Zacks Small-Cap Research

October 16, 2014

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Net Element Inc. (NETE-NASDAQ)

NETE: Zacks Company Report – INITIATING COVERAGE Betting on Management With a Track Record- BUY

Current Recommendation	**BUY**
Prior Recommendation	N/A
Date of Last Change	10/15/14
Current Price (10/15/14)	$1.72
Target Price	**$2.42**

OUTLOOK

Net Element is a financial technology company, which operates a small merchant processor in the US and a mobile payment processor in Russia that has restructured its operations and should be on the way to growth after divesting all its former entertainment business. Since its acquisition of Unified Payments in June 2013, its new CEO has focused the company on payments. This CEO took his former company from 0 to $67 million in two years in the same business and we believe he can be successful once again.

SUMMARY DATA

52-Week High	**$5.75**
52-Week Low	**$0.88**
One-Year Return (%)	**-60.0**
Beta	**0.05**
Average Daily Volume (sh)	**2,562,061**
Shares Outstanding (mil)	**45.6**
Market Capitalization ($mil)	**$77**
Short Interest Ratio (days)	**0.18**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**0**
P/E using TTM EPS	**N/M**
P/E using 2014 Estimate	**N/M**
P/E using 2015 Estimate	**N/M**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Business Services**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	0 A	0 A	0 A	1 A	$1.0 A
2013	$0.9 A	$5.6 A	$6.5 A	$5.8 A	$18.7 A
2014	$4.8 A	$4.9 A	$6.0 E	$7.0 E	$22.8 E
2015					$28.0 E

Earnings per Share
(Non-GAAP EPS before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012					-$0.75 A
2013	-$0.10 A	-$0.11 A	-$0.11 A	-$0.12 A	-$0.44 A
2014	-$0.07 A	-$0.07 A	-$0.04 E	-$0.04 E	-$0.21 E
2015					-$0.15 E

Zacks Projected EPS Growth Rate - Next 5 Years **25%**

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KEY POINTS

- Net Element is growth company in the payments industry that should benefit from the adoption of mobile payments in the US and Russia.
- The new CEO took his former company, Unified Payments, from 0 to $67 million in revenues in two years. We believe he has the experience and drive to replicate this success with Net Element.
- Management has been restructuring operations and finances and we believe the fruits of these efforts will show in 2015 and beyond.
- The integration of Unified Payments and Aptito provide a unique offering to merchants and should allow the company to capture market share in the SMB merchant acquirer market in the US.
- We believe the company could grow to $28 million in revenues in 2015 through a combination of internal growth as well as portfolio acquisitions and reach non-GAAP breakeven in 2016.
- If NETE achieves our forecasts, we believe its common stock will be worth $2.42 per share twelve months from now based on an industry average valuation of approximately 5xs enterprise value to sales, up 43%.
- We are INITIATING COVERAGE with a BUY.

OVERVIEW

Net Element (NETE) is the US-listed public company that owns TOT Group, a value-added merchant payment processor and point of sale (POS) software-as-a-service (SaaS) provider in the US, and a mobile payment processor in Russia. It is located in North Miami Beach, FL and was founded in 2010 as a blank check corporation. It went public in 2012, and launched TOT Money, a mobile payment provider through mobile phone operators in Russia, with a division involved in the entertainment industry. On April 16, 2013, Net Element bought a downsized Unified Payments, a US merchant processor, and Unified's founder, Oleg Firer, took over the company as CEO. Five months later he divested the entertainment portion of the company in order to focus on payments. The company's name was changed to "Net Element" on December 15, 2013. It currently has 58 employees, half in the US and half in Russia.

Today, TOT Group consists of two main segments:

- US merchant processing and mobile POS platform (Unified Payments and Aptito)
- Mobile payments in Russia (TOT Money)

1. **Unified Payments** contributes the bulk of the revenues for Net Element. It is a merchant processor for US customers. Based on last quarter's revenues it is at an $18.3 million annual run rate. Its prime processing vendor is Total System Services (TSS).

2. Aptito is a cloud-based Point of Sale (POS) platform and restaurant management service that, combined with the services of Unified Payments, offers small and medium sized businesses (SMBs), merchants and restaurants, a full front and back office solution. Its low priced service offers differentiation to the company's merchant processing offering and its value added should ultimately inch margins upward.

