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Investor Presentation

EML Payments Limited (ASX: EML) is pleased to provide investors with a transcript of its investor presentation held yesterday.

About EML Payments Limited

At EML we develop tailored payment solutions for brands to make their customers lives simpler. Through next-generation technology, our portfolio of payment solutions offers innovative options for disbursement payout's, gifts, incentives and rewards. We're proud to power many of the world's top brands and process over $17 billion in GDV each year across 28 countries in Australia, EMEA and North America. Our payment solutions in 27 currencies are safe and secure, easy and flexible, providing customers with their money in real-time. We know payments are complex, that's why we've made the process simple, smart and straightforward, for everyone

We encourage you to learn more about EML Payments Limited, by visiting: EMLpayments.com

This announcement has been authorised for release by the Company Secretary, Paul Wenk.

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Company: EML Payments
Title: FY20 Annual Results Webcast
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Time: 10:00AM AEST

Start of Transcript

Operator: Ladies and gentlemen, thank you for standing by and welcome to the EML FY20 Annual Results conference call. At this time all participants are in a listen only mode. After the speakers' presentation, there will be a question and answer session. To ask a question during the session, press star 1 on your telephone. I must advise you that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Group CEO and Managing Direction of EML Payments, Tom Cregan. Thank you, please go ahead.

Tom Cregan: Thanks for that, good morning and welcome to the EML Payments earnings call for the 2020 financial year. My name is Tom Cregan, Managing Director and Chief Executive Officer, and I'm joined today by Rob Shore, our Group Chief Financial Officer. We'll take you through a business update and our financial results, but we will also use the opportunity to share with you some details on our corporate strategy Project Accelerator which went live on 1 July.

This is certainly an unusual reporting season for EML, given we experienced the impacts of COVID-19 as well as the closing of the acquisition of Prepaid Financial Services on 1 April. We've included as much detail as possible to try and explain the relative impacts of both on the 2020 financial year result, but more importantly and in the absence of earnings guidance on the future outlook for the business.

As those who follow the company know, we've had a long-term strategy of diversification, be that at a product level, geographic level and financial level. We've had a clear strategy of transitioning our company from one deriving the majority of its revenue from gift cards, into one that derives the majority of its revenues from GPR programs, and concluding the acquisition of Prepaid Financial Services on significantly improved terms was a clear demonstration of that strategy.

That strategy has served us well in weathering the immediate impacts of COVID in the second half of the financial year, which started to impact our results in our gift and incentive segment in late February, and saw GDV in mall gift card programs fall by more than 90% in April due to lockdown measures in most countries. Putting that into perspective, each $100 million of GDV in the gifted incentive segment equates to approximately $6 million in revenue and $4.9 million in gross profit.

So, the impact on our financials was immediate and significant. Offsetting that was an increase in our incentive gift card programs which ended up representing a larger share of the GDV in the G&I segment, and our GPR segment continued to grow both organically and inorganically through the contribution of PFS. The impact of COVID gave us the perfect opportunity to refine and focus on our strategy, and courtesy of our renegotiated terms on the PFS acquisition, the balance sheet to execute on it.

We'll get into that later in the presentation but it is important that we share our strategy with investors, it's probably something we don't do often enough, and that you understand where we will see ourselves competing and winning in the global payment market in the years to come. We've embraced the disruption to our business, and we will benefit from working with companies looking to disrupt their own industries and using our payment technology to do so.

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On slide 3 we have our Company snapshot. Group revenue increased by 25% to $121.6 million, driven by a 54% increase in GDV to $13.88 billion. Group EBITDA increased 10% to $32.5 million, and Group NPATA increased 17% to $24 million. EBITDA was excluding our acquisition costs for the PFS transaction and included $600,000 in one-off restructuring costs that we incurred in late June with respect to targeted redundancy payments which we expect will generate $1.5 million of savings in FY21.

But without restructuring costs, we would have come in at a number closer to $33.1 million, but it made sense to make those decisions in late June and clear the decks for FY21. So, we've had the impact of COVID and expanded all of our key measures was a pleasing result, and a testament to the team and to our customers and our partners' ability to adapt to changing circumstances. Such as the New South Wales Health Department salary packaging launch without any in-person meetings being possible, or our card manufacturing partner G&D managing supply chains that became more complex, particularly due to the lack of availability of freight, yet managing to have cards manufactured and delivered with no customer impacts.

Moving to slide 5, the main callout here is that our underlying cashflow was $35.8 million at 110% of EBITDA. Again, underlying cashflow excludes acquisition costs and also excludes a one-off $3 million foreign exchange cash gain we made on the unwinding of the hedge put in place in November 2019 and unwound in March 2020. But as this was a one-off cash FX gain we've excluded it from our calculations of underlying operating cashflows.

The second callout is that the $118.4 million in cash obviously gives us a very strong balance sheet. Whilst we would not expect to see much in the way of acquisitions in the next 12 months, our cash balance and access to debt markets would position us favourably to take advantage of opportunistic M&A opportunities if they were to be around. But what we do have is the cash to fund Project Accelerator, which is focused fairly and squarely on driving organic growth.

On slide 6 we have a recap of the PFS acquisition. The original purchase price was $425 million, representing an EBITDA multiple of 17.5 times plus a performance based earnout. Under the revised terms of the acquisition, the valuation was $268.4 million, whilst their short-term financial results were also impacted by COVID due to lockdowns in their key markets in the UK, France and Spain. GDV has recovered to a Company record of $520 million in July 2020, which is a positive sign and certainly befits out view that their programs are more non-discretionary in nature.

