Another solid quarter

Payright's 3Q22 trading update revealed that all business volume metrics improved, including gross receivables, total customers, total merchant stores, quarterly fee income and contracted future revenues, with the exception of quarterly gross merchandise value, which was down on the seasonally strong (Christmas) December quarter.

Credit quality still very reasonable

Credit quality deteriorated slightly with 30+ day arrears rising from 3.63% in December to 4.40% in March, and losses to cumulative GMV at 1.84%, up from 1.79% in December; however is still very good and still just a fraction of Payright's reserving level of 5.70% of gross receivables.

We think that Payright's underwriting including credit checks and focus on higher value more considered purchases positively differentiates it from other short term BNPL providers who are experiencing significantly greater deteriorations in credit quality and benchmarked to other Australian personal lenders and US credit card data from the Federal Reserve it continues to compare reasonably.

FY24 looking plausible for profitability

With this continued strong momentum, combined with its recent warehouse transaction, allowing it to considerably reduce its finance costs and increase its leverage, Payright continues to make significant progress towards becoming profitable.

Payright continues to suggest that an indicative book size for breaking even is when gross receivables are around $200m based upon current profitability and the reduced finance costs associated with its new warehouse; it is now roughly half this size with gross receivables at 31 March of $97.2m, up 59% on pcp. Should it be able to continue this rate of growth, then FY24 looks very plausible for the group becoming profitable.

Rising interest rates should enhance the attractiveness of Payright's customer proposition and should further enhance its receivables growth momentum in coming quarters.

Valuation remains attractive

We make no changes to our earnings forecasts or valuation in this note. We continue to value shares of PYR at A$0.98 using a General Residual Income Model (GRIM) with a cost of equity of 14.0% and terminal growth of 3.0%. Full details are within.

payright

Payright offers buy now pay later solutions for higher value more considered purchases.

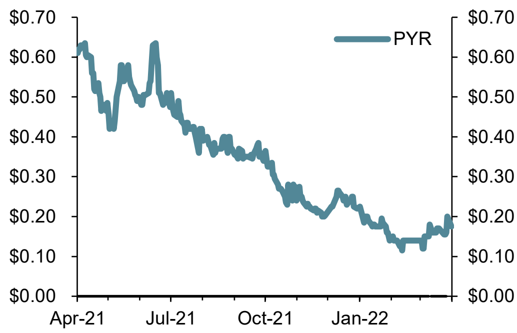
It provides its customers with access to a diverse range of goods and services on flexible and interest-free payment terms (averaging 24 months) and is a provider of choice for many businesses wishing to provide a buy-now-pay-later (BNPL) service to their customers for amounts typically between $1,000 up to $20,000.

Stock	PYR.ASX
Price	A$0.175
Market cap	A$15.6m
Valuation	A$0.98 (Unchanged)

Company data	
Shares on issue:	89.1m

Next steps	
4Q22 trading update	July 2022
FY22 final result	Late August 2022

PYR Share Price (ASX)



Glen Wellham, Senior Analyst

Financials

PAYRIGHT LIMITED PYR-AX

Year end 30 June, A$

MARKET DATA		
Price	A$	$0.18
Valuation	A$	$0.98
52 week low - high	A$	0.00 - 0.66
Market capitalisation	A$m	15.6
Shares on issue (basic)	m	89.1
Options / rights (currently antidilutive)	m	5.3
Other equity	m	0
Shares on issue (fully diluted)	m	94.4

