

October 30, 2015

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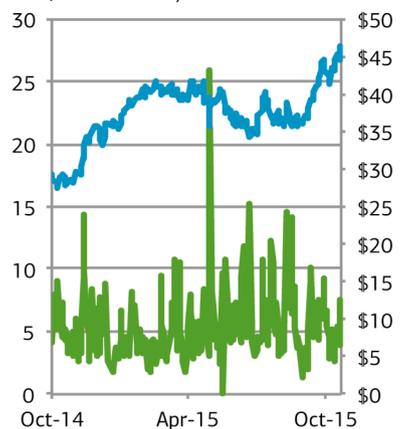
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Wirecard (WDI GR)

Price	EUR 46.41
Rating	SELL
Price Target	EUR 17.2
Difference	62.90%
Market Cap	EUR 5.76 bln
P/E	46.3x
Float	87.70%

Wirecard (WDI GR) last share price in EUR (blue) and volume (green, in 100,000 shares)



Wirecard (WDI GR) Looking for the Money

► Fictional acquisitions?

Wirecard is ostensibly spending heavily to acquire growth in Asia by buying companies in Vietnam, Laos, Cambodia, Singapore, and India. We visited several of these acquisitions and found either string operations or no presence at all. We think that fictional assets in Asia may be hiding the uncomfortable truth that there is no profit.

► Where is Wirecard?

In fact, we think the actual business is tiny. We have been unable to fund a prepaid card in the United States, China, most of Europe, or Australia. The company lists only German retailers and gas stations where Wirecard payment cards may be obtained in return for cash.

► Not POSSible

Wirecard reports gross margins of 43%, but about half of its business appears to be the resale of Point of Sales terminals in which distributors normally receive 5-10% GM, while the rest of the business is in payments processing services that probably yield around 20% gross margins.

► Unsavory

Wirecard's original and possibly only market is the online gambling netherworld. Even here, Wirecard is not an option on most of the gambling sites we checked. Its partner e-wallets are, but we have found it very hard to fund a Wirecard prepaid card that would convey funds to one of these partners. To the extent Wirecard does fund this business, the company bears significant risk of fraud, default, reversed transactions, and merchant insolvency.

► Just a gambling tool

Try as we might, we cannot find much besides gambling for which Wirecard solutions are used. That makes sense, because we think the business is probably far smaller than the stated size.

► Valuation

Assuming 15% gross margins and applying a DCF model with terminal growth of 1.3% and an 11.5% WACC, we come to a valuation of EUR 17.2 per share, a downside of 60%. We view this valuation as generous.

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We believe the real business is vanishingly small.

We found very few executives in the industry who know of Wirecard.

Executive Summary

Wirecard is a payment-solutions company based in Germany and listed on the Frankfurt Exchange. The company sells prepaid cash cards with Visa and Mastercard logos, sells Point of Sales machines, and offers online payments platforms. It reports about 18,000 customers and EUR 10.7 bln in transactions in Q2 2015. In a very crowded competitive space, Wirecard is trying to present itself to investors as an online-offline PayPal that blends prepaid cards with online transactions. Originally a payment mechanism for online gambling, as far as we can determine, Wirecard has not been successful in branching out—or even becoming widespread in gambling. The only evidence we have for high-volume activity comes from a criminal complaint in which Wirecard Bank AG, its wholly owned bank in Germany, held accounts from which illegal payments to U.S. online gamblers were made. We believe the real business is vanishingly small and that the company likely has no profit. In this report, we show that some of Wirecard’s acquired subsidiaries are empty offices with little value.

Currently trading at EUR 42.69, Wirecard is valued at about 4x stated book, about 12.5x tangible book, and 37x stated earnings. The company has enjoyed an eightfold price increase since 2008 based on the view that it is a challenger to PayPal. That is fanciful. In fact, we have attempted to use Wirecard in many parts of the world and have found it virtually impossible outside of Germany to fund the prepaid cards or use Wirecard in payment for anything. Although Wirecard is named as a payment mechanism on some websites outside of Germany, when we click through, we almost never reach a live page. We have found very few executives in the payments industry who know of Wirecard or call it a competitor; Worldpay, which seems to be the most directly comparable business, never mentions Wirecard. Hardly needful to say, neither does PayPal.

Having found little evidence that Wirecard has any volume of business, we visited five of the subsidiaries in Southeast Asia. Only one of the premises had a reasonably credible presence, and even that one appeared much smaller than disclosures would suggest. At two of the listed locations we could find no company at all, although there were unrelated companies with similar names.

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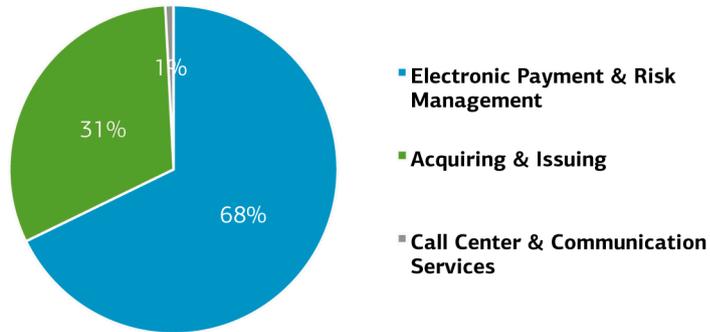
The location of Wirecard’s reported subsidiary in Laos. | All photos by J Capital, late July 2015

We believe that Wirecard’s business is much smaller than stated in the company reports and that the company is likely insolvent.

The Basics

Wirecard divides its business into electronic payments & risk management (two-thirds of revenue), acquiring & issuing (one-third of revenue), and call center & communication services (1-2% of revenue).

Chart 1. Revenue Breakdown



Source: Company data

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EP&R

The electronic payments & risk management segment involves providing a technology platform for authorizing and batching payments and making sure they are secure. This is the core business of Worldpay.

Your transaction has been processed by WorldPay, on behalf of Coach USA Inc.

Related Google+ Page



Worldpay
Follow

Transaction details:

Transaction for the value of: USD [REDACTED]
 Description: Travel Tickets
 From: Coach USA Inc
 Merchant's cart ID: 58570889-1445690470930
 Authorisation Date/Time: 24/Oct/2015 12:45:51
 WorldPay's transaction ID: [REDACTED]
 This is not a tax receipt.

Enquiries

This confirmation only indicates that your transaction has been processed successfully. It does not indicate that your order has been accepted. It is the responsibility of Coach USA Inc to confirm that your order has been accepted, and to deliver any goods or services you have ordered.

If you have any questions about your order, please email Coach USA Inc at: Payment-Inquiries@coachusa.com, with the transaction details listed above.

Thank you for shopping with Coach USA Inc.

When you submit your transaction for processing by WorldPay you confirm your acceptance of WorldPay's shopper privacy policy, a copy of which can be viewed at: <http://www.worldpay.com/shopper/privacy/>

To find out more about how your transaction was processed, visit WorldPay's Frequently Asked Questions at: <http://www.worldpay.com/shopper/faqs/>

Receipt for a credit card transaction that was enabled by Worldpay. | Screenshot by J Capital

The business of issuing prepaid cards and virtual credit cards, meaning temporarily generated credit card numbers that exist for a given transaction, would likely fit into this business segment. Wirecard offers a range of prepaid cards available from retail locations in Germany: we could not find any way to acquire a card outside of Germany. The cards can be pre-paid at these retail locations and offer limited anonymity for the user.

Once you have a card, it can be theoretically funded using digital wallets from partner companies, including China's AliPay, GiroPay, Safecard, etc.

What Is the EP&R Business?

It is difficult to find instances of Wirecard's EP&R business. How many customers buying books online or clothes at a retail outlet or an airline ticket at an agency would choose Wirecard instead of a conventional credit card, debit card, PayPal, or cash? The advantage of Wirecard and the myriad other online wallets and prepaid credit cards is anonymity for people who want to look at porn, bet on fantasy sports, or buy something they don't want anyone to know about.

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The Wirecard payment mechanisms are uniquely visible in the online gambling business.

The screenshot shows a list of three gambling sites: Titan Poker, PokerStars, and Full Tilt. Each site entry includes the site's logo, a 'WIRECARD' logo with a green checkmark, and a 'US' flag with a red 'X'. Below each logo is a 'VISIT SITE' button and a 'Sign-up and get an exclusive \$1000 bonus today!' link. The Wirecard Rating for each site is displayed in the top right corner of its respective section: 4.39/5 for Titan Poker, 4.21/5 for PokerStars, and 3.82/5 for Full Tilt.