As a result, we would therefore expect that our effective acquisition multiple is significantly improved versus the original. On slide 7 we restate what the GDV breakdown was for PFS when we acquired them. We have seen a mix shift between those segments post acquisition but given the impact of COVID and the fact we've only had three months of ownership, we'll need another quarter or two to determine whether that shift is temporary or extended.

GDV as I mentioned, in July the record at $520 million with a strong performance in the banking-as-a-service and government segments, at a conversion rate of 124 basis points. The conversion rate when we acquired PFS was circa 165 basis points, and that yield has come down in the last quarter to 124 basis points, driven largely by lower volumes in the multicurrency segment due to lower worldwide travel, those programs are at a higher conversion yield; lower interest rates; and the establishment and setup fees being amortised over the life of the contracts as required by the AASB accounting standards.

Moving onto slide 8, we're showing GDV trends by segment over a two-year period so investors can see the impact of COVID at a segment level on GDV. In the gift and incentive segment, our seasonal GDV in FY20 was 17% up on the prior year in those key seasonal months, and we were 26% up at the end of February on a year to date basis. So, travelling very well relative to the prior year in that segment. As I mentioned before we then saw significant declines in our mall programs for the next few months but offset to some degree by growth in incentive gift card programs.

For example, in April when our GDV in that gift and incentive segment was $30 million, the vast majority of that was incentive programs. In the GPR segment we saw resilience in gaming programs and continued growth of salary packaging, and PFS volumes obviously came into play in the last quarter. In the VANS segment we saw a volume decline in the last quarter as well, particularly in the healthcare industry, our customers in the healthcare industry, due to social distancing and mobility restrictions, but obviously this is the lowest revenue yield of our three segments.

On slide 9 we've shown a number of new contracts that we entered into, some of which were shown in our previous presentations during FY20. On slide 11 we're pleased to announce some additional contracts entered into that will launch in the current financial year and continue to drive our growth, despite the impacts of COVID and remote working, the pace of digital payment adoption has increased significantly, and our sales pipeline is reflective of this, which augers very well for future revenue growth.

In terms of terminology, just one point I'll make on that slide is that Control Pay remains our banner for programs involving consumer credit and companies disrupting traditional consumer credit programs. Salary as a Service is just new terminology for programs involving salaries, whether that be salary packaging, payroll cards or earned wage access programs where workers are able to access parts of their payroll prior to payday. Given Salary Packaging is largely an Australian program, we need to standardise our terminology so overseas partners and prospective investors understand the programs that we're offering in that broader space.

On slide 11 we intended to provide a bit more clarity on the metrics of each segment, and it's a breakdown for investors and analysts. The gross profit we generate on a per card or per account basis, and you could obviously back solve with a revenue generated on a per card, per account basis as well. We continue to try and simplify our investor relations narrative, and with the business at its current size, boiling that down is now the simplest way to analyse the business, versus trying to do an assessment of segment by segment by segment and understanding all of the moving parts in those segments.

As we've previously disclosed in March, we have suspended our guidance and we won't re-initiate that until the new calendar year, but we are a platform technology company and with millions of cards issued every year and millions of accounts on the platform, it would take a significant new customer at a disproportionately higher or lower yield or higher or lower margin to change those averages. Meaning we can simplify our guidance going forward and focus on the number of cards and or accounts we expect to manage irrespective of what industry our customers operate in. That, I think, should simplify our modelling and our analysis in the market and be advantageous to investors.

Again, there is a COVID impact in these numbers, so that has to be taken into account, but in the G&I segment we generated approximately $5.44 per card in gross profit, $25.41 per account per annum in the GPR segment and $0.38 per transaction in the VANS segment. The other main takeaway from this slide is our gross margin at 72.9%. EML has previously been working to increase our gross margins from the low mid-70% region to circa 80%, largely through self-issuing and removing those input costs, and excluding PFS we did achieve that this year, but including PFS the Group result was 72.9%

Investors will recall that salary packaging programs are lower margin because of higher transactional usage. PFS margins are lower than EML because of outsourced processing costs. We previously indicated that we expect to generate circa $6 million in synergy savings over three years from PFS on the processing side, and that would equate to a roughly 5% to 6% margin uplift. So, that and a recovery in multicurrency volumes at a higher yield would also lead to margin uplift closer to the original expectations when we acquired the business.

Realistically, if we see a recovery and more gift card volumes this year, particularly in the seasonal peak months, our expectation would be that overall gross margins remain in the low 70% range in FY21 for the combined business.

I won't spend as much time on slide 12, but to grow GDV and revenue in each segment was a great result, in our view. Obviously $1.25 billion in GDV from PFS in the fourth quarter means we're positioned to have real material growth in our GPR segment in FY21.

On slide 14, if I kick onto that, we show our five-year track record of EBITDA growth and our growth drivers going forward and our July gross debit volume. Whilst it's only one month, we processed $72 million in the G&I segment, $834 million in the GPR segment, and $727 million in our VANS segment. So, we've started the new financial year well with $1.63 billion processed in July. That refers back to slide 3, I think, of the deck where we said the annual GDV run rate stands at $17 billion.

Clearly, it's one month and we can't read too much into one month, but always better to start positively than not. So, we are pretty optimistic about the way we started the year. Our growth drivers are many, but we certainly see Banking-as-a-Service and FinTech programs supported by general long-term growth thematics in that space. We see an expansion of salary-related programs and we see them in the market, we see them within our existing sales pipeline. We've got Control Pay and launches pending in the buy now pay later segment and as previously mentioned, sales growth in digital incentive gift cards.

Malls, interesting have gone from the mainstay of the business to providing earnings optionality as volumes recover. Albeit that sector is not without its challenges and it's still too difficult to predict what that recovery looks like and over what time period.

