

MONITISE PLC

# Mobilising Money

15 July 2011

Monitise Plc is a research client of IS Research Ltd

Analyst | Philip Carse  
T +44 (0)1189 001362

E [Philip.carse@is-research.co.uk](mailto:Philip.carse@is-research.co.uk)

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All share prices quoted in this document are as at the close of business on **13 July 2011**.

\* *Monitise Plc is an equity research client of I S Research Ltd*

## Company description

Monitise plc is a leading provider of B2B mobile money services. The company has built up an impressive eco-system of over 250 banks, payment providers, other financial institutions, retailers and mobile network operators, including Visa Inc, Visa Europe, Best Buy Europe, First Eastern, Standard Chartered, VocaLink, FIS, HSBC, Lloyds TSB, first direct, Royal Bank of Scotland, NatWest, Vodafone, Orange, O2, T-Mobile and Hutchison 3G. The company was founded and incubated as part of Morse in 2004, and spun out and listed on AiM in June 2007.

**Table 8: Monitise Key Shareholders**

| Shareholder                  | Stake |
|------------------------------|-------|
| Visa Inc                     | 14.2% |
| First Eastern (Holdings) Ltd | 6.2%  |
| Norges Bank                  | 6.0%  |
| Standard Chartered Bank      | 5.4%  |
| 3i Group                     | 4.5%  |
| Duncan McIntyre              | 3.5%  |

Source: I S Research Ltd, Monitise Plc

## Executive management

### Alastair Lukies, Co-founder and Chief Executive Officer

Alastair is the driving force behind Monitise, having formed the company whilst it was part of Morse plc. Prior to Monitise, Alastair was a co-founder of epolitix.com, the portal for Westminster, Whitehall and the devolved institutions.

### Duncan McIntyre, Chairman and Non-Executive Director

Duncan is a qualified account, who joined Morse as Finance Director in 1994 and rose to become Chief Executive Officer and Executive Deputy Chairman.

### Lee Cameron, General Counsel and Executive Director

Lee is a trained lawyer, who oversees Monitise's legal, IP, corporate development, compliance and HR departments. He was previously General Counsel at Morse plc.

### John Brougham, Chief Financial Officer and Executive Director

John assumed the CFO role in 2010, having previously been a Non Executive Director at Monitise. He has extensive CFO experience at BT.

### Mike Keyworth, Chief Information Officer

Mike has over 20 years experiencing of managing major projects for financial services companies. He joined Monitise early in 2004 as Programme Director for MONILINK™, and took up the post of CIO in October 2005.

### Peter Radcliffe, Chairman, Emerging Markets

Peter switched from a non-exec to an executive role in December 2010, to lead Monitise's expansion in emerging markets. Previous experience includes being Asia Pacific MD of First Data.

In addition, Monitise has a heavyweight board, including several highly experienced individuals from the telecoms world (David Dey, Colin Tucker) and from finance (Tim Wade and Jan Verplancke), as well as Elizabeth Buse (Visa Inc) and Sushovan Hussain (Autonomy) as non-executive directors.

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#### I S Research Ltd

Davidson House, Forbury Square  
Reading, RG1 3EU  
Telephone 01189 001 362  
E info@is-research.co.uk  
www.is-research.co.uk



Research

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# Mobilising Money

## Company basics

|                     |       |
|---------------------|-------|
| RIC                 | MONI  |
| Share price £       | 39.3  |
| Market cap £m       | 275.6 |
| Net cash £m         | 23.1  |
| Enterprise value £m | 252.5 |

Monitise has established itself as a leading provider of mobile money technology and services, highlighted by Visa Inc. significantly upgrading (for a second time) its agreement with Monitise to just under 4x the original agreement, guaranteeing at least \$10m in annual revenues for five years. In the last year, Monitise has also signed up Visa Europe as a customer, extended its eco-system of financial partners, launched its Mobile Money Network retail JV with Best Buy Europe, enhanced its technology platform, and achieved strong customer growth and user generated revenues. We are now upgrading our forecasts for Visa and the year end trading update. Though Monitise trades at high multiples of near term revenues, we believe it is a core holding for anyone wanting exposure to mobile money, with the company's potential strategic value highlighted by recent activity in the sector, including eBay's \$240m acquisition of Zong and the \$1bn valuation reportedly achieved by Square.

Table 2: Estimates and valuation

| Y/e June | Financials |                  |                 |          |                   | Valuation         |                   |          |       |
|----------|------------|------------------|-----------------|----------|-------------------|-------------------|-------------------|----------|-------|
|          | Rev<br>£m  | Adj<br>PBT<br>£m | Adj<br>EPS<br>p | DPS<br>p | Net<br>cash<br>£m | EV/<br>sales<br>x | EV/<br>NOPAT<br>x | PER<br>x | Yield |
| 2010 A   | 6.0        | -14.3            | -2.2            | 0        | 13.2              | 43.6              | -26.2             | -17.9    | 0%    |
| 2011 E   | 13.9       | -15.4            | -1.5            | 0        | 23.1              | 18.2              | -23.4             | -25.7    | 0%    |
| 2012 E   | 28.3       | -10.8            | -1.0            | 0        | 7.6               | 9.5               | -35.5             | -37.9    | 0%    |
| 2013 E   | 42.3       | -2.7             | -0.2            | 0        | 0.7               | 6.5               | -144.4            | -170.1   | 0%    |
| 2014 E   | 59.8       | 5.9              | 0.6             | 0        | 3.2               | 4.6               | 66.0              | 62.5     | 0%    |
| 2015 E   | 79.1       | 15.1             | 1.5             | 0        | 16.2              | 3.3               | 24.6              | 25.4     | 0%    |

Source: ISR, Company Plc, Morningstar

## Market Opportunity & Strategy

Mobile money, incorporating account management, payments, transfers and associated advertising and marketing, is likely to be substantial, given over 5bn mobile subscribers worldwide. A mobile device is ideal for electronic money and targeted marketing, with user ID and security, wider availability than PC and bank accounts, and having location-specific capabilities. Mobile money is attracting significant attention from financial institutions (eg Visa), mobile operators, and strategics (eg Google with its m-wallet). The mobile money technology market is competitive, but Monitise has established a strong position through offering leading edge solutions on a managed services basis, partnering with organisations such as Visa (Inc. and Europe), First Eastern and Best Buy Europe, and promoting an open eco-system of banks, mobile operators, retailers and other financial institutions.

