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Payment Data Systems (Nasdaq/PYDS)
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BUY Revenues growing, nearing cash flow positive
Payment Data Systems is an electronic payment solutions company offering ACH, credit card, debit card, prepaid card and electronic billing services
Investment Highlights

1) **Payment Data Systems (PDS)** recently reported strong financial results for their Q4/18 quarter, including revenues of \$6.4 million, up 14% from the prior year period, and a net loss of \$876,000 or (\$0.07) per share, an improvement over the loss of \$1.3 million or (\$0.13) per share in the same period one year ago. Revenue growth in the fourth quarter was led by an increase of 20.5% in Automated Clearing House (ACH) revenue, which also helped boost gross margins to 23.7% in Q4/18, up from 23.3% in Q4/17. Combined with level operating expenses and reduced non-cash charges, the Company was able to improve its bottom line during the quarter, leading to an adjusted EBITDA loss of \$83,000, nearly break-even, as compared to a negative \$274,000 adjusted EBITDA figure for the same period last year. For the 2018 year, PDS posted revenues of \$25.0 million, up 72% from 2017, driven by 12.1% organic growth, including 17% increases in ACH processing volumes, and the inclusion of 8 months of revenues from the Singular Payments acquisition completed in Spring 2018. Net loss for 2018 was \$3.8 million or (\$0.31) per share, up from a net loss of \$3.0 million or (\$0.33) per share in 2017, although much of the increased loss in 2018 could be accounted for by non-cash expenses and investments in new growth businesses in the prepaid and card processing area - Adjusted EBITDA remained steady at approximately \$600,000 for both years. At the end of the year the Company had \$2.7 million in cash, down from \$4.8 million at the start of the year, with no long-term debt, but later supplemented by \$1.8 million in proceeds from a February 2019 equity financing.

2) **The Company has not provided financial guidance for the current 2019 fiscal year, but we are considering recent quarterly trends for PDS to forecast revenues of \$28.2 million for 2019E, equating to a 12.7% year-over-year increase, with an improved net loss of \$3.1 million or (\$0.24) per share. Expected to fuel**

Current Price \$2.52
Price Target \$5.00

Estimates	F2017A	F2018A	F2019E
Revenue(\$000s)	\$14,571	\$25,024	\$28,200 E
1Q March	2,811	5,844 A	6,600 E
2Q June	2,550	6,284 A	6,900 E
3Q September	3,589	6,474 A	7,200 E
4Q December	5,621	6,423 A	7,500 E
EPS	(\$0.33)	(\$0.31)	(\$0.24) E
1Q March	(0.03)	(0.09) A	(0.07) E
2Q June	(0.06)	(0.09) A	(0.06) E
3Q September	(0.10)	(0.07) A	(0.06) E
4Q December	(0.13)	(0.07) A	(0.05) E
P/E (x)	N/A	N/A	N/A

EBITDA/Share	(\$0.06)	(\$0.05)	\$0.02
EV/EBITDA (x)	N/A	N/A	N/A

Stock Data	
52-Week Range	\$1.38-\$3.82
Shares Outstanding (mil.)	16.9
Market Capitalization (mil.)	\$42.5
Enterprise Value (mil.)	\$39.8
Debt to Capital (12/18)	0.0%
Book Value/Share (12/18)	\$0.57
Price/Book	4.4 X
Average Trading Volume (3-month)	112,000
Insider Ownership	50.2%
Institutional Ownership	1.8%
Short interest	160,000
Dividend / Yield	\$0.00/0.0%


 Price target and ratings changes over the past 3 years:
 Initiation - October 23, 2018 – Buy - Target \$5.00

Please find Important Disclosures beginning on Page 5.

growth for this year for PDS are volume growth in the ACH area, as well as new clients in the prepaid and PayFac card businesses. For 2019E, we are further estimating that overall gross margins will improve to 24.8% from 22.3% in 2018, driven by economies of scale from higher processing volumes as well as further integration of new products and acquisitions, for example Singular Payments. We are also forecasting that operating expenses will increase at a more moderate rate, only 8% year-over-year, and that adjusted EBITDA will actually come in at break-even or positive for PDS for 2019E, a significant milestone for the Company.

3) Looking ahead, Payment Data Systems can point to a number of recent developments to pave the way for future growth.

In the custom payment processing area, the Company earlier this year signed partnership agreements with two property management software companies, TenantMagic and propVIVO, to use PDS’s proprietary PayFac-in-a-Box platform to provide tenants and homeowners flexibility in terms of making routine or recurring payments.