A website offering links to gambling sites that accept Wirecard. | Source [here](#)

A 2010 legal action cast a rare spotlight onto the real nature of Wirecard's acquiring business.

A 2010 legal action cast a rare spotlight onto the real nature of Wirecard's acquiring business. The criminal complaint was brought against a German citizen living in Florida who was helping an online gambling business collect payments from and deliver them to U.S. citizens. Although not included in the criminal complaint, there were credible allegations that the then-28-year-old Michael Schuett had been directly commissioned by Wirecard to deposit money in multiple bank accounts and post bank checks to resolve card balances or pay out winnings. The [complaint](#) does list Wirecard AG accounts in Germany that were used to wire proceeds from online gambling to dozens of accounts held by Schuett. The [documents](#) in the lawsuit list over USD 2.2 mln in illegal payments from one account at Wirecard Bank AG held by a UK company called Bluetool Ltd., which apparently is a conduit for gambling activities. In one year, the Bluetool account wrote about 1,500 checks to U.S. residents. It is unlikely that Wirecard, which in 2010 reported about EUR 118,000 in total customer deposits, could have

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Few online gambling sites list Wirecard as a form of payment.

been ignorant of Bluetool’s illegal money laundering. Schuett pled guilty. No action was taken against Wirecard.

Despite this growing balance sheet item that would suggest ballooning payments, few online gambling sites list Wirecard as a form of payment. The sites we most recently checked that do not list Wirecard among their payments options are:

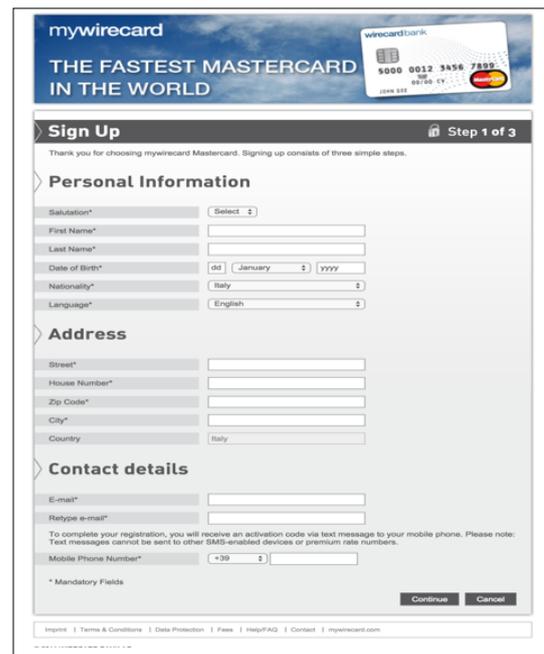
- ▶ Royalvegascasino.com
- ▶ Allslotcasino.com
- ▶ Au.casinocruise.com
- ▶ Spinpalace.com
- ▶ Guts.com
- ▶ Vegas.betway.com
- ▶ Pokerstars.com
- ▶ Harrahcasino.com
- ▶ Onlinegambling.ca

We accessed these sites from the United States using a VPN that assigned us IP addresses in Hong Kong and the Netherlands.

Acquiring & Issuing

Wirecard acts as an “acquirer” when it exchanges funds with issuing banks on behalf of the merchant and pays the merchant the daily net balance of sales. The risk is that merchants may defraud customers, who then reverse payments or demand returns, so the merchant’s solvency and credibility matter to the business.

Wirecard’s prepaid card business would fit into this category. The Wirecard-branded cards, however, are not easy to obtain. They can be purchased from a number of [retail locations](#) in Germany. A friend was able to get a list of locations to buy a Wirecard in Italy, but we have not been able to replicate the results.



Screenshot showing access to Wirecard Italy

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We asked German friends to confirm that they were able to make deposits to and purchases with Wirecard. Initially, two friends said that the card could easily be obtained at retail locations, but that store clerks seemed unfamiliar with how to fund the cards. The cards are also reportedly hard to use.

One friend, whose experience with Wirecard was described by a colleague, was angry enough to post a (German-language) [blog](#). The colleague explained the experience this way:

"He applied for the account online and was hoping for immediate activation but it didn't go through. He was told he needed to make a minimum deposit to the card (10€), which he did, and his bank confirmed that the money had been transferred. However he did not receive the card in the mail as promised. He was later told he would receive a virtual card. He went to a gas station to use the virtual card. The first station staff could not handle the transaction. At the second station, he tried to load the card three times and was blocked.

"He was out 10€ to set up the card and two payments of 1€ each for the failed in-person loads. He called Wirecard's "life support" line to resolve this but they asked him to call a paid call center. Initially opting for an email complaint, after 24 hours he called the paid support line. He had to provide copies of government-issued ID and proof of address to get his cash back. He made one purchase with the now-activated card and requested a refund for the balance according to their terms and conditions. WireCard only complied with the refund after a very lengthy period to receive and verify his documents.

"His initial load was 50€ (over the 10€ minimum) his charge attempt at gas station No. 1 was also 50 as was his second attempt at gas station No. 2."

Given a wide array of options for cards that can be purchased and loaded online, we cannot figure out how cards so difficult to use could really generate a lot of revenue.

Wirecard advertises cooperation with digital wallet companies including Alipay, Skrill, Yandex, PayPal, and MercadoPago. The Skrill Mastercard, issued by Wirecard, is a well-known payment system used for transactions by foreign nationals in countries with unstable currencies, including [Nigeria](#), [Iran](#), and [Albania](#). Some of Wirecard's prepaid cards:

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- ▶ [The WEX Prepaid MasterCard® Card](#)
- ▶ [The Alto Mastercard](#)
- ▶ [The Mytravelcash Card](#)
- ▶ [Mywirecard 2go Visa](#)
- ▶ [World Travel Currency](#)
- ▶ [Endsleigh Prepaid Travel Card](#)
- ▶ [Payoneer](#)
- ▶ [AA Travel Currency](#)
- ▶ [EZ Pay](#)

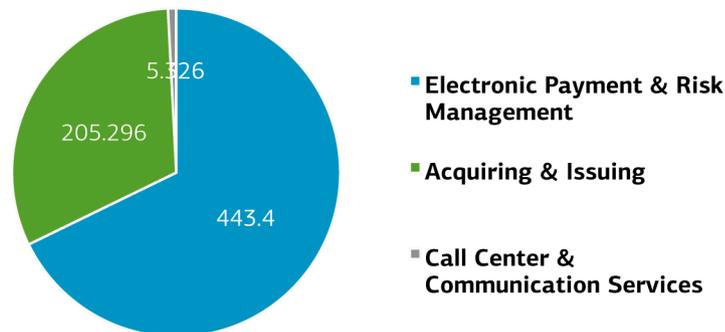
We were able to fund a Wirecard Skrill Mastercard. Skrill is an online payments company out of Bulgaria that specializes in facilitating online gaming. Skrill charges 1% for a user to make payments; merchants may pay more. There is a 2.99% fee for a forex transaction.

Prepaid cards come with risk to merchants. The company BinDB, dedicated to preventing online fraud, has this to say about prepaid cards:

"BinDB can currently identify over 6,400 different Prepaid, Virtual and Gift cards. Making it impossible to check the credit history of the buyer, prepaid and gift card related fraud generates millions of dollars of losses every year. Another danger is when people sign in for recurring online services. A common scenario includes a person signing up for a service after pre-loading the initial balance needed for signup, however once he used the service for a month, the prepaid card does not contain enough balance for re-billing."

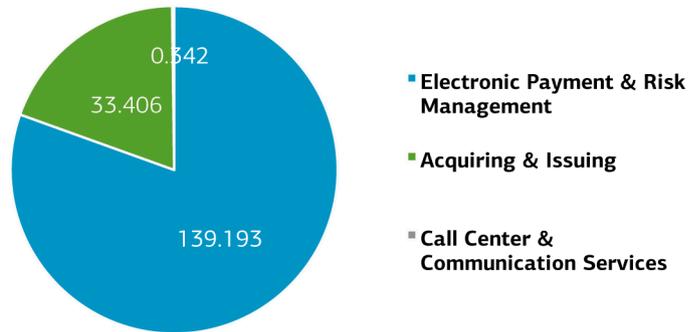
Wirecard also offers a portal to Electronic Funds Transfer (EFT), iDEAL, Giro pay, PayPal payments, mobile payment, and others. Some merchants pay a monthly fee, although this seems to have been discontinued, and some pay a percentage of the transaction.

