

# Paycloud Holdings | 4015 TSE Growth

High-growth fintech company trading at a P/B ratio of just under 1.4x

## Summary

• **1H Results:** On April 12, 2024, Paycloud Holdings Inc. announced its 2Q FY2024/8 earnings, its first earnings announcement since becoming a holding company and changing its name on March 1, 2024. In 1H FY2024/8, the company reported net sales of ¥1,990 mn, adjusted EBITDA of ¥226 mn, and operating profit of ¥86 mn. It had an irregular 5-month accounting period in 1Q FY2023/8 that included the July-August 2022 earnings following a change in the accounting period of the former Valuedesign Inc., which was merged with the company. As a result, the company's earnings summary for 1H FY2024/8 show sales being down 12% YoY, adjusted EBITDA up 2% YoY, and operating profit up 237% YoY. Excluding the impact of the irregular accounting period, net sales rose 6% YoY, adjusted EBITDA grew 35% YoY, and operating profit increased 467% YoY, reflecting steady business growth. The company's management is becoming more confident after 1H adjusted EBITDA came in higher than initial projections, mainly driven by steady sales growth and reductions in cost of sales and SG&A expenses such as outsourcing and subcontracting expenses.

• 1H ordinary profit amounted to ¥77 mn, but the company reported a net loss of ¥14 mn. This is attributable to the fact that the company had not yet implemented the group tax relief system, under which the pre-tax income of each subsidiary is added to the group's total income and taxed as a whole. Specifically, while the taxable income of cashless service operator Valuedesign increased and resulted in commensurate tax obligations, this was not offset by the loss recorded by the former arara, which had a concentration of corporate functions and cost centers for new businesses. As a result, Valuedesign's corporate tax obligations remained. According to the management team, this falls within its expectations and the corporate tax rate for FY24/8 will appear somewhat skewed, but this problem will be resolved in FY2025/8 with the implementation of the group tax relief system.

• **Performance Trends:** Key March 2024 KPIs disclosed on April 25 showed a strong start to 2H, with monthly recurring revenue (MRR) growth of 18% YoY, including 21.7% YoY growth in MRR for cashless services, as well as a 12.2% YoY increase in transaction value to ¥117.4 bn.

Y mn, %	Sales	YoY	Operating profit	YoY	Ordinary profit	YoY	Net profit	YoY	EPS	DPS
2020/8 NC	1,201	15.3	136	29.5	142	27.9	143	25.4	25.32	0.0
2021/8 NC	1,461	21.6	305	124.3	280	97.2	229	60.1	37.34	0.0
2022/8 NC	1,165	(20.3)	(160)	(152)	(1,506)	(638)	(1,834)	(901)	(252.06)	0.0
2023/8 C	4,476	284.1	163	N/A	133	N/A	114	N/A	10.65	0.0
2024/8 CE	6,900	54.2	200	22.7	-	N/A	-	N/A	-	0.0

Source: Compiled by SIR from the company's financial statements.

Note1: The company has not disclosed projections for ordinary profit and profit attributable to owners of parent for FY24/8 as it positions net sales, adjusted EBITDA, and operating profit as key performance indicators in its management strategy. Furthermore, since it does not disclose profit attributable to owners of parent, it does not disclose EPS figures either.

## 2Q Follow-up



### Focus Point

The company's selling point is its evolution into a promising high-growth fintech company, taking advantage of its company name change that better reflects its business to transition to a holding company and separate management and execution, while also rectifying the information asymmetry that has likely contributed to the discount on its share price.

### Key Indicators

Share price (4/25)	367
YH (24/1/12)	617
YL (24/4/17)	338
10YH (20/11/24)	3,905
10YL (22/12/29)	273
Shrs out. (mn shrs)	15.711
Mkt cap (¥ mn)	5,766
FY24/2 Equity ratio	48.8%
2024/3 P/B (Est.)	1.39x
FY24/8 P/E (CE)	—
FY23/8 ROE (act)	6.34%
FY24/8 DY (CE)	—

### Stock Price Chart 52 Weeks



Source: Trading view

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• **Share Price Insights:** Based on the company's EBITDA forecast for FY2025/8 (¥1,500 mn), the recent share price stands at just 3-4x Enterprise Value, equivalent to that of a zero-growth company. Furthermore, the P/B ratio comes in at 1.39x based on the latest estimated diluted BPS (¥263), a surprisingly low valuation even for a small cap value stock. The company's shares have been sold off excessively in response to news headlines of "disappointing results" each time the company announces quarterly earnings. However, SIR believes that there are no negative factors that justify the current share price level, which has fallen beyond the impact of the approximately 31% share dilution, in light of the underlying fundamental factors that point toward a strong likelihood that earnings will surpass company projections.

