# Wirecard: The Death of Fundamental Accounting Shorts or Peak Euphoria?
**SHORT @ €79**

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[redacted]

[redacted]

Wirecard – View All Notes and Models

Recommendation: **Short (No Change)**

| | | |
|---|---|---|
| Price: **€79** | Market Cap: **€9.8bn** | Ticker: **WDI GY** |
| 3m Average Daily Volume (USD): **$62.3m** | 2 Year Price Target: **€30** | Forecast Return: **62%** |
| Valuation Metric: **FY'20 Price/FCF** | Current Multiple: **20x Consensus** | Target Multiple: **15x The Analyst Adjusted** |

**Investment Thesis**

- **Given the spending needs, investors are unlikely to recover €11bn of cash flows from the company (€10bn market cap and €1bn debt). In fact, they may need to keep giving the company equity and debt.**
- **The high 'take-rate' on the processed payment volumes and the growth could be explained by the use of the balance sheet to pre-fund customers and partners in the ecosystem, which is not captured in the free cash flow definition. Using your own balance sheet to drive growth is a smart commercial tactic, but may prove unsustainable and is not captured in the free cash flow statements.**
- **Real free cash flow available to the company is 54% (on average FY'10-H1'17) of the published free cash flow and explains our previous concerns; that the presence of the company is difficult to measure and discover in fundamental research, that the company pays low cash taxes, and that they have raised €975m of gross debt whilst free cash + equity could have been used to fund the business.**
- **Returns have halved in the last five years due to rising capital intensity, whilst the stock trades on 6.5x book value, with a 12% return on equity. Unlike the consensus, we believe there is a valuation limit on this stock despite the 'bubble characteristics' currently in play.**
- **Pre-M&A and increases in transitory receivables (post increases in FinTech receivables), Wirecard could generate €270m of free cash flow in 2020. We assume more equity is raised and the debt burden will not decline in the near-term. Applying a 15x multiple (undiscounted) to these cash flows gives us a price target of €30, well over 60% downside.**

## Introduction

Since FY'10, Wirecard has accelerated revenue growth from +20% (FY'10-FY'13) and +30% (FY'14-FY'16), to +40% (FY'17e). However, this revenue acceleration required a massive consumption of capital, and Wirecard has not generated any cash flow (after M&A) during this entire period. Wirecard burns cash to deliver perfect revenue and EBITDA growth to the stock market.

Wirecard has spent at least €1 of capital for €1 of revenue, and it is a highly capital-intensive business. This means the EBITDA margin overstates the returns of the business, and EBITDA is a really bad way to measure the economics. Wirecard may require additional debt and/or equity funding to meet targets assuming the current rate of capital consumption continues.

### Key Points:

- 30-40% of revenue is invested in capex, M&A, working capital, customer relationships, trade receivables (non-transitory), medium-term financing and/or FinTech loans (compared to EBITDA margins of 30%).
- At least €1 has been spent, to drive €1 of revenue (e.g. €306m spending in 2015 drove €257m revenue growth in 2016, €388m spending in 2016 will drive €368m revenue growth in 2017).
- Cash must always be spent on capex, M&A, working capital and FinTech business to maintain current growth rates and win business. Cash goes out before the business comes in – a legitimate business strategy, but one which explains the capital consumption, the growth, and the large debt burden.

- A further €1.3bn may be spent by 2020 to hit the €2.5bn revenue target, assuming continuation of these trends.

- Even on 20-25% annual growth in adjusted free cash flows, there may be still a funding gap, considering the increase in FinTech loans, capex and likely M&A spend in the coming years.

### Exhibit 1: €1 of Capital Spending generates €1 of Revenue Growth

| Capital Spend and Revenue Growth | FY'10 | FY'11 | FY'12 | FY'13 | FY'14 | FY'15 | FY'16 | FY'17e | FY'18e | FY'19e | FY'20e |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | **272** | **325** | **395** | **482** | **601** | **771** | **1028** | **1396** | **1713** | **2101** | **2500** |
| **Revenue Growth (€m)** | | **53** | **70** | **87** | **119** | **170** | **257** | **368** | **317** | **388** | **399** |
| Revenue Growth (%) | | 20% | 21% | 22% | 25% | 28% | 33% | 36% | 23% | 23% | 19% |
| **Capital Outflows (€m)** | **-7** | **-49** | **-50** | **-114** | **-181** | **-306** | **-388** | **-519** | **-388** | **-399** | **-375** |
| **% of sales** | **3%** | **15%** | **13%** | **24%** | **30%** | **40%** | **38%** | **37%** | **23%** | **19%** | **15%** |
| Revenue growth to prior spend (%) | | 756% | 141% | 176% | 104% | 94% | 84% | 95% | 61% | 100% | 100% |
| ***Capex*** | *-10* | *-14* | *-18* | *-34* | *-52* | *-54* | *-73* | *-100* | *-123* | *-151* | *-179* |
| *% sales* | *4%* | *4%* | *5%* | *7%* | *9%* | *7%* | *7%* | *7%* | *7%* | *7%* | *7%* |
| ***M&A*** | *0* | *-21* | *-41* | *-38* | *-91* | *-169* | *-227* | *-317* | *-145* | *-128* | *-76* |
| ***Working Capital*** | *4* | *-14* | *17* | *-15* | *-27* | *-23* | *-2* | *-28* | *-20* | *-20* | *-20* |
| ***FinTech Loans*** | | | | | | *-45* | *-82* | *-75* | *-100* | *-100* | *-100* |
| ***Medium-term financing (e.g. to sales partners)*** | *0* | *0* | *-8* | *-28* | *-12* | *-14* | *-3* | | | | |

*Source: Company Financials, The Analyst and Consensus Estimates*

*NB: Consensus revenue estimates (FY'17-FY'19), company guidance (FY'20 revenue), capital outflow forecast based on 100% of revenue growth in subsequent year, assume €20m annual working capital consumption, assume H2'17 fintech loans in-line with H1'17 then €100m p.a.), no more medium-term financing, M&A is balancing item for capital spend forecasts, €110m due on existing acquisitions spread evenly H2'17 and FY'18.*

- The company now spends 7% of revenue on the three capex accounting items; investment in property, plant and equipment, investment in intangible assets (internally-generated), and investment in other intangible assets (software). We should also consider the historic capital outflows for medium-term financing with sales partners, which was disclosed in the footnotes as additional cash outlays in previous years.

- Wirecard spends less capex, as measured in euros, than the peer group. With this spend, they manage to achieve the highest growth rates, and high margins. This is difficult to explain without looking at the capital spending elsewhere in the cash-flow and balance sheet statements.

### Exhibit 2: Relative levels of capital spending and growth

| 2016 | Worldline | Wirecard | Worldpay | NETS | Ingenico |
|---|---|---|---|---|---|
| Revenue (€mn) | 1309 | 1028 | 5160 | 960 | 2312 |
| Capex (€mn) | 85 | 73 | 183 | 90 | 77 |
| Organic Growth | 4% | 21% | 15% | 6% | 8% |
| EBITDA margin | 20% | 30% | 42% | 35% | 21% |

*Source: Company Financials*

- The M&A expenditure we consider is the total acquired in the year, plus the cash on prior year deals relating to earn outs and other phased acquisition structures. We also consider much of the M&A spend as expansion capex, but this is an academic debate, and investors must take their own view.