Chart 2. Business Segment Revenue (mln Euro)



Source: Company filings

Chart 3. Business Segment Ebitda (mln Euro)



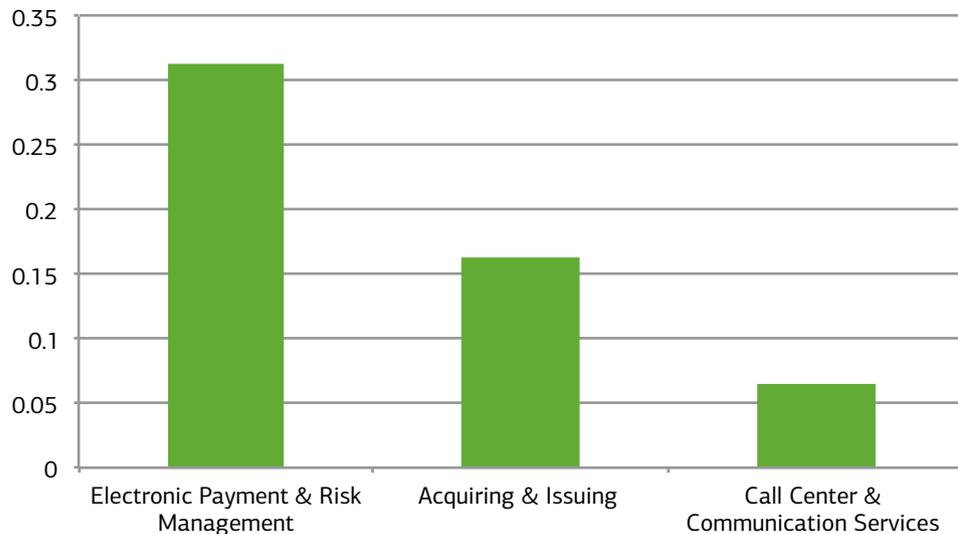
Source: Company filings

CC&CS

This is a legacy business Wirecard acquired when it merged with InfoGenie, which provided telephone-based advisory services and conventional call center services. CC&CS includes after-sales servicing of Wirecard products.

This smallest segment of revenue provides next to no margin, suggesting that Wirecard has limited after-sales servicing. CC&CS has been contracting as a portion of revenue over the last five years, even as costs associated with product sales have increased.

Chart 4. Wirecard Margins (EBITDA) by Segment, 2014



Source: Wirecard company statements

POS Sales

Wirecard’s focus seems to be primarily on online payments processing services, both in the company’s own descriptions and in the apportion-

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ment of revenue. However, the cost structure suggests a much more physical business. Nearly 70% of Wirecard’s costs come from raw materials & consumables, which are for physical sales of point of sales (POS) devices, terminals, and payment cards.

The premise of this business since the mid-2000s has been that it will be the basis for the adoption of higher margin segments of its business up the value chain. This has never materialized. Wirecard has seen this cost account for 56-60% of revenue consistently. This suggests that Wirecard’s main ability to scale its business is through physical sales, necessarily low margin as this space is competitive and low-barrier to entry, rather than through value-added online services that could be higher margin.

Our checks indicate that Wirecard distributes POS machines made by PAX Global, a Hong Kong-listed company with operations in Shenzhen. The distribution we have been able to verify is in Vietnam via Wirecard’s Vietnamese acquired subsidiary Trans Infotech.

In general, POS is a low-margin business for resellers, with distributors looking for after-sales servicing and contracting as the main way to build margin—components of the business that are absent from Wirecard. After-sales service is increasingly competitive. Wirecard describes its POS sales segment in the following way:

Wirecard Retail Services GmbH complements the range of services of the sister companies with the sale and operation of point of sale (POS) payment terminals. This provides our customers with the option of not only accepting payments for their Internet-based and mail-order services but also processing electronic payments made at their PoS outlets through Wirecard...



A PAX POS terminal manufactured in Shenzhen. | Source [here](#)

How Big Is the POS Segment?

We have telephoned major POS manufacturers and reviewed their reports, and none discloses a partnership with Wirecard. Competitors in Vietnam said that Trans Infotech, a company that Wirecard acquired, distributes POS machines for PAX Global (0327 HK), a Hong Kong-based POS company that manufacturers in Shenzhen. We spoke with the company, and they had not heard of Wirecard. PAX Global does about HKD 2 bln in revenue per year, of which half is in China, where

No major POS manufacturer discloses a partnership with Wirecard.

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the company does not use overseas distributors.

The company discloses that its biggest overseas segment is Brazil. If Vietnam is 20% of the overseas portion of revenue, then gross revenue from this segment can be no more than HKD 100 mln. If the distribute received a 25% gross margin—unlikely—then Wirecard would make HKD 25 mln, or EUR 2.9 mln, in gross revenue from the POS business in Vietnam.

Yet given the high costs attributed to consumables, at more than 50% of

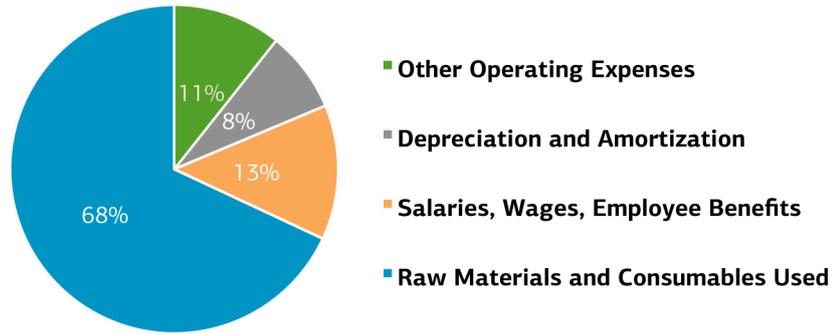


Trans Infotech product page, all categories listed on the left except for Infrasy are exclusively manufactured by PAX. | Screenshot by J Capital

revenue, we’d expect the physical sales of POS terminals to account for at least 50% of revenue, or EUR 300 mln. In fact, POS sales are likely even higher if Wirecard’s accounts are to be believed, given that Wirecard’s payments segment appears to be only 20% of revenue. In our research, the only evidence we’ve found for physical sales have been POS distribution for third-party manufacturers and payment cards, most of which are purchased digitally, so we find it unlikely that a different product segment is contributing to cost of materials.

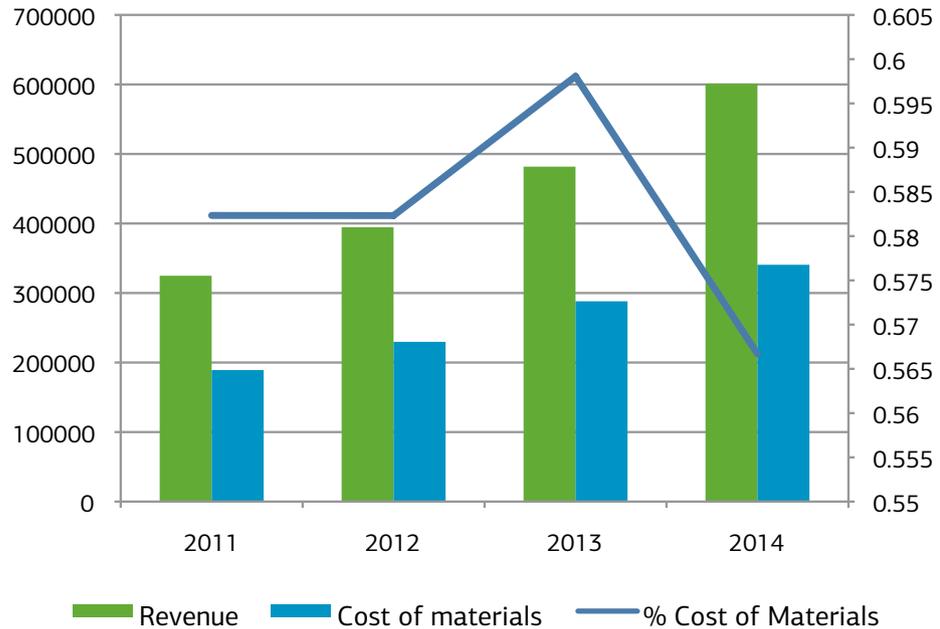
Typical gross margins for POS manufacturers are around 40% for manu-

Chart 5. Wirecard Cost Structure



Source: Wirecard company statements

Chart 6. Cost of Materials and Revenue (,000 Euros)



Source: Wirecard company statements

facturers, with net margins under 10%. Margins for resellers like Wirecard are much lower than for POS manufacturers. That leads us to question why the EP&R segment claims such a high margin. On EUR 300 mln in product costs, we'd expect a sub-10% margin, meaning that all other business would have to have margins north of 50%. But settlement services and payment cards typically see margins as low as 0.5-2%. So how does the EP&R segment manage to get 16% margins?