In the prepaid card area, PDS’ partnership with Fancards recently received a marketing boost with the launch of Fancards’ Mobile App compatible with Apple Wallet. Fancards is the only collegiately-licensed prepaid card in the country, offering prepaid reloadable cards and prepaid gift cards for over 20 teams, supported by a partnership agreement with Payment Data Systems to support reloadable card program management, processing, and the development of Fancard web and mobile applications.



Also in the targeted healthcare vertical prepaid card market, a recent agreement with Bowen Center, an Indiana-based behavioral health company, to provide PDS subsidiary FiCentive’s Akimbo Commercial Prepaid MasterCard product to Bowen’s employees at its locations in 20 counties across the state shows the potential for this product in the commercial area.



Akimbo prepaid MasterCard’s can help service providers by replacing petty cash and improving employee expense reimbursement systems for managing day-to-day expenses. Finally, the Company’s recent attainment of NACHA Certification of effective controls, standards, and oversight in ACH processing is expected to strengthen the company’s relationships with Originating Depository Financial Institutions (ODFIs), and help fuel additional growth in the Company’s core ACH processing area.



Conclusion/Stock Valuation

With new products and partnerships fueling revenue growth, now over one year into the integration of the recent Singular Payments, an improved balance sheet, and as an undiscovered entrant in the fastest growing segment of the payments industry, both short-term and long-term investors have much to be excited about PYDS shares. Therefore, we are maintaining our BUY rating on PYDS and our 12-18-month price target of \$5.00, based on average price revenue multiples for future years for a group of comparable companies in the electronic payments market. (For a more complete analysis of our stock valuation methodology on PYDS shares please refer to our Initiation Report dated October 23, 2018).

Risk Factors

In addition to normal economic and market risk factors that impact most equities and the common risks shared by Payment Data Systems with other companies in the industry, we believe an investment in PYDS involves the following risks:

- **Reliance on key management** – At present, PYDS relies on several key members of its management team who have been in key executive positions for an extended period of time. Should one or more of these key executives leave the Company, PYDS could find it difficult to replace their long-standing knowledge of operations and industry expertise.
- **Reliance on partnerships and collaborations** – To date, PYDS has signed a number of marketing and development partnerships and collaborations for its technologies and services. Thus, in the future certain factors related to sales and new product development may be determined by third parties and out of the control of Company management.
- **Limited stock liquidity** – Trading volume in PYDS stock is comparatively light and these shares have a relatively limited history of trading on major US stock exchanges compared with other technology stocks. As such, news regarding PYDS, its target market, partners and/or competitors could lead to significant volatility in the stock price.
- **Competitive Markets** – The Company and its partners compete in its target electronic payments market with a number of companies, many of which are considerably larger than the Company. There can be no assurance that the Company and its partners will be able to successfully compete and launch new products into these competitive markets in the future.
- **Lack of historic profitability** - PYDS has not historically achieved operating profitability, and according to our forecasts is not projected to do so in the near future. Although the Company maintains adequate cash reserves at the present time, there can be no assurance the Company will not need to raise additional working capital in the future should operating losses resume.
- **Need to defend intellectual property** – PYDS currently relies on a combination of trade secrets, nondisclosure and other contractual arrangements, and copyright and trademark laws to protect its intellectual proprietary rights. The Company may be required to defend its intellectual property rights in the US and overseas in the future, and there can be no assurance these defenses will be successful.

Payment Data Systems, Inc.
Consolidated Statements of Operations
 (In 000s, except per share data)