- The working capital consumption refers only to the trade receivables and payables presented in the Wirecard adjusted cash flow statement. We have excluded the transitory working capital and FinTech loans (described separately), as the company also does.

- As FinTech loans are revenue generating through interest income, and the processing business, the extension of loans to these partners should be considered further capital spending. This capital used is offset by the deposits held in the bank, but is nonetheless, working capital from an analytical point of view. Wirecard details €97m of receivables from the bank business at Q2'17, held in the Trade Receivables line, with a further €116m in the non-current assets in Financial and Other Assets. We have added these capital items into our capital spend analysis. Oddly, Wirecard, continually describes FinTech investments as receivables in their 2016 annual report, before, conveniently excluding them from the adjusted free cash flow statement.

- This analysis shows that Wirecard has required at least €1 of capital spend to grow revenue by €1. It has not been a scalable technology platform by any stretch of the imagination. Asset turn is 0.3-0.4x and the company makes a low return on capital considering the margin structure of the P&L. As a reminder, the stock trades on 6.5x Price/Book, with a 12% return on equity – the returns look like a banking business, but the multiple is above that of Visa Paypal, and Mastercard.

## Why Raise all the Debt?

- From FY'10 to H1'17, €893m of cumulative net income generated €727m of free cash flow (Wirecard's 'adjusted free cash flow'), but €839m of cash flow went out on M&A spend and €111m went out on dividends. **Wirecard is a big hole for cash, sucking in capital from equity and debt investors.** To fund the growth, Wirecard firstly raised equity of €141m in 2012 and €367m in 2014. This injection of €508m at an average price of €24, has provided equity investors with a 3x return on capital at the current share price (if they sell now). Secondly, they accumulated a gross debt position of €975m, despite generating all this cash flow and earnings in the period. On free cash, net cash and equity raise, they could have funded the M&A. However, they now sit on nearly €1bn of debt.

**Exhibit 3: Whatever the company's own definition of net cash, the fact is that Wirecard now has €975m of gross debt, incurring interest.**

| II. Liabilities | | |
|---|---|---|
| 1. Non-current liabilities | | |
| Non-current interest-bearing liabilities | 695,571 | 579,475 |
| Other non-current liabilities | 49,187 | 31,425 |
| Deferred tax liabilities | 88,574 | 59,747 |
| | 833,331 | 670,648 |
| 2. Current liabilities | | |
| Liabilities of the acquiring business | 381,420 | 404,767 |
| Trade payables | 53,107 | 34,920 |
| Interest-bearing liabilities | 279,923 | 15,066 |
| Other provisions | 1,906 | 3,914 |
| Other liabilities | 181,801 | 119,505 |
| Customer deposits from banking operations | 820,906 | 734,003 |
| Tax provisions | 27,974 | 24,276 |
| | 1,747,036 | 1,336,452 |
| Total liabilities | 2,580,368 | 2,007,099 |
| Total equity and liabilities | 4,092,590 | 3,482,062 |

4.7 Financial result

Financial result

| in kEUR | 6M 2017 | 6M 2016 |
|---|---|---|
| Unwinding the discount on liabilities | 3,733 | 4,681 |
| Interest expenses from loans and leasing | 5,754 | 3,870 |
| Losses from fair value valuation | 2,716 | 0 |
| Impairment of financial assets | 61 | 287 |
| Currency-related expenses | 55 | 14 |
| Financial expenses | 12,319 | 8,852 |
| Currency-related income | 484 | 0 |
| Interest income | 1,817 | 616 |
| Gains from fair value valuation | 0 | 0 |
| Income from sale of Visa Europe Ltd. | 95 | 91,662 |
| Income from securities and loans | 279 | 181 |
| Financial income | 2,674 | 92,459 |

*Source: Wirecard H1'17 Interim Report*

- This leaves investors with a conundrum? Why does a company that generates significant free cash flow and profit, and possesses a unique and scalable technology platform, consistently consume cash and require significant external capital?

- Wirecard, on their own definition of free cash flow, has produced cumulative free cash flow prior to M&A spend of €727m (FY'10-H1'17) and only paid out cumulative dividends of €111m. Prior to equity raising, debt raising, and M&A there was €616m available to the company. To this balance, we add the €508m raised from equity placings giving theoretical total cash available of €1124m.

- The cumulative M&A spend has been €839m, which means that **Wirecard really had no need to raise any debt**. The M&A spend could have been covered by organic free cash generation and the historical equity funding. Instead, we have witnessed an explosion in gross debt. In 2014, the company had just €98m of interest-bearing liabilities – this has increased to €975m and they are incurring the matching financial expenses. At H1'17, the company carried short-term interest-bearing liabilities of €280m and long-term interest-bearing liabilities of €696m. Offsetting this debt balance there is €1,597m of cash and cash equivalents, of which €658m (customer deposits in the bank) do not belong to the company. Even in 2014, the company had €695m of cash and cash equivalents, of which €225m were in customer deposits leaving a 'net cash' position on a reasonable definition of €400-500m at that point in time, with the €98m gross debt mentioned above. Why the explosion in debt?

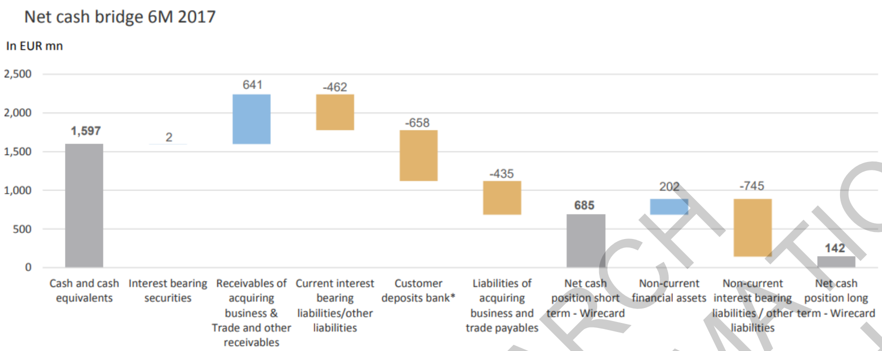
- We still have issues with Wirecard's own definition of net cash, that includes working capital and other long-term financial assets (not liquid).

