

PHOTO-ME

SUPPORT SERVICES

PHTM.L

164p

Market Cap: £616m

SHARE PRICE (p)



Source: LSE Data

KEY INFORMATION

Enterprise value	£579m
Index/market	FTSE AIM
Next news	AGM Oct 2017
Gearing	n/a
Interest cover	n/a

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Instant service – long term delivery

Rapid innovation within very tight parameters

Photo-Me is something of a paradox – although it is a £600m market cap business, it still operates as if it were a nascent entrepreneurial business. It is risk averse and yet highly innovative. Its strength derives from the interaction between three core capabilities - building durable relationships with retail site owners, strong management of technology and product development, and delivery of operational logistics excellence. This note describes the Group's positioning, and the core investment thesis.

- Photo-Me operates instant service vending in high footfall locations, mainly third-party owned retail sites. The key markets are Identification, Laundry and digital printing Kiosks.
- FY17 results are in-line with market expectations. Revenues in constant currency grew 3.3% to £190m and EBITDA by 6.5% to £60.4m, reflecting margin expansion. Reported revenue was £214.7m and EBITDA was £69.2m, with continuing strong investment in both innovation for future growth and upgrading of existing vending units. The Group continues to perform well, buoyed by currency and benefiting from the growing contribution from Laundry and multiple expansion plans.
- Revenues are generated from a broad geographic base, 80% of FY17 revenues originated from outside the UK. Sterling has depreciated some 13% since the UK referendum. This has materially enhanced earnings but the share price is only modestly above pre-Brexit levels.
- Photo-Me benefits from a strong balance sheet with £39.2m net cash at April 2017. This guarantees capital to drive future innovation. In its mature markets it enjoys significant market scale, operating 47,946 vending units of different types. This critical mass is augmented by a clear focus on R&D within strictly defined payback criteria.
- This combination of skills, market expertise and a highly disciplined and focused approach to rapid innovation has led to many years of growth, and strong cash generation. The dividend grew by 20% in FY17 and is forecast to grow another 20% in FY18. Shareholder rewards have been significant, and we suggest that readers meet with management to learn more about the Group's next steps.

YE APRIL (£M)	2016A	2017A	2018E	2019E
Sales	184.0	214.6	225.3	236.6
EBITDA	56.7	69.2	73.7	78.2
Adj EPS (p)	7.7	9.3	9.7	10.2
DPS	5.86	7.03	8.44	8.86
P/E	21.1x	17.7x	16.8x	16.0x
EV/EBITDA	10.1x	8.8x	7.8x	7.4x
Yield	3.6%	4.3%	5.1%	5.4%

Source: Company Information and Progressive Equity Research estimates

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Executive summary

Photo-Me has delivered in-line revenues of £214.7m reported and £184.0m on a constant currency basis. This represented a top-line growth of 3.3% on a constant currency basis. EBITDA grew by 22% and the EBITDA margin expanded to 32.2%, an increase of 140bps. The net cash position now stands at £39.2m after a dividend distribution of £32.6m as well as combined capex and investment in R&D of £40.9m. This leaves the Group in a strong position to continue to invest in its high quality R&D and drive future growth in new products and new markets.

The Photo-Me Group possesses three core skills which allow it to grow and exploit new markets. It has good long-term relationships with site owners which provide first mover advantage in placing new products in existing locations. The Group also has a depth of experience in vending-specific technological innovation and R&D. Thirdly, it has, over time, built-up an unparalleled logistics network and base of expertise which keeps maintenance and repair costs to a minimum. It is the interaction of these three key attributes which gives the Group an edge over competitors.

The business proposition is that of a tech driven support services company. The Group is a market leader in innovation in the areas of 3D image capture, biometrics and secure data transmission. It is well placed to take advantage of the growing market for secure applications for passports, driving licences and other forms of ID. During the year it has achieved the roll-out of 300 ID Photo booths in Ireland for passport renewals and in France the majority of the Group's estate has been upgraded to enable secure transfer of digitised e-photos and e-signatures for the purposes of driving licence applications. Other newly developed technology includes turnkey voting solutions. With its large number of existing locations and presence in 18 countries the group is very well placed to take advantage of this growing market.

The Group is rolling out Revolution, its un-manned laundry business located in high footfall areas. Its innovative design and the Group's ability to access attractive locations are making this business a driver for future growth. A new smaller footprint unit but with the same revenue potential has just been developed. In Continental Europe this will allow more rapid deployment as it has reduced planning requirements.

The Group is also building on its leased laundrette business where it acquires and refurbishes laundrettes to provide a much more attractive customer offering. It recently entered the market in Japan which the Group believes is the largest addressable laundrette market globally.

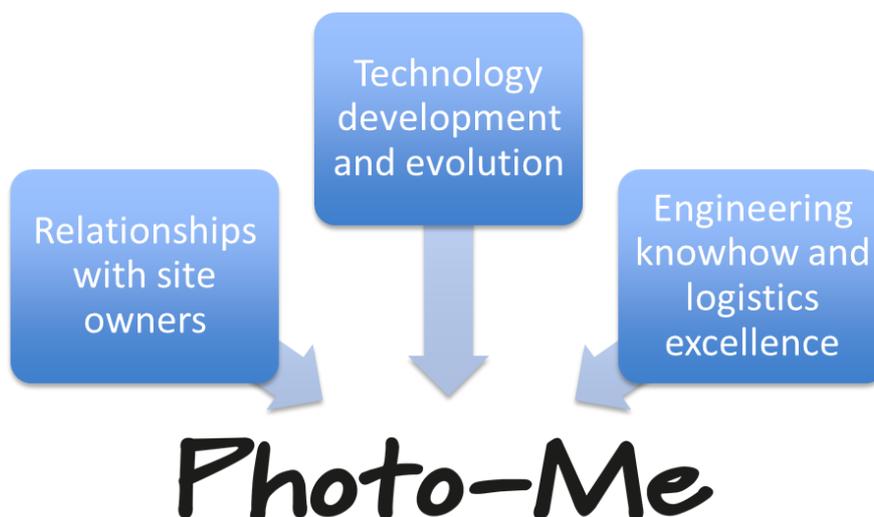
The Group is at the same time highly entrepreneurial in product development but also focused on return metrics which ensure that capex is focused on viable opportunities. A strong balance sheet allows the Group to fully fund its R&D and capex from reserves and also means it can move quickly should consolidation opportunities arise.