On slide 15 we continue to be committed to the G&I segment and mall cards, that shouldn't be read any differently, but clearly there are COVID related impacts that make volumes unpredictable. We see malls that are open but do not have any attendants selling gift cards, Simon Malls being one of those examples. We see others that are in administration, such as Intu Properties in the UK. So they're open but selling a fraction of their previous volume because customers have been questioning whether they would buy a gift card and whether they could use it going forward, because obviously they're reading in the news media that Intu is in administration.

We have others that are open but selling a fraction of previous volumes. We see malls open and selling and with foot traffic down 30% on historical levels, we've got malls that are open but 20% of tenants closed within the mall. Then we've got malls in countries like Italy and Scandinavia that are basically back to pre-COVID levels already. So, it is a mishmash of what we're seeing there still in the malls space.

It's also possible that European countries reinstitute some lockdown measures as they go through the European winter, which could also negatively impact seasonal peak volumes. So, again hence why we've suspended guidance for the year, and we'll look to do that and reinstitute that in the new calendar year once we've got through that peak seasonal period. We continue to roll out EML Connect, which is a platform to enable malls to sell cards digitally through eCommerce channels, and we've made a decision to exit the UAE market.

Slide 16 is self-explanatory, we've added 58,000 active accounts in our salary packaging programs, with a further 67,000 accounts in transition over the course of the financial year, which is an exciting proposition for us. As exciting, the majority of those customers have transitioned across to Mastercard and our self-issuance platforms, and be that the ACT Government, New South Wales Health, Southgate, PBI Solutions, Smart Salary, AccessPay, Maxxia and so on, so we have made a lot of progress with our key partners in that space in the last 12 months.

Now I want to spend a few minutes on Project Accelerator, given we are often asked by investors how we compete successfully against other large players in the payments industry. Referring to page 18 of that deck, investors would be well aware of our mission statement, they've heard it many times, and part of the project was defining a vision statement. For us, and this is a strategy that's been worked on for several months, not for a number of weeks, the

vision that we've settled on is to offer customers a feature rich, fully embedded payment solution via a simple single touch point.

As you would have seen earlier in the deck, we are pleased to announce that we will be partnering with Laybuy, a leading buy now pay later company, soon to list on the ASX, to support their business in Australia and the UK later this calendar year. A new partnership that we're really excited about but one that also requires Laybuy to undertake two integrations with EML, one to our Australian processor and one to our European processor.

These multiregional fintech partnerships are what we want to see more of and what we want to compete more often for. To compete for those programs, we need to offer our customers a single integration touch point. As we've grown through acquisition and have three processors, we do not intend on migrating to a single processor. We do intend on building middleware so that it's one integration, one application layer, one touch point to the customer, irrespective of which processor or processors are then used to actually process transactions.

Our purpose statement has also been refined to - as inspiring transformative digital change for our customers and our communities. What that means is that if a customer wanted to process $1 billion of VANS through our platform, we would obviously do that, because our shareholders would expect that, and our budgets would demand that. But we will generate longer-term shareholder value by partnering with fintechs that are disrupting their own respective industries and will be using EML in part to support the payments aspects of their business and of that disruption.

This is obviously a summary of the strategies, but looking at slide 19 we will be investing in our technology and our infrastructure to support that single touchpoint integration, as well as enhancing our sandbox capabilities, becoming cloud native and becoming scheme agnostic, so offering the same solutions across all scheme networks. We expect to invest roughly $10 million to $15 million over the next two years.

Whilst we support Visa products in Australia and North America, we don't support digital tokenised payments on the Visa network. Historically this hasn't really been an issue because customers seem to see them in the same light. But in Visa and Mastercard there are investment funds, we are seeing them use their balance sheets to invest in and therefore lock in certain programs to certain networks. We've been caught in the crossfire on that on a couple of occasions, so we will invest in product parity so we can support whatever scheme preference our customers might have committed to.

We expect to spend $10 million to $15 million over two years, and roughly speaking we'd expect that to be a 65/35 split over those two years. We expect part of that to be capitalised, and the non-capitalised component we'll self-fund through expense rationalisation elsewhere in the business, such as the $1.5 million of savings generated through employee rationalisation late in FY20.

We will become a product-centric organisation partnering with other companies and integrating their solutions into our own, providing additional functionality and value to our customers and their cardholders. We will look to invest in technology companies that can enhance our own solutions, our own go-to-market offerings and expand the ecosystem of opportunities that flow from that, which we've coined internally as FinLabs, and we will align our decisions behind Accelerator. So, whether that be who we hire, whether that be where we invest our capital, where we focus our marketing, our marketing spend, our decisions as an organisation will be driven by Project Accelerator and that vision and that purpose statement.

Slide 20 expands on these themes a little, including the fact that we will be partnering with disruptive fintechs and supporting their programs and looking for ways of integrating their solutions and/or cross selling our solutions to their customers.

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On slide 21 we'd like to announce the first FinLabs investment in the USA, an investment of US$2 million into the series A raising of a company called Interchecks, which is a payment platform specialising in non-card payment mechanisms. For example, if a gaming customer wants to pay out to a card, we can clearly facilitate that. If that gaming company wanted to partially pay out to a card but also to a bank account, we would have development effort there. If they wanted to partially pay out to a card, some to a bank account and potentially some to a social media account, again we would have development effort there. Interchecks provides us with that capability from the get-go, and the ability to offer our customers a more feature rich product as well as cross sales capability to their customers looking to integrate a prepay payout functionality.

We're actively progressing a second opportunity in terms of FinLabs and hope to close that in the next 30 days. The combined investment level for both investments would be circa US$9 million to US$10 million. We are very clear on where we would look to invest and why, and these are key points. We're approaching each opportunity based on its ability to generate a cash on cash return for EML, with any gain on valuation upside being a secondary consideration. So, we're not entering these investments thinking like a traditional PE investor may think.

