

June 2, 2016

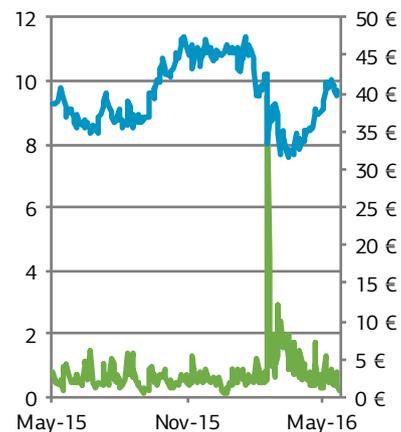
**Anne Stevenson-Yang**  
anne@jcapitalresearch.com

+1 917 929 7142

## Wirecard AG (WDI GR)

Price	EUR 40.10
<b>Rating</b>	<b>SELL</b>
<b>Price Target</b>	<b>EUR 17.20</b>
Difference	57%
Market Cap	EUR 4.94 bln
P/E	32.54

Wirecard AG (WDI GR) last share price in EUR (blue, RHS) and volume (green, mln shares, LHS)



Source: Bloomberg

## Wirecard AG (WDI GR)

# Where We Are Now

- ▶ **We believe that the core business** of Wirecard is to provide money-laundering services for companies involved in gambling and adult content. We find little evidence of legitimate acquiring volumes.
- ▶ **While investors now acknowledge** that Wirecard was involved in illegitimate activities in 2006-11, we are confident that Wirecard continues to process online gambling proceeds across the world, including from gaming in the United States. We think it reasonable to assume that the U.S. market supplies about 14% of volumes.
- ▶ **The ex-European acquisition strategy** provides clear evidence that the company sees its future in laundering money, chiefly from gaming.
- ▶ **Besides being unpalatable**, this business is risky. The legal risk enables high fees, but investors are not applying the discount that risk should attract.
- ▶ **Reiterate SELL**, with a TP of EUR 17.20 based on a DCF valuation with a WACC of 11.3% and terminal growth of 1.3%. Based on our research, we assume gross margins going forward of 15% rather than the 43% reported in 2015.

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Wirecard is in the business of white-washing transactions.

## The Gambling Professionals

The story of Wirecard has been publicly dissected now by the Financial Times, Zatarra Research & Investigations, Quintel Financial, and, less publicly, ourselves. The narrative has become complex, and we thought it useful to provide our own bite-sized summary.

Our work leads us to conclude that Wirecard is in the business of white-washing transactions. That is the core business and the only one that Wirecard appears to be pursuing.

### Where Is the Legitimate Acquiring Business?

Wirecard evidences little legitimate acquiring business. The Nilson Report is a commonly used third-party source for information on the payments industry which conducts regular industry surveys and publishes an annual [report](#) on the top acquirers in each regional market. The June 2015 Nilson Report on page 11 listed Europe's top 40 merchant acquirers in 2014; Wirecard was not among them. The smallest of the banks, First Data Polska, in Poland, reported EUR 9.6 bln in total transactions through card schemes and online, far lower than the EUR 26.4 bln in processing volumes that Wirecard reported in Europe in 2014. Other acquirers listed in the top 40 included Bankia, Spain (EUR 15.1 bln), Raiffeisen Bank, Austria (EUR 13.5 bln), Erste Bank, Austria (EUR 13.55 bln), Euroline, Sweden (EUR 17.98 bln), and Vakifbank, Turkey (EUR 25.5 bln).

Similarly, [The Lafferty Group](#) publishes reports and statistics on payments systems worldwide. Lafferty's 2015 list of Europe's top 50 merchant acquirers by volume does not include Wirecard. The smallest volumes are for Nova Ljubljanska Banka in Slovenia (EUR 1.961 bln) and Bank Asya in Turkey (EUR 1.987 bln), again, far lower than the EUR 33.99 bln in European volumes that Wirecard reported for 2015.

Wirecard has estimated that it should receive EUR 78 mln when Visa Inc. acquires Visa Europe. Each member bank in Europe will receive a payment that is a function of its transaction volume as a proportion of Visa's total volume.