TOT Money a carrier-integrated mobile payments platform is a Russian-based business that allows mobile phone customers to pay bills and make purchases through all types of mobile phones— both feature phones and smartphones. It was founded in 2011 and currently is at a $1.4 million run rate based on last quarter's sales and is one of the top three providers for this service in Russia.

Company Strategy

After selling its entertainment business, the company is now focused on payments and only payments. It has restructured operations as well as debt and is making progress to break-even. The US company was restructured last year, and early this year the Russian operations were revamped and management was replaced. Additionally, the company has been significantly deleveraged. In Russia, the company launched its new platform in April with an API that should jumpstart sales.

Currently the company is operating at a loss and after revamping operations, we expect sales growth to move the company to profitability rather than expense cutting. Last quarter the company reported almost $5 million in revenues and a GAAP profit of $0.04 because of significant one-time gains. Taking out these gains, the GAAP loss was $2.8 million or $0.09 per share, and the company had an adjusted non-GAAP loss of $0.07 per share. In the September quarter the company restructured it debt and reduced interest expense to approximately $450,000 per quarter in 2014, from the $1.8 reported in Q2 2104.

Thus ex-one time charges, the company had a non-GAAP loss of $2.2 million. Since then $15 million in debt has been eliminated and converted into stock, and interest expense has been significantly reduced. Given current expenses and interest charges and using the 25% gross margin the company attained last quarter (taking out a favorable one-time reversal of vendor allowances of $353,000), the company should reach break even at $14 million per quarter in revenue, which we believe could happen next year.

Plans for both internal growth and acquisitions

To grow the business, management is pursuing acquisitions as well as internal growth. Acquisition is an extremely efficient way to grow for the company. Unique to this industry and business model, the company has a right of first refusal to buy portions of its sales partners' portfolios should they seek liquidity. The company is often able to acquire these revenues with very favorable terms. For a $1 million investment, the company could acquire a portfolio that could add as much as $670,000 per year in revenues. At EBITDA industry margins of 30%, this could result in a cash flow payback of five years or an ROI of 20%. The company has in place a line of credit that can be used to make portfolio acquisitions. Internally, the company will achieve growth by expanding the external sales force of agents and resellers as well as by expanding the company's offerings particularly in Russia where it has added new payment options beyond SMS and a new payment platform.

COMPANY OPERATIONS

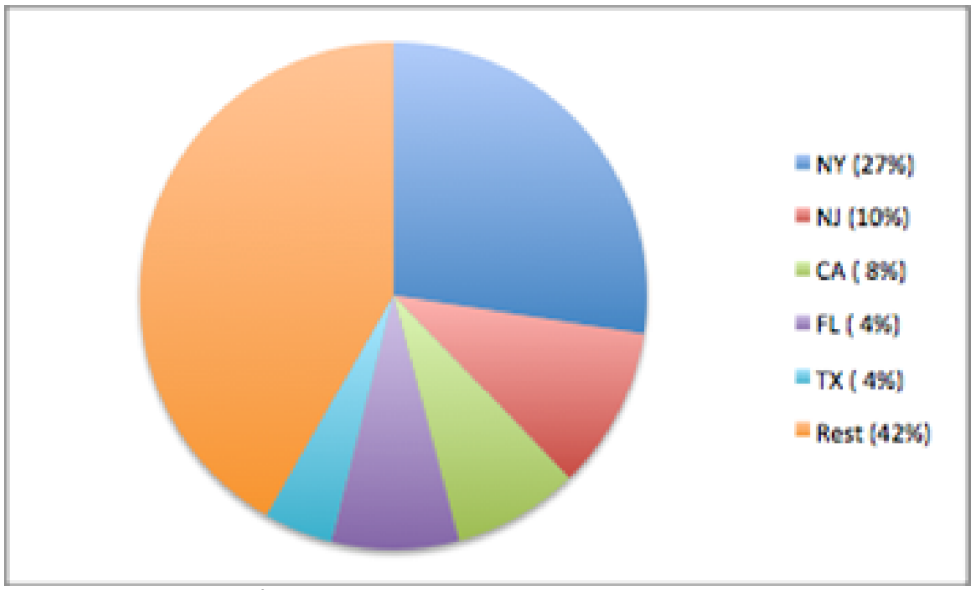
UNIFIED PAYMENTS

TOT Group consists of Unified Payments, a merchant processor in the US with a front-end hardware and software platform for merchants and restaurants called Aptito. Unified Payments contributes the vast majority of revenues and operates solely in the US. TOT Group competes in the merchant acquirer industry. TOT Group has a small internal marketing and sales group and instead relies on independent reps and partners. It has over 100 independent sales groups (ISGs) and third party resellers to sell its services.