Our forecasts are conservative and show revenue growth of approximately 5% p.a. for FY2018 and FY2019 with EBITDA growth of 5.4% and 5.9% respectively. This reflects margin expansion from the roll-out of the higher margin laundry units. There is room for upside in the forecast as we have not included any potential for significant expansion in the secure data and transmission market, banking booths or revenues from turnkey voting solutions. We have also not accounted for a significant expansion into the Japanese laundrette market or significant roll-out of other products currently being developed or trialled.

Capturing the essence

The Photo-Me group provides shareholder value on the basis, we believe, of three core skills and attributes. These are shown in the diagram below:

Photo-Me...three positive attributes



Source: Progressive Equity Research Ltd

Relationships – the group has forged, over many years, strong relationships with large organisations that own or control high footfall locations. Retail venues, sports locations, public areas and many others make good locations for instant vending machinery, and Photo-Me has a proven ability to negotiate commercial terms.

Technology – the application of technology to mainstream or ostensibly unexciting markets can make the difference between mediocre performance and excellent return on investment. Photo-Me's development team and rigorous methodology is described on page 14. There are also a number of identity-based market developments, notably around biometrics, identification and enhanced passport/document technology. These factors combine to make Photo-Me an innovative player in a rapidly evolving market.

Logistics – Photo-Me employs around 700 engineers to install, maintain and service the large numbers of machines it owns and operates. The management of this workforce and its training and optimal deployment is a significant logistical exercise, and the group has many years of experience doing so. The group clearly benefits from economies of scale with a broad, well established geographical coverage which allows it to run machines with better levels of up-time, and at lower cost than smaller rivals.

Overall differentiator – combination of all three skills

The unique differentiator is probably not any one of these three areas, but the combination of all three. Many organisations have ability to negotiate commercial relationships with site owners, many are strong in development of technology, and some are well-versed in logistics and workforce management. Very few organisations, in our opinion, successfully combine all three attributes and remain both flexible and entrepreneurial. We believe that combination drives Photo-Me's ability to maintain its competitive edge and hopefully, over time, to deliver good shareholder returns.

A differentiated investment thesis

Photo-Me as described on the front page, is a somewhat unusual investment opportunity. The list below highlights some of its key attributes which, in our opinion, merit attention:

- **The Group is both conservative and highly entrepreneurial** - a team of 60 R&D experts evolve new products and innovative services, but these are almost always within the core markets of instant-service vending. The products are developed in a systematic and structured way, with a requirement for cash-payback (12 months of gross takings including VAT) on the cost of the machine within a year. In our experience, it is unusual to find this, potentially very valuable, combination. Organisations tend to be either entrepreneurial and somewhat chaotic, or organised and disciplined but less innovative. Photo-Me appears to have found a way to combine the benefits of both innovation and discipline.
- **A technology driven business with a strong cash flow** – Photo-Me is able to fund speculative R&D projects with the protection of a strong balance sheet and a reliably recurring cash-flow from mature businesses. This allows a level of focus on business development and operations which might be more difficult in a similar business with significant financial gearing.
- **Target markets are well-defined but offer rapid growth** – Photo-Me is confident of ongoing growth but in markets which it understands well. Photo booths are leading to identity-based opportunities in other areas. The laundry market is well understood and new geographies (particularly Japan) could offer material growth. Finally, innovative uses of high-footfall retail space, in conjunction with kiosk and vending technology, are leading to entirely new revenue streams – the MoneyGram platform which acts as a “micro-branch” for an innovative new banking business
- **A hybrid of technology, support services and retail** – Photo-Me is generally viewed as a Leisure Services or Retail company. In our view this has led to a glossing over of its focus on tech R&D and leads to an assumption of a greater degree of cyclical than may be appropriate. We would suggest that it is better to consider it as a tech-led support services company, which may have implications for the valuation multiples investors are prepared to apply.
- **A strong balance sheet allows for consolidation** – The Group's strong cash position allow it to quickly consolidate smaller competitors in order to expand its footprint. It was able to acquire the Fowler (UK) Laundry business and Asda's in store photo booths. This not only provided a pre-existing revenue stream but also the potential for siting new products.

Photo-Me is, in our opinion, a well-funded and highly profitable business, with a very clear strategy, a strong product development pipeline and methodology and a rigorous, disciplined approach to business management. This discipline may, on occasion, mean that opportunities are foregone, and that the balance sheet is less “efficient” than capital markets theory would suggest but the group remains low risk because of this strategy, and in the longer term, investors appear to have benefited handsomely from the chosen course.