## 1H FY2024/8 Earnings results

\*Share-based payment expenses were added as a part of adjusted EBITDA starting in FY2024/8.

The formula for **adjusted EBITDA** is: Operating profit + depreciation (including amortization related to intangible assets) + share-based payment expenses.

### ■ Cashless Service Business Performance Trends

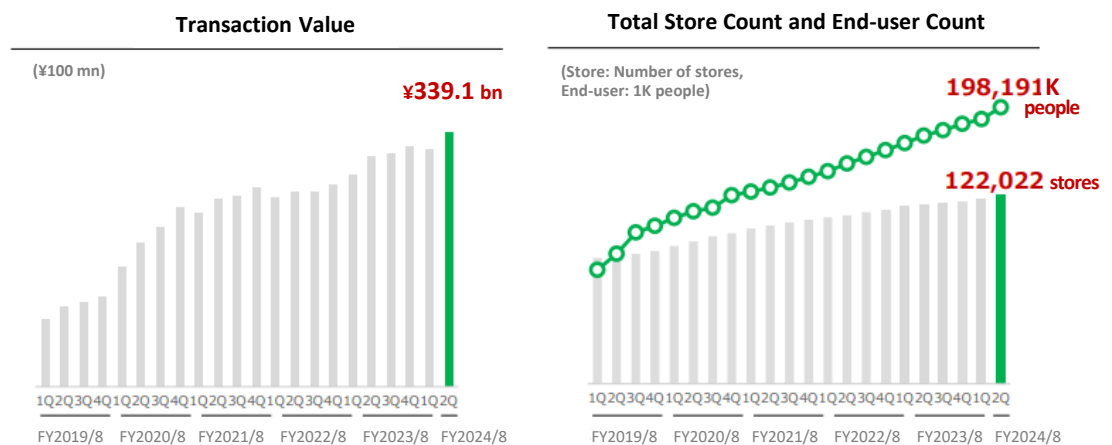
The cashless service business, where the company receives a portion of the transaction value from the *Dokuji Pay* service provided by consolidated subsidiary Valuedesign as a system usage fee, accounts for 82% of the group's total sales. In 1H, net sales rose by ¥95 mn YoY (+6%) to ¥1,633 mn, adjusted to exclude the impact of the irregular accounting period. This business drives overall earnings growth and is the company's cash cow, generating adjusted EBITDA\* of ¥443 mn, which exceeds the companywide adjusted EBITDA of ¥226 mn. Transaction value, one of the main KPIs, remained strong, reaching ¥339.1 bn in 1H. Both total store count and total end-user count are expanding steadily thanks to new customer acquisitions.

The main factors driving the sales growth were an increase in payment commissions and higher initial sales from new installations. In particular, the increase in payment commissions reflects better-than-expected acceptance of the system usage fee revision (price increase) that has been underway since the beginning of FY2024/8, and the full impact of the revision will likely be seen in FY2025/8, if not within FY2024/8.

On the other hand, business performance appears slightly weak for the three-month-period of 2Q (December 2023-February 2024), where YoY comparisons were not affected by the irregular accounting period in FY2023/8. Sales fell nearly 10% YoY to ¥761 mn and segment profit came in largely flat at ¥161 mn. This is because sales recognition for some one-time sales secured in 2Q slipped into 3Q. Furthermore, YoY comparisons were more challenging as sales in the cashless service business were boosted by special demand related to My Number Point campaigns in 2Q FY2023/8.

Note: Figures on the right show the sum of KPIs for the former arara and Valuedesign.

Note: Transaction value is defined as transaction value directly related to recurring sales as shown below.  
 1. Dokuji Pay transaction value (previously referred to as "payment value")  
 2. Amount deposited into Dokuji Pay through comprehensive agreements with credit card companies (added as KPI in FY2024/8)



Source: The company IR material.