It partners with banks such as BMO Harris Bank in the United States for sponsorship as members in the Visa, MasterCard or other card associations and to settle transactions with merchants. Its services for merchants include: application processing, underwriting, account set-up, risk management, fraud detection, merchant assistance and support, equipment deployment and chargeback services.

Unified Payments operates through out the US but has a large concentration in the tri-state area where it was founded as seen on the pie chart. The largest number of customers is in NY with 27% and New Jersey contributes another 10%.

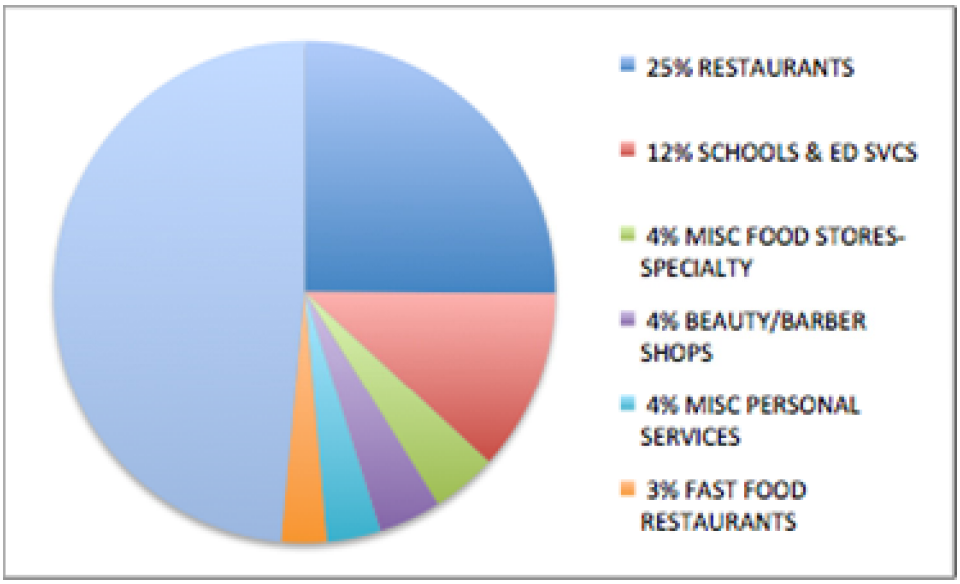
Chart 1: Location of Unified Payment customers



Source: Company data

The types of businesses that use Unified Payments are across the board, but the highest number of establishments is restaurants that fits well with the Aptito that has an excellent restaurant management offering.

Chart 2: Customer Distribution by Industry



Source: Company data

MERCHANT ACQUIRER INDUSTRY

A few large players who serve the 8 million merchants in the US that accept credit cards dominate the merchant acquirer market. The top ten are responsible for over 50% of the world's transactions, but there are hundreds of smaller players. The merchant acquirer provides a system to the store that allows it to take credit and debit card payments. The merchant acquirer takes payment information and using a network processor (in Unified Payments' case, TSYS) to send data to the card association to collect money from the buyer's bank and sent it to the seller's bank.



1. Cardholder uses a card as a payment mode
2. Merchant sends transaction information to the Acquirer by swiping or manually feeding card information
3. The acquirer or third party processor on acquirer's behalf sends the transaction information to the card association
4. The card association sends the transaction information to the Issuer for authorization
5. Issuing bank pays the card association network once it validates the transaction (after deducting its charge)
6. Card association pays the acquirer or processors on acquirer's behalf (after deducting its charge)
7. Merchants account is credited for the transaction amount by the processor (after deducting its charge)
8. Purchase transaction is completed
9. Issuer bills the Buyer for the transaction.
10. Buyer settles the bill

Source: Capgemini Analysis, 2012; *Global Trends in the Payment Card Industry: Acquirers*, Capgemini, 2011