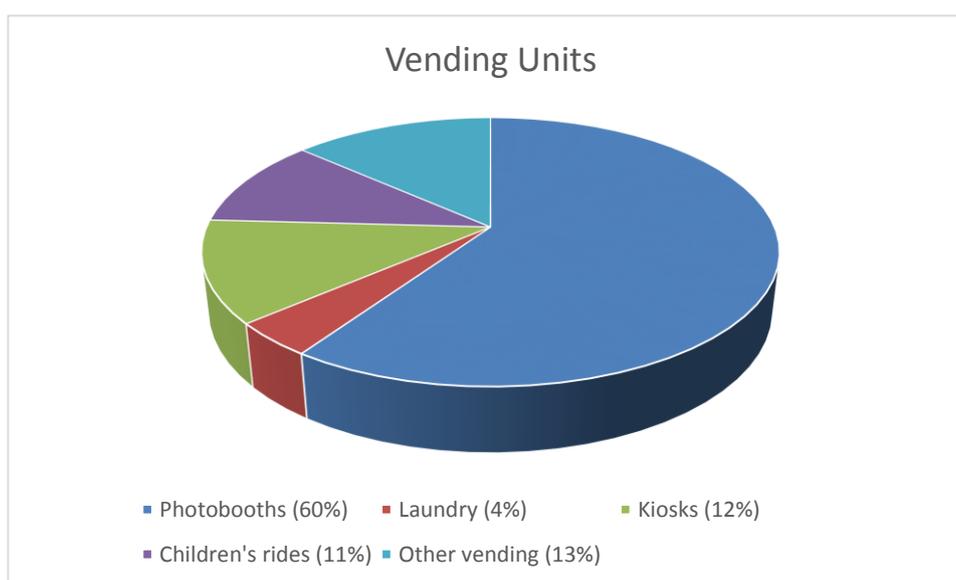
The key to understanding whether such performance will continue is, of course, to consider the group's positioning and capabilities, and the growth profile of the markets within which it operates. The remainder of this note attempts to look at these areas, and we will return in more detail in future documents relating to the Identification, Laundry and retail Kiosk businesses.

Marketplace and industry positioning

Photo-Me operates in a combination of mature and growing business segments across both mature and developing geographic markets. In many instances, it is the existence of the more mature market and geography that allows the Group to leverage the potential of new products.

The Group operates across Continental Europe (52% of revenue), UK & Republic of Ireland (25% of revenue) and Asia & ROW (23% of revenue). The Group divides its businesses into three categories – Identification, Laundry and Kiosks and all of these operate across all three geographic segments. As at 30 April 2017 the Group operated a total of 47,946 unattended vending units.

Vending units by type



Source: Company information, Progressive Equity Research Ltd

Although these businesses appear diverse, there are considerable benefits from operating them alongside one another, on both a revenue and cost level. For example, an existing photo booth gives the group access to a retail owner for the placement of laundry machines and kiosks and each engineer can be trained to service all the Group's vending units. The Group also relies on the same design philosophy across all business groups. Their expertise allows them to design equipment so as to minimise the square footage it occupies thus maximising yields. Similar technologies are also used across products to keep equipment and service costs to a minimum. The Group can also rely on existing geographic market knowledge from one business area to leverage the potential of new products. For example, presence in Japan has given the Group a quick route to rolling out laundrettes and a cultural understanding that allows them to realise the potential of the business. The use of laundrettes in Japan is spread much more evenly across all social classes and smaller domestic spaces mean they are a necessity for a far higher proportion of the population than in Europe. Because of the existing network of engineers and presence in Japan, the Group are able to move quickly to market with any new product.

Within each business area there are both mature and developing businesses driven by the Group's continual focus on R&D and a commitment to maintaining and upgrading the existing vending units. We will now look at each of the business areas in turn.

Service offering 1 - Identification

The back-bone of the Identification business is the photo booth offering. The Group operates photo booths across 15 countries and is the market leader in France, the UK and other Continental European countries where it has a presence. It operates a total of 28,541 photo booths.

Photo booths are placed in prime footfall areas, usually retail environments, and the site owner is paid either a fixed fee or a revenue based commission. Photo-Me remains responsible for maintenance via a network of service engineers.

This estate is still expanding at around 3%-4% p.a. Analysis would also suggest that there is no stagnation in pricing power with growth in gross takings (including VAT), keeping pace with the growth in number of new units. This is being driven by both the ability to put through price increases in traditional photo booths (20% in the Netherlands, upgrading of the offering.

Upgrading the Offering

The upgrading of the offering has largely been as a result of the installation of new technology, often the result of local (governmental) adoption of technology with regard to identification – for passport, driving licence, voting or other purposes.

In France, the majority of booths have been upgraded to allow the secure transmission of both a digitised e-photo and e-signature in order to automate driving licence applications.

German booths also allow fingerprint capture which can then be verified against the database of administrative authorities and then all data uploaded to the civil service, town halls and registration offices.

In Ireland, from March 2017, the roll-out of similar technology is happening in partnership with the Irish Government to allow digital transfer of e-photos as part of the on-line passport application. Once this roll-out is completed 98% of the Irish population will live within 5km of one of these new photo booths and the price will be 60% greater than for a traditional paper photo.

The Group also provide the Swiss government with 380 Biometry enabled enrolment stations in public service offices in Switzerland which allows for data capture and secure transmission to the Government printing office for ID card and Passport applications. The Group is now developing the second generation of these booths in partnership with Siemens.

A system was established in Japan where an e-photo taken in a booth could be uploaded to a government server and linked to every citizen's unique identity number contained in a QR code. This was initially intended by the Japanese government to be a compulsory requirement but has been put on hold due to political opposition. This development contributed to the constant currency total revenue decrease in Asia & ROW of 11.7% from £44.5m to £39.3m in FY 2017A. There is the possibility that this scheme will become compulsory in the medium term 2020/2022.

Other developments include a fully integrated secure identity management system developed for Chinese government. The booth can take ICAO compliant photos, collect fingerprints and scan official documents. The booth is linked directly to an office validation centre server for manual checking and then the data is transferred to an official validation centre.