Robert M. Wasserman

FYE December	2016	2017	1Q18 March	2Q18 June	3Q18 Sept	4Q18 Dec	2018	1Q19E March	2Q19E June	3Q19E Sept	4Q19E Dec	2019E
Revenues	\$12,076	\$14,571	\$5,844	\$6,284	\$6,474	\$6,423	\$25,024	\$6,600	\$6,900	\$7,200	\$7,500	\$28,200
Cost of Services	8,293	10,803	4,573	4,964	5,015	4,903	19,455	5,000	5,200	5,400	5,600	21,200
Gross Profit	3,783	3,768	\$1,271	\$1,320	\$1,459	\$1,520	5,570	\$1,600	\$1,700	\$1,800	\$1,900	7,000
Operating Expenses:												
Selling, general & administrative	3,188	4,379	1,499	1,595	1,520	1,603	6,217	1,650	1,700	1,750	1,800	6,900
Stock-based compensation	1,054	968	374	298	289	290	1,252	300	300	300	300	1,200
Depreciation and amortization	902	1,258	459	457	473	486	1,876	500	500	500	500	2,000
Total operating expenses	5,144	6,605	2,332	2,351	2,282	\$2,379	9,344	\$2,450	\$2,500	\$2,550	\$2,600	10,100
Income (loss) from operations	(1,361)	(2,837)	(1,061)	(1,031)	(823)	(859)	(3,775)	(850)	(800)	(750)	(700)	(3,100)
Other Income (Expense)												
Interest income, net	97	101	12	15	23	26	77	30	30	30	30	120
Other income (expense)	99	2	(2)	(0)	1	0	(0)	0	0	0	0	0
Income (loss) before tax	(\$1,164)	(\$2,734)	(1,051)	(1,016)	(798)	(833)	(\$3,698)	(820)	(770)	(720)	(670)	(\$2,980)
Provision for income taxes	33	274		19	15	44	78	30	30	30	30	120
Net income (loss)	(\$1,197)	(\$3,009)	(\$1,051)	(\$1,035)	(\$813)	(\$876)	(\$3,776)	(\$850)	(\$800)	(\$750)	(\$700)	(\$3,100)
Basic income per share	(\$0.15)	(\$0.33)	(\$0.09)	(\$0.09)	(\$0.07)	(\$0.07)	(\$0.31)	(\$0.07)	(\$0.06)	(\$0.06)	(\$0.05)	(\$0.24)
Diluted income per share	(\$0.15)	(\$0.33)	(\$0.09)	(\$0.09)	(\$0.07)	(\$0.07)	(\$0.31)	(\$0.07)	(\$0.06)	(\$0.06)	(\$0.05)	(\$0.24)
Basic shares outstanding	7,838	8,996	12,027	12,076	12,145	12,129	12,129	12,600	13,000	13,100	13,200	12,975
Diluted shares outstanding	7,838	8,996	12,027	12,076	12,145	12,129	12,129	12,600	13,000	13,100	13,200	12,975
Key ratios:												
Revenue growth		20.7%	107.9%	146.4%	80.4%	14.3%	71.7%	12.9%	9.8%	11.2%	16.8%	12.7%
Gross margin	31.3%	25.9%	21.7%	21.0%	22.5%	23.7%	22.3%	24.0%	25.0%	25.5%	26.0%	24.8%
S, G & A/Revenues	26.4%	30.1%	25.6%	25.4%	23.5%	25.0%	24.8%	25.0%	24.6%	24.3%	24.0%	24.5%
Depreciation, amort, non-cash comp	\$1,955	\$2,226	\$833	\$756	\$762	\$776	\$3,127	\$800	\$800	\$800	\$800	\$3,200
Cash Flow/share	\$0.10	(\$0.09)	(\$0.02)	(\$0.02)	(\$0.00)	(\$0.01)	(\$0.05)	(\$0.00)	\$0.00	\$0.00	\$0.01	\$0.01
EBITDA/share	\$0.10	(\$0.06)	(\$0.02)	(\$0.02)	(\$0.00)	(\$0.00)	(\$0.05)	(\$0.00)	\$0.00	\$0.01	\$0.01	\$0.02

Balance Sheets

(\$000s)

Assets:	12/31/17	12/31/18
Current Assets:		
Cash and equivalents	\$4,801	\$2,695
Accounts receivables, net	970	1,214
Settlement processing assets	38,028	44,140
Prepaid expenses and other	327	210
Total current	\$44,125	\$48,260
Merchant reserves	14,977	12,646
Other Assets:		
Property and equipment	2,105	1,933
Intangible assets, net	4,676	3,676
Deferred tax asset	1,394	1,394
Other long-term assets	158	307
TOTAL ASSETS	\$67,436	\$68,216
Liabilities:		
Current Liabilities:		
Accounts payable	\$301	\$308
Accrued expenses	1,006	1,388
Settlement processing obligations	38,028	44,140
Deferred revenues		20
Total current	\$39,335	\$45,856
Merchant reserve obligations	14,977	12,646
Deferred rent		80
TOTAL LIABILITIES	54,312	58,582
Stockholders' equity (deficit)	13,123	9,634
TOTAL LIAB & EQ	\$67,436	\$68,216

Quarterly Earnings Comparisons

	March	June	Sept	Dec	Total
Revenues (in \$000s)					
2016					\$12,076
2017	2,811	2,550	3,589	5,621	14,571
2018	5,844	6,284	6,474	6,423	25,024
2019E	6,600	6,900	7,200	7,500	28,200
Earnings per Share					
2016					\$0.00
2017	(0.03)	(0.06)	(0.10)	(0.13)	(0.33)
2018	(0.09)	(0.09)	(0.07)	(0.07)	(0.31)
2019E	(0.07)	(0.06)	(0.06)	(0.05)	(0.24)

Source: Dawson James Securities, Inc. estimates; Company documents

Important Disclosures:

Price Chart:



Price target and ratings changes over the past 3 years:
 Initiation – October 23, 2018 – Buy – Price Target \$5.00

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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	36	88%	10	28%
Market Perform (Neutral)	5	12%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	41	100%	10	24%

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