Visa reported that its 2015 European transaction volume was approximate-

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ly EUR 1.5 trn, and the total initial payment being made is EUR 16.5 bln. Wirecard's estimated payment, EUR 78 mln, is 0.47% of the total, EUR 16.5 bln. The same proportion of the EUR 1.5 trn payments volume would be EUR 7 bln, or merely 26% of the payments volume that Wirecard reported in Europe in 2015. Granted, Visa represents only 60% of European payments volume and could be less important to Wirecard than it is to Europe as a whole. But likewise, if Wirecard is overstating payments volumes to its investors then it is likely overstating the expected Visa transaction as well.

In its FY2015 presentation on April 7, 2016, Wirecard for the first time disclosed the names of "top customers and partners" (page 15). Several Wirecard investors have been citing those customers as the source of solid and legitimate acquiring volumes. However, whichever name we choose, we find to be problematic:

- ▶ **Lufthansa:** Several company promoters have pointed to this rock of the German economy as a customer. Wirecard actually claims Lufthansa City Center, a network of travel agencies, as its client, not Lufthansa the airline. The relationship may stem from the March 2015 acquisition by Wirecard of LCC's acquiring customer contracts for credit card acceptance. Wirecard paid EUR 13 mln for those contracts, suggesting that the volume was small.
- ▶ **HSE24:** Wirecard announced that this European TV shopping channel had adopted its risk management solution called the Corporate Trust Center, but HSE24 announced only that it had agreed to accept the virtual Mastercard that Wirecard offers. Since Wirecard participates in the card schemes, it would be unusual for a company to refuse one of the branded cards.
- ▶ **European Retailers:**
  - ▶ **Carrefour:** Wirecard announced that Carrefour Indonesia obtains POS terminals from Bank Mega and that Carrefour's Indonesian subsidiary, PT Prima Vista, would provide technology to those POS machines. Carrefour's Indonesian stores are owned by PT Trans Retail Indonesia.
  - ▶ **Versace:** Wirecard reported in 2012 that Versace was "using our range of services for its international online strategy." Versace online does accept Mastercard and thus the prepaid Wirecard Mastercard.

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In 2015, Wirecard announced a partnership with Alipay.

- ▶ **Burberry:** This retailer accepts Mastercard and so would likely accept the prepaid Wirecard Mastercard. But the company's [list of IT service providers](#) does not include Wirecard.
- ▶ **Alipay:** Wirecard in late 2015 announced a cooperation with Alipay enabling the Alipay mobile app to be used for payment on Wirecard POS terminals at retail locations. Since Wirecard helps overseas companies establish companies in Europe to hold merchant acquiring accounts, those merchants would of necessity have Wirecard POS or accept Wirecard payments cards online. The [statement](#), carried in several news outlets, said: "Chinese users will now be able to make purchases with Alipay on their mobile devices at authorized POS retailers in Europe via an integrated barcode payment functionality from Wirecard and without incurring currency exchange fees." From Alipay's side, the POS terminal acceptance appears to be the extent of cooperation with Wirecard. Alipay does not include the Wirecard bank or Wirecard payment mechanisms in its [list](#) of overseas partners, and for the United States and some other markets, Alipay uses its own EPass service for payments integration.
- ▶ **Turkcell:** In 2014, Wirecard acquired 3pay, a mobile payments company in Turkey that works with Turkcell, Turkey's dominant mobile carrier, to accept payments from the popular football betting site [Mackolik](#). Both physical and online gambling were definitively banned in Turkey in 2007, and for placing a bet, Mackolik redirects to Tuttur.com, where the customer can make a payment with a mobile phone registered in Turkey. Mackolik/Tuttur was the only site we were able to identify in Turkey that works with Wirecard.
- ▶ **Shell:** The claim to process payments for Shell appears to rely on a partnership with the Norwegian pre-paid card company Paygoo, which issues the Wirecard pre-paid Mastercard in Norway and Sweden for use at Shell gas stations, 7-Eleven stores, and the Narvesan chain.

Generally speaking, we find that the customers claimed by Wirecard are customers for the prepaid card or POS machines in limited geographic regions. The prepaid card has very narrow application, and we have found evidence of very few Wirecard POS machines in use with some exceptions in Vietnam and Indonesia. We believe that whatever legitimate volumes may exist are small.

While we find it difficult to identify Wirecard as a processor for legitimate

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payments, the company's presence in dubious or illegitimate payments is amply demonstrated. In the [paper](#), "Priceless: The Role of Payments in Abuse-advertised Goods" written by five U.S. academics, the authors find that a relatively small number of banks is involved in processing payments from abusive advertisers that capture consumers with spam messages. Wirecard appears among the banks that process such illegitimate payments.