So why sell physical goods at all?

The value in a POS sales segment is not in the retail sales of the devices

Table 1. Gross and Net Margins for POS Manufacturers

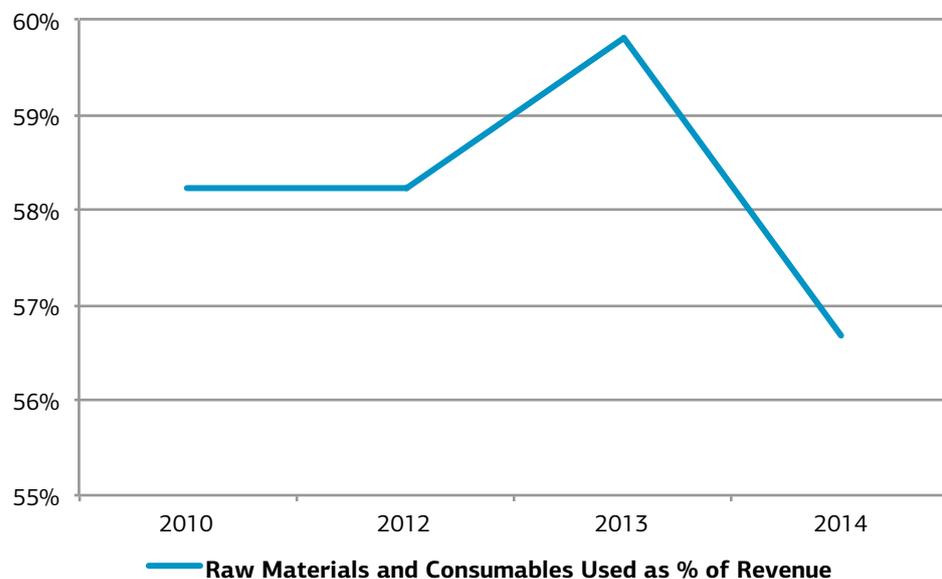
Gross Margin				
VeriFone	38%	41%	38%	39%
Ingenico	42%	42%	44%	45%
Xinguodu	53%	41%	38%	43%
Net Margin				
VeriFone	22%	4%	-17%	-2%
Ingenico	6%	8%	8%	11%
Xinguodu	25%	14%	11%	1%

Source: Company filings

but in the services associated with a POS customer. These include:

- ▶ Establishing merchant accounts for POS customers at Wirecard’s own or partner bank.
- ▶ Establishing payment connections via the acquirer (Wirecard can act as acquirer and thus capture part of the payment, for example).
- ▶ Offering customer support and help desk services for operation of the POS device.
- ▶ Offering customers of the business purchasing the POS device the ability to add/withdraw funds from related accounts (i.e. from a Wirecard prepaid card or bank card) using the POS device.

Chart 7. Wirecard Consumables as % of Revenue, 2010-2014



Source: Wirecard company statements

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The inventories on the balance sheet make little sense given the high cost of materials.

Even if Wirecard somehow managed to eke out higher margins from selling POS machines, the revenues are implausibly high. XGD, a Chinese POS manufacturer had gross revenue in the POS business last year of the equivalent of EUR 95 mln. Other POS manufacturers are similarly small.

PAX, whose machines are sold by Wirecard’s Vietnamese subsidiary, says that 90% of its sales are of low-end POS machines. On Taobao, these cost around EUR 60 at retail. To account for half of the 2014 revenue of EUR 601 mln, Wirecard would have had to sell 5,008,000 of these machines. That would be roughly half the installed base in the United States according to Gao Research.

Wirecard also sells prepaid cards, but these plastic items cannot cost much. Possibly the company offers ATM machines, although company disclosures do not say so. The highest price that can be found online for an ATM machine is USD 25,000. The cost of materials for Wirecard in 2014, then, could account for 15,000 top-of-the-line ATMs. China, which has the world’s largest ATM market, installed about 64,000 units in 2014, few of which cost anywhere near EUR 25,000. If Wirecard indeed had captured a market equivalent to 23% of China’s ATM market, that would be news.

At any rate, the inventories on the balance sheet make little sense given the high cost of materials. Inventories and work in progress at the end of 2014 amounted to EUR 3.3 mln, just 1% of the materials cost. If Wirecard is selling all those POS machines, it is selling them very quickly.

Figuring the Margins

Support services are more lucrative than straight-up sales, but the support industry is saturated. Retail customers of POS devices are under no obligation to use the distributor’s services, and little training is necessary. Trans Infotech’s description of POS support services provided (see above screen shot) is a case in point: “Smart Software, Full Support 24/24, Update.” Banks don’t work exclusively with one POS sales distributor; particularly in Southeast Asian markets where few banks sell POS devices, there is in fact an incentive for banks to work with as many distributors as possible in order to maximize the number of merchant accounts opened through their institution. Competing distributors and POS brands told us that Wirecard has no particular edge in the area of after sales support; the market is fractured and Wirecard only captures a fraction of the after sales market from its own sales, and minor third parties tend to capture the market from competing brands, as their prices and fees are lower. As a result, Wirecard operates in a paradox where their largest growth market, Asia, garners the least service revenue, thus should be a lower margin region than Europe.

Yet margins have grown, not shrunk, since the acquisitions, and growth has kept pace of costs associated with the POS sales segment, rather than becoming diluted.

Extrapolating the POS segment of the business, and assuming a range of industry standard margins, and then compare to what the payments processing business must therefore reap, the margin result becomes nonsensical. In the real world of PayPal and Visa, financial payments processing nets margins in the single digits, not 20-40%.

Table 2. Implied Margins on POS (Sales + After Sales Service)

(in mln EUR)	5%	10%	15%
50%	178.8	187.3	195.8
Implied revenue from payments processing	422.2	413.7	405.2
Implied margin from payments processing	28%	25%	23%
70%	250.3	262.3	274.2
Implied revenue from payments processing	350.7	338.8	326.8
Implied margin from payments processing	34%	29%	25%
90%	321.9	337.2	352.5
Implied revenue from payments processing	279.2	263.8	248.5
Implied margin from payments processing	44%	36%	28%

Source: J Capital Research

Our checks have found that Wirecard has not been particularly successful in locking in its customers into contracts, which also casts doubts on the margins.

Company History and Management

Founded as an online payments company in 1999, Wirecard nearly went bankrupt in 2002. CEO Markus Braun took over that year and arranged for

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the injection of capital.



The earliest available screenshot of Wirecard's website, from October 5, 1999. | Source: The Internet Archive

In 2003, a Zurich-based financial services company called ebs Holding, which sold investments in tax havens, developed an online payments tool, and Wirecard got the rights to market it. The company conveyed these rights to a failing a call center provider called InfoGenie. InfoGenie was providing information hotlines that legal advice, health information, maps, and the company also sold its services to businesses that wanted to out-source responses to customer questions about product features.

Nearly insolvent and threatened with delisting, InfoGenie allied with Wire Card AG in 2003 (spelled then as two words), obtaining an exclusive license to market the Wire Card payments solution.

InfoGenie had been struggling. In 2002, it had gross revenue of EUR 2.97 mln and losses of EUR 3.9 mln. Here is a quote from the start of the company's 2002 Annual Report:

2002 was a year characterized by change for Infogenie Europe AG. We made significant efforts to bring the company to a sound course and secure the Group's survival in the process. As early as the beginning of the year, the financial situation was still quite dramatic: in early summer, the organization's funds for investment in operations were nearly depleted. In July we were compelled to report a loss amounting to half of our capital stock. This resulted in personnel-related changes to our Board of Management.