## Business model & estimates

Monitise has a B2B strategy, selling its services to its eco-system partners (over 250) and gaining user-generated revenues. This leverages partner brands and promotes economies of scale and scope. Average revenues range from £7 per year for Advanced users, with high functionality smartphone apps, to £3 for Essentials users, with SMS-based functionality, and to pennies for feeder users (account sign ups etc) who will migrate up the value chain. Based on the recent trading update, revenues have more than doubled this year to £14m, but with breakeven not until late FY 2013 as the company invests to exploit multiple geographic and product opportunities. In our view, Monitise is a key holding for anyone seeking exposure to the mobile money opportunity.

## Risk factors

Monitise is faced with considerable risks and uncertainty, including the competitive environment, the still uncertain demand for mobile money services from banks, retailers and end-users, regulatory obstacles, as well as internal risks such as the company's ability to manage rapid growth and remain at the leading edge of mobile money technology. In our view, the risks attached to Monitise, though relatively high, continue to reduce, as the company has demonstrated its commercial viability in the UK and has become more integrated into its key partners such as RBS and Visa Inc. It is still a relatively high risk, but also potentially high reward, stock.

# Market opportunity

## 5 billion and counting

The mobile device is an ideal banking and payments device, being ubiquitous, containing inbuilt user ID and security features (the SIM) and native technologies (SMS and USSD) for providing quick and cost effective data transmission, whilst its location capabilities open up new and exciting advertising and marketing possibilities. Monitise has established itself as a leading provider of mobile money technology and services, of which there are several broad, inter-twined categories:

### Mobile banking:

- In developed markets, an alternative to telephone/online banking and bank branches, for account holders to access and manage their accounts, to obtain balances and mini-statements, pay bills, transfer money and so on. *Examples: UK banks accounting for over a half of current accounts use Monitise's services.*
- In developing markets, where banking infrastructure is poor, mobile banking enables users with a mobile wallet or bank account to store money and undertake banking transactions, with access provided via the mobile phone and physically via the mobile operator's distribution channels. *Examples: Safaricom's M-PESA in Kenya and Monitise's trial in Nigeria.*

### Mobile payments:

- Using the mobile device to pay for physical and digital goods and services using existing on-line digital payments methods (eg PayPal) or bank and credit card accounts. *Examples: Monitise's new retail Simply Tap service.*
- Remitting money overseas, or making peer to peer (P2P) payments to friends and family. *Example: SMART (Philippines).*

### Mobile wallet

- The mobile device uses short distance communications such as Near Field Communications (NFC) to interact with readers, for paying for goods and services in physical (as opposed to online) locations or for P2P transfers. Mobile wallets can also contain e-tickets (eg Oyster travel card), whilst NFC also enables targeted advertising, coupons etc. *Examples: services recently announced by Google and, in the UK, O2 and Orange, and Monitise's NFC trials in the US.*

In all cases, the underlying money account can either be an integral part of the service, or can be a linked existing account such as current account or credit card.

Monitise provides the 'glue' that makes mobile banking and payments possible:

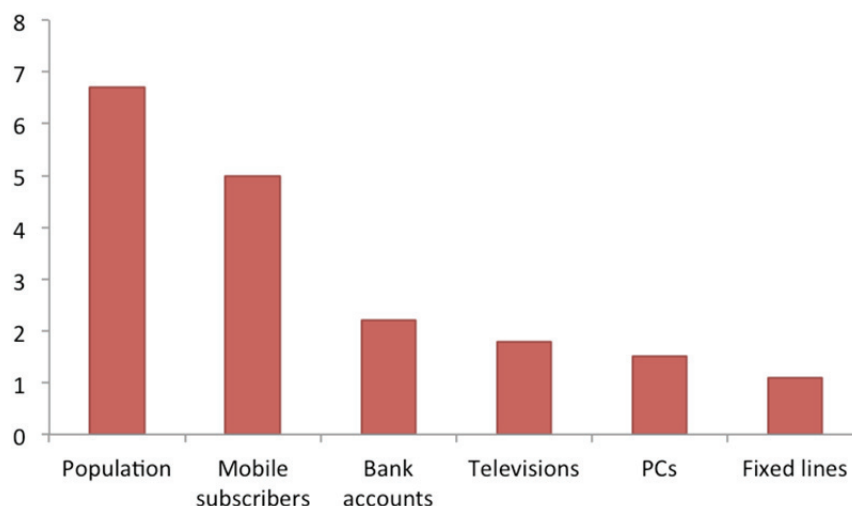
- Providing the underlying technical infrastructure that ensures interconnectivity between banks, retailers, mobile operators and other parties (eg loyalty card providers), typically using a payments network, such as LINK in the UK.
- Developing services, to maximise functionality and user experience, whilst providing customers with the flexibility to customise their own service offerings.
- Ensuring that services can be supported on the large majority of handsets, and work on different types of wireless network.

What sets Monitise apart from many technology providers is that it has driven the creation of many mobile money services, through establishing ventures with major strategic partners (eg Visa Inc and Visa Europe, RBS).

## Market Opportunity

The mobile money opportunity is vast, given that the mobile phone is the most ubiquitous communications device globally (5+ billion subscribers worldwide), representing a majority of the global population and far out-stripping fixed lines, PCs and bank accounts.

**Table 3: Global comparisons (billion)**



Source: I S Research Ltd, Monitise Plc, CSS Insight, ITU

Mobile money has received considerable impetus from faster mobile data networks (3G and 3.5G networks are commonplace, with 4G/LTE networks now being launched), lower data pricing, and the growth of the smartphone and applications, which make it easier for mobile subscribers to access advanced data services. Meanwhile, SMS in low-end handsets support basic but still very valuable services such as balance alerts.

Mobile money is not just about mobile, however, as there are strong demand drivers from banks, retailers and mobile phone operators:

- Banks in the developed world see mobile banking as a natural extension of telephone and online banking, offering better customer service at a lower cost.
- In developing countries, banks and governments see mobile banking as key to increasing banking penetration, with positive implications for economic growth.
- Mobile network operators view mobile money as a means of generating additional data and transactions revenues and increasing customer loyalty/reducing churn.
- Banks and retailers support new payments methods that increase the probability of a successful transaction taking place, particularly for digital goods, and/or which replace expensive to process cash and cheque payments.
- All parties see enormous potential in the ability to deliver targeted advertising, coupons etc to mobile users when in retail environments.

