4
Interactive Brokers	36.79	15,063	USD	1396	1430.4	1568.0	6.0%	923.0	991.0	64.5%	63.2%	26.4	23.2
Medians excluding FinTech Group							**6.9%**			**53.7%**	**53.1%**	**21.4**	**19.5**

Source: Bloomberg. Note: Prices as at 19 June 2017.

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