A new-style Philippe Starck-designed photo booth



Source: Company

“Selfies” Will Not Replace Photo Booths

There has been some concern that the improvement in photo technology in phones would damage the photo booth business. What if passport application photographs could simply be uploaded as a “selfie” taken on a personal phone? The ICAO (International Civil Aviation Organisation) is the body responsible for setting rules that all countries must follow in relation to what is acceptable for photographs required for passport documents. HM Passport Office in the UK had been exploring the idea of being able to use “selfie” photos. The rationale is that this would be popular because it would be free, quick and easy. The concern is that this would usher in the demise of the photo booth.

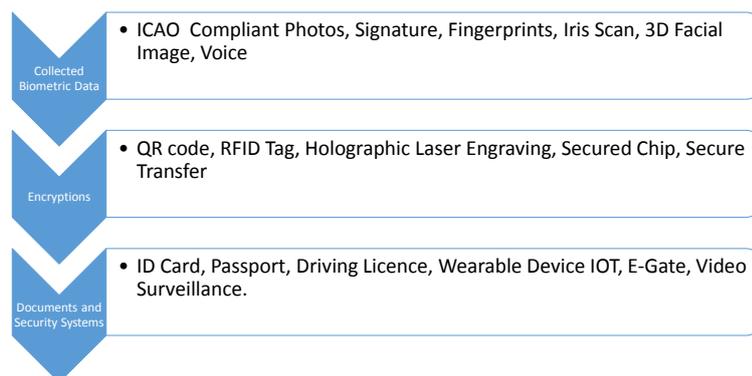
It is now recognised that it is very difficult for individuals to provide compliant, self-taken photos and HMPO asked the photo industry to develop an ICAO compliant digital upload process. Photo-Me have successfully demonstrated such a system to HMPO. An Alpha trial has already been undertaken and a public Beta trial is expected by the September 2017 when 2000 booths will be upgraded to a system similar to that already operating in Ireland. Photo-Me’s existing expertise as a result of operations in Ireland and France puts them in a strong position. In addition, as we move towards biometric security specialised equipment rather than simple image capture this expertise will become increasingly relevant.

Demand for these new booths could add significantly to revenue. As an example, there were approximately 49.5m British passports in existence in 2016. With passports generally renewable every 10 years this would imply there are at least 4.95m passport applications each year. If the uplift in revenue from old-style photo booths to new biometric enabled booths is similar to that achieved in Ireland then in the UK alone there is a potential increase in the market of £11.4m. In addition, Brexit may mean a change in UK passport style which could boost volumes. Clearly, there is great growth potential and Photo-Me is in a strong position to take advantage of that.

Regular renewal of Identity documentation allows for a recurring revenue stream with overall market growth from increased international travel linked to GDP growth. An increased appetite for providing the most secure data for identification documentation leads to adoption of higher margin technology from providers such as Photo-Me.

The diagram below shows all the data that can be captured, all the possible encryptions developed by Photo-Me and all the possible applications.

Security and Encryption Technology



Source: Photo-Me International

MoneyGram

Photo-Me are also leveraging their pre-existing location advantage through a partnership with MoneyGram. So far this is being tested in France and involves 24/7 access for MoneyGram customers through dedicated MoneyGram branded kiosks or in existing booths. Photo-Me are in discussions with MoneyGram to expand into other geographic markets. There are currently 20 dedicated kiosks and 80 transaction kiosks in photo-booths. The kiosks allow customers to create and operate MoneyGram accounts.

Identification Summary

So, on closer inspection the Identification business is a great deal more than our traditional understanding of a photo booth. Photo-Me is positioned to fully exploit the move towards secure transmission of biometric information. It can swiftly deploy its R&D capability and expertise in biometrics and combine it with functional design. In terms of the application process for identification documents, this simplifies the process for the applicant and provides reassurance that the application is ICAO compliant and will not be returned. It also simplifies the administrative process for governments by allowing digital transmission from capture to a reader and straight to the printer. The development of the MoneyGram partnership shows the Group's relentless pursuit of new applications and opportunities to leverage the existing estate of kiosks.

Service offering 2 - Laundry

Photo-Me operates a number of laundry businesses aimed at differing market segments. The group operates 1,965 laundry units in 12 countries. Initially the business was again developed by taking advantage of pre-existing relationships with site owners. The aim is to have deployed 6,000 units by 2020 and expand geographically. This includes owned and operated units as well as those sold to third parties. The group targets markets where there is high demand and limited or poor competition.

Revolution

Revolution is a 24 hour, outdoor laundry service. The units are high capacity machines in high footfall sites. There are three types of unit with either a 10 sqm footprint or a smaller 5 sqm footprint. The units either comprise two washers and a dryer or one washer and one dryer. The aim is to provide good functionality for the customer and satisfy a need in a convenient way. The machines are high speed (30minutes) so that customers can, for example, put laundry in the machines in a supermarket car park, use the supermarket, receive a notification text 5 minutes before the laundry is finished and then collect the laundry. There are a variety of customers - those who do not have their own machine, those wishing to wash bulky items, those washing large amounts (e.g. sports team kits) and those with small businesses. Most of these facilities are located on the periphery of mid-sized towns. The new smaller footprint format allows for a faster rollout. In the Far-East availability of space is an issue so the new smaller machines provide a solution to the difficulty in sourcing sites. In the UK and Europe the smaller machines also allow the by-passing of planning restrictions which might affect the placing of larger machines. Again, margins are improved by using the same service engineers that service the photo booths and keeping the footprint and thus the commission payable to the site owner to a minimum.