**Exhibit 4: Wirecard claim to have 'net cash' of €142m**

**Financial data**

wirecard

**Net cash (short- and long-term)**




| * Customer deposits bank break down in EUR mn | 30.06.2017 |
|---|---|
| Customer deposits - balance sheet amount | 821 |
| thereof in long-term interest bearing securities | -47 |
| thereof in interest bearing securities and fixed-term deposits | -115 |
| **Customer deposits relevant for net cash calculation** | **658** |

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*Source: H1'17 Results Presentation Wirecard*

- Wirecard could have easily funded all their activities from cash flow and net cash. Instead they have accumulated a huge debt burden and consumed cash at an increasing rate. The implication is that Wirecard does not have liquid access to the gross cash position, and the gross cash position overstates the real liquidity available to the company, whilst the free cash generation is unsustainable or unavailable for acquisitions, or there is additional cash consumption in the business (below the disclosed 'adjusted free cash flow' of the company).

- Our point is this:

    - In a bull case, and at best, Wirecard is a high-risk, levered, capital structure that will soon complete an intense period of M&A. After 2017, the company could, in theory, deliver genuine free cash, without M&A, grow to their 2020 targets, and then begin returning real cash to shareholders. For this, investors are now paying €9.5bn, 6x the consensus 2018 revenue, >30x consensus FY'18 earnings and ~40x FY'18 cash flows. Even in the most stretched imagination, this represents something close to fair value. Without the capital spending, growth rates will slow down and the company would miss estimates considerably.

    - In a bear case, and at worst, this is a high-risk, levered, capital structure that consumes large amounts of capital, has a declining return on that capital, operates in a highly-competitive industry with rapid technology change and utilises aggressive accounting measures and changes in disclosure to obfuscate the true cash generation of the company and achieve an unsustainable valuation by the stock market. Our view remains the latter, and in this note we run through the new total of our concerns.

- Our expectations of the real future returns to shareholders, as measured by real cash returns is materially lower than the €9.5bn valuation of the business today. In fact, after making the adjustments described below, factoring in the additional capital required by the company and netting off all the assets and liabilities of the balance sheet, we maintain a price target of €30.

- We also expect another equity raise as with a 10% equity issue, Wirecard could now collect €900m, effectively wiping out the gross debt, and taking the gross cash position to €2.5bn. Ironically, this capital raise would provide further support to the thesis outlined above of capital consumption, despite profit, cash generation, and apparent net cash on the balance sheet. Investors would be diluted further, and the potential losses should the profits be unsustainable would grow, but the company could easily remove the recently-acquired debt burden and associated funding costs.

# Hopes for Cash are Misplaced

Changes in accounting disclosure make it extremely difficult to analyse growth rates, the balance sheet and cash flows of the company. FinTech loans, medium-term financing, pre-payments on M&A, acquisition of customer relationships and growth in transitory receivables are all examples of cash going out before revenue. Would growth rates be sustainable without this cash out?

In a capital-intensive business, the EBITDA margin considerably overstates the returns of the business. EBITDA minus capex, is 23% of sales, EBITDA minus capex minus M&A, is close to zero. Wirecard could possibly require additional debt and/or equity funding.

- We have already shown the cost of growth, where we measured the additional revenue compared to prior year investment in capex, working capital and M&A expenditure.

- The sum of capex, working capital, and M&A is broadly equal to the revenue growth in the next year. For example, in FY'15, Wirecard spent €306m (€68m capex, €169m M&A, €23m working capital, €45m FinTech loans) and then grew revenue by €257m in FY'16. For FY'16, capital spend of €3388m will drive €368m of incremental revenue in 2017. Of course, if the company stops acquiring and capital spend reduces, our bear thesis is severely impaired (we saw this with SAP after the €25bn M&A binge of FY'11-FY'15). Also, spending capital to grow can be a great strategy, but the question has to be – how much growth can you really fund, when does it stop, and without it, what happens to growth rates?

- The point is, Wirecard is a 'dream equity', providing investors with;

    - Accelerating Growth, High-Returns, and fantastic Free Cash Flow. However, these three are mutually exclusive in this case. Firstly, Wirecard does not have high returns. Secondly, the real free cash flows are materially below those measured by analysts. This is, in fact, quite normal, for a growth, technology business that needs to invest.

- Our thesis is that predictions of revenue growth to FY'20 must be considered alongside the capital requirements of the growth. Consensus revenue growth for FY'18 is €317m, which is considerably below the expected FY'17 capital spending of €519m (€100m capex, €252m M&A in H1'17, and half of the purchase price liabilities of €110m settled in H2'17 on the acquisitions of MyGate and the Citigroup assets). Wirecard could even beat FY'18 estimates, but then need to spend a lot more to reach the 2020 estimates and goals.

- For Wirecard to add a further €800m of revenue from FY'18 (€1.7bn) to FY'20 (€2.5bn) will probably require at least €800m of capital spending (in FY'18 and FY'19), of which 7% of sales can reasonably be expected in capex (€334m) and €300-400m is likely to be M&A, or FinTech receivables (or a mix of both). We expect Wirecard to make more acquisitions in late FY'17 and FY'18 to fulfil this growth ambition. If Wirecard can achieve this growth with an improved capital spend ratio, of course that will invalidate our short thesis, and the stock just becomes a 'valuation short'. We would expect an amount of €400m capital spend in FY'20 also, meaning €1.3bn of total spending between now and the end of the decade.

- If Wirecard can grow free cash flow (on the company's adjusted definition and prior to M&A) at a compound rate of 20% to 2020 (in-line with consensus expectations), the company still may not be able to cover this rate of capital spend and dividends from free cash flow and will require additional capital. On consensus numbers, free cash flow estimates (H2'17-FY'20) may reach €1.3bn, but capital spend will reach €1.3bn. We also discuss below, that consensus free cash flow estimates simply do not capture the real balance sheet situation.

- Furthermore, analysts must consider the potential capital needs in any sensible valuation, or DCF, of the equity. We note consensus forecasts of capex (7% of sales) but do not believe analysts adequately model the additional M&A spend, working capital consumption, or FinTech loans, which is necessary to capture the growth numbers planned. Wirecard is very successful at growing and winning customers, but it has spent heavily and continually.

- In all likelihood, investors will need to provide more equity and debt to Wirecard. They may be willing to do this after such great share price performance and tempted by the prospect of more years of 20-30% revenue and EBITDA growth. However, based on our analysis, Wirecard is a continuously capital-consuming business, with a deteriorating return on capital and is unlikely to ever provide the €9.5bn of equity market cap or €1bn of gross debt back to their investors.

## Changes in Accounting Disclosure Make it Difficult to Analyse Growth Rates, the Balance Sheet, and Cash Flows of the Company

- After articles in the FT by journalist Dan McCrum, the company began disclosing free cash flow conversion in their investor presentations. Cash conversion has improved from 89% (FY'14) to 110% (H1'17). However, the company's own definition is difficult to track. For example, the FY'14 presentation of cash conversion shows €48.146m of 'operative capex', whereas the annual report shows capex of €74.6m. Nonetheless, after the negative analysis of the cash flows in the British press, cash conversion improved significantly from ~60% (2010-2013) to 100% (2014-H1'17). Furthermore, in the FY'16 annual report, they changed disclosure on cash from operations. In FY'17, they have reduced disclosure on M&A. Without the exclusion of FinTech receivables, we see cash conversion still at 60%, in-line with historical levels, but below the company's own definitions of cash conversion.

