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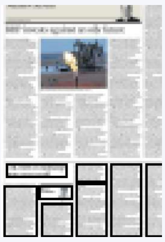

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EML bets on banking's brave new world

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James Thomson

Exactly one week after Westpac chief executive Brian Hartzer introduced the banking-as-a-service concept to a wider Australian audience, EML Payments boss Tom Cregan has inked a $420 million deal that underscores the momentum behind this trend.

The rapidly growing EML, which has seen its share price leap from $1.50 at the start of the year to $3.83, has been built around providing the financial and technological infrastructure for gift cards (and their digital equivalents) and reloadable prepaid cards, such as those used by gambling companies and salary packaging firms.

On Monday, Cregan and his team announced their biggest ever deal, paying $423 million – plus potentially another $55 million in earn-out payments – for an Irish firm called Prepaid Financial Services.

Prepaid does basically the same thing as EML. But where EML has focused on the retail, salary packaging and gaming sectors, and has only dipped its toes into financial services more recently, Prepaid is growing rapidly by providing white-label digital banking and payments solutions to the likes of Spanish postal service Correos, Spanish neobank Rebellion and Slovenian bank NLB.

EML and Prepaid essentially act as plumbers who help hook up the technological and financial pipes to the cool ideas and apps that fintechs and existing banks are developing.

"Most of them use somebody else to do the actual transactions and the payment piece," Cregan explains.

About half of EML's work comes from inbound requests from customers. In the financial services space, he gives the example of a Norwegian bank group called Instabank, which came to EML wanting to turn its idea for a revolving line of credit aimed at Millennials into a real product.

EML worked with the group and developed the technology and will soon roll it out in Australia and other markets.

But Cregan says EML hadn't developed anything like the full digital banking solution that Prepaid has, and the bulk of the synergies from the deal will be driven by cross-selling those products outside Prepaid's key European market.

The deal, priced at 17.5 times Prepaid underlying earnings, will be funded by a $250 million capital raising priced at $3.55 a share, a relatively skinny 7.3 per cent discount to EML's closing price last Friday.

Including synergies, the deal is expected to boost EML's earnings before interest, tax, depreciation and amortisation from $41 million in the 2020 financial year to $65 million.

Of course, history is littered with small cap companies striking problems following big offshore acquisitions. Cregan is quick to emphasise that the existing management team will be retained – incentivised by that $55 million earn-out payment and the issue of $77 million of shares – and this is not a play to cut costs by getting headcount down. "There really isn't a great deal of overlap between the companies, which is attractive," he told Chanticleer on Monday.

A fascinating aspect of the deal is what it says about where the banking sector is heading.

Hartzer's banking-as-a-service (BaaS) push is based around the idea that it is not just banks that will provide banking services; he wants to be able to give trusted partners such as Westpac's institutional customers and selected fintechs the ability to sell some of Westpac's products.

But notably, Hartzer will work with a UK firm called 10X to develop the technology behind this push, in a prime example of how hard it is to innovate inside a big bank.

Cregan sees the newly enlarged EML as being perfectly positioned to become "one of the largest enablers in digital banking and prepaid globally".

The banks, he says, will increasingly rethink where they are actually creating value in a world where financial services are being broken down into little chunks.

"I think the banks will start to think about where is the value created for them and they won't feel they need to do everything."

This will be true in terms of the technology they develop, which he expects will be increasingly outsourced.

But it will also be the case for core banking products.

In Europe, for example, the traditional banks are actually embracing the rise of neobanks, safe in the knowledge that they take low-margin customers who only need transaction and deposit products off their hands, but don't have the balance sheet strength to provide loans in any great volumes.

"At the end of the day when that customer needs a loan ... they still have to come back to the mothership for credit facilities," Cregan explains.

In the return-constrained Australian banking sector, models that allow the banks to focus on their biggest profit pool and shed costs will surely be embraced over time.