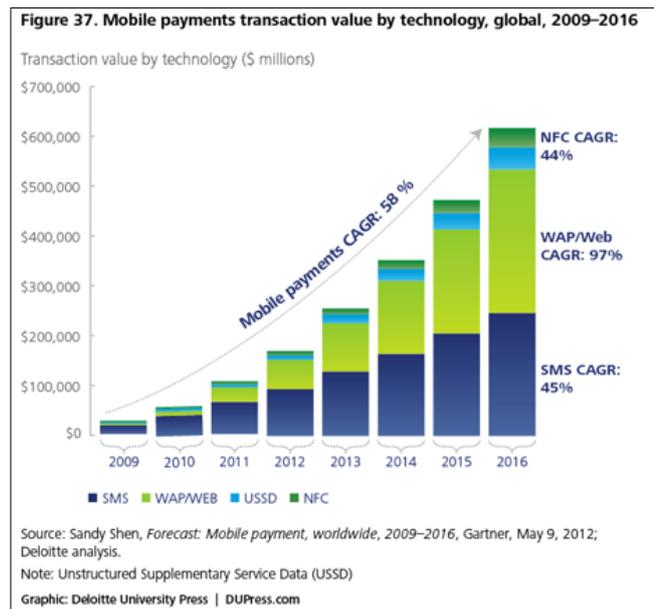
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The payments system was losing money, and the revenue rights kept InfoGenie from going under. In 2005, a company called Blue Corporate Finance did a reverse IPO for Wire Card by merging its assets with InfoGenie Europe AG. Wirecard became a listed company.

In 2006, Wirecard acquired a payments company called XCOM Bank AG for EUR 6 mln net of the bank's cash. Through XCOM, Wirecard obtained a German banking license. The banking license permits Wirecard to act as an acquirer, which has higher fees than the issuing business, and to earn interest on customer deposits.

The Industry

Mobile and online payments are growing globally at a rate of 30-40% YoY as of the end of 2014, with much dispute as to the exact volume but little dispute as to the magnitude of growth rate. This is compared to a growth rate of around 7-10% YoY for traditional modes of electronic payment (credit & debit cards), fueled mostly by growth in emerging markets. Mobile transactions now account for just over a quarter of all online transactions. Conservative estimates for 2014 put online payments transaction value globally at about USD 1.1 trn, more aggressive estimates average USD 1.7 trn.



Mobile transactions have been outpacing computer-based online transaction growth, with an average growth rate approaching 60% YoY over the last four years. Wirecard points to mobile transactions as its fastest and most significant area of growth.

Wirecard enjoys the highest net margins among its peers.

Comparables

Wirecard enjoys the highest net margins among its peers and is ranked second in operating margins. The company reports that its closest competitor is Worldpay. Worldpay is much larger than Wirecard and had 2014 revenue of GBP 3.65 bln (EUR 4.9 bln) compared with EUR 601 mln for Wirecard. Worldpay accounted 44% of card transactions in the United Kingdom in volume terms in 2014. And yet Worldpay was still loss-making in 2014 after three years of consecutive losses. Wirecard, on the other hand, reported an 18% net margin in 2014 and similar EBIT margins to Worldpay.

In the acquiring business, fair comparisons are Visa and PayPal. Acquiring is an asset-light business model with high margins, as indicated by Visa's higher EBIT margin. Yet with 67% of its business from relatively heavy-asset and lower-margin business (selling POS devices), Wirecard still achieved the highest net margins of its peer group.

Worldpay (WPG LON)

Worldpay is a provider of payments technology in store, by mobile phone, and online. Worldpay solutions and partners are easy to find, but the company has been losing money for years:

Table 3. Worldpay Margins

	2011	2012	2013	2014
Gross Margin	19%	21%	21%	21%
EBIT Margin	2%	2%	1%	3%
Net Margin	-1.94%	-1.72%	-5.84%	-1.43%

Source: Company filings

PayPal (PYPL US)

PayPal sets the standard for online financial processing and service companies, but PayPal reports much lower margins than Wirecard:

- ▶ PayPal nets USD 8 bln in revenue from USD 228 bln in online payment transaction volumes (2014), a 0.35% yield. Compare this to Wirecard's 0.87% yield (2014). In fact, if Wirecard matched PayPal's yield, it would only garner EUR 120 mln from its payments segment, or 20% of total revenue.
- ▶ PYPL's days receivable average under 35 days, which is six times lower than Wirecard's.

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- ▶ PP&E at PayPal accounts for 12% of revenue, compared to Wirecard's 2.5%, despite the fact that Wirecard has a physical business for which it would need warehouses and retail infrastructure.
- ▶ PayPal spends 12% of revenue on sales, marketing & advertising, and an additional 11% on research & development. Wirecard reports 12% of revenue spent on all these costs yet claims superior technology.

Netspend (TSS US)

Netspend Holdings is a prepaid debit card company serving under-banked U.S. customers. It was acquired in 2013 by Total Systems Solutions. Netspend provides prepaid debit (GPR—General Purpose Reloadable) cards. In 2009, when the company issued a listing prospectus for this standalone business, it had 8% net margins on USD 225 mln in revenues. Despite being exclusively an issuer of prepaid cards, Netspend derived only 19% of its revenue from interchange fees. At the end of 2009, the company had 1.7 million active cards.

A major difference between Netspend and Wirecard is that Netspend does not act as the acquiring bank. According to the prospectus: “[R]etailers collect all consumer funds related to sale and reload of our prepaid debit cards and remit them by electronic transfer directly to our issuing banks.”

Table 4. Net Margins

	2011	2012	2013	2014
Wirecard	18.8%	18.6%	17.2%	18.0%
Visa	16.0%	15.3%	14.2%	16.9%
Worldpay	-1.9%	-1.7%	-5.8%	-1.4%
PayPal	10.2%	13.2%	14.8%	5.2%

Source: Company data

Table 5. Comparative EBIT Margins

	2011	2012	2013	2014
Wirecard	23.4%	23.7%	20.5%	22.1%
Visa	23.5%	23.0%	21.7%	26.3%
Worldpay	19.0%	20.5%	20.7%	21.0%
PayPal	NA	14.9%	16.2%	15.8%

Source: Company data

The Wirecard business in some respects is comparable to that of Worldpay, which also has “inventories accounts.” However, the inventory turnover days of the two companies diverge widely. In 2014, Wirecard recorded an average of two inventory turnover days, while Worldpay had 281. That implies that Wirecard sells much faster than Worldpay. Wirecard may be 100x as efficient as Worldpay, but that is a wide gap.

Table 6. Average Number of Days in Stock

	2011	2012	2013	2014
Wirecard	2	3	6	4
Worldpay	NA	NA	281	281

Source: Company data

Worrisome Acquisitions

Wirecard reports head-scratching margins, nearly 40% higher than PayPal’s. But instead of piling up cash profits and either distributing them to shareholders or buying up accretive companies, Wirecard is acquiring Asian subsidiaries and racking up goodwill and intangibles, which is to say: it is overpaying. It is not too much of a stretch to imagine that the acquisitions may be completely fictional.

When companies exaggerate their profits, they accrue profits that become inconvenient because they’re not really there. Lest auditors ask to see the cash, companies need to move any exaggerated profits into other types of assets that are more discretionary. In Wirecard’s case, the majority of non-current assets are intangible assets, which are easier to exaggerate, and leads us to question their reporting of goodwill.

Wirecard has been on a veritable acquisition spree over the last few years, expanding operations from their European base into the Middle East and North Africa, Southeast Asia, South Africa, Australia, and New Zealand. This has led to a huge build-up in goodwill, attributed to customer acquisition and R&D, ostensibly more valuable than their annual revenue. However, we find little evidence for new technologies in their disclosures about core business that differentiate the company with its new acquisitions from itself sans these new subsidiaries, or to differentiate Wirecard from its competitors.

We visited some of the acquired companies and we had some doubts. We

It is not too much of a stretch to imagine that the acquisitions may be completely fictional.

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were unable to verify R&D facilities, or a breadth of business in terms of long-term customer base that would justify these valuations.

