

# PHOTO-ME INTERNATIONAL

## SUPPORT SERVICES

### PHTM.L

99.6p

Market Cap: £377.5m

#### SHARE PRICE (p)



12m high/low

191.4p/99.6p

Source: LSE Data

#### KEY INFORMATION

Enterprise value	£350.8m
Index/market	LSE
Next news	Interims, 2018 December
Gearing	N/A
Interest cover	N/A

PHOTO-ME INTERNATIONAL IS A  
RESEARCH CLIENT OF PROGRESSIVE

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## AGM Trading Update

Ahead of today's AGM, Photo-Me have issued a trading update for the five months to the end of September. Trading has been in-line with expectations and the Group is continuing to successfully pursue strategic objectives across all segments as well as re-structuring the Japanese photobooth business in order to position it for a return to growth. The Group remains highly cash generative and even with the dividend held steady in 2019, offers a dividend yield of 8.5%. Our forecasts for FY2019E and FY2020E remain unchanged.

- The Group continues to deploy its secure upload encryption technology booths in the UK. At present, there are 2,700 booths deployed and the Group expects this to reach 4,000 by the end of December 2018. In France, 83% of booths have been upgraded to enable this technology to be used in driving licence applications and all booths will have been upgraded by the end of December 2018. The Group is still in discussions with the Dutch government and is also exploring the possibility with the French government of this technology being used for passports and ID cards.
- Laundry expansion continues in line with previous expectations and the Group is on target to deploy 6,000 Revolution machines (owned and sold) by 2020. As well as existing territories, the Group has been active in new markets, the UK in particular. In the B2B market, the newly acquired La Wash in Spain will make a contribution in FY2019E and the Group is actively seeking further B2B acquisitions which can be integrated into the existing B2B businesses delivering synergistic benefits.
- The re-organisation of Photo-Me Retail is complete and will return to profitability for FY2019E.
- Having established a partnership with a Belgian FinTech company, the Group has begun testing its new self-service banking booths in Paris.
- The re-structuring in Japan continues with the benefits becoming apparent earlier than had been previously expected. The market there remains challenging but the Group expects a return to growth and improving profitability from FY2019E onwards.
- The forecast dividend of 8.4p offers an attractive yield of 8.5%.

FYE APR (£M)	2017	2018	2019E	2020E
Revenue	214.6	229.8	240.1	250.9
Adj EBITDA	69.0	71.0	72.2	75.5
Fully Adj PBT	48.0	46.5	46.2	48.4
Fully Adj EPS (p)	9.3	9.5	9.5	9.9
EV/Sales (x)	1.6	1.5	1.5	1.4
EV/EBITDA (x)	5.1	4.9	4.9	4.6
PER (x)	10.8	10.5	10.5	10.0

Source: Company Information and Progressive Equity Research estimates

## Strategy

### Identification

The growth strategy for Identification centres on the continued expansion of the estate and deploying ID solutions for governments. Photo-Me has already deployed this secure technology in France, Ireland and Germany. In France 83% of photoboosts have been upgraded with the remainder to be upgraded by the end of the year, and there are 300 upgraded units currently deployed in Ireland. Discussions with HMPO were successfully concluded and e-passport technology was initially deployed in the UK in December 2017. As of 30<sup>th</sup> September, 2,700 photoboosts had been upgraded in the UK and by December 2018 the Group plans to have deployed 4,000 upgraded photoboosts. The technology offers value for money and a reliable, high-quality service for customers. For governments the technology allows for a simplification of the process so that manual ID verification is not required and rejection rates are reduced. Both of these factors allow for cost savings. The technology is configured such that biometric information is held on a Photo-Me server and then when the customer inputs a unique verification code the government server can then request the information which is then automatically sent.

Photo-Me will target expansion into high footfall locations in territories where it currently operates. There is also plenty of opportunity to deploy this technology in new territories. Discussions are on-going with the Dutch government and the Group is in talks with the French government to use this technology for passports and ID cards.

