

Trading on up

3rd November, 2015

TechFinancials consists of two complementary businesses: (a) development and supply of proprietary software solutions (TechFinancials) for online brokers providing services for retail traders in binary options and other instruments, and (b) operation of its own online trading platforms (currently OptionFair and one JV). Its trading software is already licensed to 65 retail binary options trader brands, which leaves it well placed to attract new clients and expand into new markets. The group reported 108.6% y-o-y growth in active customer numbers in FY14 and another 35% so far this year.

Investment case

TechFinancials is a leader in its field with an established market share and growing client base. Its innovative, scalable product is used by major providers of binary options brokers for retail traders and a growing product base is supported by investment in R&D. This underpins plans to expand the global customer base, build stable, visible and profitable license-based revenues, grow shares in existing markets and enter regulated and emerging markets such as the US, China and Japan where it sees highest growth potential.

Strategy/ management changes and joint venture

Recent share price weakness reflects an alert in August pertaining to slower than anticipated growth in customer conversion rates at OptionFair, affecting Q2 and Q3. This was due to a decision to reduce marketing expenditure and the impact of new CySEC regulations in Cyprus. Our assumptions are as a consequence conservative, but management believes that it has addressed the key weaknesses. The outlook has since been enhanced by a joint-venture (group 51% share) with a Hong Kong based binary options trader, Optionfortune, focused on the fast-growing Asia Pacific region.

Valuation: attractive recovery play at 4.4x FY16 EV/EBITDA

Our forecasts incorporate the JV, software division performance on track and reduced contribution from OptionFair. That puts the shares on a prospective EV/EBITDA multiple of 4.4x for FY16 (net of estimated c US\$7.7m cash), supported by a FY16 dividend (33-50% of net cash generated) equivalent to a 3.1% prospective yield. On a sum of the parts, based upon a stabilised B2C business including the new JV, we argue that either division individually justifies the current group market value, which we see as a case for an initial move above 20p/share on the back of newsflow.

Summary financials, US\$m

Year to 31 Dec	2013	2014	2015e	2016e
Revenue	8.4	15.5	13.8	20.3
Adjusted pre-tax profit*	(0.4)	1.9	(0.4)	1.0
EPS – diluted (US\$ c)	(0.9)	1.1	(0.5)	1.1
Net cash (US\$m)	1.0	1.7	3.6	4.7
Dividend (GBP p)	0.00	0.16	0.00	0.35
Dividend yield	-	0.6%	0.0	3.1%

Source: Group historic data, FY15e and FY16e analyst estimates *Excl. exceptional loss on group reorganisation

Company Data

EPIC	TECH
Price	11.2p
52 week Hi/Lo	48p / 10p
Market cap	£9.1m

Share Price, p



Source: ADVFN

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Introduction

TechFinancials provides online brokers with a suite of simplified software solutions that enable them to deliver trading platforms for online traders worldwide. Its core product is a binary options trading platform, which it supports with back-office modules and other applications such as risk management and CRM.

The group was founded in 2009 by four of the current directors. They sought to capitalise upon their combined technology, FOREX and online marketing backgrounds to create an innovative product that would enable online brokers to provide a platform for retail customers to trade in binary options.

During its first two years the group developed its technology and built its own regulated (since 2013) retail binary option broker, OptionFair. It launched a beta version of its platform in 2010 at two online brokers, OptionFair (April 2010) and 24option.com, the world's largest binary option broker (October 2010) and the live version of that platform for the broader market in January 2011.

TechFinancials released its second trading platform, simplified FOREX, in Beta in H214 and is rolling out the full version to its clients this year. Other products under development, also due for launch next year include (a) a pricing engine for fixed strike binary options for US regulated exchanges; (b) a solution which addresses the Japanese regulated market; and (c) a simplified CFD trading platform.

Backed by technology specific intellectual property

The group's intellectual property is derived from software and systems protected by copyright and confidentiality. Management identifies a number of factors which it believes distinguish its product for prospective clients. The principal advantages are:

Advantages	
Proprietary pricing engine	Group software automatically calculates short-term volatility and prices of short-term options. Achieving the former for hundreds of different underlying assets requires deep comprehension of both market behaviour and theoretical mathematical models. Generating pricing for a wide variety of short-term Exotic Options pivots upon close co-operation between software engineers, theoretical mathematicians and experienced derivative traders in-house, to combine complex mathematical theory and practical market behaviour
Simplified interfaces	A simplified trading environment and user experience combines a wide range of financial instruments into a single user interface
Scalable technology	A execution engine which enables online brokers to support large trading volumes instantaneously and is relied upon by the largest brokers in the Binary Options market

TechFinancials intends to maintain its competitive advantage via investment in product R&D. Its IP is underpinned by an ability to offer binary option trading platforms that can be operated in the EU's regulated environment, which it intends to adapt for US and Japan.

It plans to introduce new trading platforms to supplement the two it currently offers, Binary Options and FOREX. Its next addition is CFDs, due next year, which will enable its online broker clients' retail customers to trade a variety of instruments.

TechFinancials expects an enlarged range of offered instruments to allow its clients to market its platform more widely and potentially, also increase customer lifetime value. That would increase revenues and should also enhance its competitive advantages.

Interims, trading update and Asia Pacific joint venture

Aggregate group sales in the first six months of 2015 were ahead of the H114 comparable; US\$7.3m revenues (H114: US\$7.2m), 2.6% ahead. The segmental split however reveals a 20% fall in OptionFair's contribution (discussed below), while software sales made up the shortfall. Divisional pre-tax profit was lower y-o-y for both divisions.

With respect to OptionFair, the group reported in August that customer conversion rates at were slower than anticipated, as a result of which the full year outcome would be behind expectations. This also adversely affected its Q2 performance, reflected in the half-year numbers. Software division margins were negatively affected by higher expenses, particularly R&D costs expensed rather than capitalised as in the prior period.

Interim results, US\$'000			
	H114	H115	
Revenue			
Trading platform - B2C	4,123	3,310	-20%
Licensed income (software) - B2B	3,033	4,033	+33%
	7,156	7,343	+3%
Pre-tax profit (excl. reorganisation costs)			
Trading platform - B2C	(437)	(185)	
Licensed income (software) - B2B	703	200	-72%
	266	15	-94%

Source: Group accounts

This inevitably had an adverse effect on profitability (and shares) but changes to divisional management and action taken at operations should improve conversion rates. These were too late for OptionFair to meet prior revenue/profit targets but management sees operations on track to achieve higher customer conversion and improved profitability in FY16.