### Exhibit 5: Definition of Capex in 2014 Cash Conversion

Financial data

wirecar

**Cash flow and conversion**

| Free cash flow in EUR k | 2015 | 2014 |
|---|---|---|
| Cash flow from operating activities (adjusted) | 199,685 | 143,994 |
| Operative CAPEX | 54,477 | 48,156 |
| **Free cash flow** | **145,208** | **95,838** |

| Cash conversion in EUR k | 2015 | 2014 |
|---|---|---|
| Free cash flow | 145,208 | 95,838 |
| Earnings after tax | 142,646 | 107,929 |
| **Cash conversion in %** | **101.8** | **88.8** |

**Consolidated cash flow statement**

| in kEUR | Notes | 1 Jan 2015 –31 Dec 2015 | 1 Jan 2014 –31 Dec 2014 |
|---|---|---|---|
| **Earnings after tax** | (5.) | 142,646 | 107,929 |
| Financial result | | 7,175 | 6,738 |
| Income tax expense | | 23,023 | 18,190 |
| Gain/loss from disposal of non-current assets | | 471 | 294 |
| Amortisation/depreciation | | 54,470 | 40,085 |
| Change from currency exchange-rate differences | | –4,593 | –1,903 |
| Change in inventories | | –286 | 1,510 |
| Change in receivables | | –76,770 | –74,836 |
| Change in liabilities of the acquiring business and trade payables | | 56,401 | 39,835 |
| Change in other assets and liabilities | | –2,680 | 6,434 |
| Net cash outflow arising from income tax | | –21,892 | –15,245 |
| Interest paid excluding interest on loans | | –260 | –416 |
| Interest received | | 580 | 502 |
| **Cash flow from operating activities** | | 178,285 | 129,115 |
| Cash outflows for investments in intangible assets | | –50,865 | –67,655 |
| Cash outflows for investments in property, plant and equipment | | –13,147 | –7,301 |
| Cash inflows from sale of intangible assets and property, plant and equipment | | 15 | 6 |

*Source: Investor Presentation and Annual Report 2015*

- We are happy to accept the adjusted free cash statement from the company for the purposes of this analysis. The table below shows the following. Firstly, free-cash flow, based on the company's own definition. Secondly, EBITDA. Thirdly, capital expenditure. Fourthly, M&A expenditure. We can see that Wirecard simply, and consistently cannot generate cash. Either on a classic definition of free cash flow minus M&A, or an alternative of EBITDA (margin of 30%) minus capex (7% of sales) minus M&A (20-30% of sales). The debate as to whether the M&A expenditure represents expansion capex, rather than strategic acquisition of scalable technology is academic. Our argument is that M&A consists of acquiring geographic footprint, sales partners, customers and operating licenses. As such, it is expansion capex, and acquisition of revenue, not classic M&A which would be acquisition of complementary technologies that allow the company to expand return on capital and scale.

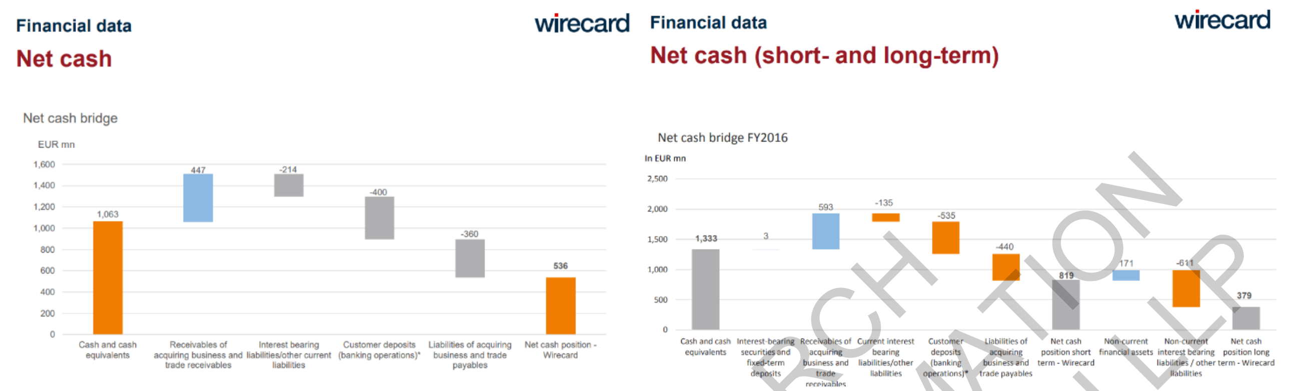
### Exhibit 6: Wirecard does not generate cash for their shareholders

| Cash Generation | FY'10 | FY'11 | FY'12 | FY'13 | FY'14 | FY'15 | FY'16 | H1'17 | TOTAL |
|---|---|---|---|---|---|---|---|---|---|
| **Company Definition of Free Cash Flow (ad** | **36** | **24** | **44** | **56** | **96** | **145** | **210** | **115** | **727** |
| **cash conversion in %** | **67%** | **39%** | **61%** | **68%** | **89%** | **102%** | **119%** | **110%** | **82%** |
| M&A | 0 | -21 | -41 | -38 | -91 | -169 | -227 | -252 | -839 |
| **Net Cash Flow (definition 1)** | **36** | **3** | **3** | **19** | **5** | **-24** | **-17** | **-137** | **-112** |
| EBITDA | 73 | 84 | 109 | 126 | 173 | 227 | 308 | 176 | 1,277 |
| Capex | -10 | -14 | -18 | -34 | -52 | -54 | -73 | -35 | -291 |
| M&A | 0 | -21 | -41 | -38 | -91 | -169 | -227 | -252 | -839 |
| **Net Cash Flow (Definition 2)** | **62** | **49** | **50** | **55** | **30** | **4** | **7** | **-110** | **147** |

*Source: Company Financials, The Analyst Estimates*

- In fact, the company themselves struggle to decide how much 'net cash' they have. In 2015, net cash of €536m was shown (relating to what by 2016 was called 'net cash position short-term'), whilst in 2016, the company decided that in fact long-term interest-bearing liabilities should probably be considered (thereafter giving us short-term and long-term net cash). We are pretty sure that net working capital is not net cash, and would like clients to reference other listed companies that consider trade receivables as net cash.

**Exhibit 7: Wirecard aren't sure what the right definition of net cash is**




*Source: Investor Presentation 2015 (LHS), 2016 (RHS)*

## Key Points:

- Regarding definition 1 (company adjusted free cash flow minus M&A) cumulative free cash flow of €727m has been eclipsed by €839m of M&A spending.

- Regarding definition 2 (EBITDA minus capex minus M&A) EBITDA margins of 30% overstate the returns of the business as capex is 7% of sales, and the cumulative free cash, after the M&A, is minimal (prior to payment of interest and taxes).