We'll manage our risk exposure and not bet the family inheritance on one deal, and the two that we have worked on have undergone extensive due diligence. It's worth noting that any impairment in valuations could impact NPATA, which in turn will impact on executive compensation, so we aren't out there spending like the proverbial drunken sailor just because we have the balance sheet to do so.

We'll be selective and we're not going to undertake dozens of these investments in an untargeted manner. We will make them selectively, we'll integrate them, we'll have a plan to monetise them before moving on to identify other opportunities. They are minority investments, they're not investment that you must have control over the entity.

As you'll see on the following page, many of our competitors and the largest players in the industry have similar incubation and investment strategies, and they've deployed their capital to drive their own organic growth and valuations over the years. So, Stripe has, I think the last valuation was $35 billion, has Stripe Atlas as their similar part of their business.

Edenred, a €10 billion market company, has Edenred Capital Partners. FIS, one of the largest payment companies in the world, has $150 million investment fund. Mastercard and Visa have similar, Mastercard Fintech Express and Visa have their own similar option, and more recently in Australia you can see the big banks have started doing something similar. So, it's common in the payments industry and probably more common than most investors would appreciate.

We feel that we can deploy our capital smartly to drive our own organic growth rates, and whilst larger M&A is more difficult, unless the company is known to us, those challenges are less when considering investments of this nature. As you would appreciate, a significant part of M&A is understanding the people and understanding the team and understanding the cultural fit and understanding how you would integrate two businesses. In this case, we're an investor into those businesses, so the focus from our due diligence is far more on technical, far more on integration than it is on those other items.

On slide 23 we've got a general slide talking about what the fintech ecosystem includes, there's different slides available that would show different things, but what we wanted to say, we already service several customers across these different segments. At the end of the day Project Accelerator and its constituent parts are there to turbocharge those endeavours over the coming three years.

When COVID hit, we did not see that through a narrow prism of survival, nor did we want to recover from COVID in the same shape that we went into it. We did not want to come out of COVID as the largest mall card provider in the world, we took the opportunity to reimagine what this business could look like in three years and we hit the ground running.

The investments in Interchecks and others and deal flow and other product partnerships that will be made in due course reflect the work that's already been done in the previous six months to get us into this position.

Finishing up quickly, looking to slide 25, we are holding EMLCON virtually this year, but will include a range of global industry experts, partners and customer presentations and we'll include our FinLab investment partners in that. So, it's a great opportunity for us and for them to show you Accelerator in action. One point I would make is that we won't be pushing to provide investor access to our FinLabs investments given we are a minority shareholder and they have businesses to run. But EMLCON and the use of other social media platforms provides us with the opportunity to communicate those to the market.

Before I hand to Rob to go through the financials, we are committed to our people, and we've included a few slides on those initiatives. It's not corporate speak, it's a serious commitment and we feel that when challenges are thrown at us such as COVID, our people rise to the occasion and in and of themselves are a competitive advantage for us. Our environmental initiatives which you may have seen through media channels is called Change for Good, which will see us try and replace as many plastic cards as we can with more environmentally friendly and digital alternatives.

Our aim is to eliminate 25 million plastic cards over the next three years. So, we're not eliminating the volume, we're just eliminating the - switching the form factor if you like - from plastic to more environmentally friendly or digital alternatives. So far, we've had orders worth about $600,000 in environmentally friendly alternatives, and many of our retail partners share the same goal as we do with respect to the environment. So, they're looking forward to championing this change along with us.

With that I'll hand over to Rob.

Rob Shore: Thanks, Tom, and good morning everyone. I'll take you through the financial results review shown on slide 29 of the pack. The financial year ended 30 June 2020 was a split story, we had a strong set of trading results for the first eight months of the year, followed by a challenging period where COVID impacted us quite significantly, and then there's signs of recovery through June. I'll talk more about the July 2020 results and what we can share on the outlook for FY20 later in this presentation.

Whilst the year was impacted by COVID, the result for the year still delivered record GDV, record revenue, record EBITDA, record net profit after tax excluding acquisition related costs, which is our preferred metric moving forwards. Record underlying operating cash conversion 110% or $35.8 million, and also the largest acquisition we've completed to date in PFS.

There's quite a bit to walk you through as shown on the highlights in this slide, and in all the comments I'm about to make, it's important for you to remember that PFS was consolidated from 1 April 2020.

Starting with Group gross debit volume on slide 30, there are some key takeaways to highlight. Whilst we saw COVID impact all segments and regions at some point form March, the GPR and the VANS segments were impacted much less significantly than our Gift and Incentive segment. Our Gift and Incentive segment saw significantly reduced volumes in malls due to global closures during the worst months of the pandemic.

It's kind of impossible to accurately quantify the impact of COVID on the segment, but we'd estimate it would be significantly more than $200 million of GDV based upon the run rates as at the end of February. We've seen the majority of the volume for the segment recover through June and July, and whilst we're encouraged by this, we remain cautious about interpreting too much from one- or two-month's volume data.

What we have seen in these most recent months is firstly mall volumes have recovered to about 75% of pre-COVID levels, we've got better numbers out of Europe than North America, but we do expect social distancing will remain an

issue for some months to come. So, what that means is service desks are not necessarily open to sell gift cards in all malls at all times. Simon Malls for example is only expecting to reopen all their service desks during August. The European customers seem to be working through this on a mall by mall basis.

We've seen a customer, Intu, in insolvency in the UK. Whilst we've got no material financial exposure to EML, mall customers are obviously aware of this and it might be discouraging the purchase of gift cards that have got a one-year life on them. So, it's a volatile market. We're certainly more positive than we were in April, but there's some way to go until we see what we call normalised trading.