## Segment information

Segments	¥ mn	FY2023/8	FY2023/8	FY2023/8	FY2023/8	FY2023/8	FY2024/8	FY2024/8	FY2023/81	FY2023/81	FY2024/8	Change 1H	Change 1H
		9-11	9-11	12-2	3-5	6-8	9-11	12-2	H	H	1H	YoY	YoY
		Gross	Net						Gross	Net		Gross	Net
Cashless Service	Net Sales	1,069	695	842	900	981	872	761	1,911	1,537	1,633	-15%	6%
	Operating Profit	101	N/A	159	183	177	162	161	261	N/A	323	24%	
	OP Margin	9.5%		18.9%	20.4%	18.0%	18.5%	21.2%	13.6%		19.8%		
Solution	Net Sales	176		167	166	174	167	190	344		357	4%	
	Operating Profit	64		51	42	69	52	71	115		123	6%	
	OP Margin	36.3%		30.7%	25.2%	39.8%	31.0%	37.3%	33.6%		34.3%		
Total	Net Sales	1,246	872	1,009	1,066	1,155	1,039	951	2,255	1,811	1,990	-12%	6%
	Adjustments*	(197)		(153)	(143)	(190)	(163)	(197)	(350)		(360)		
	Operating Profit	(39)	(49)	64	82	56	50	36	26	15	86	237%	467%
	OP Margin	-3.1%	-5.6%	6.3%	7.7%	4.8%	4.8%	3.8%	1.1%	0.8%	4.3%		
	Adj EBITDA	83	29	138			120	106	221	168	226	2%	35%

Source: Compiled by SIR from the company IR materials.

Note: (\*)Adjustments include company-wide expenses that are not included in each segment, and most of them are SG&A expenses.

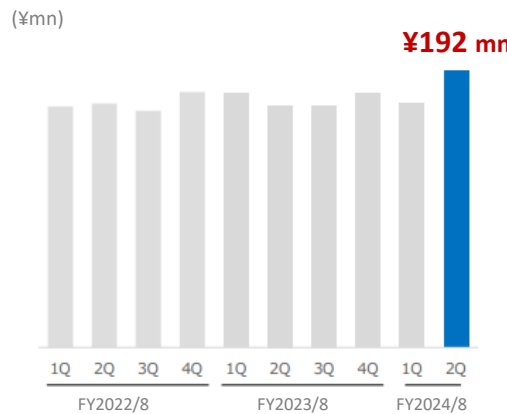
Gross is a 5-month irregular financial statement including revenue for July-August 2022 due to the change in the fiscal year-end of the former Valuedesign, which was merged in the 1Q of the previous year.

Net is a three-month financial statement that does not include revenue for July-August 2022.

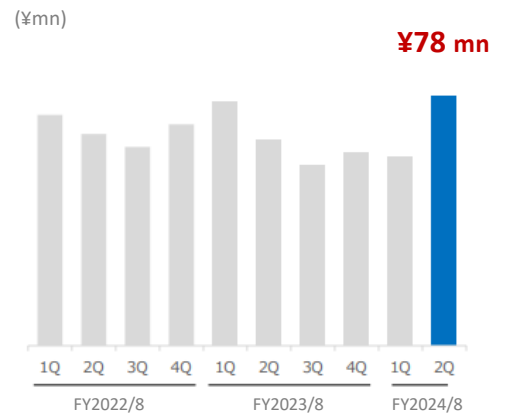
**Solutions Business Performance Trends**

In the solutions business operated by consolidated subsidiary arara, the company provides a high-speed e-mail delivery messaging service, a data security service featuring a personal information search solution, and an AR service. The business expanded steadily in 1H FY2024/8, with sales up 4% YoY to ¥357 mn and adjusted EBITDA coming in at ¥138 mn on the back of solid growth in messaging services coupled with the recording of one-time sales from the AR service.