Top Merchant Acquirers

According to the Nilson Report, the 10 largest merchant acquirers of 2013 were:

1. Bank of America Corporation (BAC)
2. Chase Paymentech Solutions
3. First Data Corporation
4. Vantiv, Inc. (VNTV)
5. Elavon, Inc.
6. Wells Fargo Merchant Services (WFC)
7. Citi Merchant Services (C)
8. Global Payments Inc. (GPN)
9. Heartland Payment Systems, Inc. (HPY)
10. WorldPay

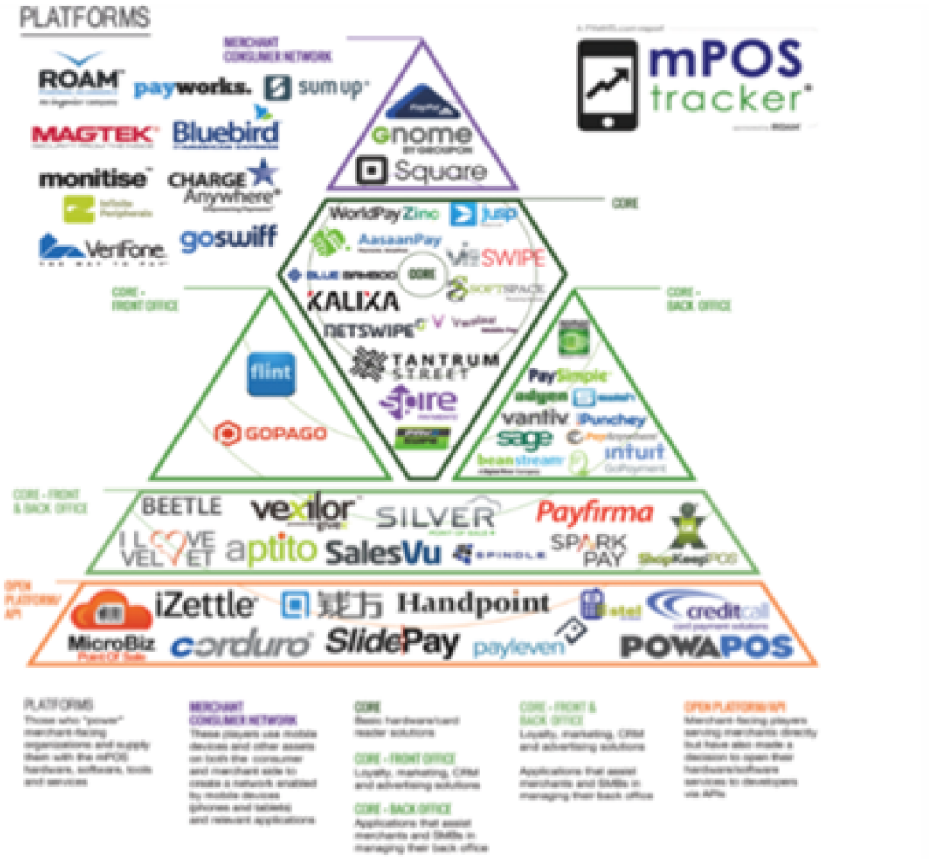
APTITO



Aptito is a complete point of sale solution for the merchant or restaurant. Starting with a digital menu program, it now provides a customer facing ordering system and mobile server solutions all integrated with the kitchen management and financial systems. It is offered as a service to Unified payment's customers and is a huge differentiator in evaluating merchant processors. Customers pay a monthly fee of $79 per month, which includes hardware with no upfront cost to the merchant. There is an excellent **overview video** of the product on Aptito's web site.

MOBILE POINT OF SALE INDUSTRY

According to **PYMNTS.com** which follows the mPOS (mobile point of sale) industry Aptito provides core front and back office functionality these includes: loyalty, marketing, CRM and advertising (front office) as well as applications to manage the customer's business. Aptito place in the mobile payments ecosystem is shown on the chart below and its major competitors are listed.