INVESTMENT FUNDAMENTALS		FY20A	FY21A	FY22E	FY23E	FY24E
EPS - diluted reported	cps	-13.04	-21.85	-15.75	-3.33	3.14
EPS - diluted cash	**cps**	**-13.04**	**-21.24**	**-15.75**	**-3.33**	**3.14**
EPS growth	%	-34%	63%	-26%	-79%	-194%
PE	x	-1.3	-0.8	-1.1	-5.3	5.6
DPS	cps	0.00	0.00	0.00	0.00	0.00
Franking	%	n.a.	n.a.	n.a.	n.a.	n.a.
Dividend yield	%	0%	0%	0%	0%	0%
Payout rato	%	0%	0%	0%	0%	0%
Operating cash flow per share	cps	-0.40	-0.56	-1.22	-0.80	-0.93
Free cash flow to equity per share	cps	-0.02	-0.29	0.04	0.07	0.09
FCF yield	%	-10.7%	-167.4%	23.1%	40.2%	48.7%
Enterprise value	$m	48.6	59.1	151.1	228.9	319.3
EV/Total Revenue	x	4.9	4.9	8.1	7.4	7.1
EV/Gross Profit	x	-126.0	20.0	32.3	15.9	13.8
NAV per share	A$	0.22	0.21	0.08	0.05	0.08
Price / NAV	x	0.78	0.82	2.06	3.38	2.06
NTA per share	A$	0.22	0.21	0.08	0.05	0.08
Price / NTA	x	0.78	0.82	2.06	3.38	2.06

GROWTH PROFILE		FY20A	FY21A	FY22E	FY23E	FY24E
Gross Merchandise Value (GMV)	%	64%	25%	64%	50%	38%
Gross receivables	%	82%	47%	125%	53%	43%
Total revenue	%	188%	24%	54%	65%	46%
Gross profit	%	large	-766.8%	158.2%	307.2%	160.9%
Reported NPAT	%	64%	68%	-9%	-74%	-200%

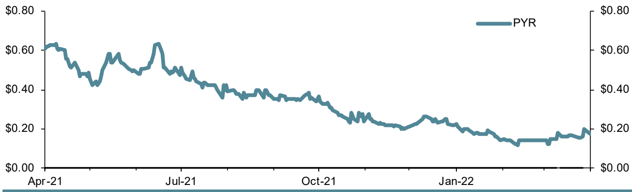
KEY RATIOS		FY20A	FY21A	FY22E	FY23E	FY24E
NTA/Net Receivables	%	17%	28%	5%	2%	2%
ROE - reported	%	-145%	-101%	-90%	-49%	48%
ROE - cash	%	-145%	-98%	-90%	-49%	48%
Net debt	A$m	33.0	43.5	135.5	213.3	303.7
Interest cover	x	-0.35	-1.11	-0.29	0.71	1.29
Gearing (net debt / equity)	x	4.52	2.44	17.25	44.62	38.75
Leverage (net debt / invested capital)	%	82%	71%	95%	98%	97%

DUPONT ANALYSIS		FY20A	FY21A	FY22E	FY23E	FY24E
Net Profit Margin	%	-77.1%	-104.6%	-62.0%	-9.9%	6.8%
Asset Turnover	x	0.2	0.2	0.2	0.2	0.2
Return on Assets	%	-18.0%	-20.4%	-10.0%	-1.5%	1.0%
Financial Leverage	x	8.1	5.0	9.1	32.0	46.9
Return on Equity	%	-145.1%	-101.3%	-90.5%	-48.7%	48.5%

HALF YEARLY DATA		2H21A	1H22A	2H22E	1H23E	2H23E
Total revenue	A$m	6.3	7.9	10.9	13.9	17.0
Gross profit	A$m	0.7	2.1	2.6	6.5	7.9
Cash operating expenses	A$m	-8.2	-8.0	-8.2	-8.5	-8.8
Reported NPAT	A$m	-8.0	-6.0	-5.6	-2.1	-1.0
Cash NPAT	A$m	-7.6	-6.0	-5.6	-2.1	-1.0
EPS - diluted cash	**cps**	**-0.13**	**-0.10**	**-0.06**	**-0.02**	**-0.01**
EPS - diluted reported	cps	-0.14	-0.10	-0.06	-0.02	-0.01
DPS	cps	0.00	0.00	0.00	0.00	0.00