The vast mix in the Gift and Incentive segment has shifted to incentives. Customers are taking advantage of our mobile or plastic solutions to deliver incentives for employee engagement, customer engagement, marketing programs and the like. Incentive programs are not typically restricted to where the funds can be spent, and so the breakage income is typically lower and so you've got a lower yield on these programs.

So, the mix shift to incentives is unfavourable and it will be a headwind on the overall segment yield through FY21, but we're clearly pleased to see volumes returning from the lows of April. June was only down 6% on the prior years, and July 2020 was up 7% on the prior comparative period.

The segment yield for Gift and Incentive has historically run either side of 600 basis points. Looking forward to FY21, I'd expect to see it move towards the more 500 basis points level for the next year, given the mix shift towards incentives.

In our General-Purpose Reloadable segment, again volumes have dipped, but they recovered through May and June. Our payroll cards and salary packaging vertical were not impacted and have been performing strongly in July with revenue up about 50% on the prior comparative period, so the July 2019 numbers. In PFS the Banking as a Service programs and the multicurrency programs were impacted earlier than we saw for EML programs because their key markets of Spain and France went through a severe lockdown earlier, which was prior to EML ownership.

Since taking ownership of PFS, we've seen the recovery through April to June and we've seen that recovery continue through July with record volumes in July 2020 of $520 million. This is mostly Banking-as-a-Service programs and government programs. The multicurrency programs remain impacted by travel restrictions. There were some delays to healthcare payments in the VANS segment as people delayed healthcare procedures during the pandemic, and so we saw a smaller impact to that segment, but it is our lowest yielding segment.

Looking at slide 31, the record GDV growth converted into record revenues which were up 25% to $121.6 million. This revenue number's adjusted by $671,000 of non-cash amortisation, and that's on AASB3 fair value uplift on the PFS bond portfolio. It's non-cash, it relates to the acquisition, and so consistent with our treatment of other AASB3 items we added back, we're calling it out as it did impact FY20 and it will impact future years as this unwinds, so we'll be consistent in our approach moving forwards as well.

The majority of our revenues are generated from recurring revenue streams, and we're making less than 22.8% of Group revenues from breakage now. It's been falling for a number of years and we expect it to continue to fall as percentage of Group revenue in FY21. Looking at the redemptions on the cards during March to June, we've seen lower redemptions and lower spend on the cards and that has impacted our interchange revenue stream throughout the March to June period.

We've taken a conservative approach not to adjust breakage rates through this period, as our assumption is that the redemptions will come through in FY21. So, at this point it's the delay rather than expectation that customers will spend less of the balance on their cards. But we'll update on this as consumer behaviour trends become more evident in the data that we review.

Interest has been a headwind across all segments with lower interest rates throughout the year, and then falling further as governments have responded to the economic impacts of COVID. I'd certainly expect this to be a headwind in FY21 as our view, and probably consistent with most views, is essentially that bank rates aren't increasing any time soon. We generate approximately $6 million of revenue for each $100 million of GDV in our Gift and Incentive segment, so the loss volumes certainly impacted the Group over the year, and this is about $4.8 million of gross profit on each $100 million of lost volume.

At a headline level, gross profit margins fell back to 73%, but this headline level's masking some great improvements of gross profit margins, because the diluted impacts of consolidating PFS for that last quarter of the year. Excluding PFS Group, margins increased to 82.1% as our self-issuance strategy delivered our expected outcomes. So, investors who followed the EML story for some time will recall this has been a two to three-year focus of the Group, so we're pleased to meet our targets on a like-for-like basis.

Looking at PFS, PFS is dilutive to Group margins because they outsource processing. But as we bring a direct connection to faster payments online and we bring processing inhouse over coming years, those synergies were identified in the acquisition thesis of $6 million total synergies, their margins will improve and they'll come back to be more in line with Group margins for the GPR segment in the mid 60s.

PFS has also adopted AASB accounting standards for the last quarter since EML acquired them, which means they're spreading out establishment income, setup income over a longer period. As I said before, they've also seen lower multicurrency volumes which also depressed margins for that last quarter of the year.

Onto slide 33. We regard cash overheads as a percentage of revenue to be a key metric of operating performance. It increased in the period to 46.2%, and that was due to lower unit sales from Gift and Incentive really impacting the metric. In the context of the loss of several hundred million dollars of GDV for the segment and the associated revenue on that, the percentage would have been much lower, so we're comfortable with where the business is heading.

At a headline level, 84% of the year-on-year increase in cash overheads, that was $12.9 million was the year-on-year increase, 84% of that relates to the acquisitions of FlexiCard, which was consolidated from 1 July 2019 and the acquisition of PFS which was consolidated from 1 April 2020.

A couple of callouts on this slide as well, we took on about $600,000 of costs, predominantly to restructure parts of the European business post the acquisition of PFS. This is going to generate recurring savings of $1.6 million in FY21, and these savings are additional to the $6 million synergy number we identified in our acquisition thesis.

We received trifling amounts of government assistance during COVID worldwide, but we took the decision not to force employees into taking annual leave over the period. So, to some extent we incurred additional costs for annual leave accruals over this period.

We're comfortable with this philosophy of looking after our employees and we're certain this is going to benefit the Group in FY21 and beyond, so there's no issues to us on that. We've made the decision to close the UAE business, the challenges of growing this business out into a GPR segment business or into a larger gift and incentive business in other countries, whilst dealing with the impacts of COVID that we think are going to be multiyear to that region, it just wasn't going to deliver us a sufficient return that we could have gotten elsewhere, and so we've decided to close that business down. We'd expect the region to be closed down by the end of FY21.