REVOLUTION LAUNDRY INSTALLATION



Source: Photo-Me International

Laundrettes

The Group also opportunistically acquires laundrettes in good locations which have potential but have typically suffered from under-investment. They are then re-furbished to create modern pleasant spaces with facilities such as free wi-fi. This creates a branded environment along the lines of budget hotels such as Premier Travel Inn where the customer knows exactly what to expect regardless of location and the operator can build brand trust. They are usually situated in town centres under the KIS brand. The Group's particular growth focus is Japan. As previously discussed, Japan provides good market opportunities. There is a strong culture of laundrette usage and also good opportunities to create a strong brand in a previously fragmented market.

B2B Laundry Leasing

The third strand to this business segment is B2B. The Group acquired Fowler(UK) in 2015 which operates in the UK market and distributes and leases laundry and catering equipment to care homes and similar institutions. Fowler (UK) contributed £0.7m to PBT in 2017. Although Fowler(UK) currently only operates in the UK there is undoubtedly the opportunity for expansion into other territories, either organically or potentially through further acquisitions.

B2B – Commercial Laundry products



Source: *Photo-Me International*

Service offering 3 - Kiosks

The Group operates digital printing kiosks which allow customers to download their own photographic images and have those images printed in a large number of formats. Products include posters, canvas, t-shirts and mugs for future delivery. Other kiosks allow for instant printing of photos, photo albums, posters and phone cases. Images can be downloaded from personal devices via wi-fi. There is also the facility to print directly from Facebook.

ASDA Acquisition

On the 31 October 2016 the Group acquired the UK Photo Division of Asda for £3m emphasising its ability to use a strong balance sheet to make strategic acquisitions and remove competitors. The acquisition comprised 363 sites. This business was loss-making before acquisition but the Group aims to upgrade equipment and make synergistic cost savings which will return the business to profitability.

Digital Printing

The Group operates 5,872 digital printing kiosks in Europe and Japan. The acquisition of the UK Photo Division of Asda and new openings sited in Morrison's supermarkets in the UK accounted for 700 new units in H1 2017. The Group aims to continue to grow its Asia and European business and potentially take advantage of the collapse of Kodak. The Group is currently replacing 1,000 old Kodak kiosks with new Photo-Me kiosks. The Group sees the collapse of Kodak as an opportunity to move into North America. Kodak currently operates 100,000 kiosks globally. This represents an addressable market of c.£450m. Photo-Me is well placed to capture some of that market. The Group also sees the opportunity to expand globally (including the US) its network of Speedlab kiosks, designed by Philippe Starck.

Other Kiosks

Other new kiosk products include dedicated MoneyGram kiosks, selfie-booth kiosks which are hired out for special events and gift card kiosks which allow customers to purchase gift cards for a variety of retailers, with the latter currently being trialled in Switzerland.

Photo-Me digital printing range through Asda self-ordering kiosks



Source: Company website, Progressive Equity Research

R&D – The Photo-Me “difference” across the board

A key differentiator for Photo-Me lies in its innovative approach to product development. The main driver is being able to leverage existing sites and proprietary technological and engineering expertise. At its core the vending machine business is essentially one of automation of transactions that previously required human participation. It also aims to make that transaction a simpler and more efficient experience for the customer. A transaction should ideally require a smaller physical space than prior to automation. This means profitability is improved by driving sales through being customer focused and higher sales per square foot (in retail terms). Cost is reduced by the removal of the requirement of labour. Photo-Me approaches any potential retail transaction as an opportunity for automation. It is continually developing new ideas and trialling them. There is a team of 60 located in Europe and Asia who comprise the R&D function.

Good product design allows the Group to solve problems and create innovative products in markets that were previously thought to be commoditised. An example of this is the design of the Revolution laundry unit. Customers want to do their laundry in as short a time as possible. A large amount of time in doing laundry is the time it takes to heat the water. Revolution machines are designed with a fast boiler which significantly reduces that time, allowing the customer to complete their laundry in the time it takes them to shop in the supermarket - they then receive a text message to tell them the laundry is complete.

Product Development Process

The product development process follows a pre-determined order and product viability is assessed via fixed criteria. The process is as follows:

- New market opportunity identified;
- Design process;
- Pilot product manufactured and tested for functionality and cost efficient manufacture;
- Product placed in approximately 10 key sites;
- Product retained if gross annual takings per machine exceed the cost of manufacture;
- 50 then 100 machines produced and if payback criteria continue to be met then the machine will be introduced across more sites.

The R&D function not only develops new products but is also continually considering how technology can be used to reduce operating costs. Continued improvements to remote monitoring for faults and remote servicing mean reduced site visits by engineers.

New Product Pipeline

New products currently being developed or trialled include:

- Photo-Me is developing the capability to provide banking services via existing booths which will be upgraded to cater for this. The traditional banking model is evolving quickly with many companies already offering branchless banking. Photo-Me is uniquely placed to take advantage of this. It already operates booths in prime footfall locations such as major

transport hubs and shopping centres which would also be ideal locations to offer banking services. Photo-Me's booths will allow for instant client enrolment, delivery and activation of a card. The client scans ID, proof of address and registers their mobile phone and the account is created. The booth allows customers to print transactions and IBAN documents. Customers will also be able to deposit cash and cheques or make an electronic transfer with a card. There will also be video-link customer support. A similar business, Nickel, which operated 55,000 machines in tobacconists in France was recently acquired by BNP Paribas for c.€200m. In a growing market Photo-Me's advantage comes from owning pre-existing kiosks and having existing relationships with retailers which will allow them to rapidly deploy upgraded booths offering banking services.