## Europe as Drycleaner

In Europe, Wirecard's acquiring business appears to serve companies that want to hide the nature of their transactions by putting payments through shell companies. This is a common strategy for high-risk payments providers. Brian Krebs, author of Spamnation, in his [blog](#) quotes Pavel Vrublevsky, the CEO of ChronoPay:

"Basically you own the companies that have those merchant IDs, plus you do customer support and everything which is related to that. And that's how any other payment service provider does it, and you can find the same thing if you dig into companies like Wirecard and Visa Iceland. So most payment service providers basically register the companies themselves and monitor the whole [operation] from the inside."

ChronoPay is a payments solutions company that claims to be the leader in online payments and has been credibly accused of processing payments for a range of criminal operations.

Some apparent Wirecard affiliates assist clients in creating dummy companies. Those affiliates include Worldnetpay, Unichannel, and Paylock Global Solutions. Paylock, in the Philippines, [offers](#) the service of incorporating a European company that can receive payments:

"[2] **European Company Incorporation** - A European Company is needed in order for you to get a Merchant Account with our European Acquirer. **PAYLOCKGLOBAL** can help you in your Incorporation requirements in Europe"

Paylock appears to be affiliated to Wirecard via its chief operating officer, Bob Lock, who was vice president of development at Wirecard through 2011.

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## The Real Business of Wirecard

Documents from a 2010 case in the United States make it clear that Wirecard was deeply involved in processing illegal payments for U.S. gambling through 2010. The Zatarra work has demonstrated that wire transfers to the United States that were deemed illegal in 2010 came from Wirecard. The U.S. case enumerated USD 70 mln in transfers from Wirecard AG.

Wirecard was also a processor for the Full Tilt Poker companies, which in 2011 were accused of having disguised online gambling payments from U.S. residents by routing the payments through shell companies posing as online merchants. What is less appreciated is that Wirecard today remains involved in payments processing for U.S. online gambling, likely in violation of U.S. law; the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) prohibits gambling sites from accepting payments from U.S. residents. Wirecard evades that restriction by using anonymous pre-paid cards on the client end and by helping merchants establish nondescript shell companies to white-label transactions.

Wirecard's Click2Pay solution is widely recommended by gambling sites such as [Real Online Gambling](#) and [Online Gambling.org](#). Click2Pay has been closed in the United States but it is accepted by a number of online casinos:

Click2Pay is widely recommended by gambling sites.

**ALL CASINOS THAT ACCEPT CLICK2PAY**

USA?	Click2Pay Online Casinos	Click2Pay Bonus	Software	Visit Casino
Yes	<a href="#">Lucky Red Casino Review</a>	400% Up to \$4K	RTG	<a href="#">VISIT CASINO</a>
Yes	<a href="#">Club USA Casino Review</a>	100% Up to \$777	RTG	<a href="#">VISIT CASINO</a>
Yes	<a href="#">Bovada Casino Review</a>	100% Up to \$500	RTG	<a href="#">VISIT CASINO</a>
No	<a href="#">Bet365 Casino Review</a>	100% Up to \$/€/£200	Playtech	<a href="#">VISIT CASINO</a>
Yes	<a href="#">Manhattan Slots Review</a>	100% Up to \$747 (2x)	RTG	<a href="#">VISIT CASINO</a>
Yes	<a href="#">High Noon Casino Review</a>	200% Up to \$2,000	RTG	<a href="#">VISIT CASINO</a>
Yes	<a href="#">All Star Slots Review</a>	100% Up to \$787	RTG	<a href="#">VISIT CASINO</a>
Yes	<a href="#">Aladdins Gold Review</a>	200% Up to \$2,000	RTG	<a href="#">VISIT CASINO</a>
Yes	<a href="#">Buzzluck Casino Review</a>	100% Up to \$747	Nuworks	<a href="#">VISIT CASINO</a>
Yes	<a href="#">Las Vegas USA Review</a>	125% Up to \$125	RTG	<a href="#">VISIT CASINO</a>

Screenshot from [Casino Deposit Reviews](#) | Photo by J Capital May 31, 2016

Poker Stars explains:

To create a new account with C2P US players can only register by click-

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ing on the Quick Sign up link available at the PokerStars cashier, then fill the registration form that will pop up on your screen. Once you establish and confirm your C2P account, it takes only seconds to make transfers to your PokerStars account by selecting the C2P option from the PokerStars Cashier screen. To make the deposit request at PokerStars use the C2P information required and the money will be credited on real time.