**Solutions Business : Net sales**



**Solutions Business : Adjusted EBITDA**

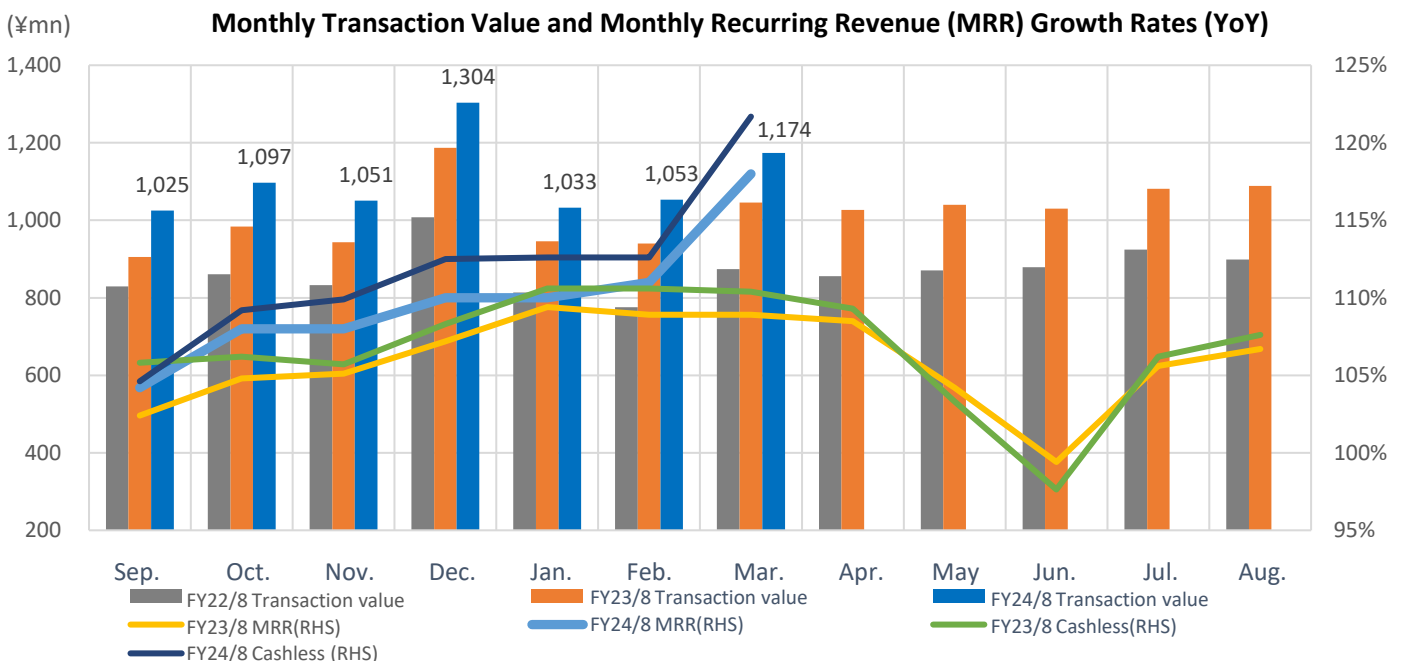


Source: The company IR material.

\*A bulk sender refers to someone who sends more than 5,000 emails per day to Gmail addresses.

<https://blog.google/product/s/gmail/gmail-security-authentication-spam-protection/>

One interesting event that took place during 2Q was Google's decision to strengthen its anti-spam measures by reinforcing requirements for bulk senders\* sending emails to Gmail accounts from February 2024, including setting and authenticating the source domain, authenticating IP addresses, and encrypting communications. Failure to comply with these requirements is resulting in emails not being reached. arara was quick to pick up on this change in requirements, and its in-house system development team took action to create an environment that enables bulk email distribution. This has proved successful, and arara has been able to capture customers switching over from competing services that were unable to address the change.



Note: The company defines recurring revenue as the sum of payment fees in the cashless service business and system usage fees in the solutions business (cashless services, messaging services, and data security services), which are paid to the company on an ongoing basis based on the use of its services, and is directly related to the sales line in the company's income statement.

Source: Compiled by SIR from the company IR material.

### ■ Goodwill for Cloudpoint coming in smaller than initially expected

Effective March 1, 2024, the company made digital signage-related business provider Cloudpoint a wholly owned subsidiary through a stock swap, partially amended its articles of incorporation, including changing its company name to Paycloud Holdings, and transitioned to a pure holding company structure.

The company recorded ¥1,411 mn in goodwill as a result of the business integration of Cloudpoint through a stock swap. The calculation is as follows:

- (1). In accordance with the stock swap ratio (3.47 shares of former arara common stock were allocated for each share of Cloudpoint common stock), 3,755,785 shares of the company's stock were distributed to Cloudpoint shareholders.
- (2). The applied share price for the company's stock is ¥511 per share, the closing price on March 1, 2024.
- (3). The acquisition value of Cloudpoint amounted to ¥1,919 mn, after multiplying (1) and (2) above.
- (4). Cloudpoint's net asset value at the end of February 2024 was ¥508 mn
- (5). The difference between the acquisition value from (3) and the net asset value from (4) came out to ¥1,411 mn, which was recorded as goodwill for the Cloudpoint acquisition

Accordingly, if the company were to amortize the goodwill over 10 years starting in March 2024, the annual amortization expense would be approximately ¥141 mn, and the impact on FY2024/8 earnings would come out to about ¥70 mn for 2H FY2024/8.