Source: PYMNTS.com August Report

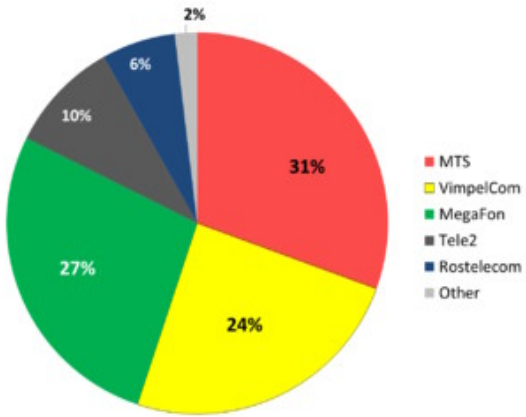
In addition, the site rates each vendor as shown on the following table. Aptito scores a solid 19 and is beat only by Vexilor, I Love Velvet, Payfirma and BEETLE. Three of the major competitors are owned by large companies while other are tiny startups with promise.

Table 1: **Core Front and Back Office Competitor**

Company/ Division	Founded	Employees		Location	PYMTS Score
BEETLE	NA	[illegible]	[illegible]	[illegible]	[illegible]
I Love Velvet	2009	25	Private	NYC	24
Payfirma	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
SalesVu	2007	15	$0.6m funding	Round Rock, TX	12
Silver	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
ShopkeepPOS	2010	140	$37.5 m funding	NYC	17
Spindle, Inc. (OTCBB-SPDL)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
SparkPay	2010	28,000	Formerly Bundle acquired by Capital One (COF)	NYC	12
Vexilor	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

TOT MONEY

TOT Money has been in business in Russia since 2012. Its service allows consumers with mobile phones to pay for products or services by either: text (PSMS), through a mobile browser (WAP), or even IVR billing (in which the merchant sends a reverse SMS) to make a payment. The charge is then billed directly to the customer's phone bill by their phone service provider. This is called "direct carrier billing". In Russia TOT Money works with the three top mobile phone operators: VimpelCom (brand name Beeline), MegaFon and Mobile TeleSystems (MBT), which together have over 80% of the Russian market.



The vast majority of payments through TOT Money are done via SMS and most payments are for small transactions like in App purchases. SMS transactions were more popular in the past and are being somewhat replaced by mobile wallets. In April, TOT Money launched its new platform with an API that will allow merchants to more easily use it service for payment acceptance. As TOT Money moves to alternative payment systems for mobile transactions it should be able to expand its total addressable market significantly.

MOBILE PAYMENT INDUSTRY IN RUSSIA

Russia has remained a vastly unbanked society due primarily to consumer wariness. They are fearful of using banks after a number of them collapsed, and wary of using credit cards due to rampant fraud. In Russia only 25% of the population have a bank account, and even fewer a credit card. When they do use credit cards it is mostly for taking cash out of the bank and then spending the cash. This also helps keep the government from tracking purchases. Given the lack of desirable alternatives, being able to bill to a mobile phone—which far more people have than bank accounts or credit cards—it useful. According to J `son and Partners Consulting, the Russian market for mobile payments is growing 29% per year. In 2013, it was a 34.4 billion rubles ($867 million) market and may reach 122 billion rubles ($3.1 billion) by 2018.

There are 256 million mobile phones in Russia, 107 million credit cards, and a population of 143 million. EMarketer believes mobile phone users in Russia will reach 122.3 million in the next four years. Now 80% of the population has mobile phones and 86% should have them by 2017. Over half of the mobile phones sales in use in Russia are smartphones, of which over 75% are Android.

Globally, direct carrier billing is huge and should grow to $12 billion in revenue in 2022, according to research firm Analysys Mason. In Europe, Jupiter Research believes just paying for digital content billed via direct carrier billing could reach more than $7.1 billion in 2017. Mobile Internet users are expected to rise from 61.5 million in 2014 to 88.1 million by 2017.

Competitors in Russia

In Russia TOT Money competes with a variety of mobile payment methods as well as just those that process SMS payments through mobile operators. Carrier billing was once more popular, but as smartphones grabbed market share, purchases are now being made by credit cards and alternatives like PayPal, Yandex Money, Qiwi purse and WebMoney. The main reason for this is despite the convenience of carrier billing, the percentage mobile operators take for facilitating the transactions has been uncompetitive. Credit cards themselves are very rarely used for purchasing anything and are a relatively new concept. At most they are used to withdraw cash from bank ATMs and little else. Fraud is rampant with credit cards there and there seems to be no appetite at all to use them.