## Market Opportunity

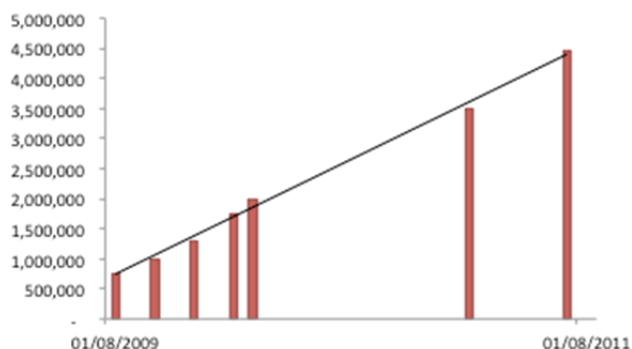
### Market forecasts and data

There is a wealth of studies predicting strong take up of mobile money services. Just to take three recent examples: Juniper forecast a doubling of mobile banking users globally to 200m in the next two years; Forrester predicts an increase in US mobile banking penetration from 12% to 20% by 2015; and Yankee Group predicts a 6x increase in the value of mobile money transactions to \$984bn by 2014. These are obviously broad numbers, and there is no differentiation between heavy and occasional users, but they still point to strong take-up of mobile money services.

### Developed markets

Monitise provides an excellent example of take up of mobile banking services in developed markets. After launching in 2008, the company reached 0.75m users in August 2009, 1.75m in February 2010, 3.5m in February 2011 and is approaching 4.5m as of mid July 2011. Net additions have averaged 160,000 a month, with a particular spike in late 2009/early 2010 following the launch of an iPhone app in the UK. Assuming the UK is 80% of the total, we estimate that Monitise has achieved penetration rates of 25% of online banking users and 13% of telephone banking users of its addressable market, which is an impressive take up rate for a new service.

**Table 4: Monitise registered users**



Source: I S Research Ltd, Monitise Plc

Whilst many new mobile services achieve a high level of registrations, this is not always matched by on-going usage. In Monitise's case, however, UK smartphone subscribers are using the mobile application service an average of 16 times each month, which suggests that mobile banking is becoming an integral part of users' banking interaction.

### Developing markets

Mobile banking in developing markets, particularly to the 'unbanked', is a significant opportunity. CGAP/GSMA estimate 1 billion mobile subscribers without a bank account currently, rising to 1.7bn by 2012. They forecast 364m low-income, non-banked users of mobile banking services by 2012, generating \$7.8bn of banking revenues (approximately \$20 pa per user).

## Market Opportunity

M-PESA in Kenya is the most established developing country mobile banking service. Operated by Vodafone's Safaricom, it enables users to deposit cash on their account, send money, withdraw cash, pay bills, buy airtime, and manage their account from their mobile phone, interacting where necessary with Safaricom's 27,000 agents. As of March 2011, M-PESA had 13.8m account holders (out of its 17.2m mobile subscribers, and a third of the Kenyan population!), generating 12.4% of total Safaricom revenues. M-PESA revenues actually grew faster than subscribers, up 56% versus 46%. For Safaricom, M-PESA generates additional revenues and boosts customer loyalty, and Vodafone is now replicating the model in other markets, for example Tanzania and Afghanistan.

There are plenty of other examples of successful mobile money services in developing markets. For example, True Money in Thailand is a mobile wallet, with a focus on payments rather than P2P transfers, as with M-PESA. According to the GSMA, True has 6m users, processing \$900m in payments and 120m transactions a year.

Monitise has recently launched similar services in Nigeria, which is described below.

# Competitive Environment

Not surprisingly given its potential, mobile money is being competed for by a large number of players from a variety of backgrounds, which are summarised in the following table:

- Banks and other financial institutions themselves, developing their own mobile money applications in-house.
- Specialist banking systems and mobile money software providers such as IBM, Fiserv, mFoundry, m com, and Parseq (formerly Intelligent Environments).
- Technology-focussed competitors, particularly those in Near Field Communications.
- Companies with a background in mobile roaming and billing systems, branching into mobile money, eg Roamware, Earthport and eServGlobal.
- Country-focussed providers, particularly in emerging markets, e.g. M-PESA, True.
- Specialist mobile service providers, such as Monitise, Nokia/Obopay and Firethorn.

Many of these are or will be strong competitors to Monitise, but we would in particular highlight two of the highest profile competitors, Nokia and Qualcomm/Firethorn, which have attracted significant strategic investment.

**Nokia Money** launched in August 2009, in conjunction with Obopay, a US company in which Nokia invested a reported \$70m in June 2009. Nokia Money is a mobile wallet aimed at the unbanked in emerging markets, enabling users to top up their accounts, check balances and make payments. Nokia launch a trial in Pune, India with Yes Bank in early 2010, and has just announced a full commercial service in India with Union Bank. The service is likely to be available only on Nokia handsets initially.

**Firethorn** was founded in 2001 as a mobile banking service provider and was acquired by Qualcomm for \$210m in November 2007. The company provides mobile banking services primarily in the US, mainly serving 2<sup>nd</sup> tier banks. According to Qualcomm's most recent SEC quarterly filing, Firethorn does not yet generate operating profits; revenues are not disclosed.

Whilst the competitive landscape is crowded, we would argue that Monitise is the market leader in the UK and a strong player in the US, among independent service providers, and will be a significant early mover in markets such as India (where it has already launched services) and China. The fact that it has also been selected by major financial players such as Visa Inc, Visa Europe and Travelex is testimony to its strong competitive position.

