

# Net Element Inc. (NASDAQ: NETE)

## Consumer Discretionary | Retail - E-Commerce Discretionary

- NETE 1Q18 EPS of -\$0.40 beats by \$0.03, revenue of \$15.98 million (+17.8% increase YoY) beats by \$1.78 million
- Continuous organic growth in North American Transaction Solutions segment with management's goal of international market expansion
- Focus on the development of blockchain-backed technology as well as partnerships in SMB

## Company Description

Net Element ("NETE" or the "Company") is a global financial technology and value-added group that supports electronic payments acceptance in a multi-channel environment, including point-of-sale (POS), e-commerce and mobile devices, in the United States and emerging markets. NETE has two primary business units: North American Transaction Solutions and International Transaction Solutions Segment. NETE is headquartered in Miami, FL, and its website is netelement.com.

Key Data	
52-Week Range	2.56 - 33.51
Shares Outstanding	3,855,833
Market Cap	29.40
3-Months Avg Volume	913,249
Total Cash	9.19
Total Debt	6.50

*in USD million except price, shares and volume*

Key Financials			
	Q1 2016	Q1 2017	Q1 2018
Revenue	11,261	13,562	15,982
EBIT*	(1,713)	(2,263)	(989)
EBITDA*	(825)	(1,605)	(286)
Earnings	(1,848)	(2,488)	(1,611)
CFF	1,043	1,551	(553)

*in USD thousand*

*\*does not include non-operational expenses or revenue*



## Reflections on 1Q Financials

### Result of Operations

The Company reported its 1Q financials and performances on May 14, 2018, and hosted the earnings call on May 15. There is a decrease in net loss attributable to stockholders of \$876,651 (net loss of \$0.42 per share of 1Q18 and net loss of \$1.51 per share of 1Q17), primarily due to an increase in revenues and decreases in general and administrative expenses, non-cash compensation and bad-debt expenses, which is inline with the management's discussion in April 2018 as NETE focuses on SG&A expenses reduction. The North American Transaction Solutions segment still accounts for the major source of revenues, amounting to 87.4% versus 80.9% in 1Q17, driven by the division's organic growth and particularly backed by its Aptito line in restaurant sectors. We do expect Net Element's actions in the international (Russian) market for its restaurant POS solutions and services in the rest of 2018 to boost its International Transaction Solutions segment.

Revenue and Gross Margin					
<i>in USD</i>					
Source of Revenues	Three Months Ended March 31, 2018	Mix	Three Months Ended March 31, 2017	Mix	Increase / (Decrease)
North American Transaction Solutions	\$ 13,966,617	87.4%	\$ 10,964,919	80.9%	\$ 3,001,698
International Transaction Solutions	2,015,777	12.6%	2,597,022	19.1%	(581,245)
Total	\$ 15,982,394	100%	\$ 13,561,941	100%	\$ 2,420,453

  

Cost of Revenues	Three Months Ended March 31, 2018	% of revenues	Three Months Ended March 31, 2017	% of revenues	Increase / (Decrease)
North American Transaction Solutions	\$ 12,064,072	86.4%	\$ 9,461,450	86.3%	\$ 2,602,622
International Transaction Solutions	1,554,262	77.1%	1,998,542	77.0%	(444,280)
Total	\$ 13,618,334	85.2%	\$ 11,459,992	84.5%	\$ 2,158,342

  

Gross Margin	Three Months Ended March 31, 2018	% of revenues	Three Months Ended March 31, 2017	% of revenues	Increase / (Decrease)
North American Transaction Solutions	\$ 1,902,545	13.6%	\$ 1,503,469	13.7%	\$ 399,076
International Transaction Solutions	461,515	22.9%	598,480	23.0%	(136,965)
Total	\$ 2,364,060	14.8%	\$ 2,101,949	15.5%	\$ 262,111

Source: Company Filings

### Liquidity and Capital Resources

NETE's total assets as of March 31, 2018, were \$29.3 million, compared to \$32.3 million at Dec. 31, 2017. The Company had total current assets of \$16.2 million, including \$9.2 million of cash, \$5.1 million of accounts receivable and \$1.9 million of prepaid expenses and other assets. At Dec. 31, 2017, NETE had total current assets of \$19.0 million, including \$11.3 million of cash, \$5.5 million of accounts receivable and \$2.3 million of prepaid expenses and other assets. The Company is projected to spend \$6.0 million in continuing operations as currently conducted over the next 12 months, backed by its ~\$9.2 million FCF.

## Recent Development on Blockchain-Enabled Technology

---

Backed by NETE's proprietary Netevia platform, the Company has launched "Fast Pass Funding" under its Unified Payments subsidiary, which allows Unified Payments' merchants to receive funding within hours during the same business day.

Eligible merchants may receive funding in as little as three hours during regular business days, compared to the previous average funding times of 12 to 24 hours. Fast Pass Funding is also available to NETE's merchants using Aptito, the Company's proprietary cloud-based restaurant POS and management system. Fast Pass Funding is one of the many value-added services being delivered to merchants through the Netevia platform. Additional value-added services include fast, easy merchant account opening and integration; payment conversion optimization; more than 150 risk-monitoring filters; and very competitive pricing for payment acceptance services. We believe the blockchain-based Netevia platform is able to bring more advantages and features to the Company's existing products and services in addition to Unified Payments.