In contrast to the US where according to eMarketer, one-third of online purchases are being done on a mobile device, cash is still king for transactions in Russia. As the society adopts electronic payments, and smartphone penetration increases, we should see more rapid growth in Russia and surrounding countries than in the US.

MasterCard

The recent sanctions by the US have made Russian authorities rethink their reliance on MasterCard and Visa and have begun to shift alliances away from these bankcards. For example, Russia's third-largest lender, Gazprombank, recently started issuing bankcards using Chinese payment system UnionPay. Banks VTB-24, Promsvyazbank, Alfa Bank and MTS Bank are also testing a link up with Unionpay. (Alfa-Bank recently gave Net Element a line of credit.) We believe this blacklisting may provide Net Element with an opportunity to expand its payment business as alliances are changing.

The main competitors TOT Money sees in Russia are:

i-FREE - http://www.i-free.com/en

I-Free was founded in 2001 and is headquartered in St. Petersburg. It operates in over 100 countries and according to its web site generated $250 million in revenues in 2012, and has more than 750 employees.

In June 2013, it introduced and NFC based mobile wallet usable with MasterCard's PayPass. Last November it added the ability to buy transportation cards and use a phone to use them when boarding. It also provides SMS payments as well as IVR, QR code or NFC technologies. These are also available to be integrated into vending machines.

A1 - http://www.alt1.ru/en

A1 was founded in 2005 and based in the Russian Federation. It partners with more than 132 mobile carriers, but appears to have less than 10 employees. In 2010 it expanded beyond Premium SMS billing to direct mobile billing, acquiring, e-currency transactions (WebMoney, Yandex Dengi, etc.) and payments via terminals.

Fortumo - http://www.fortumo.com

Fortumo was founded in 2007 in Estonia and currently has US headquarters in San Francisco. It currently has 64 employees mostly in Estonia. It raised $10 million last year. The company says it operates in 80 countries and it allows app and in-app purchases for games.

Plastic Media - http://www.plasticmedia.ru

Plastic Media Company was founded in 2003 in Moscow and employees over 50 people. It offers Premium SMS payments for digital content as well as goods and services. It advertises that it merchants would receive as much as 60% of the fee for digital content and 97% for ecommerce transactions.

SMS Online - http://en.sms-online.com

SMS Online, headquartered in Russia provides a number of SMS services besides payments. It also does bulk SMS, the spam of the cellular system, as well as quizzes, voting and chat via SMS.

i-Cube - http://i-cb.ru

I-cube is a small company based in Moscow with less than 10 employees that offers complete outsourcing of mobile solutions in Russia and the CIS countries. This includes aggregation of SMS, MMS, WAP and IVR traffic to mobile operators and content aggregation for operator portals. It also provides SMS billing, micropayments systems management, USSD-portals, Sim-menu deployment platform for SMS-information, support for IVR-service and call-centers, custom-tailored services based on technology LBS, systems geo-positioning and the development of WAP and WEB portals.

Additionally there are two global companies that claim to serve the Russian market but the company doesn't see them in the marketplace and they are Boku and Zong, both of which are well funded and have worldwide operations. Boku has been very successful elsewhere in gaming while Zong, as a unit of eBay could eventually gain traction in the Russian market.

Boku

Boku is a private company founded in 2009 in Munich, and is now headquartered in San Francisco and London and has had over $75 million in venture funding. In Russia, Boku can be found on the Beeline, Megafon, Motiv, MTS, NTC, Smarts, Tele2 networks that comprise of 205 million subscribers. Boku entered Russia in 2010 by purchasing Laika Mobile Connectivity the first SMS payment processor in the country. It operates in 67 other countries through more than 250 carrier partners and is connected to merchants such as Facebook, EA, Sony, Spotify, Lookout, and Riot Games. It has over 120 employees worldwide.

Zong, a division of PayPal, and part of EBAY

Another provider of payments through mobile phones in Russia is Zong, which was bought by PayPal in 2011 for $240 million. It allows purchases through all the mobile carriers: MTS, Beeline, Megafon, Tele2, SMARTS, and Uralsbyazinform.