**Table 5: Mobile Money Competitive Environment**

| Background         | Players   |
|--------------------|---|
| Mobile wallet      | M-PESA, Oxigen (India), Nokia Money (Obopay), Blaze Wallet (US) |
| Banking systems    | IBM, Sybase, Fiserv, retail banks in-house                      |
| Remittances        | SMART (Philippines), Earthport, eServGlobal                     |
| Digital payments   | Obopay  |
| Disintermediators  | Blaze Wallet (US), Mint.com (US), Firethorn                     |
| NFC                | Gemalto, Oberthur, Proxima                                      |
| Software suppliers | mFoundry, Firethorn, m com, Parseq                              |
| Mobile roaming     | Roamware, eServGlobal   |

Source: I S Research Ltd, Monitise Pl

# Strategy

Monitise's ambition of being a major global provider of mobile money services is challenging for the biggest of companies, let alone a young UK-based business. However, the company has a well thought through strategy that plays to its relative strengths, the main elements of which are:

- focusing initially on B2B rather than B2C services
- providing an end to end managed service solution
- leveraging existing payments platforms for interconnectivity
- creating an eco-system of financial partners, retailers and mobile operators
- partnering with strong local and global financial players.

The Monitise proposition to banking clients is simple: they can buy ready-made, customisable, mobile money products on a software as a service basis, rather than having to incur the expense and time of developing and maintaining their own technology, and will benefit from the on-going costs of R&D etc being spread across other partners.

## Key Strategic Features

### B2B

Monitise sells services primarily on a B2B basis, where services are branded by client financial institutions and retailers, rather than attempting to establish itself as a B2C brand. This is a sensible approach given the costs in establishing consumer brands and the importance of trust and branding in financial services. The company has some retail exposure, for example its UK Monitise Mobile Money service, but this is effectively just another distribution channel alongside the banks' own channels.

### Fully managed services

Monitise provides a fully managed, end to end service, that both lowers the cost of service take up by customer financial institutions and retailers and maximises security. Monitise owns the underlying technology for this provision of payments and banking on mobile phones, which was granted UK patent protection in February 2009, and continues to extend the range of functionality and services on offer, including supporting new device/operating system developments. For example, Monitise announced a RIM/Blackberry version of its application in June 2011, and recently launched a much upgraded service for RBS/NatWest.

It should also be noted that the Monitise solution has been designed specifically for the mobile phone environment, whereas some of the competitive offerings can be described as 'screen-scraping' – taking an online-banking interface and re-purposing for a mobile device. The latter approach can potentially suffer from issues of security and ease of use.

### Partnerships

Monitise's approach in each new geographic or product market is to partner with a strong local player, e.g. First Eastern in Asia typically an existing bank, payments infrastructure provider (e.g. Vocalink in the UK and FIS in the US), or a strong player in the product area (e.g. Best Buy Europe in the new retail mobile money venture). The JV licenses the mobile money technology from Monitise Group, and is responsible for local sales and marketing, admin and commercial agreements.

## Strategy

In some JVs, the partners have also injected equity into Monitise Group to help fund Monitise's share of the JVs, most notably Visa Inc, which is Monitise's largest shareholder.

**Table 6: Key Monitise Partnerships/Customers**

| Partner                      | Date    | Role/details   |
|------------------------------|---------|--|
| Visa Inc.                    | June 09 | Monitise is the strategic development partner for Visa's suite of mobile services, including payments, money transfer, transaction alerts and marketing. Upgraded in June 2011 to be worth at least \$50m to Monitise over 5 years. Visa has invested £11.9m in Monitise. Visa Inc and Monitise also launched an Indian operation in May 2010. |
| RBS                          | 2007    | Key UK banking partner, now taking the fullest range of Monitise service offerings, with Monitise fully integrated into the company's banking systems.   |
| Visa Europe                  | Feb 11  | Complementary deal to Visa Inc., extending support for the Visa brand to Europe. Value not published but probably high single-digit \$m.   |
| First Eastern (Holdings) Ltd | Dec 09  | JV partner for Asia Pacific, particularly Hong Kong and China. First Eastern invested £10m in Monitise (though has subsequently sold some of its stake).   |
| FIS                          | 2007    | US mobile money partner (initially Metavante, taken over in early 2010 by FIS).  |
| Best Buy Europe              | Dec 09  | JV partner for retail Mobile Money Network. BBE (via Carphone Warehouse) is also a UK distribution partner for Monitise mobile banking.  |
| Travelex                     | Nov 09  | Monitise is operating mobile applications for Travelex's Global Passport foreign exchange card.  |

Source: I S Research Ltd, Monitise Plc

As the following table shows, Monitise's key partners have been important participants in the company's various equity funding rounds, with Table 8 highlighting their resulting status as key Monitise shareholders. Indeed, First Eastern, Visa Inc. and Standard Chartered together account for 25.8% of Monitise shares.

**Table 7: Monitise Funding Rounds**

| Date    | Investor(s)  | Price  | Amount raised (£m) |
|---------|--|--------|--------------------|
| Jun-07  | Institutional placing                                  | 22p    | 21.4               |
| Jul-08  | Standard Chartered, PCCW + institutions                | 15p    | 11.8               |
| Jul-09  | Visa Inc. + institutions                               | 7p     | 5.1                |
| Jan-10  | First Eastern, Visa, Standard Chartered + institutions | 13p    | 7.4                |
| 1Q 2010 | First Eastern, CPW + institutions                      | 13-15p | 8.4                |
| Jul-10  | Visa Inc., First Eastern + institutions                | 20.75p | 32.4               |
| Total   |  |        | 86.5               |

Source: I S Research Ltd, Monitise Plc

**Table 8: Monitise Key Shareholders**

| Shareholder                  | Stake |
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| 3i Group                     | 4.5%  |
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Source: I S Research Ltd, Monitise Plc

## Strategy

### Eco-system

Monitise's aim, both in local markets and globally, is to attract commercial partners – financial institutions, retailers and mobile operators – in order to generate virtuous network effects and economies of scale, and it now has over 250 partners in the UK and US. Whilst individual banks will be happy to provide their own branded services just to their banking client base, mobile phone operators and retailers will be more likely to want to distribute mobile banking applications if several banks are supported. Likewise, the new Mobile Money Network retail JV with Best Buy Europe will, like conventional loyalty cards, have more attraction to consumers, the more retailers are involved.

### Current Status of Geography/Products/Technology

Monitise is already well established in the US and particularly the UK. The next 12 months promises to be very eventful for the company, as new JVs launch services, and the company also trials Near Field Communications (NFC) technology.