According to the management team, the goodwill of about ¥1.4 bn came in smaller than initially expected as a result of the applied share price being lower than originally anticipated.

### ■ Latest estimated diluted BPS is ¥263

As a result of (1) above, the company's issued shares increased from 11,955,563 shares at the end of February 2024 to 15,711,348 shares as of March 1, 2024, an increase (dilution) of approximately 31%.

At the same time, net assets grew by ¥1,919 mn, the same amount as in (3), to ¥4,103 mn as of March 1, 2024. Diluted book value per share (BPS) increased to ¥263.

### ■ Cloudpoint performance remains steady

During the three-month period from December 2023 to February 2024, Cloudpoint installed 2,250 new digital signage screens and 1,450 new locations (addresses), bringing the total installation base to 51,150 screens and 22,750 locations at the end of February. Installations moved forward across various industries, such as for menu boards in major convenience stores (retail media), commercial facilities, car dealerships, as well as in major fast food stores and drive-throughs. In addition, there were many cases where digital signage has been installed during office renovations as part of efforts to create comfortable work spaces.

Even before the business integration, Cloudpoint had projected sales of ¥3,370 mn and operating profit of ¥220 mn for FY2024/8. According to the management team, the growing demand for digital signage has served as a tailwind and boosted 1H results, with sales coming in at ¥1,860 mn (55.4% progress vs. full-year plan) and operating profit at ¥120 mn (56.1%).

## FY2024/8 Full-year earnings forecast

### ■ Confidence in Creating Synergies with Cloudpoint

The management team has gained considerable confidence that it will generate synergies with Cloudpoint in earnest starting in 3Q, when the business integration took place.

Cloudpoint's clientbase overlaps with that of Valuedesign and includes major convenience stores, large commercial facilities, and major fast-food chains. This has already created a positive dynamic of cross-selling Cloudpoint's signage to Valuedesign's existing and new clients, and Cloudpoint selling *Dokuji Pay* as an added option. The management team has made it clear that it intends to have each operating company flexibly work together in reaching out to its common client base. It also appears that the company plans to reduce costs by having Paycloud absorb some of the corporate functions that Cloudpoint had before the merger.

### ■ Maintained initial projections but progressing ahead of plan

Paycloud Holdings has a three-year medium-term management plan that ends in FY2025/8 and calls for sales of ¥7,000 mn and EBITDA of ¥1,500 mn. In FY2024/8, the midpoint of the plan, the company expects annual transaction value in its mainstay cashless service business to grow to ¥1.5 tn, up from ¥1.2 tn in FY2023/8. In addition, the company projects net sales of ¥6,900 mn, adjusted EBITDA of ¥650 mn, and operating profit of ¥200 mn, as Cloudpoint will become a consolidated subsidiary in 2H.

In addition to adjusted EBITDA surpassing initial forecasts in 1H, there is a high probability that Cloudpoint, which will become a consolidated subsidiary from 3Q, will show an upswing in performance. Despite this, the company maintained its initial full-year earnings forecast after announcing 1H earnings results. SIR believes that there is little cause for concern about the company's earnings outlook, and given the steep upturn in KPI figures for the most recent March period, an upward earnings forecast revision is highly likely. If this happens, investor attention is likely to shift toward the scale of the upward revision to performance targets for FY2025/8, the final year of the medium-term management plan, as well as the details of the next medium-term management plan, which will kick off in FY2026/8.

## New initiatives in Japan and overseas

### ■ Japan: Launched *Furumachi Pay* to support community revitalization and local governments

Valuedesign developed a service that enables users to make hometown tax donation payments right away while traveling. By scanning QR codes placed in stores and facilities at travel destinations with a smartphone, the user can make a donation to the local government on the spot, and an e-gift (digital coupon) will be downloaded to the user's smartphone right away as a thank-you gift. The company only provides the payment system, and is not involved in a hometown tax payment agency business.