- So far, we have primarily considered the adjusted free cash metrics. However, additional capital spending can be identified. The message here is that Wirecard is very commercially successful and extends money into its ecosystem to help grow the customer base in payments, the processing volumes, and their banking business. This is smart of the management, and why shouldn't they use all the capital to grow at these rates? However, our thesis is that these capital outflows must always occur, and repeat, to maintain the current growth. This ultimately means shareholders cannot get cash returns without suffering a material slowdown in growth rates. In the following analysis, we look at some of the other uses of cash.

## An Old Concern - €64m Cash Outflow to 'Medium-Term Financing-Agreements, i.e. with Sales Partners'

- Disclosures and descriptions change. For example, in the 2013 annual report, Wirecard disclosed €28m of cash outflow for 'Medium-term financing-agreements i.e. with sales partners'. This sounds a bit like lending money to customers or partners, and that money might be coming back as revenue. There's nothing wrong with this, but a €28m loan to a customer that comes back as €28m of revenue does not look like real, long-term revenue to us, and the loan would be working capital. Nor would this be simple banking business, where a loan is issued to a customer to generate interest income. This would be a case of loans that generate interest income, but are also used to purchase services (e.g. payment processing) off the loan issuer, or to provide capital to support the growth of the customer's business. Companies with this circularity of revenue and cash flow should be treated with caution by investors, as the growth needs escalating capital spend. We simply reclassify these medium-term loans as working capital, as we do with FinTech loans. In FY'14, the company outlaid another €12m, followed by €14m in FY'15. By FY'16/FY'17, this activity appears to have stopped (possibly to be replaced by the FinTech activity described below). The FT wrote about it in July 2015, it reduced to €3m in 2016 and soon disappeared from the financial statements at €0m in H1'17. The description also changed to 'Securities and medium-term financing arrangements', helpfully dropping the words 'i.e. with sales partners'. Nonetheless, we take the cumulative cash outflows of €64m when considering our adjusted cash flow definition below.

## A Newish Disclosure and Consumer of Cash - FinTech Receivables of €212m

- Wirecard has provided €212m of financing to FinTech partners as shown in these balance sheet items. This disclosure arrived in more detail from the FY'16 accounts onwards. Wirecard offered additional cash flow disclosure, with new lines referring to changes in assets in the banking operations and changes in customer deposits. As the company is now providing more significant financing to the FInTech partners/customers of the business (in addition to payment processing services) they give more financial details.

### Exhibit 8: €116m to FinTech (Non-current assets) and €97m to FinTech (Current assets)

**Breakdown of financial and other assets / interest-bearing securities**

| in kEUR | 30 Jun 2017 | 31 Dec 2016 |
|---|---|---|
| Visa preferred stock | 16,938 | 15,256 |
| Financing agreements (amongst others sales partner) | 28,550 | 28,534 |
| convertible bonds | 33,008 | 32,735 |
| Securities | 1,941 | 2,805 |
| Securities/collared floaters | 47,018 | 42,558 |
| Receivables from bank business (mostly from FinTech business) | 115,672 | 85,035 |
| Other | 7,603 | 9,274 |
| | 250,730 | 216,196 |

**Trade receivables**

| in kEUR | 30 Jun 2017 | 31 Dec 2016 |
|---|---|---|
| Receivables from bank business (mostly from FinTech business) | 96,730 | 89,892 |
| Receivables from prepaid card business | 17,199 | 0 |
| Other trade receivables | 95,840 | 72,239 |
| Other receivables | 35,495 | 28,053 |
| | 245,264 | 190,185 |

*Source: Wirecard Interim Report H1'17*

### Exhibit 9: Cash flow presentation for 2015 changes from 2015 annual report into 2016 annual report with new disclosure on movement on assets in the banking operations

**Consolidated cash flow statement**

| in kEUR | Notes | 1 Jan 2015 –31 Dec 2015 | 1 Jan 2014 –31 Dec 2014 |
|---|---|---|---|
| Earnings after tax | (5.) | 142,646 | 107,929 |
| Financial result | | 7,175 | 6,738 |
| Income tax expense | | 23,023 | 18,190 |
| Gain/loss from disposal of non-current assets | | 471 | 294 |
| Amortisation/depreciation | | 54,470 | 40,085 |
| Change from currency exchange-rate differences | | –4,593 | –1,903 |
| Change in inventories | | –286 | 1,510 |
| Change in receivables | | –76,770 | –74,836 |
| Change in liabilities of the acquiring business and trade payables | | 56,401 | 39,835 |
| Change in other assets and liabilities | | –2,680 | 6,434 |
| Net cash outflow arising from income tax | | –21,892 | –15,245 |
| Interest paid excluding interest on loans | | –260 | –416 |
| Interest received | | 580 | 502 |
| Cash flow from operating activities | | 178,285 | 129,115 |

**Consolidated cash flow statement**

| in kEUR | Notes | 1 Jan 2016 – 31 Dec 2016 | 1 Jan 2015 – 31 Dec 2015 |
|---|---|---|---|
| Earnings after tax | (5.) | 266.749 | 142.646 |
| Financial result | | 24.000 | 7.175 |
| Income tax expense | | 34.440 | 23.023 |
| Gain/loss from disposal of non-current assets | | 616 | 471 |
| Amortisation/depreciation | | 72.175 | 54.470 |
| Gain/loss from disposal of available-for-sale non-current assets | | -89.861 | 0 |
| Change from currency exchange-rate differences | | -536 | -2.916 |
| Change in inventories | | -509 | -286 |
| Change in receivables | | -77.887 | -70.233 |
| Change in liabilities of the acquiring business and trade payables | | 53.788 | 56.401 |
| Change in other assets and liabilities | | 9.661 | 18.647 |
| Net cash outflow arising from income tax | | -24.544 | -21.892 |
| Interest paid excluding interest on loans | | -1.936 | -260 |
| Interest received | | 343 | 580 |
| Cash flow from operating business before banking operations | (6.) | 266.498 | 207.826 |
| Change in non-current assets of banking operations | | -64.174 | -21.145 |
| Change in current assets of banking operations | | -56.810 | -16.746 |
| Change in customer deposits of banking operations | | 148.837 | 187.991 |
| Cash flow from operating business of banking operations | | 27.853 | 150.100 |
| Cash flow from operating activities | (6.1.) | 294.351 | 357.926 |

*Source: 2015 and 2016 Annual Reports*

- The Fintech loans generate some interest income for the company, and is simply smart business to assist customers and partners in need of capital, provide liquidity to their platforms and probably ensure they do business with Wirecard in exchange for financing. One interesting area for further research would be to investigate if any of the FinTech partners are undisclosed related-parties. This is good business, but should be considered as working capital investment, which it is not by the company. The company excludes the increase in FinTech business from their definition of free cash flow and adjusted working capital movements. This interest income is generated and recognised in revenue, not in financial results.

- In 2016, 'adjusted free cash flow' of €210m was prior to €120m of FinTech receivables outflow. Free cash flow was ~40% of the published number.