New joint venture to capture share of Asia Pacific market

Trading division revenues and profits have also been underpinned by a recent joint venture agreement (51% TechFinancials) with the owners of Hong Kong registered Optionfortune Trade Limited. The JV deal structure is subject to approval at a GM to be held on 19 November 2015.

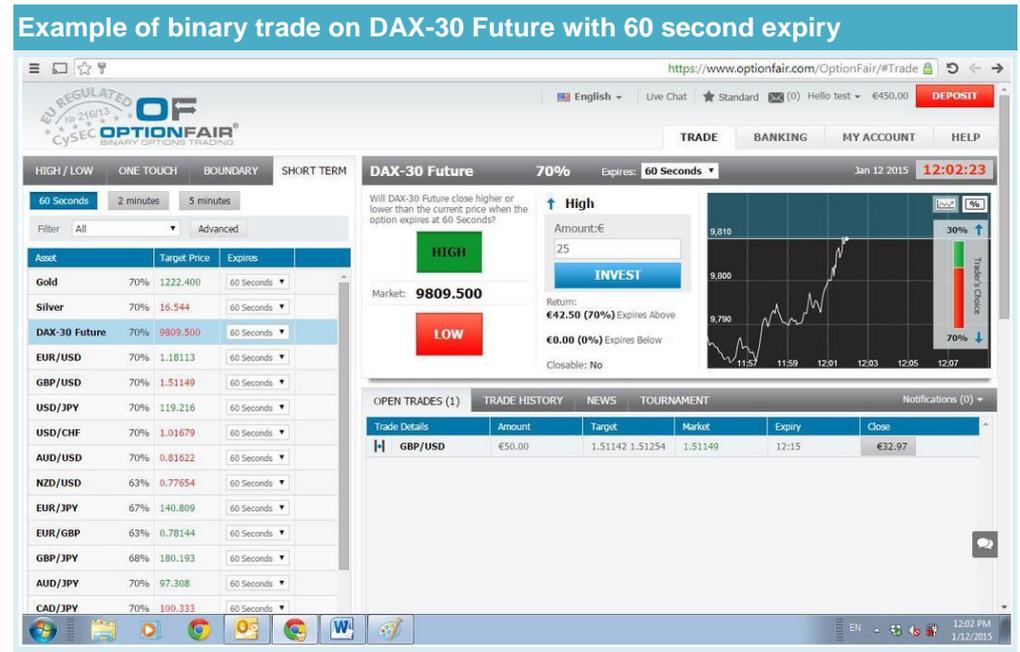
The new JV will run a B2C binary options trading platform focused on the Asia Pacific region. It is the culmination of a successful two year trading partnership; Optionfortune established a new binary options brand in 2013 using TechFinancials' software and has seen significant growth in its market. Average monthly trading volume during the period between January and September 2015 was US\$8.56m, and average monthly revenues US\$0.35m.

This agreement is the first significant component of a strategic expansion into the Asia Pacific region since IPO and provides access to markets with high growth potential. The JV will seek to expand its business activities in the region, where it has already established a strong trading record, as the market for binary options in the region continues to grow.

Binary Options

The group’s trading solution is designed for the worldwide binary options market, estimated to be worth c US\$1bn pa in customer deposits in 2014, implied growth of c 50% pa.

A binary option is sometimes referred to as an “all-or-nothing option” as the return is either a predetermined fixed amount or nil, depending upon whether a certain condition has been fulfilled at its expiry date. They are also known as digital options (in forex/interest rate markets), and fixed return options (FROs) on the American Stock Exchange.



Example of binary trade on DAX-30 Future with 60 second expiry

The screenshot shows the OptionFair trading interface. On the left, there is a list of assets with columns for Asset, Target Price, and Expiry. The 'DAX-30 Future' is selected, showing a 70% probability and a target price of 9809.500. The main panel displays a candlestick chart for the DAX-30 Future, with a 'High' button and an 'INVEST' button. The market price is 9809.500. The return for a 'High' trade is €42.50 (70%) Expires Above, and for a 'Low' trade is €0.00 (0%) Expires Below. The expiry date is Jan 12 2015 at 12:02:23.

Source: OptionFair trading platform

Binary options are different from traditional or “Vanilla” options, which can have a range of outcomes. As the latter is referenced to say, the price of a particular share, its value will be the difference between the share price at expiry and the option exercise price.



Example of binary trade EUR/USD exchange rate with expiry at 14:00

The screenshot shows the OptionFair trading interface for a EUR/USD trade. The main panel displays a candlestick chart for the EUR/USD exchange rate, with a 'High' button and an 'INVEST' button. The market price is 1.17006. The return for a 'High' trade is €0.00 (81%) in the money, and for a 'Low' trade is €0.00 (0%) Out of the money. The expiry date is Jan 15 2015 at 13:51:53.

Below the chart, there is a section titled "Traders with the Longest Run of Successful Trades" with the following data:

Name	Country	Total	Prize
1. M. B.	South Africa	9	AAA++
2. M. S.	Russian Federation	9	AAA+
3. a. c.	Hungary	7	AAA
4. C. L.	Switzerland	7	AA
5. P. L.	Greece	7	A
6. c. c.	Germany	7	\$750

From: 12 JAN, 2015 (00:00:00) To: 17 JAN, 2015 (00:00:00)

Source: OptionFair trading platform

With respect to a binary option a trader makes a CALL or PUT which, if successful at contract expiration i.e. the anticipated direction of the underlying financial instrument or asset price has been called correctly the contract expires 'in the money' and if not, 'out of the money'.

In the example above the trader can secure an option which reflects their view of the direction in which the DAX-30 Future will move in a very short period. The second example below illustrates a possible trade on the EUR/USD exchange rate.

If the expiry level is equal to the strike price the contract expires 'at the money' and the trade will be returned without any gain. Normally a fixed cash settlement will be returned (a percentage of the initial investment) depending on the terms of the option contract.

Product suite includes trading on mobile devices

The group intends to provide a range of products which enables its clients to provide comprehensive, convenient trading platforms for retail customers, including access via mobile devices - tablets and smartphones - post its latest update launched earlier this year. Currently being trialled in beta by OptionFair, it is due for full roll out in the second half.