## New PayOnline Partners with Bank Sputnik targeting SMB

---

In May, NETE's PayOnline subsidiary started a partnership with Bank Sputnik, aiming to offer a comprehensive multi-channel payment facilitator solution for SMB merchants in Russia, one of Net Elements' key international markets. The solution offers a set of tools not available from any other transaction processing company in the region and expands PayOnline's offerings beyond electronic commerce.

The exclusive partnership offers a fully compliant legal framework and bank sponsorship to enable PayOnline to process transactions as a payment facilitator. PayOnline ensures merchants and their clients benefit from an automated, real-time and seamless onboarding experience. The API-driven platform simplifies merchant account enrollment. A sub-merchant can be enrolled, approved, boarded and processing payments within a few minutes. PayOnline's merchants have instant access to a suite of value-added merchant solutions, including credit card auto account updater, multi-currency pricing, tokenization, advanced fraud detection tools and smart transaction routing.

According to Statista, the total transaction value in the digital payments segment in Russia will amount to US\$39.5 billion in 2018, up from US\$27.9 billion in 2016. Total transaction value is expected to reach US\$61.8 billion in 2022, a CAGR of 11.9% from 2018 to 2022.

## Risk Considerations

---

**Foreign Exchange.** The Company has Russian operations that transact in foreign currencies, including Russian rubles, euros, and the Kazakhstan tenge. NETE did witness the effect of exchange rate changes in the form of a decrease in its USD-denominated cash balance by \$3,720 for the three months ended March 31, 2018, as compared to a \$57,288 increase for the three months ended March 31, 2017.

**Rapidly increasing competition in the payments space and ever-changing landscape.** In general, as technology evolves at an exponential pace, the competitive environment dynamically shifts. Aside from tech-based competitors in payment systems, traditional financial services companies seek means to develop more and more technology and fin-tech-driven products and services as the industry takes shape.

**Reliance on third-party processors and service providers.** NETE relies on its partnerships with numerous payment processing organizations to permit card authorization, data capture, settlement, and merchant accounting services, etc. Given that many of these organizations are also competitors and long-term agreements are not in place, the relationships could be vulnerable.

## Appendix: Financial Statements

CONSOLIDATED STATEMENT OF CASH FLOWS <i>(in USD)</i>	3 Months Ended	
	Mar. 31, 2018	Mar. 31, 2017
<b>Cash flows from operating activities</b>		
Net loss attributable to Net Element stockholders	(1,610,847)	(2,487,498)
<b>Adjustments to reconcile net loss to net cash provided by operating activities</b>		
Noncontrolling interest	27,553	(50,701)
Share based compensation	82,011	596,404
Depreciation and amortization	703,538	657,363
Non cash interest	16,759	46,135
<b>Changes in assets and liabilities</b>		
Accounts receivable	1,032,930	510,498
Deferred revenue	(535,748)	(445,953)
Prepaid expenses and other assets	(308,648)	(231,755)
Accounts payable and accrued expenses	(545,306)	449,284
<b>Net cash used in operating activities</b>	<b>(1,137,758)</b>	<b>(956,223)</b>
<b>Cash flows from investing activities</b>		
Purchase of portfolios and client acquisition costs	(401,980)	(403,585)
Purchase of fixed and changes in other assets	(2,393)	355
<b>Net cash used in investing activities</b>	<b>(404,373)</b>	<b>(403,230)</b>
<b>Cash flows from financing activities</b>		
Proceeds from common stock		1,437,132
Proceeds from indebtedness		92,000
Repayment of indebtedness	(515,834)	(92,680)
Related party advances	(33,027)	57,159
<b>Net cash provided by financing activities</b>	<b>(548,861)</b>	<b>1,493,611</b>
Effect of exchange rate changes on cash	(3,720)	57,288
<b>Net decrease (increase) in cash</b>	<b>(2,094,712)</b>	<b>191,446</b>
Cash at beginning of period	11,285,669	621,635
Cash at end of period	9,190,957	813,081
<b>Cash paid during the period for:</b>		
Interest	226,479	166,394
Taxes	4,140	64,314