### Exhibit 10: Wirecard disclosures on FinTech businesses. Wirecard generated €5.5m interest income in the Acquiring & Issuing segment in H1'17 and €9.7m in 2016.

| Item | FY'15 | Q1'16 | Q2'16 | Q3'16 | Q4'16 | FY'16 | Q1'17 | Q2'17 |
|---|---|---|---|---|---|---|---|---|
| **BALANCE SHEET** | | | | | | | | |
| **Financial and Other Assets:** Receivables from bank business (mostly from FinTech business) | 24 | ? | 46 | 39 | 85 | 85 | 89 | 116 |
| **Trade Receivables:** Receivables from bank business (mostly from FinTech business) | 68 | 89 | 85 | 89 | 90 | 90 | 84 | 97 |
| **CASH FLOW** | | | | | | | | |
| Change in non-current assets (banking operations) | -21 | -29 | -5 | ? | ? | -64 | -12 | -24 |
| Change in current assets (banking operations) | -17 | -98 | 7 | ? | ? | -57 | 46 | -13 |
| **INCOME STATEMENT** | | | | | | | | |
| Revenue from Interest Income (Acquiring and Issuing) | 4 | 1 | 3 | 2 | 3 | 10 | 3 | 3 |

*Source: Company Filings*

- At Q2'17, Wirecard held customer deposits of €821m, which are included in gross cash, but is not the company's own cash. They use this to provide financing. One example might be directly to Funding Circle, or on the lending platform of Funding Circle, a UK based company, that is a strategic partner of Wirecard. Wirecard can help their customers with financing, particularly FinTech start-ups in need of capital. In exchange, we assume Wirecard can get more favourable pricing on the processing volumes, secure the customer as a banking client and grow with them over time. However, this does mean that your customer acquisition and growth is concomitant on providing financing. Therefore, we should consider FinTech receivables as actual trade receivables, to be included in any calculation of free cash flow.

- In total, average loans of €133m to FinTech partners in FY'16, generated €9.7m interest income (average interest rate of 7.2%) and average loans of €193m in H1'17, generated annualised interest income of €11m (average interest rate of 5.7%). These interest rates also seem quite low relative to the returns available on lending platforms and in high-yield markets, so the short-term economic return on the activity is not obvious to us. Nonetheless, it's an excellent way to grow a business, by helping your customers with their financing. The only problem is that another €212m has left the asset side of the balance sheet, and should be included in free cash calculations.

### Exhibit 11: Movements in FinTech Receivables are excluded from adjusted cash flow despite describing them as Receivables

Receivables and liabilities from acquiring are transitory in nature and subject to substantial fluctuations from one balance sheet date to another as, inherent to the business model, these balance sheet items are significantly influenced by the overall transaction volume and the security reserves. Receivables from acquiring mainly comprise receivables from credit card organisations, banks and acquiring partners and liabilities exist to retailers. The customer deposits from the banking business and corresponding securities or receivables from the banking business likewise constitute items that can be eliminated for the Cash flow (adjusted). To enhance transparency and illustrate this influence on cash flow, Wirecard AG, in addition to its usual presentation of cash flows from operating activities, reports a further cash flow statement that eliminates items that are of a merely transitory nature. These supplements help to identify and present the cash-relevant portion of the company earnings.

Depending on the age structure of the receivables, uniform value adjustments (impairments) are made to receivables across the Group. The majority of receivables relate to credit card organisations, banks and acquiring partners. In this area, there have been no noteworthy defaults in the history of Wirecard. In the area of FinTech, receivables are secured by cash collateral in line with the industry standard above and beyond the expected level of default. In the case of trade receivables from retailers/merchants and trade receivables that are more than 180 days overdue, the Group carries out an impairment to the full amount in the absence of any other information on the recoverability of such receivables. In determining the recoverability of trade receivables, any change in credit standing is taken into account from the date on which deferred payment was granted up to the balance sheet date. In the case of receivables of acquiring business, trade receivables and other receivables that were not overdue and whose

> Receivables and liabilities of acquiring business are transitory in nature and subject to substantial fluctuations from one balance sheet date to another as, inherent to the business model, these balance sheet items are significantly influenced by the overall transaction volume and the security reserves. Receivables of acquiring busiess mainly comprise receivables from credit card organisations, banks and acquiring partners and liabilities exist to retailers. The customer deposits from the banking business and corresponding securities or receivables from the banking business likewise constitute items that can be eliminated for the Cash flow (adjusted). To simplify the identification and reporting of the cash-relevant portion of the Company's own earnings, Wirecard AG has decided to present a further statement in addition to the usual statement of cash flow from operating activities with those items eliminated.

*Source: 2016 Annual Report*

- We can see that the use of customer deposits to lend money to customers and partners is accruing interest which is valuable to the corporate entity and above the interest earned on the bank deposits (like a bank!). However, most banks trade on a low multiple of book value, whilst Wirecard trades on 6.3x Price/Book (the business made a 12% return on equity in 2016). The business is small, in the context of the total business (1% of revenue) but large in the context of the free cash flow movements. We do not yet see any meaningful bad debt accruals in the balance sheet, and have no visibility on the average duration of the lending or risk profile. Nor do we know if the FinTech partners are also customers (we assume they are, and Wirecard describe them as such) in the processing business.

## Pre-payments on Deals, and Lower Disclosure on the Citi Deals than Previous Asian Deals:

- On 13th March 2017, Wirecard signed the acquisition of the customer portfolio of the Citigroup, following the acquisition of control over Citi Prepaid Card Services on 9th March, and Mygate Communications on 6th March. In neither the press releases, the 2016 annual report, nor the 2017 interim report, does Wirecard detail the specific cost of the two Citigroup deals. We don't know the amount paid, only that closing occurs in stages on Citi APAC, with a €20m EBITDA benefit from consolidation in 2019, and that the value of the assets is €112m. We also know Citi Prepaid will contribute $20m in FY'17, and that Wirecard's valuation of the net assets the business acquired is €183m.

- We know the company paid €237m in H1'17 for acquisitions and there is a further €110m of purchase price liabilities recorded on the balance sheet. However, the deal structures and prices are far lower disclosure than in previous deals.

- In addition, Wirecard has historically provided loans to the acquisition targets, prior to the closing of the deals. These prepayments on acquisitions could be added into a more negative analysis of the cash flows, and add to the thesis of cash being advanced prior to business being received. However, these prepayments are captured in our summation of total M&A spending, and we leave this analytical point for others to calculate and debate.

**Exhibit 12: Wirecard are not specifically disclosing the purchase price on the Citi deals**

> The agreed purchase price consists beside the already paid amount of a further payment, of which EUR 54.4 million will be recorded as liability. The parties agreed not to disclose the precise purchase price. As a result of the short period before issue for publication of the consolidated financial statements, the amounts recognised are not final. Non-separable assets, such as the specialist knowledge and contacts, as well as the synergy effects within the Wirecard Group, are recognised under goodwill.

*Source: H1'17 Company Report*

- Compare this to previous detailed disclosures about the phased payment plans, loans prior to acquisition, earn-out formula, and total price paid on the acquisitions in FY'12-FY'15.