Platforms



Source: OptionFair trading platform

Investment case: strong product, growth sector

TechFinancials listed on AIM in March 2015, and raised £2.2m (net). It is a leader in its field, a major supplier of trading software solutions to the fast growing binary options market with an expanding product portfolio which is already used by industry leaders. It has an established market share and growing client base, to which it offers innovative, proven products trusted by leading providers of binary options platforms for retail traders.

Growth sector – Further opportunities ahead to grow via acquisition Management aims to take advantage of both projected market growth and the expected impact of increased regulation of binary options trading across all important jurisdictions to build stable, visible and increasingly profitable license-based revenues. It anticipates that there will be opportunities for acquisitions in the Binary Option market over the next few years, both in the software (B2B) and online broker operation (B2C) fields. This may be driven by increased regulation, which it believes will prompt market consolidation. According to data published by industry analyst Forex Magnates the binary options market has seen substantial growth in client deposits since it took off in 2009; monthly deposits have roughly doubled every year since 2010. Forex Magnates sees further 2015 and 2016 market growth and potential for the sector to grow considerably over the next few years.

Innovative, differentiated product Competitive advantages are derived from bespoke, copyright protected technology and an expanding product base underpinned by significant planned investment in R&D over the next few years. There is also potential for the group to capitalise upon bespoke technology specifically designed for compliance with regulated environments, such as the EU.

Increasing revenue visibility The quality of group revenues should improve progressively over the next few years as client businesses mature and gain critical mass, and it begins to access new growth markets such as the US, Japan and China. The group's cash generative characteristics should help finance expansion, significant further R&D and marketing.

High margin Product implementation is a relatively high margin activity. We estimate that incremental revenues generate a c 90% gross margin as all group costs are covered by upfront fees, with an immediate contribution to revenues from license fees calculated as a percentage of client trading revenues, subject to a minimum monthly fee. Group returns will ultimately pivot upon that customer's success, which it intends to support by expanding the range instruments available via the TechFinancials trading platform to include FOREX and CFDs, and innovations such as access via mobile devices.

Potential acquisitions The group may seek to secure acquisitions to accelerate growth of the client portfolio growth and benefit from increased royalty income, as an enlarged client-base accesses its enhanced product range. The group should be well placed to pick up market share and potentially lead consolidation of its market niche. The group will also look to acquire businesses and/or assets that can provide it with access to new markets, enhance its product offering and/or enlarge its customer base and believes its growing network of brokers will help it to identify target acquisitions. Increased regulation may present its competition with potentially expensive challenges to adapt to stricter rules and leave them in a weak position relative to platforms such as TechFinancials' which have been designed with compliance in mind.

Valuation: recovery play

Considerable support on a sum of the parts basis

The current share price implies a £5.2m group enterprise value, falling to £4.6m by end next year. These are based on our US\$3.6m (end FY15e) and US\$4.6m (end FY16e) net cash projections and a 1.55 USD/GBP rate. We see that valuation as modest, supportable by either division alone.

Below we set out our view of potential divisional revenues and EBITDA for this year and FY16, which includes a deliberately conservative contribution to B2C from the new 51% owned JV and prospective divisional growth. The figures are consolidated and eliminate intercompany sales which are effectively B2B income and a B2C expense i.e. licence fees attributable to OptionFair and potentially, in due course other group brands for use of the TechFinancials software. All R&D expense is allocated to the software division.

Forecasts US\$m – Consolidated			
Revenues	FY14	FY15e	FY16e
Software Licensing	7.5	9.3	12.1
Trading platform	8.9	5.0	9.1
Intercompany sales	(0.9)	(0.5)	(0.9)
Total group	15.5	13.8	20.3
EBITDA			
Software Licensing (B2B)	2.8	1.3	1.3
Trading platform (B2C)	(0.8)	(0.8)	0.3
Group EBITDA	2.1	0.6	1.6

Source: Group accounts / FY15e and FY16e analyst estimates

We expect forecast group profits to be derived exclusively from software (B2B) sales this year, with the net result from the trading (B2C) platform performance affected by relatively high costs of client acquisition in the early stages of building its customer base.

There is however potential for trading platform (B2C) revenues and margins to stabilise during H216 as it achieves greater scale. Critical mass should help improve performance measures such as customer life-time value (LTV) and average cost per customer acquisition (CPA) and in turn profitability, as the division achieves a better balance between direct sales/marketing led growth and introductions from affiliates. We thus expect B2C revenues to grow sufficiently to generate positive EBITDA next year as its brands mature and to see a proportional fall in sales & market costs. Direct marketing should evolve as the brand strengthens, reducing reliance on more expensive affiliate introductions.

The software (B2B) division should contribute US\$1.3m to consolidated group EBITDA this year, a 47% y-o-y decline due to relatively high projected R&D to support an increasing customer base up to end FY16. The benefit will be seen during the forecast period, but a number of new products and initiatives are expected to fully kick-in from FY17.

We thus expect the group to achieve overall positive EBITDA this year and next despite continued promotional spend. That puts it on modest prospective EV/EBITDA multiples of 13.7x this year, falling to 4.4x for FY16e.

Taking this a step further, the table below illustrates the real potential for each division to contribute independently to operating profit from FY16 (year 3) onwards and hopefully adds some clarity to potential improvement in underlying group margins.

Taking FY14 as year one, we incorporate forecast FY15 and FY16 growth and conservative assumptions for the next two years. We project top line USD revenue growth as the group approaches critical mass i.e. a decline in annual percentage growth, similar US\$ R&D investment, declining marketing cost as a proportion of group revenues from Year 4 and a broadly similar administrative expenses ratio, despite higher turnover.

Margins	Actual		Forecast		
	1	2	3	4	5
Year	1	2	3	4	5
Revenue	100%	100%	100%	100%	100%
<i>Revenue growth y-o-y</i>		-10%	+46%	+31%	+24%
Cost of sales	(35%)	(29%)	(27%)	(30%)	(30%)
Gross margin	65%	70%	73%	70%	70%
Research & development	(9%)	(17%)	(18%)	(14%)	(11%)
Sales & marketing	(28%)	(31%)	(32%)	(27%)	(24%)
General & administrative	(15%)	(23%)	(18%)	(17%)	(17%)
Operating margin	13%	(1%)	5%	11%	18%

Source: analyst estimates

As we illustrate above, B2C divisional revenues above US\$9m in FY16e at steady group gross margins should translate into better than EBITDA breakeven. We see potential for B2C revenues to have stabilised by FY17, with greater visibility derived from longer-established client trading relationships.