VALUATION

There are a number of public companies in the merchant acquiring/processing business. The largest is Cielo with a $24 B market cap located in Brazil. The smallest is we are using is Qiwi, who runs payment systems in the Russian Federation and is based in Moscow. The rest are located in the US. If we take the average enterprise value to sales of this group of companies and apply it to the revenues we expect Net Element to generate next year, and turn that back to price per share we get a share value of $2.42.

Merchant Acquring/Processing

	Ticker	Revenue		EBIDTA	Enterprise Value / Sales	
Company		2014E	LTM	Margin	2014E	LTM
Cielo	CIOXY	$3,100	$2,900	51%	8.0x	8.6x
Vantiv	VNTV	$1,400	$1,223	36%	5.5x	6.3x
Total System Services	TSS	$2,450	$2,420	23%	2.8x	2.9x
Global Payments	GPN	$2,730	$2,630	21%	2.4x	2.5x
EVERTEC	EVTC	$370	$359	42%	6.5x	6.7x
Heartland Payment Systems	HPY	$658	$617	26%	2.9x	3.1x
Qiwi	QIWI	$221	$218	27%	5.3x	5.4x
Average				**32%**	**4.8x**	**5.1x**

	Projected Revenue		EBITDA	Enterprise Value / Sales	
	2015E	LTM	Margin	2015E	LTM
Net Element	**$28**	**$26**		**4.8x**	**5.1x**
YoY growth					

Conclusion of Enterprise Value	**$132,910,997**
Market Value	**$132,182,713**
Fully DilutedShares Outstanding	54,546,011
Price per Share	**$2.42**

MANAGEMENT

Board of Directors

Kenges Rakishev- Chairman

Kenges has been Chairman since October 2, 2012. He served as a director of the Company's predecessor, Net Element, Inc., from April 23, 2012, until October 2, 2012. Mr. Rakishev runs an investment fund that invests in early stage technology and also has been Chairman of SAT & Company JSC (a metal and mining company in Kazakhstan) since 2008. He has invested $32 million in Net Element. He is also involved in a number of industrial companies located in China and Turkey as well as Kazakhstan. Mr. Rakishev is VP of the Union of Chambers of Commerce of the Republic of Kazakhstan. Most recently Mr. Rakishev partnered with Kazkommertsbank to acquire BTA Bank, one of the largest banks in Kazakhstan. Mr. Rakishev currently serves the Chairman of the Board of Directors of BTA Bank. He is also VP of The Boxing Association of Republic of Kazakhstan and the VP of Asian Boxing Confederation. He holds a BA in Law from the Kazakh State Law Academy, a B.A, in International Economics from Kazakh Economic University, and an AMP Diploma from Oxford University.

Oleg Firer- CEO

Oleg is the founder of Unified Payments, the merchant card processor that was bought by Net Element in June 2013. Unified Payments' revenues grew by 23,646% was ranked as #1 fastest-growing company by Inc. Magazine in 2012. Prior to Unified Payments, Oleg worked in private equity, payment processing, wireless communications and technology companies. He is a member of the Electronic Transactions Association (ETA) Mobile Payments, ISO Practices and Risk, Fraud & Security committees.

David Kelley II

Mr. Kelley became a director in August 2010. He is a partner of Zenith Capital Partners, LLC, a private equity firm in New York, where he has served since 2006, and a founding partner of Andover Partners Strategic Security Solutions, LLC (AP-S3, LLC), a security and intelligence consulting firm, where he has served since December 2009. From 1985 to 1988, David was a tax lawyer in the law firm of Brown and Wood. From 1988 to 1991, Mr. Kelley was Director of the Global Swap Group at Merrill Lynch. He also worked in Structured Products at UBS Securities and Deutsche Bank Securities. From 1998 to 2006, Mr. Kelley was a Managing Director of Integrated Capital Associates, a private equity firm. Mr. Kelley is currently a Director of the Apex-Guotai Junan Greater China Fund, headquartered in Hong Kong. He earned a BA from Emory University in 1979, a JD degree from Temple University School of Law in 1983, and a LLM in Taxation from NYU School of Law in 1985.

Drew Freeman

Drew is currently the President of Freeman Consulting, Inc., a payments consulting firm to private equity groups and independent sales organizations. Before that, Drew was President of Merchant Data Systems from 2009 to 2013, Group Executive at Chase Paymentech from 2006 to 2007, and EVP at JP Morgan Chase-First Data JV (Chase Merchant Services) from 2000 to 2006. Mr. Freeman earned a BBA from the University of Miami in 1982.