When a gamer tries to fund an account on Poker Stars he or she must use an account form outside the United States. Once funded, the player can bet in the U.S. Some of the sites that accept Click2pay:

- ▶ [Planet Kings](#)
- ▶ [Party City Casino](#)
- ▶ [Crazy Monkey Casino](#)
- ▶ [Chips-for-Free](#)

An online casino called Play Million, which [promotes](#) the pre-paid Wirecard, is registered to a Florida-based company called Moniker Online Services LLC whose parent company, Key-Systems GmbH, is a German company founded in Friedrichstahl, Baden-Wuttemberg in 1998 and now part of a Luxembourg holding company.

Typically, Wirecard has used related-party pass-through companies to sanitize transactions that might otherwise be rejected by banks and credit card schemes. The pass-through companies have business licenses that identify them as travel operators. Payments for a legally questionable activity such as gambling or pornography might be directed through the dummy company, where it is labeled as “travel,” “financial services,” etc. The payment would then be processed by a bank and a card scheme.

Streber Weekly, a publication on offshore banking, payments, and compliance, [writes of Wirecard](#):

Something as simple as forming a payment processing subsidiary in a reputable jurisdiction can open new doors. UK is the foremost choice for this. A UK company can cost as little as under a hundred GBP to form; a few hundred if you want nominees in order to keep your name out of public records (nominees come with their own host of challenges, though).

UK banks very likely will not accept you (unless you are resident in the UK), but banks like Wirecard Bank and Deutsche Handelsbank

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are generally happy to take on European shell companies. While quite dreadful banks, they are tolerable enough for a pass-through account. With a bit of effort, you can find other European banks willing to take you on.

Several companies specializing in offshore incorporation of shell companies recommend Wirecard to serve as the shell company bank. One such is the [BRIS Group](#).

In the case of gambling and other risky proceeds, Wirecard arbitrages national financial regulation to make it possible to pay for illegal or gray-area activities without detection by authorities.

Wirecard also assists clients in establishing shell companies in Europe that can be used to get a merchant account with Wirecard AG and then process payments from outside of Germany.

## Example: Full Tilt Poker

In 2011, the U.S. Department of Justice indicted Full Tilt Poker on violations of the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) and operating an illegal gambling business. Wirecard processed payments for Full Tilt Poker through its Click2Pay subsidiary. Zatarra Research identified some of the company names used to process payments: Janus Services, Online Entertainment, and Axxis.

### The U.S. Volumes

The Zatarra work identified a company called Bluemay, which That case also identified represented about 14% of Wirecard's assets, and it is reasonable to conclude that the U.S. payments business may have accounted for the same portion of Wirecard's volume overall. Since evidence indicates that U.S. gambling proceeds are still very much a part of Wirecard's business, 14% seems a reasonable standard to apply for assessing today's volumes.

### Gambling Operator

Wirecard actually operates at least one gambling site through a sister company. [7Red](#) is operated by a company called BlueMay Enterprises, which is a Wirecard sister company, owned by the same shareholders as Wirecard UK. The shareholders of BlueMay are Fermoya Ltd. and BMIE Ltd., which are also the registered shareholders of Wire Card UK, a company that Wirecard has publicly admitted it owns. The disclosure on the 7red site, accessed on June 1, 2016, reads:

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BlueMay Enterprises N.V, who operates this site, does not hold an operating licence in Malta. We must however inform players that all Jackpot games from Netent, a Maltese licence holder, are subject to the regulations of the Maltese Gaming Authority.

The BlueMay operations are material to Wirecard. A notice of insolvency in the U.K. in 2013 reported that BlueMay held Euro 36 mln in total credits in a Wirecard Bank account, amounting to 14% of Wirecard's deposits. 7red is likely a source of payments volume for Wirecard as well. The site accepts the Wirecard Sofort bank transfer payment system.

## Valuation

Reiterate SELL with a target price of EUR 17.20 based on our DCF valuation, projecting near-term annual revenue growth of 22%, gradual margin erosion, and terminal growth of 1.3%.

## Risks

The company's share price has proven extremely resilient despite iterative public reports connecting Wirecard to money laundering. We think that the buy side may simply not be interested in whether Wirecard supports illegal gambling.

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