In addition the JV may perform better than expected as it capitalises upon its two-year trading record and focus on far eastern markets, which the group has identified as a source of potential faster growth.

Dividends to resume in FY16: 3.1% prospective yield

Our above model sees potential improvement in EBITDA/pre-tax margins matched by cash accumulation, which we expect to be used to fund acquisitions and dividends. The group plans to implement a progressive dividend policy and we expect it to resume distributions in FY16 with a dividend target of 33-50% of net cash generated in the period.

Our forecast cash earnings suggest a potential 0.35p/share distribution in FY16 (at the low end of the dividend policy), a 3.1% forward yield.

Business description: complementary divisions

TechFinancials group consists of two independent, complementary businesses. These are development of trading software solutions, and operation of trading platforms (OptionFair currently). The latter provides it with a strong understanding of the market in which its software clients operate, a means to test and trial new product launches prior to full roll out, and direct access for retail customers to trade an expanding range of financial instruments.

B2B – trading solutions for online brokers

This division provides innovative, simplified trading solutions for online brokers targeting retail customers. It has developed a multi-asset platform which can combine a range of different trading instruments in one wallet, aimed at the retail market. It plans to progressively expand its product offering in order to allow retail customers to trade additional instruments via its simple, unified user interface. This strategy reflects management's expectation that a substantial and increasing proportion of trading in financial instruments will be undertaken on multi-asset platforms.

TechFinancials' products target online brokers and exchanges in a number of different jurisdictions, as well as marketers or media businesses looking to diversify into online broking. The key target markets include:

- Regulated/unregulated (in non-regulated jurisdictions) retail financial brokers globally
- Regulated online brokers targeting the Japanese market (when product is ready)
- US regulated binary exchanges (in the future when the full product is ready)

The core software provides a complete operating solution for online brokers and an easy to use trading platform for end users. It is designed to help online brokers benefit from higher (a) customer lead conversion rates than normal for Binary Options traders and (b) lifetime customer value due to a broad range of products that will keep them on the platform.

Software supplier, tech support

This division is solely a software supplier i.e. does not process payments or execute trades on behalf of its online broker customers. It provides full technical support for all of its own products and can additionally integrate other software (either developed in-house or sourced from third parties) including back-office and accounting, CRM, business intelligence and reporting systems and assist clients to integrate these with existing marketing and affiliate management systems. The group offers licensees an integrated set of modules.

The product suite is designed as a complete turnkey solution which allows an online broker to both price options and benefit from an integrated back-office solution. The group currently offers simplified Binary Options and FOREX trading platforms; Binary Options is the core product, FOREX a more recent addition (see below).

The platform automatically processes trades and synchronises them in real time with the relevant back-office modules e.g. customer accounts database and trade monitoring software. This enables licensees to limit their own financial risk without a requirement for detailed technical knowledge of Binary Options or FOREX. The end-user interface interacts with TechFinancials' proprietary pricing engine and its back-office modules. It allows online brokers and their customers to continually monitor open positions and trading activity.

FOREX launched during FY14, new product launches in pipeline

In H2 2014, TechFinancials launched a beta version of its second trading platform, simplified FOREX, with the final product going live earlier this year (adoption is at clients' discretion). Other projected launches include full versions of other products:

- A pricing engine for fixed strike Binary Options, suitable for market makers that wish to connect to a regulated US Exchange which offers Binary Options to the retail market. The pricing engine was launched in H1 and is at relatively low volumes currently due to limited numbers of traders. The group is developing a regulated solution – which it expects to complete in H2 2016 – which it expects to draw higher traffic to the exchanges.
- A fixed strike Binary Options trading platform with supporting IT systems for retail brokers (in H2 16). This has been designed to address the Japanese regulated market.
- A simplified CFD trading platform (during H1 2016) to enable customers to trade CFDs on stocks and indices in a broadly similar way to how they currently trade FOREX.

B2C – online trading platforms for retail traders

OptionFair is the group's first online broker. It was one of the earliest established Binary Options trading platforms (in operation since 2010) and has been regulated by CySEC from September 2013. It is now among the leading EU regulated online Binary Options brokerages and serves a principally European retail customer base. It offers Binary Options referenced to a wide range of financial instruments and assets. This division is a group profit centre and a means to trial and evaluate products under development. Trading platform revenues are derived from dealing spreads on the various trading instruments offered.

The division only operated one platform, OptionFair, in FY14, which generated revenues of US\$8.9m, 112% year-on-year growth, although it experienced slower than expected customer conversion rates in H215 for the reasons discussed. The potential is reflected in its performance in FY14 vs a range of specific KPIs identified by management i.e. it more than doubled (a) total value of its customer deposits; (b) numbers of new customers on its platform (c) trading volumes and gross trading P&L. This was achieved by concentration on multiple European markets, with a particular focus on Eastern Europe.

The principal underlying revenue driver is anticipated growth in online trading by retail customers globally in the instruments covered by TechFinancials' expanding product base. Group trading platforms can capitalise upon that market growth by expanding into new markets subject to the roll out of enabling legislation. The divisional strategy is to enter new regulated and emerging markets where management has identified significant growth potential, such as the US, China and Japan, and it announced an Asia Pacific focused JV in October.

OptionFair and future group owned trading platform brands will use technology developed by TechFinancials, which conducts full trials of its software in beta mode before it introduces upgrades to existing customers and/or sells updated products to new customers. Earlier this year it launched a simplified FOREX trading platform for OptionFair clients, followed progressively to other group clients. The group measures the performance of its trading platforms against market-wide criteria to confirm that they achieve comparable revenues and margins. This underpins potential for this division to become an entirely independent entity at some future date.

Growth strategy

The group has a significant position in the binary options market, and currently licenses TechFinancials' software to 65 brands operated by online brokers, including OptionFair. According to group estimates, c 18% of all global deposits made to trade binary options are processed using group software.