We expect the cash overheads for FY21 including PFS and the synergies mentioned above to come in around the middle of the range we've given there, so around the $68 million mark for the next year.

Closing out the P&L on slide 34, we delivered a record EBITDA for the Group of $32.5 million and a record NPATA of $24 million. You'll see us placing increasing importance on NPATA moving forwards as the lease accounting standard AASB16 and share based payments are making the EBITDA measure less relevant to us.

I've detailed out some items that fall below EBITDA on this slide, and on slide 42 you'll see a full reconciliation between NPAT, NPATA and EBITDA just to keep this nice and easy. We exclude a $3 million cash gain that we made on unwinding forward exchange contracts that were connected to the acquisition of PFS, and we exclude that from both EBITDA and NPATA. We also exclude all FX gains and losses from the EBITDA numbers.

Tax was a net gain this year due to the impacts of share-based payments being deductable as they vested. This isn't expected to occur at the same levels in future years. We generate the majority of our profits in our UK, Irish, US and Canadian entities, and so the average tax rate is sensitive to the mix of earnings in those countries where the rate of tax varies between 12.5% and 26.5%.

We've obviously incurred significant acquisition expenses, $15.8 million in connection to the PFS acquisition, and that's bringing statutory NPAT to a loss of $5.8 million, which we don't expect to recur.

Looking at the balance sheet on slide 35, the first callout is that we split our cardholder assets at $1.265 billion and liabilities owed to cardholders of $1.265 billion. These amounts are held on behalf of our customers and cardholders and they directly offset the liabilities to them. So, following the acquisition of PFS, it's a little bit more complicated than it was last year in that there is a long-term asset in the shape of bond investments, which I'll talk more on in a moment.

As we continue to increase the self-issued element of our business in Europe and Australia, these amounts have been growing and we expect them to continue to grow. So, concentrating on the corporate balance sheet, the Group's sitting on surplus cash of $118 million, we've got no secured debt. Our business remain cash generative, which I'll discuss more on the next slide. We're also holding a contract asset or a breakage asset of $31.8 million, about $22 million of that is expected to convert to cash over the next 12 months.

Looking at the bond investments. The Group have funded the premium on the bond investments, these are what the European regulator deems as zero risk, so very low risk government backed assets where we invest cardholder funds but the Group will receive the economic return, the interest on those bonds. We have a policy of not actively trading the bonds, and we hold them to maturity, so we've invested the premium on those bonds to purchase them at the outset. This is more than $10 million of Group cash which will convert back to cash in future periods.

The bonds are an important part of our treasury policy to offset extremely low or negative central bank interest rates on the cardholder float, so in terms of the short-term liquidity funding across the business, we've got $118 million of cash, $22.3 million of breakage that we expect to convert under 12 months, and then we've got this bond premium of more than $10 million which will convert back to cash.

Intangibles in our books mainly relates to the acquisitions we've made, because the businesses that we buy are not capital intensive, so you typically end up with quite large intangible assets and goodwill making up a significant portion of the purchase price. The AASB3 valuation of PFS has been provisionally completed in the period and reflected in those numbers. We've got a deferred tax asset of $25 million on the books, which $16.5 million relates to tax losses available for use in future periods, and we started using the tax losses in Australia this year, and we expect to utilise the overseas losses within the FY21 year.

Looking at the cashflow on slide 36. Statutory operating cashflow includes acquisition costs, it includes the cash gain on the unused acquisition hedges, it includes tax and includes interest payments. So, these total $19.8 million which aren't included in EBITDA, so to get to a like-for-like comparison in the operating position we have added these back.

So, the underlying cashflow for FY20 was $35.8 million, which is a record for the Group, and 110% conversion of EBITDA.

This improvement in the second half cashflow was flagged in February when we reported our interim results. Cashflow conversion is more than EBITDA due to the breakage converting into cash, so we converted more breakage from prior periods in March to June than we accrued in the period March to June.

This will impact the FY21 year, so the inverse of that is next year we'd expect cash conversion percentage to be slightly lower, because we expect to accrue more breakage in the fourth quarter of FY21 than it's going to convert to cash in the fourth quarter of FY21, because our volumes this year were depressed. So, the inverse of FY20. We're going to continue to invest in Capex related to building the technology that's going to drive the Group's growth in future periods. As Tom mentioned earlier, investors should expect this to increase in FY21 above the $8 million or so we spent in FY20.

To wrap up before questions, on slide 37 we've summarised some of the talking points in relation to FY21. It's important for me to clear this point, we're not giving guidance and we don't expect to do so until February 2021, because of the continued uncertainties in the Gift and Incentive segment in particular our mall programs, and the ongoing impacts of COVID to those programs.

What we're doing on this slide is trying to give investors some more detailed information on what we're seeing right now. We won't be breaking PFS out from the GPR segment in future periods, we don't run our businesses in this way, disaggregated entities, so from our perspective it's part of the overall GPR segment and it's included there. But to give investors some confidence, they continue to trade extremely well, the July volumes were a record $520 million, as detailed on page 7.

The variability in the FY21 result will really be driven by the performance of the gift and incentive segment in November and December when we typically see between 43% and 46% of our annual volumes for the segment in those two months. This is linked to consumer behaviour in the malls and how those programs perform, given social distancing and other challenges.

Both June 2020 and July 2020 have shown improvements in the Gift and Incentive volumes and very strong volumes in the GPR space. Australian salary packaging is one to call out because they continue to perform well with GDV and revenue up 50% on the prior comparative period from last year, alongside some strong results from the PFS business. VANS volumes dropped in July relative to a year ago, but they were up on June 2020. Monthly volumes do move around on a month-to-month basis, you can see this on slide 9 and 15 where we present monthly volumes in a graph.