Trans Infotech Vietnam

Headquartered in Singapore, Trans Infotech, which changed its name to Wirecard a year ago, is nominally a “leading provider in the payment services sector for banks” (2014 financials) in the region. Their competitors told us the company had about 20 employees and that trans Infotech has no capacity for providing services, which would require at least 100 people. The facilities we visited were very quiet. We visited their offices in Hanoi and Ho Chi Minh, checking both current and former addresses to ensure we had covered all facilities. They were located in office parks rather than a mixed retail/office facility like some of their competitors. While competitors had visible call centers and employees talking with customers, Trans Infotech had almost nothing.

In Ho Chi Minh City, the office building Trans Infotech occupied until approximately three years ago, just before rumors of acquisition began, was in an old office building that predominantly housed offices for shell companies. There were at least 20 companies in residence but the security guard said that fewer than a dozen people worked there daily. We were unable to locate a previous location for Trans Infotech in Ho Chi Minh.

At the new space in Ho Chi Minh City, we found a large office space with



At left, the Wirecard office in Ho Chi Minh, empty mid/late-morning. At right, the Hanoi Trans Infotech office, mid-afternoon, with under 10 staff.

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capacity for 50 or more people, but no more than five people were in the office in the late morning and early afternoon. Occupants of neighboring offices confirmed that only a handful of people worked at Wirecard. Unlike for adjacent businesses in the building, where office workers had a reasonable idea of their neighbors’ businesses and knew some of the workers personally, no one seemed to know anyone who worked at Wirecard or knew what their business was. This is despite the fact that there were at least three other tech companies on the floor. By contrast, when we visited competitor offices, we found teams of office workers, customer service support people, and offices operating at capacity.

Competitors also told us that what Trans Infotech was known for in Vietnam was selling POS machines under exclusive contract for PAX (XGD), the Chinese manufacturer. Wirecard was ostensibly responsible for after-sales service, but there are many suppliers in Vietnam of cheap, third-party services, and the business is unlikely to come with margin.

Competitors also told us that, while expansion has been rapid in the payments sector in Vietnam over the last two to three years, with annual growth surpassing 30%, the margins have grown slim—no one had margins above 10%. This is widely discrepant with Wirecard’s 25% margin, which went undiluted at the time of acquisition of Trans Infotech.

Nothing in Cambodia

In Cambodia, we were unable to verify the existence of Trans Infotech, Wirecard, or related entities. We spoke to the leasing agent for the office in Phnom Penh, and he confirmed that Trans Infotech, or Camsingnet, the original name for the Cambodian subsidiary, had not been a tenant in the past 10 years. We did note that there was another company with “Trans” in the name at the office complex, Trans Star Freight Pte. Ltd., a logistics company, but it was unrelated. All phone and fax numbers were disconnected, and emails bounced.

We investigated offices with similar addresses and spoke with competitors and financial institutions, and were unable to find anyone who had heard of the company. We were also unable to locate the financial filings for Trans Infotech or Camsingnet through the Ministry of Commerce databases, and spoke with an MOC data collector, who assisted us in checking the Khmer records, and came up empty there as well. The website for Camsingnet no longer exists. We were unable to find anyone who knew of Trans Infotech, Camsingnet or Wirecard in the online payments or POS terminal sales businesses in our checks.

All phone and fax numbers were disconnected, and emails bounced.

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Leasing agent offices for Trans Infotech offices in Cambodia.

Or Laos

In Laos, we were unable to locate the offices and confirmed that the company did not lease space in any office complex in the district. Similarly, we were unable to locate the local financial filings in English or Lao. Just as in Cambodia, there was a company adjacent to where Trans Infotech supposedly had office space in Vientiane that had a similar name—Infotech Co. Lao—but was unrelated to Wirecard or Trans Infotech pre-acquisition according to the company’s Lao financials. Upon investigating we found that

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it was a post office box, not a physical address, and the person who fielded our inquiry to Infotech Co. informed us that the number on file was only for PO boxes, and she had no forwarding contact info for the company.

When we visited the district the PO box addresses are associated with, we found a predominantly Chinese business district with wholesale, retail, and money transfer businesses. None of the businesses we spoke with had heard of Trans Infotech or Wirecard. When we met with competitors in the POS business, they were unaware of Wirecard, and told us that PAX, who Trans Infotech distributes for in Vietnam, sold through several distributors in Laos and Cambodia. In the service space, most retailers use third party providers rather than the distributors as distributors charge on average 25% more.

Wirecard reported in 2014 that the acquisition of Trans Infotech had netted the company EUR 22.2 mln worth of customer relationships. Given that the average Wirecard transaction value, according to [Gateway Index](#), is EUR 11, if Wirecard were realizing 5% margins from each transaction, the company would need to see 40 mln transactions through Trans Infotech in a single year to justify the customer relationships added to its balance sheet. Those 40 mln transavtions would simply not be feasible with only 10 visible employees in the three countries.

Korvac and Systems@Work (Malaysia)

Wirecard acquired two entities in Malaysia and has merged them and changed their names. When we visited, Korvac had just moved from an office space we estimate could have held no more than 10 employees. The office was located in a building where fewer than 10% of occupants had their offices unlocked during business hours. The new office, in a glitzy building downtown, had capacity for 50 employees, but we observed fewer than a dozen. Despite having moved offices over a month prior, only a few desks and computers were set up, with lots of boxes stacked and untouched. We also found that a third registered address for Korvac was actually that of a secretarial outsourcing firm, which handled logistics and mail for Korvac before the company set up office space a few years ago.

Systems@Work has a registered address in a technology park, and the listed address was inside a building owned and operated by a single conglomerate (IRIS), which does R&D in contactless payments and other high-tech payments and identification solutions. While management confirmed that Systems@Work had at one point had an affiliation and operated in their facilities, they had moved out an indeterminate amount of time prior, and all contact information that had been left was either invalid or disconnected.

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Above: Old Korvac office building in Kuala Lumpur, one month after Wirecard vacated, above. Below at right: the new Wirecard space, largely unoccupied.

Other payments providers in Malaysia said that Wirecard’s operations made them a marginal player, with no significant banking relationships to rely on to make their payments solutions the mode of choice for any segment. Unlike for Trans Infotech, we were unable to find a physical retail explanation for their revenue.



Wirecard reported paying a premium of EUR 27 mln for Korvac’s customer relationships as well as EUR 1.9 mln in goodwill. It purchased the company for EUR 30.6 mln.

PT Prima Vista Solusi and PT Aprisma Indonesia
(now absorbed by Prima Vista) (Indonesia)

Of all the subsidiaries we visited in Southeast Asia, Prima Vista was the most plausible. The staffing rates were closer to what we expected, at around 100 employees, although fewer than the 200-300 range Wirecard reports, and the company had operating post-sales service centers. Our assessment in speaking with competitors was that Prima Vista operated a reasonable POS business with post-sales service and has an online payments-processing presence. They said the company has low volumes, however, and undifferentiated technology.

Wirecard acquired Aprisma for EUR 56.498 mln.

From local filings for these entities, we found that most of these subsidiaries and their predecessors were run by two to three individuals who had been working together as company heads prior to their entrance into the payments processing business. The heads of Korvac previously ran an

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Above, One Wirecard office in Jakarta: the desk was manned, but we observed less than a dozen people entering or exiting at lunch hour. Below, the Aprisma office, we estimate no more than forty people occupied the office.



entertainment company, which they shut down 14 months after starting Korvac a decade ago. An earlier acquisition, Card Techno, was run by one of the same directors as Trans Infotech, and this director's earliest venture was in electronics manufacturing. Most of the directors have been involved

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Wirecard's Asian businesses seem to be focused on physical sales of POS machines.

in forms of consulting as opposed to technological development, though they claim to have technical backgrounds that ensure an advantage over competitors.

Wirecard's Asian businesses, where they exist at all, seem to be more focused on physical sales of POS machines than on the disclosed services sectors. While this may be a legitimate contributor to revenue, it does not offer the same value proposition as payment services, nor is it as deserving of the same multiple Wirecard is trading at today. Furthermore, Wirecard did not acquire R&D capacity or new technologies in these acquisitions, another stated reason for the volume of acquisitions in Asia.

How Valuable Are the Acquisitions?