Penetrate new markets with high growth potential

The business is generating revenues in several countries worldwide, with a strategy to expand its customer base and revenues by increased penetration of new and existing markets, including JVs and risk-controlled M&A, and focus on investment which enables it to adapt to more highly regulated markets. It regards increased regulation as a barrier to entry for new competitors or those providing only simple products for unregulated markets.

Management intends to grow its client base and expand into new markets, the latter subject to - possibly facilitated by - the roll out of enabling legislation. It believes its market-leading proprietary pricing engine provides it with competitive advantages as it provides its online broker customers with the most effective way to price short-term options.

Focus on regulated markets such as US and Japan

Management sees regulated markets such as the US and Japan as the territories with highest growth potential, plus China. Potential increased regulation may challenge some industry competitors but TechFinancials expects to increase its market penetration, the benefit of its focus on reinforcing its status as an approved operator in regulated markets. Marketing and product development activity will be focused in three main territories:

Market	Current plans
US	The group plans to launch a US solution next year to allow its licensees (incl. its own trading platform) to operate in a fully regulated environment via Cantor Exchange. The US represents a new market for the group and its licensees.
Japan	<p>A software solution currently under development will enable TechFinancials to offer its suite of products to regulated online brokers targeting the Japanese market. FFAJ, the Japanese regulator, has introduced new regulation to the Binary Option market.</p> <p>The group is also considering establishing a trading platform as a regulated online broker in Japan. This would use TechFinancials software and seek to capitalise upon its existing B2B sales and support presence in Japan.</p>
China	The group secured its first online broker customer in China in 2014, currently serviced from its offices in Israel. It intends to open a local office in Hong Kong this year to sell and support its software locally.

The group expects that, over the next five years, financial market regulators in other jurisdictions will follow the lead set by Japan and the EU and introduce regulation into the Binary Option market. Its plan is to seek to protect and indeed, enhance its long-term strategic advantage, by creating solutions which fully comply with existing regulation in jurisdictions where it plans to do business.

Financials - Interim results

H1 2015 profit reflected the impact of lower customer conversion rates at OptionFair, primarily in Q2, due to previous (end Q1) decisions taken by senior management to reduce marketing expenditure and the impact of compliance with new CySEC regulations in Cyprus. Operating profit was US\$0.1m (H1 2014: US\$0.74m) and pre-tax profit US\$15,000 (H1 2014: US\$0.27m). EBITDA fell 31% to US\$0.55m, also affected by an increase in necessary R&D expense.

In order to address the above issues the division has made changes to its management team and improvements to its operations to ensure compliance. This is not expected to have a sufficiently strong short-term impact on customer conversion rates to enable OptionFair to achieve its previously anticipated levels of business. However management does anticipate that these measures will help progressively restore customer conversion rates and with the new JV will restore divisional profitability, reflected in stronger B2C performance during 2016 (reflected in our forecasts).

Consolidated forecasts US\$m			
Revenues	FY14	FY15e	FY16e
Software Licensing	7.5	9.3	12.1
Trading platform	8.9	5.0	9.1
Intercompany sales	(0.9)	(0.5)	(0.9)
Total group	15.5	13.8	20.3
Gross profit			
Software	6.2	6.5	7.9
Trading platform	3.9	3.2	6.9
Total group	10.1	9.7	14.8
Expenses			
Sales & marketing expense			
Software	(0.8)	(1.2)	(1.7)
Trading platform	(3.6)	(3.2)	(4.7)
General & administrative expense			
Software	(1.2)	(2.1)	(2.2)
Trading platform	(1.1)	(1.2)	(1.5)
Research & development			
Software	(1.3)	(2.4)	(3.6)
Total group expenses	(8.0)	(9.9)	(13.8)
EBITA			
Software Licensing (B2B)	2.8	1.3	1.3
Trading platform (B2C)	(0.8)	(0.8)	0.3
Group EBITDA	2.1	0.6	1.6

Source: Group accounts / FY15e and FY16e analyst estimates

The first half also saw higher R&D expenses expensed (previously capitalised) through the P&L and a US\$0.39m increase in non-cash expenses. H1 2015 revenue was however steady at US\$7.34m (H1 2014: US\$7.16m) and the group's core software licencing revenue grew 33% to US\$4.0m (H1 2014: US\$3.0m). Gross Profit was 16% up y-o-y at US\$5.18m, at a 71% gross Margin, (H1 2014: 62%).

The profile of TechFinancials' licenced software product continues to grow. H1 15 saw the launch of Simplified FOREX, the final version of the second trading platform and growth in the number of active brands using group trading software from 48 to 65.

Group net cash was US\$4.6m at end June 2015 (H1 2014: US\$2.0m), the benefit of the March 2015 AIM listing. This will help financed plans to continue to invest in software development in order to create regulatory compliant products suitable for the US and Japanese markets and further develop its solutions in the EU market. Additional marketing activities will also help increase global brand awareness and enable it to evaluate potential JVs and acquisitions. Although Europe remains the focus of activities management continually reviews opportunities to build both its brand and revenues in new domestic and overseas markets where it sees high growth potential.

Group expenses and their impact on margins are carefully managed and monitored. As is typical for an online business marketing costs are closely linked to sales and run at c 28% of total revenues. Administrative costs and R&D expenditure are less directly linked. In the group's case these reflect the relatively early stage software development and the brand rollout. First half administrative costs were 32% up y-o-y at US\$1.7m.

The group increased R&D costs in FY14 and spent US\$1.3m on software development (US\$0.9m in 2013) and US\$1.2m in H115. This included the Forex trading solution, mobile and tablet applications and software which integrates with the US Exchange to provide liquidity for binary traders. The Forex trading solution, and mobile and tablet applications were completed in FY14 and will be amortised from the current year. Current investment in R&D is focused upon completion of the US regulated solution for Introducing Brokers (IBs), CFD project and IBs regulated solution in Japan, all of which should complete in 2016.

New JV: Asia Pacific focused partnership

In October the group announced that it had entered into a joint-venture (51% held by TechFinancials) with Hong Kong registered binary options trading provider Optionfortune Trade Ltd. The new entity will run a B2C binary options trading platform focused on the Asia Pacific region. Optionfortune will transfer its assets to the JV, including its trading platform.

The JV is the group's first material transaction since its AIM listing and reflects its intention to expand its business into the Asia Pacific region, a market identified as a source of significant high growth potential. The new entity emerged from a successful two year partnership; Optionfortune established a binary options brand in 2013 using the group's software. It has achieved monthly trading volumes this year (January to September) of US\$8.56m and average monthly revenues of US\$0.35m.