KEY PERFORMANCE INDICATORS		FY20A	FY21A	FY22E	FY23E	FY24E
Gross Merchandise Value	$m	68.1	85.0	139.4	208.9	287.8
Revenue / Gross Merchandise Value	%	14.5%	14.3%	13.5%	14.8%	15.7%
Cost to income ratio	%	-93%	-119%	-139%	-564%	427%
Credit losses as a % of receivables	%	10.6%	4.9%	3.4%	2.7%	2.1%
Coverage ratio (gross/net receivables -1)	%	8.4%	6.9%	5.3%	5.8%	5.8%

12-MONTH SHARE PRICE PERFORMANCE



PROFIT AND LOSS		FY20A	FY21A	FY22E	FY23E	FY24E
Fee income	A$m	9.3	11.5	18.1	29.9	44.1
Other income	A$m	0.5	0.7	0.7	1.0	1.0
Total revenue	**A$m**	**9.8**	**12.2**	**18.8**	**30.9**	**45.1**
Finance costs	A$m	-5.6	-6.0	-9.0	-10.5	-15.3
Expected credit losses	A$m	-4.6	-3.2	-5.1	-6.1	-6.7
Gross profit	**A$m**	**-0.4**	**3.0**	**4.7**	**14.4**	**23.1**
Cash operating expenses	A$m	-7.1	-15.2	-16.1	-17.3	-18.6
Depreciation and amortisation	A$m	-0.1	-0.2	-0.2	-0.1	-0.1
Loss on conversion of convertible notes	A$m	0.0	-0.4	0.0	0.0	0.0
Profit before tax	**A$m**	**-7.6**	**-12.7**	**-11.6**	**-3.1**	**4.4**
Income tax	A$m	0.0	0.0	0.0	0.0	-1.3
Reported NPAT	**A$m**	**-7.6**	**-12.7**	**-11.6**	**-3.1**	**3.1**
add back non-cash items	A$m	0.0	0.4	0.0	0.0	0.0
Cash NPAT	**A$m**	**-7.6**	**-12.4**	**-11.6**	**-3.1**	**3.1**
Weighted average diluted shares	m	58.3	58.3	76.3	97.4	97.4

BALANCE SHEET		FY20A	FY21A	FY22E	FY23E	FY24E
Cash and cash equivalents	A$m	8.2	7.1	11.7	18.5	26.8
Receivables	A$m	43.2	64.6	147.9	224.6	320.3
Property, plant and equipment	A$m	0.1	0.1	0.1	0.1	0.1
Goodwill and other intangibles	A$m	0.0	0.0	0.0	0.0	0.0
Other assets	A$m	0.8	0.6	0.6	0.8	0.8
Total Assets	**A$m**	52.3	72.4	160.2	244.0	348.0
Trade and other liabilities	A$m	3.3	3.1	4.4	6.4	8.7
Borrowings	A$m	41.2	50.5	147.2	231.8	330.5
Other liabilities	A$m	0.5	0.9	0.8	1.0	1.0
Total Liabilities	**A$m**	45.0	54.5	152.4	239.3	340.2
Net assets	**A$m**	**7.3**	**17.8**	**7.9**	**4.8**	**7.8**
Net tangible assets	**A$m**	**7.3**	**17.8**	**7.9**	**4.8**	**7.8**
Invested capital	**A$m**	**40.3**	**61.3**	**143.3**	**218.0**	**311.5**
Tangible invested capital	**A$m**	**40.3**	**61.3**	**143.3**	**218.0**	**311.5**
Contributed equity	A$m	21.3	44.5	46.0	46.0	46.0
Treasury shares	A$m	0.0	0.0	0.0	0.0	0.0
Reserves	A$m	0.0	0.1	0.2	0.2	0.2
Retained earnings/accumulated losses	A$m	-14.0	-26.7	-38.3	-41.4	-38.4
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	0.0
Total equity	**A$m**	**7.3**	**17.8**	**7.9**	**4.8**	**7.8**
Basic shares on issue	m	32.6	83.8	92.4	92.4	92.4