- The Group has developed three automatic turn-key voting solutions. The first option allows for a voter to have their photo taken and scan their passport. The 3D technology then allows for identification to take place. The voter then votes and signs in the booth and an encrypted vote is uploaded to a server and a receipt produced. This allows for real time results and monitoring. The second option allows pre-registered voters to enter a unique pre-assigned registration number, vote and sign. This produces a receipt which is then scanned and uploaded by an official who has performed a manual ID check. The third solution allows a manual ID check and an electronic voting machine which produces and encrypted vote receipt which is then manually scanned and transmitted. This product is currently in development and represents a medium term opportunity for 2019/2020.
- The Group also develops proprietary security biometric identification solutions. Photo-Me is the only company in the market which is capable of instant 3D image capture. The proprietary scanning system produces an ultra-high resolution image that cannot be falsified. Encrypted 3D photos provide the most reliably secure method for producing photos for ID documents.
- The Group is currently piloting a number of other kiosk ideas including gift card kiosks, selfie booths which allow photos to be super-imposed on to themed backgrounds with the eventual photo being able to be shared instantly on social media platforms and even customised wallpaper printing machines. Customers will be able to upload their own images and have customised wallpaper printed instantly in-store.

Photo-Me's R&D philosophy and capability gives it a clear edge and this is augmented by its funding structure. The R&D is wholly supported by a strong balance sheet and reliable recurring cash-flows from established businesses. This, in conjunction with an established network of sites, allows the Group to swiftly scale any attractive product development opportunities. In addition, constant implementation of technology to reduce cost and a disciplined approach to assessing product viability contribute to a tightly monitored gross margin.

Recent performance and financial drivers

The final results for the financial year ended 30 April 2017 were in-line with market estimates. Although headline revenue grew 16.7% from £184m to £214.7m, after accounting for exchange rate differences the underlying growth was 3.3%. EBITDA was £69.2m (+22%) or £60.4m (+6.5%) on a constant currency basis. EPS was 9.27p, an increase of 20% from 7.72p in the prior year. The Group's progressive dividend policy was maintained and the dividend rose 20% from 5.86p to 7.03p.

The Group analyses revenue and operating profit by geographic segment. Operating profit is defined as EBIT with corporate central costs added back.

Revenue and operating profit by geographic segment

	Constant Currency Revenue			Constant Currency Operating Profit		
	2017 £m	2016 £m	% change	2017 £m	2016 £m	% change
Continental Europe	97.6	93.7	4.16%	29.6	24.1	22.82%
UK & Republic of Ireland	53.1	45.8	15.94%	7.2	8	-10.00%
Asia & ROW	39.3	44.5	-11.69%	6.9	10.7	-35.51%
	190	184	3.26%	43.7	42.8	2.10%

Source: Photo-Me International Final Results

Continental Europe

In Continental Europe, Identification revenue was broadly flat and growth at both the revenue and operating profit line was driven by the Laundry business expansion. Revenue overall grew by 4.2% in constant currency terms and operating profit grew by over 22.8%. This is clearly reflective of the higher margin Laundry business. Our forecast reflects a continuation of this trend.

The focus within the Identification business was on up-grading photo booths in order to enable secure driving licence application directly from the booths and in developing secure data capture and transfer technology. We expect the progressive roll-out of this technology to continue.

As at 30 April 2017 the Group operated approximately 1,500 Revolution Laundry units in Continental Europe. The Group intends to continue to focus its expansion of the Laundry business in France, Belgium and Portugal. Our forecast implies a continuing roll-out in Europe of around 700 units p.a. We also assume that it takes approximately one year for revenues from new machines to reach maturity. In FY 2017 the average full-month takings per machine in Continental Europe was €16,586, growth of 7.8% from the previous year. Our forecast assumes that growth in Laundry revenues continues at this pace as the roll-out continues and the estate moves towards maturity.

The number of printing kiosks in Continental Europe grew by 3% during the year. For the most part these were the new Philippe Starck designed printing kiosks. We expect this trend to continue and also for the Group to continue to roll-out its MoneyGram kiosks in France.

UK and Republic of Ireland

As of 30 April 2017 28% of the Group's estate was located in the UK and Republic of Ireland. Revenues increased 15.9% at constant currency rates and, as with Continental Europe this was driven by an increase of 57% in the size of the laundry estate. The number of laundry units operated increased from 318 to 499 during the period. We expect this growth to continue and make similar assumptions concerning revenue growth as for Continental Europe.

Although revenue growth in the year was strong, operating profits fell by 8.8%. This was largely attributable to the acquisition of the UK Photo Division of Asda. Had it not been for the start-up costs associated with this acquisition, then operating profit would have grown by c.12%. We assume in our forecast that the operating losses associated with this acquisition are reversed and that underlying Identification and Kiosk growth continues at current rates at the revenue line, with margins remaining constant.

Asia and Rest of World

Asia & Rest of the World contributed 23% of revenue during the year and 23% of the total estate is sited there. In constant currency terms revenue decreased by 11.7%. Although there was steady growth in China (28.4%) and Korea (45%), the cessation of the compulsory MyNumber programme in Japan resulted in an overall decline in both revenue and operating profit. Overall, our forecast assumes modest growth in this territory and that margins will continue in the same range.

Investment and Capital Expenditure

We expect the Group to continue its investment programme and that total capital expenditure will run at around £25m p.a. over the forecast period, with around £20m p.a. being spent on tangible balance and the balance representing capitalised intangibles.

Forecast Risks- Brexit

The Group operates across Continental Europe and the UK. Following the UK's decision to leave the EU this could have trading implications. The UK may or may not remain part of the Customs Union and may or may not either remain a member of the Single Market or have other access arrangements. There may also be implications for taxation and movement of capital and resources.

Forecast Upside

Our forecast is essentially conservative and excludes the potential revenue and operating profit uplift from various sources, namely:

- The forecast does not assume that the Group's secure data capture and transmission technology is rolled-out any markets other than those in which it currently operates. Given its market leading expertise, it is well placed should other governments move towards adoption.
- The Group opened its first laundrette in Japan during the year. The Group estimates that Japan is the largest market in the world for laundrettes. The Group hopes to become the largest operator of laundrettes in Japan over the medium term. This represents upside to the forecast.