On the basis that the JV generates a US\$2.0m net profit in calendar 2016, Optionfortune will be entitled to shares held in escrow valued at US\$1.54m at the date of the agreement. If net profit is below US\$2.0m the payment will be adjusted pro rata; if it is under US\$0.6m the group can elect to transfer 38.5% of the JV to its partner, rather than its own equity.

If the JV's net profit and revenue exceed US\$2.0m and US\$4.0m respectively, a further payment (equity or cash at the group's option) equivalent to 171.5% of net profit above US\$2.0m. TechFinancials has also agreed to provide US\$0.5m of debt, the partner US\$0.3m to the JV. This is repayment on a quarterly basis, subject to available cash surpluses at each period end being above the US\$0.8m loan principle.

Revenue model & assumptions for forecasts

Software sales: high margin operation

We assume that the software division will generate the bulk of its revenues from a relatively small number of clients. Software is a high margin operation and additional royalties are generated without significant additional expense from a predominantly fixed cost base.

If this division experiences materially higher volumes the group may recruit additional account managers and add servers, but this should still have a relatively modest impact on our margin assumptions.

Expenses related to ongoing investment in new product development/R&D may have a disproportionate (but not excessive) impact on profitability over the next few years, but then diminish as new products are introduced and begin generating revenues.

Software & services to online brokers

Set-up and maintenance	A one-time fee charged for setting up a new broker. This will vary upon on the scale of work required
Ad-hoc development services	Payment for ad-hoc services carried out for licensees. This may include development of a new user interface or creation of a customised landing page. Such development services are charged separately from licence, set-up or maintenance fees.
Software licensing	Licensees which use TechFinancials' software generally pay a percentage of their monthly trading revenues as a licence fee, subject to a minimum monthly charge. The percentage varies by customer and depends upon the size of the trading P&L or trading volumes and breadth of solutions licensed. TechFinancials monitors each licensee's trading activity to calculate the monthly licence fee payable. These fees should grow in line with the market scale and contribute an increasing proportion of group income.

Trading platform: growing returns from online trading platform

This division's returns pivot upon the success of its sales and marketing strategies to drive effective and low cost traffic to the platform and in turn, convert that traffic into deposits on the platform. We have assumed conservative growth in first time deposits and client retention rates for OptionFair and the new Joint Venture. Margins may vary depending on their geography and whether new business is attracted directly or introduced via affiliates.

The key component of profitability is to ensure that the lifetime value of any customer vs their acquisition cost is sufficient to cover overheads. We assume an average customer lifetime value of c \$1,200 and average cost of customer acquisition of c \$300. The growth strategy focuses on maximising traffic flow with higher lifetime value at lowest overheads, which puts an emphasis on efficient customer acquisition strategies. From the current year the strategic focus is creation of new ventures and more profitable revenue growth.

Four years of available trading data suggests that c 30% of new binary brokerage clients will fall away but still contribute to revenue and profit via a US\$10-20,000 initial fee for the software installation and a royalty fee, calculated as a percentage of trading revenue, subject to a minimum US\$3,000 per month.

Trading platforms

Dealing spreads	The majority of revenue is generated from dealing spreads on the range of trading instruments offered on platforms such as www.OptionFair.com. That spread reflects the amount due to the client for trades which expire 'in the money' vs the sum invested. As trading volumes transacted through each brand grows the group expects to be able to generate a growing proportion of its revenues from dealing spreads. Trading platforms do not charge commissions on trades unless these are specifically agreed by the customer.
Overnight premiums	Fees levied on those customers which hold certain spot FOREX positions overnight.
Gains on customer positions	Gains (offset by losses) are derived from customers' trading positions.

Strategy: build on strong underlying FY14 performance

The underlying growth story is perhaps better reflected in the strong growth in revenues and profitability in FY14, driven by positive operational performances from both divisions. FY14 revenue of US\$15.5m was 85% ahead y-o-y and underlying operating profit (adjusted EBITDA) US\$2.1m vs a US\$0.3m operating loss in FY13. Growth was broadly based; licence revenues grew 57% to US\$6.6m (FY14), revenues from OptionFair 112% to US\$8.9m and a reported 108.6% increase in the number of active customers.

The majority of FY14 group profit was contributed by the software division; licence income generated US\$1.9m pre-tax profit vs a US\$0.3m loss in FY13. The trading platform contributed US\$23,000 (FY13: US\$8,000 loss); its performance was affected by the higher cost of customer acquisition as a result of introductions by larger affiliates.

Affiliate introductions and margins

New business flows are very dependent upon successful marketing to drive customers to the platform. Use of affiliates benefits revenue growth but at a lower margin. In the previous full year the group gross margin fell slightly as a result from 70% (FY13) to 65% (FY14), and recovered to 71% in H115 (H114: 62%).

Trading Platforms pays affiliates a success fee (generally US\$250-450 depending upon quality) based upon conversion rates. Such introductions may be an expensive way to grow the business, but such leads are typically qualified and thus easier to convert into active clients.

Aggregate spending on affiliate introduction is expected y-o-y in line with a greater use of smaller affiliates and other marketing channels, such as direct media or search engine optimisation (SEO). Our forecasts incorporate conservative assumptions for both industry and new customer growth, average costs to add additional clients and the longevity of trading relationships. Cash collection from operators and receipt of most of the annual fee from the group's largest customer in advance generated US\$2.3m in FY14; payments are received monthly currently. This helps finance business growth and promotion of the brand globally, specifically via continued investment in the development of its regulatory compliant solutions. The latter will support planned expansion into the US, China and Japanese markets, and further growth within the EU during 2016.

Contribution from new product launches builds into FY17

We have assumed further growth in revenues in FY15-FY16 from new projects and platforms. In 2014 the group had three projects, two (Binary Options and FOREX) mature and beginning to generate revenues, one (mobile/tablet access) being trialled within OptionFair as a test bed will be rolled out in H215 to other clients. A CFD trading platform is on track for introduction during FY16.

We expect revenue growth to benefit from the roll out of new products across the entire customer base, with the full impact seen from 2017 as customer implementations take time to achieve full momentum with traders. Enhancements to the product portfolio are offered as free upgrades as the group benefits from royalties on additional volume generated.