#### The UK

The UK is Monitise's most developed market, and the showcase for the potential of mobile money in a developed market. The UK business was set up initially as a JV between Monitise and Vocalink, which operates the UK's ATM network and is a major provider of payments infrastructure. Monitise bought out Vocalink from the JV in August 2009, though Vocalink will continue to receive transaction fees from Monitise.

Monitise's UK customer base comprises Lloyds Bank, HSBC, RBS/NatWest, First Direct and Ulster Bank, together accounting for 55% of UK current account customers. RBS/NatWest is the flagship UK customer, with Monitise now fully integrated into RBS's back office systems, enabling the fullest range of mobile banking functionality, including a new iPad application.

In our view, Monitise has established a market leading position in the UK. Of the other major banking groups not served by Monitise, Barclays has its own internally developed mobile banking service, whilst Santander has yet to launch mobile banking services.

The UK demonstrates the commerciality of mobile money in a developed market, with Monitise's UK operation having reached the important milestone of cash breakeven by the end of 2010. The UK cash cost base is approximately £4m a year, or £0.33m a month which, given gross margins of c60%, suggests monthly revenues of £0.55m to achieve breakeven. Assuming the UK was 80% of the total 3m customer base at December 2010, breakeven was achieved with average revenue of £2.75 a year, split between Advanced users generating £7+ ARPU per year, Essential users generating £2-3, and Feeder users at less than £1.

#### The US

The US has developed more slowly than the UK for Monitise, though the company notes that it has seen an acceleration in take up, aided by the rollout of services to H&R Block, with imminent new services from Visa Inc. likely to further fuel growth. According to the February 2011 interim results, US revenues have been running at £0.4m per 6 months for the last three half years, at breakeven.

## Strategy

### Hong Kong, China and Indonesia

Monitise is progressing well on a Hong Kong rollout, working in partnership with First Eastern, with a target launch date of mid 2011; Monitise is collaborating with mobile operator PCCW and payments infrastructure provider JETCO. Hong Kong will serve as a springboard for the much bigger prize of China, with 886 million mobile subscribers as at April 2011, and the company has recently signed MoUs with Chinese companies Handpay (mobile payments) and China Rewards (loyalty programmes). Monitise has also signed Heads of Terms with a local conglomerate in Indonesia.

### India

Standard Chartered has launched Monitise mobile money services in India, in a format that can easily be extended to other markets where Standard Chartered is present. Visa Inc. is expected to launch services in India later this year. India holds enormous potential, with 811 million subscribers as at March 2011, growing by 10-20m subscribers each month.

### Africa

Monitise has received a provisional licence in Nigeria, where it launched a mobile wallet trial in 2011.

### Visa International and Visa Europe

Monitise and Visa Inc. signed an agreement in June 2009 for Monitise to be its strategic mobile money partner, upgraded in July 2010 and June 2011 and now worth at least \$50m to Monitise over five years. The first products were launched in late 2010, and Visa has also been granted exclusive rights to the Monitise platform in Russia and Mexico for \$1.5m. Aside from being Monitise's largest shareholder, Visa Inc. is a very important client for Monitise, with 1.8 billion credit card account holders worldwide, and 42 billion transactions annually. The recent deal with Visa Europe (a separate company but sharing the same brand) extends coverage of the Monitise service to Europe.

### Mobile Money Network (MMN)

Monitise's retail-focussed JV with Best Buy Europe and Carphone Warehouse founder Charles Dunstone was established in November 2010, and announced its first service offering– Simply Tap for one touch ordering of goods and services – as well as a heavyweight board (including Stuart Rose and Lord Mervyn Davies) in March 2011. MMN extends Monitise's existing UK services, providing a base for a broader product set that will ultimately include mobile-based payments, coupons, location based promotions, loyalty cards (eg a mobile Nectar), advertising and marketing and ticketing. Best Buy Europe will be a useful partner for Monitise, not just in the UK, with 800 stores, but also in Europe and potentially the US, given parent company Best Buy's major presence there.

### Near Field Communications

NFC is a technology that supports secure short range 2-way transmission of information to and from mobile devices, and which can be used, for example, for paying for goods and services, for ticketing and for delivering advertising and marketing to handsets, thus allowing very targeted and location-dependent promotions. The technology has existed for some time, but device manufacturers are now starting to support it, and mobile operators, banks, service providers etc are exploring its potential. Monitise is undertaking trials in the US with Visa and technology partners Device Fidelity and ViVoTech and, in time, NFC could be a key element of the Mobile Money Network. The potential of NFC is highlighted by a Yankee Group forecast of NFC-based transactions growing to \$40bn in 2014.

# Business model

Monitise's business model is based on garnering user-generated fees, plus on-going licence and deployment fees from its financial and retail partners. For financial services, Monitise receives user-generated fees directly from its banking and payments customers, with the banks deciding whether to charge their account holders for mobile banking services, or absorb the cost. We suspect a mixture; there will be customers who are prepared to pay for the utility of mobile banking, but the banks will also have an incentive to provide mobile banking services for free (as they do with online banking) given that it improves customer service and represents a much lower service cost than branch and telephone banking. Over time, banks will also generate revenues from their share of broader mobile money services, eg the retail Mobile Money Network.

Monitise segments the market into three main groups:

- Advanced users – the high end user, downloading a smartphone mobile banking application, offering the widest range of mobile banking services (account management, payments, access to m-commerce) and generating a typical ARPU of £7 per year (c60p per month)
- Essentials users –SMS-based services for low-end/feature phones, delivering more basic functionality such as user-initiated balance enquiries, alerts (weekly balance, large transactions, impending overdraft etc), and generating typical ARPU of £2 per year (15-20p per month).
- Feeder users – basic services, for example including banking sign up and credit card activation, used to attract customers to mobile banking.

Some customers will be attracted straight away as Advanced users, for example iPhone users downloading the relevant app, whilst others will migrate up from Feeder to Essentials, and possibly on to Advanced, driven by increasing comfort at using mobile banking and users upgrading to smartphones. According to the interim results statement, Advanced users now account for 29% of all registered users, Essentials for 25% and feeder for 46%, in the UK, generating an estimated weighted average ARPU of just under £3 a year.

Future average revenues will depend on a variety of factors, including the growth in ARPU per type of user driven by new revenue sources such as the Retail Mobile Money Network, and the mix between Advanced and Essentials. In a market such as the UK, it is hard to see ARPU falling below current levels, given that overall fees per type of user are likely to trend upwards, whilst the proportion of Advanced users is also likely to increase.