- During the year the Group acquired Fowler(UK), a B2B laundry business leasing equipment to institutions such as care homes, hospitals and student accommodation. Although this business only contributed £0.7m operating profit during the period, it is the Group's aim to expand this business both within the UK and other territories. Again, this would provide upside to our forecast.
- Although MyNumber is no longer compulsory in Japan, the Group does expect it to become compulsory around 2020/2021. Although this is outside our forecast horizon, it nevertheless provides long-term up-side for revenues.
- The Group may be able to profit from the collapse of the Kodak kiosk business with 100,000 units potentially available in the US. So far the Group has a limited presence in the US and the acquisition of that estate would provide instant scale within that territory. Again, there is no assumption of US expansion within the forecast although the Group is actively engaging with site owners.

Board and senior management

John Lewis, Chairman. Joined the Board in 2008 and appointed Chairman in 2010. Chairman of the Nomination Committee and a member of the Audit and Remuneration Committees. Currently a consultant to Messrs Eversheds and a Director of AIM market company, Prime People plc as well as various private companies. Previously a practising solicitor. Also served as Chairman of Cliveden Plc and Principal Hotels plc and as Vice Chairman of John D Wood & Co plc and Pubmaster Group Ltd.

Serge Crasnianski, Chief Executive Officer & Deputy Chairman. Appointed to the Board in 2009. Previously served on the Board from 1990 to 2007; until 1994 as a Non-executive Director, from 1994 as an Executive Director and as Chief Executive Officer from 1998 to 2007. Founded KIS in 1963 and joined the group at the time of its acquisition.

Gabriel Pirona, Group Finance Director. Appointed Group Finance Director in August 2015 following a short period as Deputy CFO. Previously CFO Europe for Recall and held positions as Finance Director within various divisions of Avery Dennison. Held a number of senior financial positions at Netdecisions and TeleGlobal following having been a Manager with PwC. Qualified DESCAF, Accounting & Finance at ESC Amiens.

Eric Mergui, Chief Operating Officer. Joined the Group in 1994, and as COO has responsibility for management of the group's subsidiaries, initially within Europe and now globally. Eric was previously employed by Bricorama and Felix Potin.

Françoise Coutaz-Replan, Non-Executive Director. Appointed to the Board in 2009. Retired from her executive role as Group Finance Director on 27 August 2015, continuing as a Nonexecutive Director. Joined KIS in 1991.

Yitzhak Apeloig, Non-Executive Director. Appointed to the Board in 2012. A qualified accountant and Managing Partner of ATE Technology Equipment B.V., a private equity firm active mainly in Israel. Chairman of Leader Holdings and Investments Ltd and Director of Leader Capital Markets Ltd (all Israeli listed). Chairman or Director of a number of other private companies. Previously Executive Chairman of Telit Communications plc, having led its flotation on the London AIM market in 2005.

Emmanuel Olympitis, Non-Executive Director. Appointed to the Board in 2009. Previous directorships include China Cablecom Holdings Limited (NASDAQ), Canoe International Energy Limited (Canada), Matica plc, Secure Fortress plc, Bulgarian Land Development plc, Norman 95 plc, Pacific Media plc (Executive Chairman) and Bella Media plc (Chairman). Early career in merchant banking and financial services, including as Executive Director of Bankers Trust International Ltd, Group Chief Executive of Aitken Hume International plc and Executive Chairman of Johnson & Higgins Ltd.

Jean-Marcel Denis, Non-Executive Director. Appointed to the Board in 2012. Chairman of the Audit Committee and a member of the Nomination and Remuneration Committees. Founded his own auditing firm in 1970 in Paris; Auditeurs & Conseils Associes (ACA) and sold his interest in ACA in 2005. He was subsequently a consultant in Finance & Conseils Associes, which specialises in business valuations.

Del Mansi, Company Secretary. Joined the Group in 2006. A qualified solicitor. Served as interim Company Secretary from April to July 2008. Appointed Group General Counsel in 2009, a role retained upon being appointed Company Secretary in May 2013.