Access to US via Cantor Exchange to contribute from FY16

In April 2015 the group announced progress against one of the milestones that comprised the expansion strategy outlined at its AIM admission. It established a position as a software vendor for liquidity providers operating in the US binary options market. TechFinancials will provide a solution to allow adoption of its platform under the regulations of the US market.

This plus future development of its product portfolio will allow its licensees to operate in a fully regulated environment through the Cantor Exchange; a US regulated retail-focused binary options exchange owned by Cantor Fitzgerald. This is expected to generate revenues from FY16; we have included very little contribution from this in our forecasts, but see potential for it to materially boost revenues from FY17.

Distribution capabilities established in Japan and China.

The group has hired local Japan based sales staff and licensed TechFinancials software to several Japanese online brokers. In 2014 it secured its first online broker customer in China (currently serviced from Israel) and recruited a native Chinese business development manager and has recently hired its first local agent in Hong-Kong. It is considering opening a China office, in Hong Kong, this year to sell and support TechFinancials' software and or JVs with local companies.

Sensitivities: market growth, regulation

The group's direct exposure to market risk is primarily a function of short term market conditions and client activities on any trading day. This is a core component of group risk management; we have not included contingency for losses from this source in our forecasts.

Market growth and increased regulation appear to be the most important influences on forecasts. Since the simplified binary options market was introduced in 2008 (by etrader.co.il) it has experienced significant growth, both in online broker numbers and market trading volumes. The group quotes ForexMagnates' estimates of global deposits of US\$1.26bn for 2014, growing to US\$2.76bn by 2016. Based upon OptionFair's ratio of deposits to volume traded, suggest global trading of Binary Options was c US\$13.61bn in 2014, and US\$29.81bn is in prospect for 2016. Market growth is being driven by:

- Organic growth in Europe, currently the world's leading market for binary options
- Organic growth in Asia, the biggest potential growth market for binary options
- The adoption of new regulations in Japan and the penetration of binary options into the Chinese market. The new JV with Optionfortune builds upon progress by this entity which commenced trading as a binary options broker during 2014
- The entry of additional US Binary Options exchanges. In management's view the adoption of the regulated binary options offerings in the US will see the US market grow from the current 2% global market share (ForexMagnates data)

Higher volumes have prompted financial regulators to require brokers to operate under financial services licences. In January 2012, the European Commission confirmed that binary options are financial instruments within the remit of MiFID and in May 2012, CySEC introduced regulation of binary options under Cyprus law. In Japan the market has been regulated by the FFAJ since 2013 and in the US by the CFTC and the SEC.

Although greater regulation represents a potential challenge to market operators, TechFinancials' believes that as the online trading market becomes better established and subject to increased regulation, larger financial organisations will enter the binary options market. Examples are Cantor Exchange, a new US based binary options trading exchange being launched by Cantor Fitzgerald, whose systems will be integrated with group software. The NYSE introduced a binary return derivatives product in 2014 and PlayTech, a large online gaming software provider has announced plans to enter the binary options market.

This market evolution fits TechFinancials' technology and strategy and provides it with material competitive advantages. The technology is based on its proprietary pricing engine, designed to incorporate features necessary for clients to comply with regulatory requirements in their jurisdictions. The group plans to continue to adapt its products to a changing regulatory landscape and sees this as an opportunity for it to generate additional revenue streams and enhance the credibility of the industry as a whole.

As group activities expand into new products and markets, regulatory demands will inevitably increase. Requirement for specialist training and tailored recruitment may add to compliance costs and as jurisdictions with no current regulation seek to regulate the binary option and FOREX markets, online broker clients which trade in these markets would need to comply with regulation to continue trading. This could result in additional costs for trading platform brands operated by the group to attain regulated status and lower trading volumes and revenues – and license fees - from online brokers similarly affected.

Directors and Management

Asaf Lahav, Group Chief Executive Officer

Asaf Lahav co-founded TechFinancials and has been Group CEO since its inception in 2009. He is also responsible for co-managing the unit with particular responsibility for the product development team. He has 20 years' experience managing complex technological projects and was previously a director of R&D at EMC Corporation, which he left to found the group. Prior to that held senior roles within R&D at ProActivity Software Solutions Limited, a privately held business process management software solutions provider, subsequently acquired by EMC.

Eyal Rosenblum, Chief Marketing Officer and joint CEO

Eyal Rosenblum co-founded the TechFinancials and has been its Chief Marketing Officer since 2009. He has broad experience of product development and marketing positions within hi-tech companies including four years at 888.com. he co-manages TechFinancials' business unit with Asaf Lahav, and is responsible for its sales, marketing and business development.

Jeremy Lange, Group Chief Operating Officer

Jeremy Lange co-founded TechFinancials and has been COO since its inception. For the past three years he has been responsible for establishing group operations in Cyprus and has overall responsibility for compliance at BO TradeFinancials. He previously held senior sales positions at Surf Communication Solutions, a high-capacity multimedia processing solutions business, and Flexlight Networks, an Israeli technology start-up company.

Yuval Tovias, Chief Financial Officer

Yuval Tovias joined the group in May 2014 as CFO. He has 20 years' experience as CFO of public, private and start-up companies in various industries. Before joining the group he was CFO of a start-up medical devices company.

Christopher Bell, Non-Executive Chairman

Christopher Bell has 20 years' experience in the gambling industry. He was CEO of Ladbrokes plc until 2010. He joined Ladbrokes in 1991, became MD in 1994 and joined the plc board in 2000 (known as Hilton Group plc until 2006). He is the independent non-executive chairman of XL Media plc, and a director of Quintain Estates and Development plc, a Spirit plc (non-exec) and a member of the Responsible Gambling Strategy Board which advises the UK government on gambling policy.

Hillel (Hillik) Nissani, Non-Executive Director

Hillik Nissani has 25 years' experience of international sales and marketing including the technology sector and specifically, online trading. He is currently owner and managing partner of Habaneros, a Cyprus based strategy and marketing agency. Until July 2014, he was chief marketing and sales officer at Easy FOREX, a global FOREX broker, in 2007-09 worked for LSE listed 888.com as VP Americas. Previous executive roles include LSE listed Matomy Media Group Limited, and NYSE traded Amdocs Inc. Also spent 5 years in VC and private equity where he led investments in high-tech companies. He was Captain and Head of The Israeli Defence Forces' Software Development School Programming Division.