**Exhibit 13: Extensive disclosure on a €47m deal relative to minimal disclosure on >€300m of Citigroup deals**

**Business combinations in the fiscal year**

**PT Aprisma Indonesia**

PT Aprisma Indonesia, which was founded in 2000 and has its headquarters in Jakarta, was sold by its founder and sole shareholder to Wirecard at the end of November 2013. The purchase price to be paid as part of this transaction amounted to approximately EUR 47 million. The total including the liabilities acquired amounted to EUR 77 million. Furthermore, two earnout components must be paid that will depend on the operating earnings of the acquired company in the years 2014 and 2015 and could amount to up to EUR 14.5 million, of which EUR 9.7 million has been reported as a liability.

In 2014, consolidated sales revenues came to kEUR 9,908 with a consolidated EBIT of kEUR 4,481 and a consolidated result after taxes of kEUR 3,529. For the full 2014 fiscal year, the company was able to achieve a result after taxes of kEUR 3,808 with sales revenues of EUR 10.4 million. The closing of this transaction required the approval of Indonesian regulatory bodies, which was granted on 3 February 2014. The first-time consolidation also took place from this date.

*Source: Wirecard 2014 Annual Report*



## Changes in Regional Revenue Accounting Disclosure Boost Growth Rates in Europe from 19% to 30%, Underlying Organic Growth may be Closer to High Single-Digits

- Another example of a favourable change in disclosure is the reclassification of 'Regional revenue breakdown' in FY'17. For the FY'16 annual report, Wirecard disclosed revenue by Germany, Europe and Other Countries. In addition, the consolidation revenues of €82m are disclosed, relating to inter-company revenue (non-external). In the Q1'17 and the H1'17 report, the company has merged the German and European revenue into one line, and removed the consolidation revenue from the H1'16 numbers. We see growth of 30% for revenue in Europe (incl. Germany), which is an increase from the rates of FY'16 (+22% in Germany, and +25% in Europe) due to the elimination of the 'Consolidation Europe' revenue in H1'16.

- Revenue in H1'16 is reduced to €272.545m in the H1'17 accounts, from prior reporting of €297.425m in the H1'16 accounts, **thereby increasing the growth rate to 30% (prior to 'Consolidation Europe') and 25% (post 'Consolidation Europe), compared to 19% under the old measure.** We can also see this in the Q1'17 accounts – it looks like Europe (incl. Germany) has grown by 24%, but the consolidation revenue has disappeared, reducing the Q1'16 revenue base for the growth calculation. On the old accounting, the region would have grown 14%. We have no insight into the accounting for inter-company or consolidation revenues which would allow us to reconcile the changes.

- **Our conclusion is that growth in Europe and Germany is slowing**, which is inevitable as the revenue base gets larger, and Wirecard has not conducted M&A in Europe recently. This slowdown in organic growth is also supported by evidence from the financial accounts of Wirecard Bank AG (WBAG) which shows acquiring commissions grew by 7% in FY'16, down from 23% in 2015 and an average of 23% for the past five years.

**Exhibit 14: 'Consolidation Revenue' is disappearing and the 'Europe (incl. Germany) can show higher revenue growth of 30%**

**Regional revenue breakdown**

| in kEUR | 6M 2017 | 6M 2016 |
|---|---|---|
| Europe (incl. Germany) | 354,978 | 272,545 |
| Asia Pacific | 215,082 | 173,785 |
| America and Africa | 61,862 | 7,666 |
| | 631,923 | 453,996 |
| Consolidation Europe | –14,003 | –99 |
| Consolidation Asia Pacific | –2,442 | –2,107 |
| Consolidation America & Africa | 0 | 0 |
| Total | 615,478 | 451,790 |

**Regional revenue breakdown**

| in kEUR | 6M 2016 | 6M 2015 | Q2 2016 | Q2 2015 |
|---|---|---|---|---|
| Germany | 183,990 | 148,786 | 99,159 | 78,032 |
| Europe | 113,436 | 99,191 | 62,062 | 50,919 |
| Other countries | 181,451 | 103,168 | 95,074 | 54,918 |
| | 478,877 | 351,145 | 256,296 | 183,869 |
| Consolidation Germany | –11,596 | –2,724 | –4,794 | 876 |
| Consolidation Europe | –13,383 | –7,037 | –8,957 | –3,445 |
| Consolidation Other countries | –2,108 | –1,298 | –1,224 | –628 |
| Total | 451,790 | 340,085 | 241,320 | 180,672 |

*Source: Interim Reports 2016 and 2017*

## Analysis of the Bank Subsidiary Reveals the Company Missed Budget and Organic Growth may be Closer to 7%

- We examined the subsidiary accounts of Wirecard Bank AG which gives us the growth in the acquiring volumes, and could be considered a good proxy for organic growth. The two extracts below make our point. As almost all the M&A has occurred outside Europe, the German banking business should be close to organic growth, with some boost in the subsequent year from the acquired customer portfolios that should become banking customers in time.

- The subsidiary filing shows that growth in acquiring commission income was only 7% in FY'16 (€218m, compared to €202m in 2015). This is considerably lower than the 22% growth rate shown for the whole division (Acquiring and Issuing) in 2016. We believe this is a good proxy for European organic growth – still strong numbers, but considerably below the common perception that Wirecard consistently grows at organic rates of +20%, with the additional acquired revenue contributing another +15-20% to reported numbers.

**Exhibit 15: Wirecard Bank AG grew commission income by 7% in FY'16**

**4 Notes to the income statement**

**4.1 Interest income**

Wirecard Bank AG generated interest income from credit and money market transactions and securities in the amount of EUR 7,928 thousand (previous year: EUR 3,793 thousand).

**4.2 Provisions Income**

Wirecard Bank AG generated commission income mainly in the areas of acquiring and issuing. This resulted in commission income of EUR 241,436 thousand (previous year: EUR 218,379 thousand) mainly related to payment and issuing of EUR 19,742 thousand (previous year: EUR 14,261 thousand) and acquiring of EUR 217,513 thousand (previous year: EUR 202,378 thousand) ). In the area of acquiring, Wirecard Bank AG has a cross-border license from the credit card organizations, which enables it to contract traders and airlines throughout the predominantly European territory. As a result, income was concentrated within Europe.

*Source: Wirecard Bank 2016 Accounts*

- In FY'16, the company missed the targets with a transaction volume of €9,020m, which was below the budget of €9,585m. Nonetheless gross margin increased by 12% (compared to Wirecard Group AG gross margin growth of 41% in 2016).

**Exhibit 16: Wirecard Bank AG could not reach its budget in FY'16. The group never misses budgets, and has beat, raised, and upgraded EBITDA expectations for the last seven years, almost every quarter.**

**2.3 Deviation analysis**

In 2016, Wirecard Bank AG once again made a significant contribution to the overall success of the Wirecard Group with an annual net profit of EUR 107,836 thousand (previous year: EUR 23,940 thousand).