CASH FLOW		FY20A	FY21A	FY22E	FY23E	FY24E
Operating						
Net operating cashflow	**A$m**	**-23.3**	**-32.6**	**-93.0**	**-77.6**	**-90.2**
Investment						
Capital expenditure	A$m	0.0	-0.1	-0.1	-0.1	-0.1
Acquisitions and divestments	A$m	0.0	0.0	0.0	0.0	0.0
Net investment cashflow	**A$m**	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Financing						
Debt	A$m	2.3	15.9	1.5	0.0	0.0
Equity	A$m	22.3	15.7	96.3	84.6	98.7
Leases	A$m	-0.1	-0.1	-0.1	-0.1	-0.1
Net financing cashflow	**A$m**	**24.5**	**31.5**	**97.7**	**84.5**	**98.6**
Net cash flow	**A$m**	**1.2**	**-1.1**	**4.6**	**6.9**	**8.3**
Free cash flow to equity	A$m	-1.1	-17.1	3.1	6.9	8.3

Source: PYR reports, MST Access estimates

Valuation

We use a General Residual Income Model (GRIM) as our primary valuation approach for Payright, while also considering peer multiples and growth rates.

Other equity market considerations such as short sales; any likely forthcoming changes in index inclusion; depth of stock research coverage; composition of and change in the mix of investors (such as founders, board and staff, domestic institutions, foreign institutions, and retail investors) are not incorporated in our valuation; however, investors should consider such factors if they seek to develop a price target for the company.

General Residual Income Model (GRIM)

Many financial sector analysts use some form of residual income or value-added valuation approach, due to the complexities and uncertainties involved in forecasting cashflow which can be complicated by prudential regulatory capital requirements. Some of the advantages of this approach are that:

- It is logically consistent with the use of price to book multiples and the dividend discount model.
- the use of net asset value provides greater certainty around a large component of the valuation.
- uses profit, rather than cashflow, forecasts.
- is performed in the currency in which the company's accounts are presented.

We use a two-stage model, using our explicit forecasts over the next five years, followed by a terminal value based upon a 3% growth rate, to which we add current net assets per share.

We assume a cost of equity of 14%, consisting of a 2% risk-free rate, beta of 2 and 6% equity risk premium. This produces a valuation of $0.98 per share.

Figure 1 –MST Access valuation of Payright Limited

Current date		27-Apr-22									
Last balance date		31-Dec-21									
		Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26
Book value per share	A$	0.14	0.08	0.06	0.05	0.07	0.08	0.13	0.19	0.29	0.41
Equity charge	A$		-0.01	-0.01	0.00	0.00	0.00	-0.01	-0.01	-0.01	-0.02
Cash EPS	A$	-0.10	-0.06	-0.02	-0.01	0.01	0.02	0.05	0.05	0.10	0.11
Residual income	A$	**-0.10**	**-0.07**	**-0.03**	**-0.01**	**0.01**	**0.01**	**0.04**	**0.04**	**0.08**	**0.09**
Discounted cash flow	A$	**-0.11**	**-0.07**	**-0.03**	**-0.01**	**0.01**	**0.01**	**0.03**	**0.03**	**0.05**	**0.05**

Sum of discount streams	A$	-0.04	**CAPM**	
Future value into perpetuity	A$	1.53	Risk free rate	2.00%
NPV of terminal value	A$	0.89	Equity beta	2
add net assets	A$	0.14	Equity risk premium	6.00%
Residual income value per share	**A$**	**0.98**	Cost of equity	14.0%
P/B multiple implied by GRIM valuation	x	6.88	Terminal growth	3.0%
Upside/downside	%	460%		

Source: Company reports, MST Access estimates

Book value and net tangible asset value

We also think it is important to note Payright's book value and the substantial earnings contained in that book value as discussed in our FY21 result note, where we provided our receivables earnings pattern assumptions. With the company having not made any acquisitions and expensed its software development, it does not have any goodwill or intangible assets, so its book value is also equal to its net tangible asset value.