This month-to-month movement is because processing times depend on timing, they depend on the number of weekdays falling in a month, so we don't read too much into single month results. Program pricing is stable, so segment yields aren't expected to move too much in FY21, so the Group yield's going to reflect the segment mix. Cash overheads will likely be towards the midpoint of our range of $64 million to $72 million for FY21.

Operating cashflows are expected to convert around 70% or 75% of EBITDA, so we're expecting some strong cashflows in FY21. Internally generated software increasing to $12 million to $16 million including PFS and the additional spend on the Accelerator project which Tom described earlier, and we're expecting interest expense to be a headwind into FY20. There's no real signs of increasing central bank rates on the horizon.

So, we've given some ranges there was well for the below the line numbers to help investors and analysts with their models given the impacts of bringing on board PFS this year. As I said earlier, we'd expect to give guidance when we publish interim results for FY21 in February, after we see how the gift and incentive business performs in the run up to Christmas.

So, with that operator, I'd like to open the line up to any questions.

Operator: Thank you, Rob. Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. If you wish to cancel the request, please press the pound or hash key. Your first question come from Nic Caley from Baillieu, please ask your question.

Nicholas Caley: (Baillieu Holst, Analyst) Hi guys.

Tom Cregan: Hi, Nic.

Rob Shore: Hi, Nic.

Nicholas Caley: (Baillieu Holst, Analyst) Are you seeing anything in the way of client migration out of Wirecard in Europe at this stage?

Tom Cregan: No, not much, the European business for Wirecard was more issuing, a standalone issuing business. So, really low-margin, high-risk, because it got all of the regulatory risk and none of the yield upsides, and most of it was just issuing. There were very few programs where they were the issuer and processor and program manager, which are the type of deals we would look to do.

They're out there busily selling off assets all over the place, none of which we're that interested in. Their US business is an incentive gift card business which is up for sale and will probably get sold soon enough, but it didn't have any interest for us either. So, there are a few programs here and there but nothing meaningful to speak of.

Nicholas Caley: (Baillieu Holst, Analyst) Just secondly, any updates on gaming with Bet365 or GVC?

Tom Cregan: Nothing on the GVC front, there will be something hopefully to announce shortly, I think some of the European operators that have bricks and mortar stores have realised that COVID provides a bit of a challenge when you've got no stores anymore and you can only get two people in a store. Surprisingly those conversations which had gone kind of dormant have come back to life a bit. But some things in there that I think might be more in the second half of this year than the first.

In the US, not seeing much in the way of gaming volumes, with either of our existing partners, but in the non-gaming space, BGW which is an Australian poker company which operates over there, we launched with recently and that's actually been one of our better performers out of the gates. There are a couple of other daily fantasy sports companies launching, a company called Potent which is in the para-mutual space, so it can operate in 48 states without having to go state-by-state. So, making some progress on companies that are probably not household names, but out of the gate the programs look okay.

I think on the European front we'll probably have some news there at the end of this calendar year, maybe start of next calendar year.

Nicholas Caley: (Baillieu Holst, Analyst) Great, just one final one. Are your people on the ground concerned about any further lockdowns in Spain or France at the moment?

Tom Cregan: Not Spain and France necessarily but Ireland I think has started already getting its people ready for the fact that you should expect it. Spain have already had some - I think Spain are now doing more the targeted regional lockdowns as opposed to full national lockdowns. Italy, mobility's pretty much back to where it was, so I don't think

they're that concerned. But it could be Germany, it could be Ireland, it could be the UK certainly, because they've pulled back some of their opening up measures.

Nicholas Caley: (Baillieu Holst, Analyst) Great, thanks for that guys.

Tom Cregan: No worries.

Operator: Your next question comes from William Cunning from Carter Bar Securities, please ask your question.

William Cunning: (Carter Bar Securities, Analyst) Hi Tom, Rob. Just one quick one from me, I was just hoping to get a little bit more colour on the updates provided for July, and just where that GPR GDV is coming from, maybe a bit of an update on gaming from Australia and Europe as well and what you guys are seeing there?

Tom Cregan: Do you want to take that one, Rob? I'm happy to take it.

Rob Shore: Sure, no problems at all. I think it's two-fold, the Australian salary packaging business is definitely performing really well, we've transitioned a lot of the customers over the FY20 year and that's going to annualise out through FY21, that's one. Gaming has not been - it's been going okay, I wouldn't say it's been - it's been probably reasonable resilient I think, despite the lack of sporting events, we're seeing that returning to normalised levels.

Australia went okay is probably the best way of putting it, through May and June. We've seen improvements through July in Europe, so they've been going okay. Then we've seen the PFS programs going really well. The digital banking solutions and the government programs they do are growing strongly. So, although we haven't seen the multicurrency elements of the PFS business bounce back, they're probably still down at least 50% on the same time last year. The rest of their business is performing really well. So, that's where the GPR side's been going strongly.

William Cunning: (Carter Bar Securities, Analyst) Great, just the second one from me was just whether there's any update on the inhouse processing and how that's going?

Tom Cregan: In the European business?

William Cunning: (Carter Bar Securities, Analyst) Yes, just from the PFS side as well.

Tom Cregan: It's kicking along, I think the programs are starting to be migrated. The biggest bang for the buck will come when their largest customers migrate across, and that'll be done progressively because most companies in the space that have tried to do big cutovers, have actually caused themselves self-inflicted gunshot wounds to the head because things don't always work out. So, the two largest customers will eventually start to migrate onto their platform.

I think they'd be expecting their largest customers start doing that early calendar year next year, so those kinds of things have been put in place. Then that'll be a progressive thing. So, given the card life is a three-year life, as those cards expire, the cards that customers get as replacements will be on the new platform. I think the foundations are laid for it to happen, it's now just a matter of new programs going on it and their largest customers migrating to it as cards get replaced.