Group ARPU will also be affected by the mix of countries, as ARPU in developing markets such as India and China is not going to be at a similar level to the UK. However, lower APRUs will be balanced by much greater subscriber numbers in such heavily populated markets. Our financial forecasts (presented below) assume that ARPUs for the Group decline over time, reflecting the impact of the larger, less developed countries in the mix.

Aside from user generated fees, Monitise will also receive licence fee revenues and deployment/integration fees from each of its ventures.

# Results/Update Analysis

Monitise's interim results to 30<sup>th</sup> December 2010, released in February 2011, showed strong revenue growth. Total revenues trebled to £5.3m against the same period the year before, and were up 24% on the previous half. User generated fees were driven by the increasing number of users on the Monitise platform, while Deployment and Integration revenues benefited from the launch of services for customers such as Visa Inc.

**Table 9: Monitise Half Yearly Results (£m)**

| Year end June              | 1H10  | 2H10  | 1H11  |
|----------------------------|-------|-------|-------|
| Deployment and integration | £0.4  | £1.1  | £1.6  |
| Licence fees               | £0.9  | £1.3  | £1.2  |
| Transaction fees           | £0.3  | £2.0  | £2.5  |
| Total Revenue              | £1.6  | £4.3  | £5.3  |
| Revenue growth             | 41%   | 176%  | 207%  |
| Gross margin               | £1.0  | £2.9  | £3.3  |
| Gross margin %             | 66%   | 67%   | 62%   |
| EBITDA                     | -£5.5 | -£6.7 | -£7.5 |
| EBITDA margin %            | -353% | -156% | -142% |
| FCF                        | -£5.4 | -£8.9 | -£7.9 |
| FCF margin                 | -349% | -207% | -150% |

Source: I S Research Ltd, Monitise Plc

EBITDA/operating losses and cash spend both increased in the half, though as the following table shows, the operating losses can be attributed to investment in new JVs, technology and corporate costs, rather than in live operations. The live UK operations achieved cash breakeven by period end, and broke even in accounting terms for the half, whilst Global operations (Visa, Travelex) delivered significant profitability.

**Table 10: Monitise 1H11 Revenues and Losses (£000)**

| Year end June          | Revenue      | Operating profit (loss) |
|------------------------|--------------|-------------------------|
| - UK                   | 2,707        | 20                      |
| - US                   | 390          | 8                       |
| - Global               | 1,843        | 921                     |
| <u>Live operations</u> | <u>4,940</u> | <u>949</u>              |
| Future operations      | 368          | (3,083)                 |
| Technology             | -            | (3,304)                 |
| Corporate              | -            | (2,491)                 |
| <b>Total Group</b>     | <b>5,308</b> | <b>(7,929)</b>          |

Source: I S Research Ltd, Monitise Plc

On the 13<sup>th</sup> July, the company gave an update on trading for the year ending 30<sup>th</sup> June 2011, which stated that revenues will be about £14m, suggesting growth from £5.3m in 1H to c£8.7m in 2H, and a more than doubling in revenues for the year. The company also gave strong guidance of revenues doubling again in FY11/12. The release also stated that operating profits and cash flow of live operations grew strongly in 2H, facilitating investment in business development. The company ended the year with net cash of over £23m, implying c£10m cash spend in 2H.

## Financial Forecasts

We have revised our forecasts (last updated at the interims), to take account of the year end trading update and the upgraded Visa Inc agreement, both of which support higher revenues, as well as break-even pushed back to FY14, in line with company guidance of break-even at the end of calendar year 2013. The trading update suggests an increase in revenues for FY11/12, no doubt aided by the new Visa Inc. agreement, which also supports increased longer term revenue forecasts. New FY14 revenues and EBITDA are £59.8m and £8.7m against £54.9m and £7.2m previously. The forecasts are based on the following major assumptions

- Customer numbers are driven by an assumed 150,000 new users per month per JV in operation – this is the average rate of growth in the UK, though the rate of growth from JVs such as China and India is likely to be much higher.
- We assume a decline in ARPU per customer from £2.70 a year currently to £1.75, with growth in lower spending markets such as China and India offsetting rising ARPUs in individual markets from new services.
- Licence fees are assumed at £1m per JV in operation per year.
- The gross margin is 62%.
- Monitise overheads (including share of JV costs) grow from the current annualised level of approximately £18m towards £30m, reflecting the costs of supporting new JVs.

We forecast Monitise customers growing from c4.5m currently to 45.6m by June 2014 (and to 70.4m by June 2015). To put this forecast into context, 46m customers in 2014 would represent 5% of the 914m mobile banking users forecast by Berg at that date, or just over 1% of the world's mobile phone users. If mobile money grows in line with Berg's forecast, a market share of 5% for Monitise is certainly achievable given its current strong position and particularly its imminent launch in India and strategic entrée to China through First Eastern.

**Table 11: Monitise Revenue Assumptions**

| Year ended June                   | FY-11 | FY-12 | FY-13 | FY-14 | FY-15  |
|-----------------------------------|-------|-------|-------|-------|--------|
| Active country/product JVs        | 4     | 6     | 9     | 11.5  | 14.5   |
| Monthly customer adds per JV (m)  | 0.13  | 0.10  | 0.15  | 0.15  | 0.15   |
| Customers (end period) - m        | 4.4   | 11.0  | 26.3  | 45.7  | 70.4   |
| Customers (average) - m           | 3.6   | 7.7   | 18.7  | 36.0  | 58.0   |
| ARPU (£ per year)                 | 2.65  | 2.55  | 2.12  | 1.98  | 1.91   |
| Usage revenue (£m)                | 9.53  | 19.63 | 39.61 | 71.28 | 110.76 |
| Monitise share                    | 70%   | 65%   | 60%   | 55%   | 50%    |
| Monitise transaction revenue (£m) | 6.67  | 12.76 | 23.77 | 39.20 | 55.38  |
| Licence fee per JV (£m per year)  | 1.0   | 1.0   | 1.0   | 1.0   | 1.0    |

Source: I S Research Ltd

## Financial forecasts

The resulting revenue forecasts by type are shown below. Note that although we have forecast in terms of deployment, licence fees and user generated fees, the actual breakdown may turn out different depending on the types of agreements struck by the company. However, the company has visibility over revenues doubling this year, and with a significant level of contracted revenues from the Visa Inc agreement, we are confident that Monitise will experience rapid growth in revenues. According to our forecasts, user-generated revenue rise from less than a fifth of revenues in FY2009 to just under half of revenues in FY 2011, driven by the rollout in JVs, whilst licence fees continue to rise, but form a declining proportion of revenues. Deployment revenues are likely to be a significant element for some time, given the major venture-related work being done for companies such as Visa Inc and Visa Europe. In line with company guidance, we forecast total revenues to double from £14m to £28m in FY12, and then grow 50% to £42.3m in FY13, as several new JV start to build momentum, including Hong Kong and China, India, Africa and the retail Mobile Money Network.