Payright is now trading a few cents above its diluted book value per share and diluted NTA per share, and we believe that its book value should provide valuation support for the company. Book values are commonly used as a valuation benchmark for lenders, and the synergies available to any acquirer should mean that any acquisition would be at a premium to Payright's book value.

Updated Investment thesis

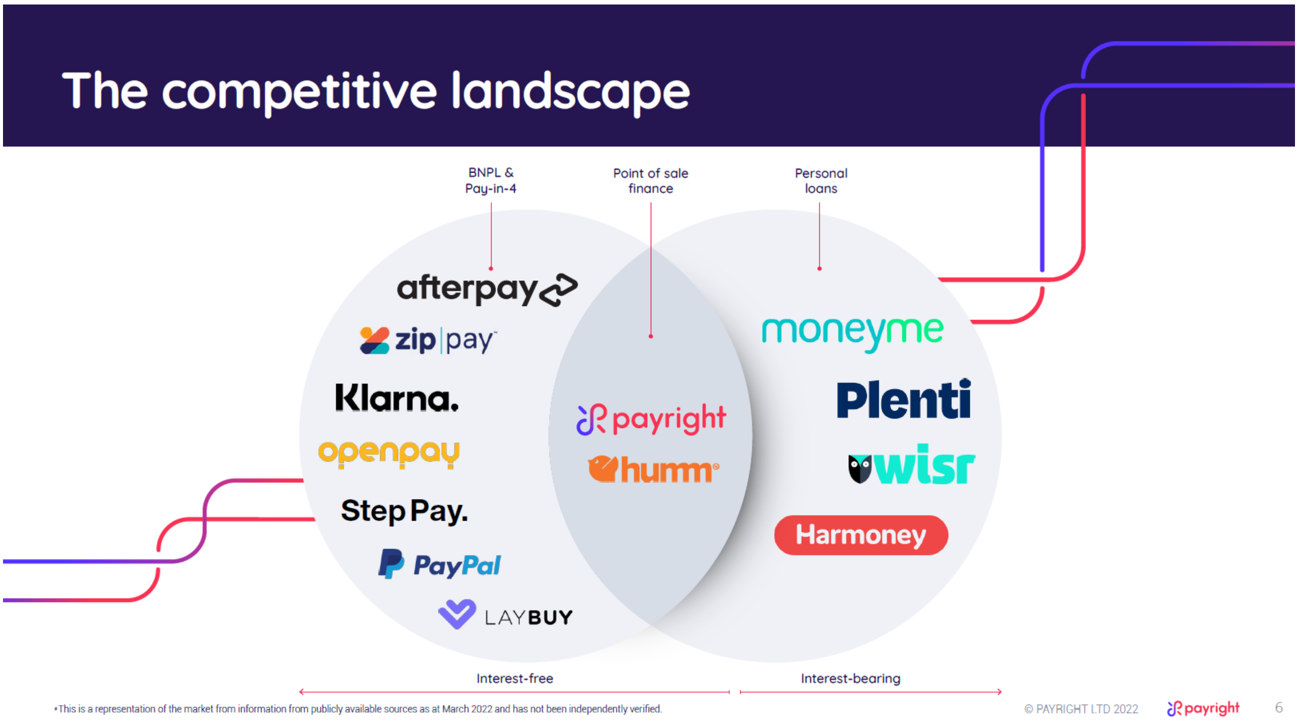
Payright offers investors a high growth, and potentially high return, niche in the point of sale finance Buy-Now-Pay-Later (BNPL) instalment payment industry within the broader consumer finance sector. We expect the company to become profitable in FY24, although it could happen earlier in 2H23 should growth exceed our estimates. The company trades on a very modest valuation just above its net tangible asset value and could rerate once it becomes profitable.