Source: Company Filings

CONDENSED CONSOLIDATED INCOME STATEMENT <i>(in USD)</i>	3 Months Ended	
	Mar. 31, 2018	Mar. 31, 2017
<b>Net revenues</b>		
Service fees	15,982,394	12,729,663
Branded content		832,278
Total Revenues	15,982,394	13,561,941
<b>Costs and expenses:</b>		
Cost of service fees	13,618,334	10,650,748
Cost of branded content		809,244
General and administrative	2,446,480	2,831,161
Non-cash compensation	82,011	596,404
Bad debt expense	121,274	279,759
Depreciation and amortization	703,538	657,363
Total costs and operating expenses	16,971,637	15,824,679
<b>Loss from operations</b>	(989,243)	(2,262,738)
Interest expense, net	(243,238)	(269,688)
Other income (expense)	(350,813)	(5,773)
Net (loss) before income taxes	(1,583,294)	(2,538,199)
Income taxes		
<b>Net loss</b>	(1,583,294)	(2,538,199)
Net (income) loss attributable to the noncontrolling interest	(27,553)	50,701
Net loss attributable to Net Element, Inc. stockholders	(1,610,847)	(2,487,498)
Foreign currency translation	39,315	12,103
<b>Comprehensive loss attributable to common stockholders</b>	(1,571,532)	(2,475,395)
Loss per share - basic and diluted (in dollars per share)	\$ (0.42)	\$ (1.51)
Weighted average number of common shares outstanding - basic and diluted (in shares)	3,853,130	1,647,606

Source: Company Filings

CONDENSED CONSOLIDATED BALANCE SHEETS <i>(in USD)</i>	Mar. 31, 2018	Dec. 31, 2017
<b>Current assets:</b>		
Cash	9,190,957	11,285,669
Accounts receivable	5,133,698	5,472,856
Prepaid expenses and other assets	1,881,628	2,282,614
<b>Total current assets</b>	<b>16,206,283</b>	<b>19,041,139</b>
Fixed assets	51,218	58,268
Intangible assets	2,898,765	3,127,760
Goodwill	9,643,752	9,643,752
Other long term assets	462,980	460,511
<b>Total assets</b>	<b>29,262,998</b>	<b>32,331,430</b>
<b>Current liabilities:</b>		
Accounts payable	6,375,505	6,785,459
Accrued expenses	3,478,918	3,674,430
Deferred revenue	1,176,843	1,712,591
Notes payable (current portion)	1,455,376	2,493,973
<b>Total current liabilities</b>	<b>12,486,642</b>	<b>14,666,453</b>
Notes payable (net of current portion)	5,044,211	4,521,449
<b>Total liabilities</b>	<b>17,530,853</b>	<b>19,187,902</b>
<b>Shareholder's equity:</b>		
Series A convertible preferred stock (\$0.0001 par value,		
Common stock (\$0.0001 par value, 100,000,000 shares	386	385
authorized and 3,855,833 and 3,853,100 shares issued and		
Paid in capital	183,201,232	183,119,222
Accumulated other comprehensive loss	(2,490,923)	(2,530,238)
Accumulated deficit	(168,966,916)	(167,356,070)
Stock subscriptions receivable		(50,585)
Noncontrolling interest	(11,634)	(39,186)
<b>Total stockholders' equity</b>	<b>11,732,145</b>	<b>13,143,528</b>
<b>Total liabilities and stockholders' equity</b>	<b>29,262,998</b>	<b>32,331,430</b>

Source: Company Filings

## JGR Capital Information

---

### Headquarters Address

300 Park Avenue, Fl. 12  
New York, NY 10022

### Contact

[research@jgrcap.com](mailto:research@jgrcap.com)  
646-688-3131

## Disclosure

---

This report contains forward-looking statements, which involve risks and uncertainties. Actual results may differ significantly from such forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in the "Risk Factors" section in the SEC filings available in electronic format through SEC Edgar filings at [www.SEC.gov](http://www.SEC.gov).

The research analysts principally responsible for this research preparation do not receive compensation that is based upon any specific investment banking services or recommendations and can be compensated based on factors relating to the overall profitability of the JGR Capital ("firm"). As of the date of research distribution, neither the firm nor the principal research analysts beneficially own 1% or more of any class of common equity securities for this issuer (including, without limitation, any option, right, warrant, future, long or short position).

The securities of the issuer(s) discussed in this research may be unsuitable for investors depending on their specific investment objectives and financial position. Past performance is no guarantee of future results. This research does not constitute a personal trading recommendation or take into account the particular investment objectives, financial situation or needs of an individual reader of this report, and does not provide all of the pertinent information to make an investment decision.

JGR Capital does not provide investment banking services nor has it received compensation for investment banking services from the issuers covered in this research content. The firm does not make a market in the issuer's securities. It has received compensation from the issuer for providing non-investment banking services to this issuer. The non-investment banking services provided to the issuer includes investor relations' advisory and services, production of this research content, comprehensive reporting analytics, and financial analysis. The fees for these services vary on a per-client basis and are subject to the amount and category of provided services. For the services provided to the issuer covered in this report, engagement with a third-party commenced on November 17, 2017. For this issuer, remuneration was provided by this third-party on behalf of the issuer on February 1, 2018 for a 12-month period within the typical \$10,000 to \$25,000 compensation structure for the services engaged by this third-party. Firm analysts and members of the research production team are prohibited from holding or trading securities in the issuer.

Additional information is available upon request. JGR Capital's research contents are based on data obtained from sources that it believes to be reliable and does not purport to be a complete statement of all material factors. This report is for informational purposes and is not a solicitation of orders to purchase or sell securities. No part of this material may be copied, photocopied or duplicated in any form or by any means, or redistributed without prior written consent from JGR Capital. All rights reserved.