**Table 12: Monitise Revenues (£m)**

| Year end June          | FY-9 | FY-10 | FY-11 | FY-12 | FY-13 | FY-14 | FY-15 |
|------------------------|------|-------|-------|-------|-------|-------|-------|
| Revenue by type        |      |       |       |       |       |       |       |
| Deployment/integration | 1.1  | 1.4   | 4.8   | 10.0  | 10.0  | 10.0  | 10.0  |
| Growth                 | 10%  | 33%   | 237%  | 108%  | 0%    | 0%    | 0%    |
| Licence fees           | 1.1  | 1.7   | 2.4   | 5.5   | 8.5   | 10.7  | 13.7  |
| Growth                 | 175% | 57%   | 40%   | 126%  | 55%   | 26%   | 28%   |
| User-generated fees    | 0.5  | 2.9   | 6.7   | 12.8  | 23.8  | 39.2  | 55.4  |
| Growth                 | 400% | 491%  | 134%  | 91%   | 86%   | 65%   | 41%   |
| Total Revenue          | 2.7  | 6.0   | 13.9  | 28.3  | 42.3  | 59.8  | 79.1  |
| Growth                 | 78%  | 126%  | 131%  | 103%  | 50%   | 41%   | 32%   |

Source: I S Research Ltd

Our summary financial forecasts are shown below. We forecast breakeven at EBITDA, net profit and cash flow in FY14, with the company generating a 14% EBITDA margin. The £23m of net cash at June 2011 should be sufficient for the company to reach cash flow breakeven, though the record shows that there is no shortage of partners willing to invest in Monitise should additional opportunities present themselves.

## Financial forecasts

Table 13: Monitise Summary Financials (£m)

| Year ended June                      | FY-09 | FY-10 | FY-11 | FY-12 | FY-13 | FY-14 | FY-15 |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|
|                                      | Act   | Act   | Est   | Est   | Est   | Est   | Est   |
| <b>Profit &amp; Loss</b>             |       |       |       |       |       |       |       |
| Revenue £m                           | 2.7   | 6.0   | 13.9  | 28.3  | 42.3  | 59.8  | 79.1  |
| Adj EBITDA £m                        | -11.4 | -13.2 | -14.5 | -9.5  | -0.8  | 8.7   | 19.3  |
| Adj EBIT £m                          | -11.6 | -14.3 | -15.4 | -10.8 | -2.7  | 5.9   | 15.1  |
| Reported PBT                         | -13.1 | -17.0 | -16.9 | -12.5 | -4.7  | 3.7   | 12.6  |
| PBT pre exceptionals and AAG         | -12.8 | -18.0 | -16.9 | -12.5 | -4.7  | 3.7   | 12.6  |
| Fully adj PBT                        | -11.0 | -14.2 | -15.0 | -10.4 | -2.3  | 6.3   | 15.5  |
| NOPAT                                | -8.1  | -10.0 | -10.8 | -7.6  | -1.9  | 4.1   | 10.5  |
| Reported EPS                         | -4.0  | -3.7  | -2.4  | -1.8  | -0.7  | 0.5   | 1.8   |
| EPS pre exceptionals and AAG         | -2.7  | -2.8  | -1.7  | -1.2  | -0.5  | 0.4   | 1.3   |
| Fully adj EPS                        | -2.3  | -2.2  | -1.5  | -1.0  | -0.2  | 0.6   | 1.5   |
| Dividend per share p                 | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| <b>Cash flow &amp; Balance sheet</b> |       |       |       |       |       |       |       |
| Operating cash flow                  | -11.4 | -14.1 | -16.3 | -10.7 | -2.2  | 7.2   | 17.6  |
| Free Cash flow £m                    | -11.3 | -14.9 | -16.5 | -11.6 | -3.7  | 4.8   | 13.8  |
| FCF per share p                      | -3.4  | -3.3  | -2.4  | -1.6  | -0.5  | 0.7   | 2.0   |
| Capex                                | -0.3  | -1.1  | -5.0  | -5.0  | -5.0  | -5.0  | -5.0  |
| Acquisitions                         | 0.0   | 0.1   | -0.5  | -0.2  | -0.1  | 0.0   | 0.0   |
| Net cash flow                        | -11.1 | -14.8 | -21.2 | -15.6 | -6.9  | 2.5   | 13.0  |
| Shares issued                        | 11.6  | 17.9  | 31.1  | 0.0   | 0.0   | 0.0   | 0.0   |
| Net cash                             | 10.1  | 13.2  | 23.1  | 7.6   | 0.7   | 3.2   | 16.2  |
| <b>Metrics</b>                       |       |       |       |       |       |       |       |
| Revenue growth                       | 78%   | 126%  | 131%  | 103%  | 50%   | 41%   | 32%   |
| Adj EBITDA growth                    | -8%   | na    | na    | na    | na    | na    | 122%  |
| Adj EBIT growth                      | -9%   | na    | na    | na    | na    | na    | 156%  |
| Adj PBT growth                       | -7%   | na    | na    | na    | na    | na    | 240%  |
| Adj EPS growth                       | -28%  | na    | na    | na    | na    | na    | 240%  |
| Dividend growth                      | NA    | na    | na    | na    | na    | na    | NA    |
| Adj EBIT margins                     | -437% | -237% | -111% | -38%  | -6%   | 10%   | 19%   |
| Operating cash conversion            | 100%  | 107%  | 112%  | 113%  | 259%  | 83%   | 91%   |

Source: I S Research Ltd

# Valuation Discussion

Monitise cannot readily be valued on conventional current year multiples, given that it is generating small (but fast growing) revenues (in the context of its market capitalisation), and is unprofitable. However, as the following table shows, by FY15 the company is trading on multiples that are in line with current year multiples of well-established companies. For example, according to Megabyte.com, banking and insurance software companies currently trade on 1.9x revenues, 11.5x EBITDA and 16.2x PE, whilst fast growth tech companies such as Autonomy and Misys trade at PEs above 20x and mid-teens EBITDA multiples. Given its exposure to end user revenues, and to potentially very fast growing revenue streams from mobile advertising and e-commerce, alongside mobile banking, Monitise should justify a premium rating.