Risks and challenges

Risk	Risk/impact	Management action/comments
Economic risk	Economic growth is a major influence on consumer spending. A sustained period economic recession could lead to a decrease in consumer expenditure in discretionary areas	The Group focuses on maintaining the of characteristics and affordability of its needs-driven products.
Currency risk	The majority of the Group's revenue and profit is generated outside the UK and results could be adversely impacted by an increase in the value of sterling relative to those currencies.	The Group hedges its exposure to currency fluctuations on transactions, as relevant.
Regulatory risk	In many European countries where the Group operates, if governments were to implement centralised image capture for biometric passport and other applications, the Group's revenues and profits could be seriously affected.	The Group is developing new systems that could respond to this situation, including the introduction of 3D technology in ID security standards. Its ID product remains affordable and of high quality. The Group is also conducting lobbying activities.
Risk to growth - new business opportunities	A lack of new business areas may impact the ability of the Group to grow in the long term	Demand in existing markets and potential new opportunities are constantly reviewed. The Group continues to invest in research for new products and technologies.
Risk to growth - benefits from new products	The realisation of long-term anticipated benefits depends mainly upon the successful launch of the "Revolution" laundry unit.	The Group regularly monitors the performance of newly installed machines, which are heavily trialled before launch.
Commercial/concentration risk	The Group has well-established long-term relationships with a number of site-owners. The deterioration in the relationship with, or ultimately the loss of, a key account would have an adverse (albeit contained) impact on the Group's results.	The Group's major key relationships are supported by medium-term contracts. It targets a high quality of service. Risk is mitigated by none of the accounts representing more than 1% of the Group turnover.
Credit risk	The risk that a counterparty fails to discharge its obligations	The Group has policies in place to ensure that sales of products and services are made to customers with an approved credit history. As noted above, the Group has no significant concentrations of credit risk.
Reliance on foreign manufacturers	The Group sources most of its products from outside the UK. Consequently, the Group is subject to risks associated with international trade.	Extensive research is conducted into quality and ethics before the Group procures products from any new country or supplier. The Group also maintains very close relationships with both its suppliers and shippers.
Reliance on one single supplier of consumables	The Group currently buys all its paper for photobooths from one single supplier. The failure of this supplier could have a dramatic effect.	The Board has decided to hold a strategic stock paper, allowing for 6 to 10 months' worth of paper consumption, to give enough time to put in place alternative solutions.
Reputation	The Group's brand is a key asset of the business. Failure to protect the Group's reputation and brand could lead to a loss of trust and confidence. This could result in a decline in the customer base.	The protection of the Group's brand in its core markets is sustained by products with certain unique features and offerings as well as regular maintenance to maintain appearance.
Product and service quality	The Board recognises that the quality and safety of both its products and services is of critical importance and that any major failure will affect consumer confidence.	The Group continues to invest in its existing estate, to ensure that it remains contemporary, and in constant product innovation to meet customer needs. The Group also has a programme to regularly train its technicians.
Failure to keep up with the advances in technology	The Group operates in fields - particularly in relation to photography - where upgrades to new technologies are mission critical.	The Group mitigates this risk by continual focus on R&D.
UK leaving the EU	The UK's referendum decision to leave the EU ('Brexit') will most probably lead to changes in regulations in the UK as well as modifications of numerous arrangements between the UK and other countries, members of the EEC, affecting trade and customs conditions, taxation, movements of resources, etc.	The Board is keeping the potential impacts of the decision to leave the EU under review and will seek to minimise any adverse repercussions of Brexit. The specific impact on the Company will depend on the details of the conditions to be negotiated by the UK and the European Union.
Liquidity risk	Liquidity risk arises from the group's management of working capital and its ability to be consistently cash generative and meet its financial obligations as they fall due.	The Group's approach to managing liquidity risk is to ensure that it has sufficient funds to meet its liabilities when due without incurring unacceptable losses.
Interest rate risk	Exposure to the effects of fluctuations in interest rates on deposits and borrowings.	Exposure to floating rate interest bearing debt is small and a change in interest rates will not have a material change on interest expense. The Group uses derivative financial instruments to reduce the risk from interest rate movements.
Key personnel	Dependence on skilled personnel, the loss of whom could have a material impact.	The Group attempts to ensure that all tasks are transferable, and that it invests in strength and depth of teams to reduce over-reliance on any one individual.

Source: Company, Progressive Equity Research

SUMMARY FINANCIALS

PROFIT & LOSS	FY-16A	FY-17A	FY-18E	FY-19E
Revenue	184.0	214.6	225.3	236.6
Adj EBITDA	56.7	69.2	73.9	78.4
Adj EBIT	39.7	46.8	49.6	52.1
Reported PBT	40.1	48.0	50.7	53.3
Fully adj PBT	40.1	48.0	50.7	53.3
NOPAT	29.2	47.2	28.1	24.3
Reported EPS (p)	7.7	9.3	9.7	10.2
Fully adj EPS (p)	7.7	9.3	9.7	10.2
Dividend per share (p)	5.9	7.0	8.4	8.9

CASH FLOW & BALANCE SHEET	FY-16A	FY-17A	FY-18E	FY-19E
Operating cash flow	49.4	61.2	74.2	78.7
Free Cash flow (£m)	(3.7)	(26.9)	10.2	8.6
FCF per share (p)	(1.0)	(7.1)	2.7	2.3
Acquisitions	(1.6)	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0
Shares issued	1.0	0.8	0.8	0.8
Net cash flow	8.7	(25.5)	11.6	7.5
Overdrafts / borrowings	(10.8)	(10.7)	(8.9)	(7.2)
Cash & equivalents	71.0	47.5	57.3	63.0
Net (Debt)/Cash	60.2	36.8	48.4	55.9

NAV AND RETURNS	FY-16A	FY-17A	FY-18E	FY-19E
Net asset value	122.8	129.2	135.1	141.2
NAV/share (p)	32.7	34.3	35.7	37.1
Net Tangible Asset Value	102.4	103.8	107.9	112.7
NTAV/share (p)	27.3	27.5	28.5	29.6
Average equity	113.6	126.0	132.1	138.2
Post-tax ROE (%)	25.6%	27.7%	27.9%	28.1%

METRICS	FY-16A	FY-17A	FY-18E	FY-19E
Revenue growth	3.8%	16.6%	5.0%	5.0%
Adj EBITDA growth	9.5%	22.1%	6.8%	6.1%
Adj EBIT growth	14.1%	17.1%	6.1%	5.0%
Adj PBT growth	14.6%	20.2%	5.7%	5.1%
Adj EPS growth	3.9%	19.9%	5.2%	5.1%
Dividend growth	30.1%	44.1%	20.0%	5.0%
Adj EBIT margins	21.6%	21.8%	22.0%	22.0%

VALUATION	FY-16A	FY-17A	FY-18E	FY-19E
EV/Sales	3.1	2.7	2.6	2.4
EV/EBITDA	10.2	8.4	7.8	7.4
EV/NOPAT	19.8	12.3	20.6	23.8
PER	21.3	17.7	16.8	16.0
Dividend yield	3.6%	4.3%	5.1%	5.4%
FCF yield	-0.6%	-4.3%	1.6%	1.4%

Source: Company information, Progressive Equity Research estimates

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