In the reporting period 2016, there were no changes to the subscribed capital and the capital reserve compared to the previous year. The profit for the year 2015 was almost completely distributed to the shareholders. The subscribed capital amounted to TEUR 16,776 (previous year: TEUR 16,776) in the reporting period 2016, and the capital reserve amounted to TEUR 3,300 (previous year: TEUR 3,300).

Wirecard Bank AG achieved its 2015 projected target and increased the interest and commission income in the year under review to EUR 249,364 thousand (previous year: EUR 222,172 thousand). Gross profit was again increased to TEUR 72,499 (previous year: TEUR 52,857).

Although the Acquiring business segment could not reach a budget of EUR 9,585 million with a transaction volume of EUR 9,020 million in 2016, the gross margin of EUR 53,475 exceeded the target for the year 2016 with EUR 47,698 thousand.

The assessment and alignment of Wirecard Bank AG confirms that in 2016, the acqui- sition acquiring with the commission income will be the most important and will contribute an outstanding result in comparison to interest income.

Issuing could not reach the goal of 231,032 issued tickets in particular due to the termination of a partnership with a company from the area of FinTechs with 137.822.

An increase in interest income was possible despite the continued low interest rate policy of the European Central Bank and the Federal Reserve. This was mainly due to the planned increase in the diversified portfolio of financing - in cooperation with FinTech companies - which was closely linked to the development of the acquiring deposit business, which follows the previously described liquidity and risk principles of Wirecard Bank AG.

*Source: Wirecard Bank AG 2016 Accounts*

## Changes in Cash Flow Accounting Render Historical Measurements More Difficult

- After Q3'16 the company changed the presentation of the cash-flow statement to show the financing (as we discuss above) provided to FinTech companies. As the cooperation with the FinTech companies has reached scale and importance, the amount of financing movements is provided in the cash flow statement. We can now assess the volume of lending Wirecard is providing to customers and partners as described above.

- The three line items for working capital movements (change in receivables, change in liabilities of the acquiring business and trade payables, changes in other assets and liabilities) were split into six new line items (change in receivables, change in liabilities of the acquiring business and trade payables, change in other assets and liabilities, change in non-current assets of banking operations, change in current assets of banking operations, change in customer deposits of banking operations). We will receive the historical accounts with the next two reports to look at the 2016 reconciliation.

- Our issue with this is that Wirecard introduces more accounting disclosure, ostensibly in the interests of transparency, whereas the additional disclosure actually makes it even more difficult to track the real movements of cash in and out of the business.

## Real Free Cash Flow is, on our Definition, 54% of Published/Adjusted Free Cash Flow

- We make some necessary adjustments based on the discussion above. To repeat, the theme is money out, prior to revenue and growth. This money has gone to the customers, helping to grow the revenue. It's a good way of growing the business, but it needs to be understood in context. We estimate cash conversion is still ~50-60%, compared to the 100% disclosed by the company. This makes sense in the context of the historical cash conversion of ~60% in FY'10-FY'13 (prior to press articles questioning cash conversion).

- If these cash outflows stop, the growth slows and the stock would be de-rated and the share price could decline.

### Exhibit 17: Potential adjustments to cash flows

| Cash Generation | FY'10 | FY'11 | FY'12 | FY'13 | FY'14 | FY'15 | FY'16 | H1'17 | TOTAL |
|---|---|---|---|---|---|---|---|---|---|
| **Company Definition of Free Cash Flow (adjusted)** | **36** | **24** | **44** | **56** | **96** | **145** | **210** | **115** | **727** |
| deduct medium-term financing to e.g. sales partners | 0 | 0 | -8 | -28 | -12 | -14 | -3 | 0 | -64 |
| deduct FinTech financing outflows | | | | | | -38 | -121 | -3 | -161 |
| deduct cash outflows for customer relationships | -14 | -12 | -32 | -17 | -23 | -10 | 0 | 0 | -108 |
| **REAL FREE CASH FLOW WIRECARD** | **22** | **12** | **5** | **10** | **62** | **84** | **86** | **113** | **393** |
| increase in transitory receivables | -44 | -40 | -47 | -51 | -48 | -33 | -78 | -5 | -347 |
| increase in transitory payables | -37 | 27 | 48 | 71 | 40 | 42 | 57 | -17 | 232 |
| deduct M&A spend | 0 | -21 | -41 | -38 | -91 | -169 | -227 | -252 | -839 |
| **NET CASH FLOW POST WIRECARD** | **-58** | **-21** | **-36** | **-7** | **-37** | **-75** | **-164** | **-162** | **-560** |

*Source: Wirecard Accounts*

1. Adjustment 1: Deduct Medium-Term Financing to Sales Partners from Free Cash Flow, €64m.
2. Adjustment 2: Deduct FinTech Financing Outflows from Free Cash Flow, €161m.
3. Adjustment 3: Deduct cash outlays on customer relationships, €108m.
4. Real free cash flow of €393m, representing 54% of adjusted free cash flow of €727m.
5. Optional Adjustment 4: Deduct increase in transitory receivables and payables, net of €115m.
6. Optional Adjustment 5: Deduct M&A spend as expansionary capex, €839m.
7. Real free cash flow of negative €560m.

- If we use our new cash flow calculation of €393m during the period, and then consider the increase in transitory working capital of €115m, we arrive at a net free cash flow of €278. Adding the equity raise of €508m, deducting the dividends of €111m, provides us with cash available of €675m (down from €1124m at the start of this analysis in the note). Then we consider seasonal and intra-period swings in working capital, the M&A spend and the future capital needs of the business, and we can begin to understand why the company needs €975m of gross debt available.

# Conclusion

We estimate free cash flow is approximately half of the adjusted published free cash flow. On the basis that the company meets consensus expectations of free cash flow in 2020 (€500m on a published 25% CAGR) but continues to convert cash at this rate, we see real free cash flow available to shareholders of ~€270m in 2020. We also consider the additional capital needs of the business to meet the 2020 targets, the likelihood of a 10% equity raising (or increasing debt), and the appropriate valuation discount for the business described in this note (low return on equity, non-scalable platform, capital-intensive growth, competitive industry) and apply a 15x multiple to the free cash.

**Exhibit 18: Summary of Valuation**

| | |
|---|---|
| **2020 Consensus Free Cash Flow** | 500 |
| **Adjusted Free Cash Flow (54% rate)** | 270 |
| **Number of shares (10% equity raise)** | 136 |
| **15x free cash multiple** | **30** |

*Source: Bloomberg, The Analyst Estimates*

*NB: €500m Bloomberg consensus free cash flow (based on 25% CAGR in published free cash flow and company 2020 guidance), The Analyst adjustment at 54% based on historic cash conversion described above, 10% equity raise as discussed above, 15x multiple (undiscounted).*

At the current market cap of €10bn, Wirecard is a vulnerable stock if there is any deviation from the perfection of the last decade.

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As at the time of publication of this report Mark Hiley (or connected persons) held a short position in Wirecard.