William Cunning: (Carter Bar Securities, Analyst) Awesome, those were the only two from me, thanks.

Rob Shore: Thanks, Will.

Operator: Your next question comes from Owen Humphries from Canaccord, please ask your question.

Owen Humphries: (Canaccord Genuity, Analyst) Good day guys, you okay? Just a question around your cash conversion guidance, I've just seen there's two numbers here, 65% to 75% or 70% to 75%, just maybe you can clarify which one is correct?

Rob Shore: I'd go 65% to 75% at a push. The impact on this is really the breakage and that we didn't accrue much breakage in Q4 of FY20, so there's not going to be as much to convert into FY21. So, we'll be accruing more, so their contract asset fell in Q4 of FY20 and you'll see it rise in Q4 of FY21. So, that's the movement, 5% on that isn't a huge number, probably pick the midpoint and say 70% is the best estimate.

Owen Humphries: (Canaccord Genuity, Analyst) Then just shifting to Gift and Incentive, well done on July, it's trending back up versus PCP, I'm guessing the incentive in Simon Malls is contributing to that uplift? You've also put a slide number there saying 43% to 47% generated in two months, is the expectation that number will hold in FY21 given what you've said about social distancing and various concierges being closed, et cetera?

Tom Cregan: At the moment Simon isn't open so none of that recovery in volume has been driven by them, so that is due to open imminently I think somewhere between now and 22 August, something in that area. But it has been moved back three times so far due to COVID. At the moment that's what we're being told but I wouldn't be surprised if it continues to get pushed back, it just depends on how cases are going in the US. So, the recovery in volume in July, not much of it all with Simon, so we've got that up our sleeve if we want to think of it in that sense from a growth point of view.

How it shapes to Christmas I think will be I think the next, I would say the next month will probably be instructive for us a little bit because it's around this time of year that the malls have to order cards because they're obviously ordering more card inventory for those peak seasonal months. So, those orders are typically coming in now and through to the end of September and the cards get manufactured in October and then distributed to locations.

I think once we start to get their orders in, I think we'll start to get an idea of how the actual mall customers think that - what they're planning for from a peak seasonal perspective. From my side right now it's just too hard to predict. It's just completely out of our bounds of forecasting, so it's a matter of just trying to settle on a number and become comfortable with that number, if that's 50% or 60%, 70%, 80%, I mean as we said, each $100 million which would basically be 10%.

Without COVID and the way we were tracking, as Rob said it's hard to be specific and put it all to COVID, but we were probably tracking to do $1.1 billion in malls, so 10% of it is just over $100 million. You'd have to come up with your own view of if you think Christmas is 50% of last year, 70%, 80%, we just don't know so we're going to have to live with it and form a view in the coming months as to what we think.

Owen Humphries: (Canaccord Genuity, Analyst) Okay, and maybe…

Tom Cregan: It'll be the biggest single swing factor on the result, no doubt about that.

Owen Humphries: (Canaccord Genuity, Analyst) Then maybe just shifting to the PFS margin, maybe I've misread those charts in slide 31 and 30. If I back solve the gross profit margin for PFS it comes out at around that 45% odd maybe, have I misread that?

Rob Shore: Yes, you've misread it, it's just below 60%. It is lower than that. I think when you add back in the savings we expect, the synergies we expect to generate from insourcing processing it will fall back in line with EMLs, because the items that fall into COGS to any of our business are there's cost of plastic which is part of it, we don't make much margin on plastic. Then you've got scheme fees and banking connections, and so their programs and our programs will operate in the same way.

GPR is a high transaction segment relative to gift, and so a slightly lower margin than that, it doesn't have the breakage, but their programs will operate in the same way as ours and then the multicurrency is probably - it's slightly higher margins, but that's where the difference is.

Owen Humphries: (Canaccord Genuity, Analyst) I back solved that fourth quarter in terms of revenue to GDV for PFS, it comes in around 125%. Then in that July number you've given, call it $500 million odd, you were doing $3 billion in calendar year '20, $500 million is a big number to annualise that. Is all of that coming through at that 125 odd basis points?

Rob Shore: 125 basis points, yes that's the average. The average for a set of programs is consistent, a program operates at its normal conversion yield, it's the mix between programs that moves the conversion rates around.

Owen Humphries: (Canaccord Genuity, Analyst) Good one, okay I might just step back there. Maybe just quickly on the OpEx CapEx, the cash OpEx guidance obviously excludes the investment you're making in software, that's right, you split out the two between OpEx and CapEx, is that right?

Tom Cregan: The OpEx will be within that number. Our view is we'll self-fund that, so the $1.5 million in restructuring costs that we took at the end of June was really just at a management level, it actually wasn't a lot of head count per se, it was just targeted jobs where we had duplication. So, that $1.5 million went into that. Suffice to say we will continue to look, and we will have other areas of opportunity and other cost savings, cost rationalisations within the business, but if we had that, we'd invest it into Accelerator.

So, if we saved $300,000, $400,000 or $500,000 from again some further staff rationalisation, it would go into Accelerator and just fund that, so it's within the expense line, the OpEx part is already within the expense line.

William Cunning: (Carter Bar Securities, Analyst) Good one, okay, good one guys.

Rob Shore: Thanks, operator, I think it's the end of the questions.

Operator: Yes, please go ahead, thank you.

Tom Cregan: Thank you, with that I'll wind up. On behalf of Rob and I, thanks for attending this morning and no doubt we'll be talking to a number of you in the coming days in the one-on-one sessions. So, look forward to that and thanks very much.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating, you may all disconnect.

End of Transcript