The problems encountered in the Japanese Identification market are being addressed. A management re-organisation is underway and new cheaper, lower commission machines are being introduced. This should improve margins and returns and increase market share. Although the Japanese market remains highly competitive, the benefits of Photo-Me's initiatives are becoming evident earlier than previously expected and the Group expects a return to growth and improving profitability through FY2019E and beyond.

### Laundry

Laundry offers significant opportunities for expansion. The Group currently operates Revolution (outdoor self-service laundry units), laundrettes and B2B laundry services. The Group aims to continue its expansion in existing territories and move into new ones. For example, the Group has developed a new Revolution machine with only one washer and one dryer. The benefits of this are lower initial capex making it economic to deploy in lower footfall areas.

Expansion of the Revolution business continues strongly, particularly in Portugal, Ireland and France with good growth also in the UK. The Group is also investigating the potential for deploying Revolution machines in Germany and Italy where it has an existing presence.

The Group expects that the recently acquired La Wash B2B laundry operation in Spain will make a profit contribution for FY2019E. Management also indicated that there is a willingness to continue to make strategic acquisitions in the B2B laundry segment. This is currently a highly fragmented market with significant opportunities for a consolidator capable of extracting synergies. Photo-Me has a pipeline of potential further B2B acquisition opportunities, with a particular focus on Continental Europe.

### Kiosks

The Kiosk market remains stable and continues to perform in line with expectations. The successful re-structuring of Photo-Me Retail means that it will return to profitability for FY2019E.

The Group operates more than 5,400 digital printing kiosks principally in France, the UK and Switzerland. The latest generation of machines are fully integrated with all major social media networks. This will allow photos to be directly printed from a phone without the need for the phone to be connected to the printing device. The Kiosk market is highly fragmented and the Group sees opportunities to capture more of this market in Europe, the US and Asia as a result of its market leading technology.

## Research and Development

A defining competitive advantage of the Group is the market leading quality of its R&D capability. The Group has R&D centres in France, China, Vietnam and Japan which employ 60 engineers specialising in software development. New product is tested on a small scale before full a and the Group's payback criterion requires that gross revenues in the first year of operation should equal or exceed the cost of investment in any new product.

The Group is committed to continuing to invest in new product development and in the refurbishing and upgrading of the existing estate. Current focus is on further development and deployment of proprietary security biometric identification solutions and the development of complementary products and services that can be deployed within the existing estate. An example of this is the banking booth technology which won the 2017 Sesames Award at TRUSTECH for Best eTransaction Solution.

The banking booth will supply front-end banking services within currently deployed photoboos in partnership with a Belgian Fintech company and compete with traditional high street banks. The Group can achieve superior ROCE by leveraging its existing presence in high footfall locations. Testing of this technology has begun in France.

In addition to the award for the banking booth, a new 3D enrolment kiosk was also a finalist at TRUSTECH. This technology improves facial recognition accuracy by more than 100% and can be used in a variety of applications such as access control, video surveillance and secure payments. The technology also addresses increased government focus on employing secure identification systems that are both data protection compliant and offer the highest possible standards in identity assurance.

It is significant that the highly cash generative nature of the business allows for this commitment to R&D to be funded from operating cashflow.

## Forecast

We are forecasting revenue growth of c.4.5% for both FY2019E and FY2020E. This growth reflects the continued strong expansion of the laundry business, the on-going roll out of Photo ID encryption technologies in new and existing markets and a successful completion of re-structuring in Japan for which we have allowed for costs of £2m.

We forecast adjusted PBT of £46.2m for FY2019E. This excludes the £2m re-structuring cost for Japan and is in-line with management expectations that reported PBT for FY2019E will be at least £44m. We forecast a return to growth for FY2020 with PBT of £48.4m, growth of 4.8%.

The reduced effective tax rate should remain at around 22% over our forecast period and we forecast adjusted EPS of 9.5p for FY2019E and 9.9p for FY2020E.

Our forecast is conservative and does not include potential laundry expansion beyond the target of 6,000 machines by 2020. At current rates of roll out, this target should be comfortably exceeded. We have also not included potential revenues from self-service banking.