Payright differentiates itself from other BNPL providers, and particularly the Australian market leaders Afterpay and ZipCo, by offering interest free instalment repayment plans for higher value purchases, whereas most other BNPL providers and credit card issuers (if they offer plans or are willing to offer credit limits of this size) and personal loan providers, charge interest in addition to the establishment, and account fees charged by Payright, thus creating an attractive niche for Payright to operate, a niche which is only meaningfully occupied by a couple of other BNPL providers. The attractiveness of this niche for customers should grow as interest rates rise.

Furthermore, Payright's larger sums and longer repayment terms (~24 months) lead to revenue recognition over an extended period, providing greater predictability for its earnings than BNPL providers with short payment terms, which could turn over multiple times a quarter, or might not.

Innovation and regulatory arbitrage have allowed the BNPL sector to service previously underbanked sections of the community, a key feature which was front and centre in Square's recent takeover offer for Afterpay. With lack of access to appropriate financial products an issue worldwide, there is no reason why BNPL providers cannot continue to expand further globally.

Figure 2 –Market positioning of Payright



Source: Company reports, MST Access estimates

Risks and sensitivities

Strategic

Given our belief that the responsible lending reforms (i.e. the NCCP Act) created the environment for BNPL to evolve and flourish, the proposals by the Morrison Government to repeal the responsible lending laws, contrary to the recommendation 1.1 from the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry create a clear risk to the industry. However, some media reports (Consumer groups campaign on non-existent threat (afr.com), 25 February 2021) suggest that the full Act is not currently proposed to be repealed and credit card restrictions will be maintained. Given the proximity to the federal election, such changes may not occur if there is a change in government; however other changes may occur following consultation.

Financial

Being a finance company, Payright has a range of risks and sensitivities applicable to most companies in the financial sector. These include:

- **Macroeconomic conditions** – many of the following risks vary through the economic cycle. Loose monetary conditions, such as those currently being experienced, supress many of these risks which can them emerge suddenly as macroeconomic policy tightens, and conditions deteriorate. Within this category we would place aggregate Gross Merchandise Value, as retail sales are inflated at the moment by closed borders due to COVID-19 in Australia and New Zealand - when travel is again allowed this could again see people opt to travel overseas rather than acquire goods on instalment. Similarly, COVID-19 economic stimulus appears to have had a positive impact on consumers' debt servicing capabilities, but this that deteriorate from 1 April 2021 when these economic stimulus measures are due to end, while merchants using Payright's services may also find their business viability challenged following the end of COVID-19 economic stimulus measures.
- **Liquidity and funding risks** – As a payment or finance provider, Payright is subject to a range of liquidity and funding risks. It can only extend funding to customers if it has the capacity to do so. Most BNPL providers use some form of debt funding as the source of funds for providing instalment plans, but need to retain a solid capital base in case of a credit event. For fast growing companies such as Payright, ensuring that its funding requirements are met during its rapid growth can sometimes be quite distracting for management. Depending on the company's expected path to profitability and remaining cash runway, this can lead to varying levels of market and shareholder support in part attributable to varying expectations around further capital raisings. As expectations of a capital raising rise, or for a number of other reasons, share prices may fall and this could lead to shareholders suffering greater dilution from any required raising.
- **Credit risk** – For organisations providing loans, advances or instalments, credit risk is usually thought of in terms of customer delinquencies or bad and doubtful debts which need to be impaired. However, there is also credit risk on the funding side, where the cost of debt funding could rapidly increase or become unavailable should lenders become uncomfortable with Payright's counterparty risk – something that might happen should there be a large rise in customer delinquencies. This impact led to several finance firms failing during the global financial crisis.
- **Fraud** – Any payments or credit provider can also be defrauded by customers, staff or third parties. An example of fraud in the BNPL sector was covered by the BBC News: Klarna: 'I got a £30 bill - but I didn't buy anything' - BBC News. In this case, fraudsters were able to conduct identity fraud, due to the low documentation requirements in place to make it easy to apply for BNPL services, purchasing items in the name of another unrelated person from a merchant through a BNPL service.
- **Compliance risks** – There are many regulations that companies in the finance sector need to follow, outlined above in strategic risks, including anti-money laundering and counter terrorist financing know your customer requirements, where failure to comply with the regulatory requirements can lead to material financial penalties or litigation.