Specifically, this *Furumachi Pay* mechanism consists of the user donating (paying) ¥10,000 using their smartphone to support the local government of the area they visit and find appealing, and at the same time, an e-gift worth ¥3,000 is downloaded to their smartphone on the spot as a thank-you gift. Apart from the donation, when users purchase ¥20,000 worth of souvenirs at their travel destination, they can use the e-gift to pay for ¥3,000 of the bill first, and then pay the remaining ¥17,000 using another payment method. In this case, (1) local governments will have more opportunities to receive donations, (2) member stores will see an increase in customer spend and overall sales, and (3) general consumers (donors) will enjoy good deals through the tax savings, taking advantage of the One-Stop Special Exception System. In addition, the company's e-gift system is easy to use, as users can track their remaining balance in one-yen increments.

The company just launched the service in April and is actively promoting activities to encourage local governments to set up QR codes, but the future potential of this service is unknown. It was launched with *Furumachi Pay*, but the company is already negotiating with some local governments to use the service for local currencies, and plans to expand the service going forward.



**\*The Open Network for Digital Commerce** is a digital infrastructure initiated and launched by the Indian government in December 2021 to boost e-commerce adoption in India, and is an integrated domestic open source e-commerce network. By connecting to ONDC, small businesses will be able to compete on an equal footing with large global e-commerce platforms.

■ **Overseas: Began selling gift cards through ONDC, an initiative driven by the Indian government**

In the Indian market, the company is working with EazyDiner, a leading local restaurant reservation service provider, to expand its digital gift distribution business serving over 12,000 partner restaurants. Most recently, the company signed an agreement with Amazon and began handling Amazon Pay eGift Cards.

In addition, Valuedesign's Indian subsidiary, Valuedesign Services Private Limited, in collaboration with Earnest Data Analytics Pvt. Ltd. will newly launch digital gift sales through the Open Network for Digital Commerce (ONDC)\*, an e-commerce network initiated by the Indian government. This will not only expand Valuedesign India's distributor base to more than 47,000 e-commerce businesses selling its clients' digital gifts, but also enable it to handle more than 1,000 types of branded digital gifts via ONDC as well as its own branded gift cards.

Previously, the company's business scope was limited to processing operations for managing in-house branded gift card balances and purchasing and handling gift cards for some customers. However, through ONDC, Valuedesign India started a new business in India as a distributor, purchasing and selling a wide variety of gift cards and earning new fee income.

Still, this initiative was also recently launched, so its future potential is unknown. In addition, the amount and scale of overseas earnings are still minor relative to the company's overall size, so the company has not provided detailed disclosures. Nevertheless, the company is considering disclosing information at some point in the future.

■ **High-growth fintech company trading at a P/B ratio of just under 1.4x**

Share price performance for Paycloud Holdings has been weak since closing at ¥725 on October 13, 2023, when the company announced its stock swap and business integration with Cloudpoint, its transition to a holding company, and the company name change scheduled to take effect on March 1, 2024, as well as its FY2024/8 earnings forecast. Its share price has roughly halved since those announcements, having been sold off excessively in response to news headlines of "disappointing results" each time the company announces quarterly earnings results. Since the company has not disclosed its forecast for ordinary profit, net profit, and EPS for FY2024/8, it goes without saying that there may be some information asymmetry when it comes to earnings figures and details. Nevertheless, SIR believes that there are no negative factors that justify the current share price level, which has fallen beyond the impact of the approximately 31% share dilution, in light of the underlying fundamental factors that point toward a strong likelihood that earnings will surpass company projections.

Based on the company's EBITDA forecast for FY2025/8 ( ¥1,500 mn), the recent share price stands at just 3-4x Enterprise Value, equivalent to that of a zero-growth company. Furthermore, the P/B ratio comes in at 1.39x based on the latest estimated diluted BPS (¥263), a surprisingly low valuation even for a small cap value stock.

The management team is proactive about disseminating information through videos and social media. However, its IR activities are limited to Japanese language only, and the company has expressed its commitment to providing information in English as a priority going forward. Once the company refines its IR activities both quantitatively and qualitatively, including through information distribution, and rectifies its information asymmetry in the process, the the equity market may gain more conviction of the company's earnings growth story for FY2025/8 onward and evaluate it as a high-growth fintech company.

**Share price insights**

\* As of the end of Feb 2024 (¥mn)

Interest-bearing debt	+ 1,090
<u>cash equivalent</u>	<u>- 1,919</u>
<b>Net debt total</b>	<b>-829</b>

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