**Table 14: Monitise Valuation metrics**

| Valuation      | FY-11 | FY-12 | FY-13  | FY-14 | FY-15 |
|----------------|-------|-------|--------|-------|-------|
| EV/sales       | 18.2  | 9.5   | 6.5    | 4.6   | 3.3   |
| EV/EBITDA      | -17.4 | -28.1 | -324.2 | 31.3  | 13.5  |
| EV/NOPAT       | -23.4 | -35.5 | -144.4 | 66.0  | 24.6  |
| PER            | -25.7 | -37.9 | -170.1 | 62.5  | 25.4  |
| Dividend yield | 0%    | 0%    | 0%     | 0%    | 0%    |
| FCF yield      | -6%   | -4%   | -1%    | 2%    | 5%    |

Source: I S Research Ltd

We are not fans of DCF valuations, given the difficulty in forecasting even two years ahead for a company like Monitise, let alone ten years ahead! However, the current share price of 39p is equivalent to applying a 17x EBITDA exit multiple and a 15% discount rate to FY16 forecasts. Thus the current price, whilst involving high multiples, can be rationalised in terms of company forecasts. This would imply an exit value of £515m in 2016, which is plausible if the market and Monitise develop as we expect.

An alternative approach is to consider Monitise's strategic value, which we believe could be significant. Indeed, the company's strategic value has been amply illustrated by companies such as Visa Inc., Standard Chartered, Carphone Warehouse and First Eastern being willing to invest in Monitise, at premiums to the prevailing share price. The mobile world has seen significant strategic activity, often involving high valuations. Some of these are summarised below, and include four mobile money deals: Nokia investing \$70m in Obopay, Qualcomm buying Firethorn for \$210m, eBay's recent acquisition of Zong for \$240m, as well as Visa Inc's \$110m acquisition of emerging markets focused mobile banking provider Fundamo (announced at the same time as Visa's upgraded agreement with Monitise). Visa Inc. has also invested in Square, a start up that enables users with an Apple or Android phone to accept credit card payments; press reports suggest that Square recently raised \$100m at a \$1bn valuation. In this context, the £515m exit valuation for 2016 implied by the current share price for a strong player in a rapidly growing market does not seem out of place.

This of course raises the question of who would buy Monitise? It is unlikely that an existing banking customer would, for fear of alienating Monitise's other financial partners. One exception might be Visa Inc, which presumably could more easily co-exist with Monitise's banking customers. Outside of banking, Nokia has invested heavily to expand beyond its handset and networks manufacturing activities and although the company has already invested in Obopay, its recent tie-up with Microsoft could presage further activity, particularly given Microsoft's evident desire for strategic M&A (paying \$8.5bn for Skype). The other contenders include Google and Apple, who regard mobile as major growth areas (and a priority area in the case of Google), as well as the major banking technology or software suppliers.

## Valuation discussion

**Table 15: Example Mobile Strategic Investments**

| Date      | Buyer     | Target/sector               | Details                          |
|-----------|-----------|-----------------------------|----------------------------------|
| July 2012 | eBay      | Zong, mobile payments       | \$240m                           |
| June 2011 | Visa Inc  | Fundamo, mobile banking     | \$110m                           |
| Jan 2010  | Apple     | Quattro, mobile advertising | \$275m                           |
| Nov 2009  | Google    | AdMob, mobile advertising   | \$750m, or 7.5x current revenues |
| Mar 2009  | Nokia     | Obopay, mobile banking      | Reported \$70m for a stake       |
| Nov 2007  | Qualcomm  | Firethorn, mobile banking   | \$210m                           |
| Nov 2007  | Microsoft | Musiwave, music             | \$46m                            |
| Sept 2007 | Nokia     | Navteq, navigation          | \$8.1bn                          |
| July 2007 | Nokia     | Twango, social networking   | \$97m                            |
| Dec 2005  | EA Games  | Jamdat, mobile games        | \$680m                           |

Source: I S Research Ltd

Overall, we believe that the current share price of 39p can be rationalised by our financial forecasts, but can also see significant value appreciation as the potential of the new JVs becomes more apparent and new JVs are signed. The fact that Visa Inc. has now twice expanded the scope of its activities with Monitise, along with Google's recent mobile wallet initiative, shows how major strategic players are broadening and accelerating their mobile money ambitions, which gives us increasing confidence of the likely substantial size of the market opportunity and also the possibility of continued revenue upgrades for Monitise. Visa's recent further vote of confidence in Monitise also provides yet more assurance that Monitise will play a key role in the development of the market.

## About I S Research

I S Research was founded by Ian Spence in 2007. Ian has been involved in researching and advising companies in the UK technology sector for over 15 years and was voted TechMARK analyst of the year in 2004 and again in 2008 making him the only analyst to win twice and the only independent analyst to be recognised in this way. In 2009, he was joined by Philip Carse, who brings 20 years telecoms experience as a consultant and equity research analyst, expanding Megabyte coverage all aspects of communications services and technologies.

The business was founded on Megabyte. Originally a free blog, our market intelligence service is now available to subscribers only and is now read daily by many of the sector's leading CEOs, investors and advisers.

From this firm foundation we went on to launch our Equity Research service. Our blend of high quality, genuinely independent research combined with intelligent distribution has led to rapid growth for this element of the business.

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**IS Research Ltd**

The Granary, Home Farm  
Ridge Lane, Rotherwick  
Hampshire, RG27 9AX

T +44 (0) 1256 768833

E [info@is-research.co.uk](mailto:info@is-research.co.uk)

[www.is-research.co.uk](http://www.is-research.co.uk)



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