Wirecard's purchase prices for companies on which it provides valuation detail appear to be based on the target company's "customer relationship" value, but that value does not seem to be based on the number of customers acquired: some of the acquisitions are of companies providing a technology platform that are unlikely to deal directly with individual customers. Others seem to be very small companies with few customers.

Table 7. Acquisitions (in mln Euro)

Acquisitions	Asset Value of Customer Relationships	Goodwill	Property, Plant, and Equipment
Aprisma Indonesia	€ 59.35	€ 24.48	€ 0.229
Mikro Odeme	€ 10.76	€ 13.07	€ -
Amara Technology	€ 7.44	€ 26.53	€ -
GFG Group	€ 26.70	€ 7.62	€ 0.049
Visa Processing Service India	€ 4.74	€ 8.03	€ 0.907
Trans Infotech Vietnam	€ 22.22	€ 0.90	€ -
PaymentLink Pte (Korvac Group)	€ 27.12	€ 1.99	€ -
Total	€ 158.33	€ 82.62	€ 1.185

Source: 2014 Annual Report

All of this is physical evidence that the balance sheet is bloated with phantom assets. Wirecard's goodwill and intangibles ballooned to a nearly com-

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Wirecard may lack the ability to prevent illicit transactions through its payment portals.

bined 50% of revenue by 2014, with no explanation.

All the Growth, None of the Resources

Wirecard says it derives its growth from outside Europe. The ex-European portion of the business has grown from 9.1% of total transactions in Q1 2012 to 24.3% in Q2 2015. The implied growth rate of transactions is 47% for Europe over the 2.5-year period and 372% for ex-Europe. In our analysis of the last three years of earnings, we found that less than 10% of Wirecard’s growth is organic, and the rest has been generated through acquisitions.

To achieve these growth rates, Wirecard tells investors, it needs to acquire customer relationships in Asia by buying companies at inflated valuations. While Wirecard claims that the acquisitions enable it to boost payments activities in the region, it does not appear to have sufficient on-the-ground resources to offer value in payments clearing.

Businesses like PayPal provide strong controls over illicit or illegal activity. This ranges from being able to detect multiple identical charges to the same account to preventing payments for sex work or illegal substances. These controls insulate the payment processor from liability, but they are expensive to implement and require significant staffing to oversee transactions and follow up with businesses and customers. The fact that we were unable to verify even a fraction of the staffing in the Southeast Asian acquisitions, therefore, makes it seem unlikely that Wirecard has the ability to prevent illicit transactions through its payment portals.

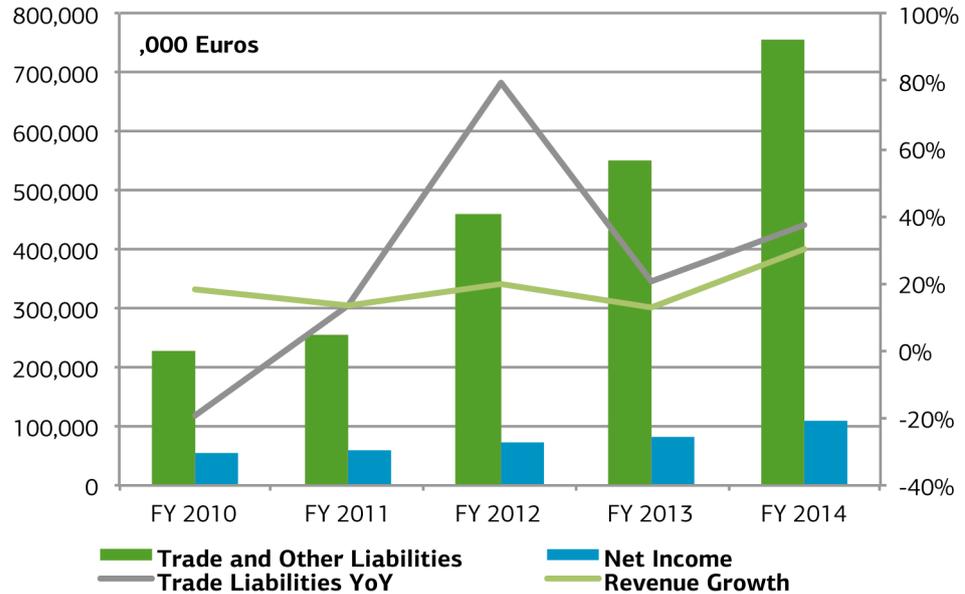
Weird Financial Statements

For a company with the segment-beating profits Wirecard reports, liabilities should be low. But Wirecard borrows money from its customers, building up trade and other payables that are 126% of revenue in a business that is all about instant money transfer. It also claims an awful lot of value in the companies it acquires. While the reported profit has been rising at a steady 20%+, the payables rose at 38% in 2012 and 2013 and 15% in 2014.

Just as odd is the accumulation of intangibles on the balance sheet. “Intangibles,” like “goodwill,” are the ultimate in unverifiable assets. If Wirecard were exaggerating payments for subsidiaries, then the exaggerated payments would appear on the balance sheet as intangibles and goodwill. The

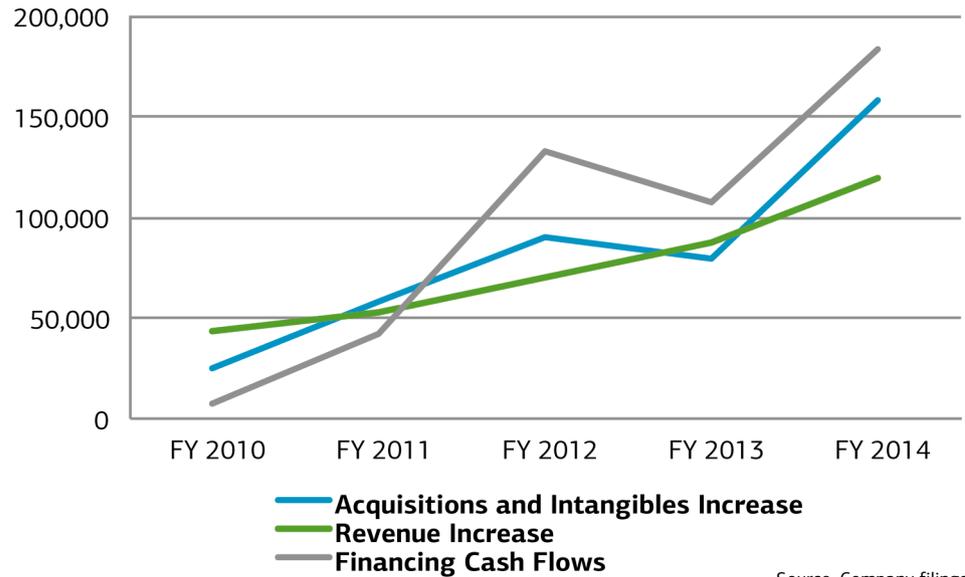
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Chart 8. Trade and Other Payables vs. Profit



Source: Company filings

Chart 9. Growth in Acquisitions and Intangibles (,000 Euro)



Source: Company filings

value is likely a plug for where there should be cash and isn't.

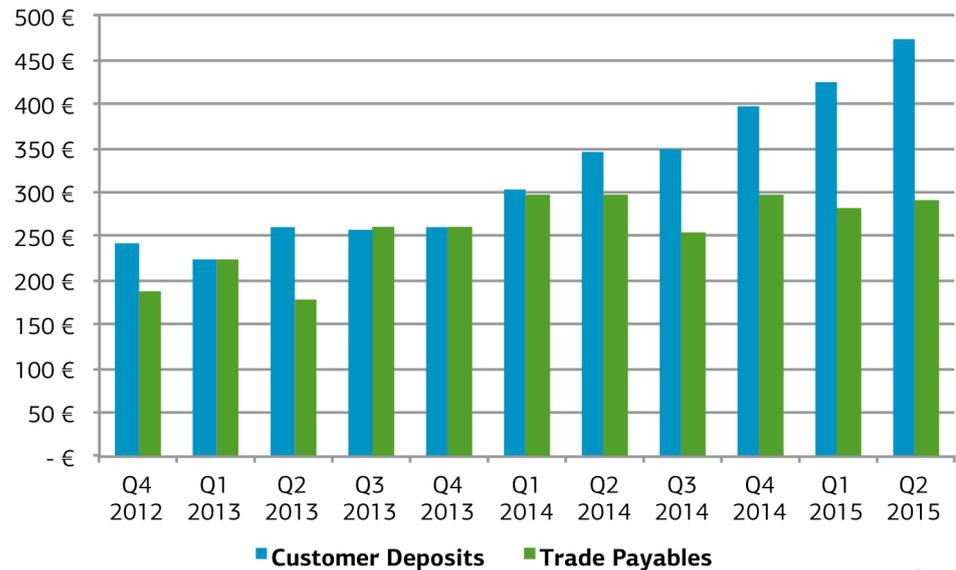
We are very skeptical of the revenue growth. But the increase in intangibles exceeds even the fantastical increase in revenue.