Operational

Most companies, including Payright, have a range of operational risks. These include:

- **Governance** – Increasingly an investment focus as part of ESG, governance risks include all matters of agency costs within the business, including delegated responsibilities and authorisations, internal controls and how conflicts of interest are addressed. For Payright, with several relatives of the founders working in the business, these multifaceted relationships may present some complex governance risks.

- **Key personnel** – Payright's ability to scale its business assumes availability of suitably qualified staff and a reliance on key personnel.
- **Information technology** - Payright's key technology infrastructure is a Customer relationship management platform, which is licensed to Payright by SugarCRM Inc. (the Sugar Platform). This platform delivers Payright's application functionality through configurations, customisations and third-party integrations. Currently SugarCRM is owned by Private Equity, so its long-term future is perhaps a little uncertain, as it might be acquired by a competitor, list as a stand along business, or be wound up. The SugarCRM system has been customised, so there is a risk is that any replacement CRM system would also need customised, taking time and money (although this would likely be treated as capitalised software).
- **Cybersecurity and data protection** – Like any other business providing ongoing services to customers, Payright collects a substantial amount of customer data that is classified as personal information and thus obtains certain confidentiality protections under the Privacy Act. Human or system errors exposing this data could breach these confidentiality requirements, and could expose Payright to penalties. Similarly, Payright is a digital business reliant on its IT systems. A cyberattack could disable these systems, inconveniencing merchants or customers, or result in the loss of customer data – and creating substantial damage to the firm's reputation.
- **Force majeure events** – Events such as system failures, disruptions to utilities, natural perils (both environmental and human health) and warlike hostilities which prevent Payright from operating have a severe impact on its overall business, which grows exponentially the longer the system failure lasts for. For an example of how severe system failures can impact a business similar to Payright, investors could study Tyro issues in early 2021, which led to a drop in transaction volumes and an attack on the company by a short seller. As Tyro has experienced, a prolonged outage can lead to damaged relationships leading to a loss of merchant contracts.
- **Litigation, claims and disputes** - Like any business, Payright could be subject to disputes and claims, which may end up being litigated, as well as litigation brought by regulators or class action funders. Such disputes tend to be expensive to resolve, can also result in substantial brand damage, and usually follow the realisation of another risk event. Catalysts can be contractual disputes, intellectual property infringement claims, employment disputes or indemnity claims. Payright is a member of the AFCA, which goes some way towards minimising some of the costs of some of these risks.

Company Description

Payright is an Australian payment plan provider developed for merchants to accelerate return-on-effort and for making things more affordable to consumers, by spreading the cost of purchases over time. Payright provides merchants a buy-now, pay later flexible payment option to offer their customers, intended for bigger ticket items that are more considered purchases rather than smaller impulse-driven buys

Payright specialises in providing merchants in Australia and New Zealand with both in-store and online buy now pay later (BNPL) solutions for the benefit of their customers, with a focus towards higher-value and more considered purchase items typically between $1000 and $20,000, as opposed to lower value and more impulse-driven transactions generally associated with other parts of the BNPL sector. This niche within the BNPL sector has significantly less competition with the Reserve Bank of Australia only identifying 5 providers which offer credit limits of $30,000 or more, with OpenPay and Humm's 'Big Things' the two main competitors to Payright.

The BNPL industry in Australia and New Zealand has experienced strong growth since its emergence over the past decade, and BNPL services are quickly becoming a mass market solution. In recent years, the profile of BNPL services in Australia has increased significantly, with 12.3 million Australians (59% of the population) aware of a BNPL payment option in March 2020, compared to 36.9% in September 2018.

Payright's zero interest payment plan (averaging ~24 months) provides customers with the ability to access a diverse range of goods and services across retail, home improvement, health and beauty, photography, education, and automotive sectors whilst also helping them budget and manage their spending.

Disclaimers and Disclosures

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