Eitan Yanuv, Independent Non-Executive Director

Eitan Yanuv is CEO of Implement Limited which provides consultancy services to technology SMEs in Israel. , Prior to setting up Implement in 2002 he was head of consulting and investment banking at Kost Forer Gabay E&Y. He is currently CFO of Starcom plc and SerVision Limited, both AIM-quoted companies headquartered in Israel.

Senior management

Petros Loizou, Chief Financial Officer, B.O. TradeFinancials

Petros Loizou joined the group in June 2014. He is CFO of B.O. TradeFinancials, the group's subsidiary in Cyprus. He was previously CFO of a Cyprus based investment firm and prior to that, an audit and tax manager within several audit firms in Cyprus. He is a member of the Association of Chartered Certified Accountants (ACCA) and the Institute of Certified Public Accountants of Cyprus (ICPAC).

Register

Key Shareholders	Percentage held
Eyal Alon	14.53%
Asaf Lahav	13.28%
Jeremy Lange	10.68%
Milton Group	8.78%
Danny Magen	8.47%
Eyal Rosenblum	7.77%
Equilibrium Solutions	6.33%
Fidelity Venture Capital	5.17%
Evian Investment Ltd	4.61%
Daonit Ltd	3.18%

Source: TechFinancials as end October 2015

Financials

Income Statement, US\$'000				
	FY13	FY14	FY15e	FY16e
Continuing Operations				
Revenue	8,385	15,492	13,750	20,300
Cost of sales	(2,495)	(5,403)	(4,050)	(5,500)
Gross profit	5,890	10,090	9,700	14,800
Other income	462	0	0	0
Research and development	(2,277)	(1,322)	(2,375)	(3,600)
Selling and marketing expenses	(2,374)	(4,387)	(4,320)	(6,450)
Administrative expenses	(2,016)	(2,249)	(3,230)	(3,700)
Operating profit/(loss) before exceptional items	(314)	2,132	(225)	1,050
Exceptional loss on group reorganisation	0	(1,125)	0	0
Operating profit/(loss)	(314)	1,007	(225)	1,050
Finance costs	(38)	(212)	(145)	(55)
Profit/(loss) before taxation	(352)	795	(370)	995
Income tax expense	(123)	(182)	(145)	(195)
Profit/(loss) after taxation	(475)	613	(515)	800
Total comprehensive income/(loss)	(475)	613	(515)	800
Weighted average shares in issue - basic (m)	52.40	52.60	65.90	68.19
Share based compensation (m)	0.79	3.71	3.71	3.71
Weighted average shares in issue - diluted (m)	53.18	56.31	69.61	71.90
EPS				
EPS - Basic (USc)	(0.91)	1.17	(0.78)	1.17
EPS - Diluted (USc)	(0.89)	1.09	(0.74)	1.11
GBP/USD	1.64	1.56	1.55	1.55
Basic (GBP p)	(0.6)	0.7	(0.5)	0.8
Diluted (GBP p)	(0.5)	0.7	(0.5)	0.7
Dividend per share (p)	0.00	0.16	0.00	0.35
Dividend yield	0.0%	0.6%	0.0%	3.1%
Dividend cover	0.0x	4.4x		2.0x

Source: Group accounts / FY15e and FY16e analyst estimates

Balance Sheet, US\$'000				
	FY13	FY14	FY15e	FY16e
Non-current assets				
Intangible assets	873	2,318	2,788	2,432
Property and equipment	149	214	475	507
	1,022	2,532	3,263	2,939
Current assets				
Trade and other receivables	1,576	1,414	1,312	2,007
Restricted bank deposits	160	40	248	248
Cash and bank balances	982	1,663	3,600	4,622
	2,718	3,117	5,158	6,876
Total assets	3,740	5,649	8,421	9,815
Current liabilities				
Trade and other payables	1,426	1,619	1,950	2,377
Income tax payable	126	39	3	(19)
Loan from interested party			300	210
	1,552	1,658	2,253	2,568
Non-current liabilities				
Due to shareholders	305	281	281	281
Share capital	27	27	36	36
Share premium account	1,650	2,753	5,979	5,979
Share-based payment reserve	446	557	897	1,163
Dividends	0	0	(165)	(165)
Accumulated profits/(losses)	(240)	372	(137)	215
Investment in new B2C business reserve			(719)	0
Investment in new B2C business			0	(719)
Non-controlling interest (B2C new bus.)			0	458
	1,883	3,709	6,168	7,248
Total Equity and Liabilities	3,740	5,650	8,421	9,815

Source: Group accounts / FY15e and FY16e analyst estimates

Cash Flow, US\$'000				
	FY13	FY14	FY15e	FY16e
Profit/(loss) before tax for the period	(353)	1,917	(370)	995
Adjustment for:				
Depreciation of property and equipment	56	73	397	775
Share option charge	446	111	340	261
Operating cash flows before movements in working capital				
Decrease/(increase) in trade and other receivables	(954)	162	102	(695)
(Decrease)/increase in trade and other payables	454	(125)	(440)	406
Interest Expenses	0	2	0	0
Income tax paid	(123)	(19)	(125)	(180)
Net cash generated from/(used in) operating activities	(474)	2,121	(96)	1,562
Cash flow from investing activities				
Proceeds from disposal of property, plant and equipment	0	0	0	0
Redemption of restricted bank deposits	63	120	(208)	0
Development of intangible assets	(873)	(1,445)	(792)	(260)
Acquisition of property, plant and equipment	(42)	(138)	(334)	(190)
Net cash used in investing activities	(852)	(1,463)	(1,334)	(450)
Cash flow from financing activities				
Interest paid	0	(7)	0	0
Loan from interested party			300	(90)
Dividend	0	0	(165)	0
Issue of equity	0	1,104	3,226	0
Net cash used in financing activities	0	1,097	3,361	(90)
Net increase/(decrease) in cash and cash equivalents	(1,326)	1,762	1,930	1,022
Cash and equivalents at beginning of period	2,332	982	1,670	3,600
Exceptional loss on group reorganisation	0	(1,125)	0	0
Effect of changes in exchange rates on cash	(24)	51	0	0
Cash and equivalents at end of period	982	1,633	3,600	4,622

Source: Group accounts / FY15e and FY16e analyst estimates



PETERHOUSE

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