Unexplained Assets

Wirecard has large "transient liabilities," which essentially are payments

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Chart 10. Customer Deposits and Trade Payables (mln Euro)



Source: Company filings

that Wirecard holds pending remittance. They may be customer deposits for the prepaid cards or may be payments not yet made to merchants.

The transient assets and liabilities should more or less match, but instead, Wirecard’s “transient” assets have been rising very fast. That could mean that Wirecard is fronting money to clients. Wirecard should be holding customer payments for short periods of time. And yet the customer deposits plus payables for Wirecard at the end of 2014 amounted to EUR 695 mln, more than gross revenue.

Table 8. “Transient” Assets and Liabilities (,000 Euro)

	2011	2012	2013	2014	2015E
Trade Payables	135,428	187,249	259,334	298,367	543,983
Customer Deposits	105,042	241,893	260,231	396,733	482,236
Trade and Other Receivables	182,146	215,496	278,989	354,602	431,025
Difference	58,324	213,646	240,576	340,498	595,194

Source: Company reports

Skint?

Despite a lot of cash, the company seems oddly short. Wirecard has been sued for payment of outstanding commissions and for retained collateral. The 2013 Annual Report reads: “As reported, a lawsuit against the com-

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pany and against a specific Group company relating to the payment of allegedly outstanding commissions was submitted at Munich Regional Court I in calendar 2012.” Bloggers complain that the company withholds balances.

While Wirecard has routinely held as much cash on the balance sheet as revenue, if not more, receivables are consistently more than 50% of revenue. In a payments business, typical receivable days are closer to 30 days, not 200 days. This suggests that a larger proportion of Wirecard’s real business is actually not in straightforward payments processing, though they report this accounts for 70% of the business. Payables also average around 40% of revenue, suggesting that Wirecard holds onto cash for much longer than the industry norm. We question how a transaction clearinghouse business could operate with such high payable days—who are their customers/suppliers that are willing to wait nearly four months for payment?

There is no disclosure of the currency composition of cash. But foreign exchange gains and loss accounts vary considerably, suggesting that Wirecard could use this to manipulate the cash accounts.

Table 9. Exchange Gains and Losses (,000 Euro)

	2011	2012	2013	2014
Exchange Gain/Loss	38	-808	-724	2,164

Source: Company reports

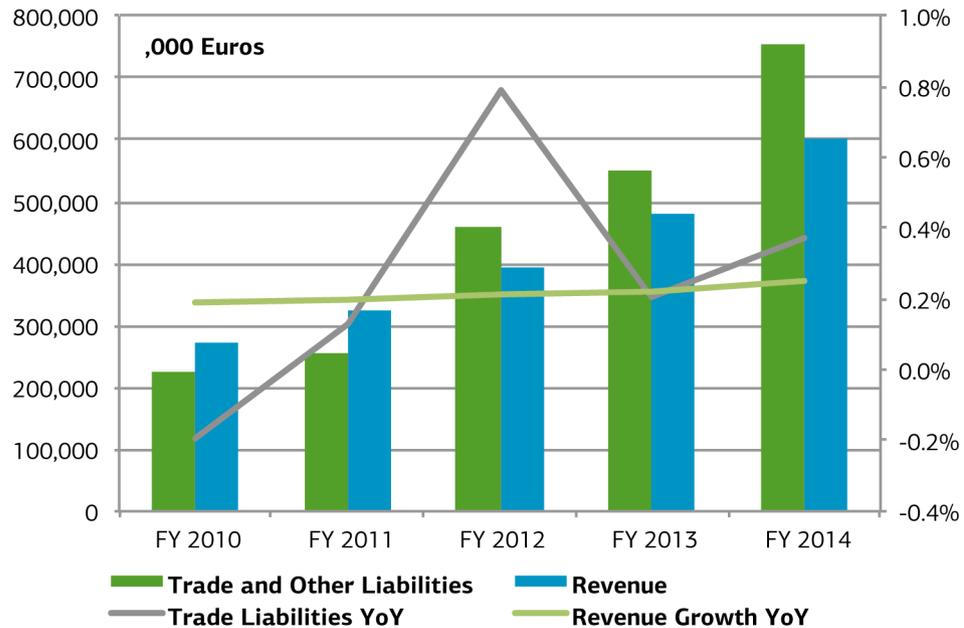
Can’t Touch It

Wirecard’s accounts indicate heavy borrowings for acquisitions, which then build up goodwill. In 2014, the company issued EUR 367 mln in shares, up from EUR 1.3 mln in 2013, and has utilized this cash for:

- ▶ **EUR 75 mln on “investments in PP&E and intangibles assets”** in 2014, yet has less than EUR 20 in PP&E on its balance sheet, and offers no guidance as to what those intangibles are.
- ▶ **EUR 226 mln on repayment of financial liabilities**, but did not provide guidance as to what those liabilities were.
- ▶ A **EUR 15 mln** dividend.

Wirecard—whose business it is to collect cash and disburse most of it overnight—has current liabilities of EUR 775 mln, in excess of annual revenue.

Chart 11. Trade Payables and Revenue Growth



Source: Company filings

Wirecard aggressively capitalizes research and development expenses. Its capitalization ratio of R&D expenses has been around 60% for last three years, which means that every dollar Wirecard spends on R&D, 60 cents is recorded in its assets. This could be a way for Wirecard to inflate the assets accounts.

It also impacts the ostensible profitability: the company reported EUR 82.7 mln and EUR 107.9 mln in after-tax profit in 2013 and 2014 respectively, while also reporting “Internally generated intangible assets” of EUR 44.3 mln and EUR 62.2 mln respectively. This asset category is a product of Wirecard’s R&D spend, which produced assets, like goodwill, at a greater value than the capital investment in those assets. It is plausibly a method by which the company, like with acquisitions, can create assets to hide the lack of profit. Netting out these R&D-generated assets from profit, Wirecard had a total profit of EUR 38.4 mln in 2013 and EUR 45.7 mln in 2014, with growth of under 20% instead of 30%.

Table 10. Wirecard R&D

	2011	2012	2013	2014
R&D as % of Sales	4.5%	4.1%	7.2%	6.4%
Employees in R&D	140	194	310	768
Capitalization Ratio	NA	63.7%	59.3%	64.8%

Source: Company data

For online payments companies, revenue is normally in line with transaction volume through the system. The conversion ratio indicates that Wirecard is more similar to Worldpay but much higher, nearly two times of Worldpay. Smaller companies usually offer lower prices in order to compete in the market, yet this is apparently not the case for Wirecard.

Table 11. Revenue as % of Transaction Volume (Value)

	2011	2012	2013	2014
Wirecard	2.1%	1.9%	1.8%	1.7%
Visa	60.1%	62.7%	63.9%	64.1%
Worldpay	1.2%	1.1%	1.0%	1.0%
PayPal	3.8%	3.9%	3.6%	3.4%

Source: Company data

Valuation

Based on our analysis of the company’s business in POS distribution and its lack of visible infrastructure for high volumes of payments, we estimate that the company’s true margins are significantly lower than stated. Instead of the 43% reported in 2014, we assign an overall margin of 15%, which we believe is very generous. On that basis, a DCF valuation puts Wirecard’s current share value at EUR 17.2, 60% lower than the current share price.

Risks

- ▶ The company may be involved in high-margin, gray-market businesses that it prefers not to report and may have cash on hand.
- ▶ Authorities could fail to enforce laws against online gambling and transfer of payments across borders, allowing Wirecard to grow in this lucrative segment.
- ▶ We could misunderstand the business and Wirecard could be a real player in online payments.
- ▶ With a coming IPO of Alipay, the online payments space could get bid up to high valuations. Wirecard could be acquired.

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