## Valuation

The Group has no real comparable listed peers. Its strongly cash generative nature does however, lend itself to DCF analysis. The current share price implies terminal growth beyond our forecast period of only 2% and a discount rate of 12.0%. The table below assumes this 2% terminal growth rate and applies a range of discount rates.

### IMPLIED PRICE

Discount Rate	7.50%	8.00%	9.00%	9.50%	10.00%	10.50%	11.00%	11.50%	12.00%
Implied Price (p)	182	166	142	133	125	117	111	105	100

**Source: Progressive Equity Research Estimates**

Dividend yield is also relevant to the valuation. Even with the dividend held at 8.4p for FY2020E Photo-Me still offers a yield of 8.5%.

As an asset backed business, it is also important to consider return on capital.

### ROCE

	2018	2019E	2020E
EBIT £m	46.1	46.2	48.4
Capital Employed £m	180.8	183.2	189.2
ROCE	25.5%	25.2%	25.6%

**Source: Progressive Equity Research Estimates**

Based on our forecast the Group will consistently deliver 25% ROCE.

Investors should view any valuation in the context of their own assessments of the relevant risks and drivers.

## Financial Summary: Photo-Me International

Year end: April (£m unless shown)

	2017	2018	2019E	2020E
<b>PROFIT &amp; LOSS</b>				
Revenue	214.6	229.8	240.1	250.9
Adj EBITDA	69.0	71.0	72.2	75.5
Adj EBIT	46.8	46.1	46.2	48.4
Reported PBT	48.0	50.2	44.2	48.4
Fully Adj PBT	48.0	46.5	46.2	48.4
NOPAT	35.1	40.3	34.5	37.8
Reported EPS (p)	9.3	10.6	9.1	9.9
Fully Adj EPS (p)	9.3	9.5	9.5	9.9
Dividend per share (p)	7.0	8.4	8.4	8.9
<b>CASH FLOW &amp; BALANCE SHEET</b>				
Operating cash flow	61.2	61.0	71.4	74.9
Free Cash flow	5.7	8.9	36.7	39.2
FCF per share (p)	1.5	2.4	9.7	10.3
Acquisitions	0.0	(1.4)	(4.2)	0.0
Disposals	0.0	0.0	0.0	0.0
Shares issued	0.8	1.4	0.8	0.8
Net cash flow	(23.5)	11.2	1.2	7.7
Overdrafts / borrowings	(10.7)	(33.7)	(33.7)	(33.7)
Cash & equivalents	47.5	58.7	59.8	67.6
Net (Debt)/Cash	39.2	26.7	26.2	33.9
<b>NAV AND RETURNS</b>				
Net asset value	129.3	144.8	147.2	153.2
NAV/share (p)	34.1	38.2	38.8	40.4
Net Tangible Asset Value	104.0	117.4	118.8	124.2
NTAV/share (p)	27.5	31.0	31.3	32.8
Average equity	126.0	137.1	146.0	150.2
Post-tax ROE (%)	27.8%	29.4%	23.6%	25.2%
<b>METRICS</b>				
Revenue growth	16.6%	7.1%	4.5%	4.5%
Adj EBITDA growth	22.1%	2.8%	1.8%	4.6%
Adj EBIT growth	24.4%	(1.4%)	0.3%	4.8%
Adj PBT growth	19.9%	(3.2%)	(0.5%)	4.8%
Adj EPS growth	19.5%	2.5%	(0.2%)	5.0%
Dividend growth	20.0%	20.0%	0.0%	5.0%
Adj EBIT margins	21.8%	20.1%	19.3%	0.0%
<b>VALUATION</b>				
EV/Sales (x)	1.6	1.5	1.5	1.4
EV/EBITDA (x)	5.1	4.9	4.9	4.6
EV/NOPAT (x)	10.0	8.7	10.2	9.3
PER (x)	10.8	10.5	10.5	10.0
Dividend yield	7.1%	8.5%	8.5%	8.9%
FCF yield	1.5%	2.4%	9.7%	10.3%

Source: Company information and Progressive Equity Research estimates

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