William Healy

Mr. Healy is an accomplished financial services industry veteran with more than 24 years of merchant financing and electronic payments industry experience. Mr. Healy is currently the President of Funds4Growth, a leading investment firm focused on financing of payment service providers in the United States. Since launching Funds4Growth, Mr. Healy has successfully structured and financed in excess of $150 million in merchant base loans. Prior to his tenure at Funds4Growth, Mr. Healy founded

MBF Leasing, LLC in November of 2003, where he was responsible for strategic planning along with the financial and operational management of MBF Leasing. Prior to that, Mr. Healy spent 13 years with the CIT Group, Inc. (NYSE: CIT), where he was the President of CIT's Lease Finance Group out of Chicago, Illinois, overseeing more than 150 employees involved in over 225,000 leasing transactions, and in excess of $125 million in merchant base financings. Prior to joining CIT, Mr. Healy held several senior level positions with NewCourt Financial, including Chief Operating Officer of the Specialty Finance Division. He is a graduate of the University of Notre Dame with a Bachelor's degree in Accounting.

James Caan

Mr. Caan has been a director of Net Element and its predecessor since January 1, 2011. He also has been Chairman of the Advisory Board of Openfilm since October 12, 2009. Mr. Caan is an actor and director, having worked in the film and television industries for over 50 years, and he is one of the entertainment industry's most renowned talents, having starred in over 80 films.

Steven Wolberg

Steven became Chief Legal Officer and Corporate Secretary of Net Element on April 16, 2013. He served in various capacities with Acies Corporation, a payment processor, from 2009 until 2012. He has been operating a solo law practice in Newton, Massachusetts, since 1997. Since 1996, he has served as president of Oakland Properties, Inc., a real estate development company and also currently owns and serves as the Managing Member of Prime Portfolios, LLC, which holds a private investment portfolio of payment processing companies. Steve received a BA and a Bachelors of Law from the University of Witwatersrand in Johannesburg and his JD from the New England School of Law in Boston. He is a member of the Massachusetts Bar Association.

MANAGEMENT

Jonathan New, CFO

Jonathan has been CFO of Net Element and its predecessor company since March 10, 2008. He has had extensive experience in the Controller and CFO positions at a variety of technology and financial companies, and also provided services to public companies on a variety of corporate accounting, reporting and audit related issues as a consultant. Jonathan earned a BS in Accounting from Florida State University in 1982. He is a member of the Florida Institute of CPAs and AICPA.

Andrey Krotov, Chief Technology Officer

Andrey became Net Element's CTO in March 1, 2014, where he has worked since 2011. From October 2008 through December 2010, Andrey worked at Interactive Tribe GmbH, as a senior software engineer. From April 2007 until August 2008, He was employed with Artsofte, a software development company, as a software engineer. Andrey has a master degree from Ural State Technical University by specialty "Calculating machines, complexes, systems and networks".

LITIGATION

OOO-RM Invest

On **March 17, 2014,** the company was served with a lawsuit brought by OOO-RM Invest in the US District Court, Southern District of Florida. In its complaint, OOO-RM Invest claims that on or about July 11, 2012 it entered into an oral agreement with the Company allegedly agreeing:

- to form a new entity, TOT Money International, LTD, that would continue the operations of Plaintiff
- that the company would provide TOT Money International, LTD financing in the amount of 600,000,000 Russian rubles
- that the Company would assume certain liabilities of plaintiff;
- that the Company would be responsible for all business operations of plaintiff and TOT Money International, LTD
- that the Company would deliver DST account and stated key DST structures to TOT Money International, LTD
- that plaintiff would receive a 30% ownership stake in TOT Money International, LTD and/or receive shares of stock in the Company's Russian subsidiary
- that Tcahai Hairullaevich Katcaev would hold the position of General Director of TOT Money
- Plaintiff would provide TOT Money International, LTD with access to plaintiff's operating accounts
- Plaintiff would transfer client accounts and contracts to TOT Money.

Plaintiff claims that the company **breached its obligations pursuant to that alleged oral agreement,** and is seeking, among other things, compensatory damages in excess of **$50 million**. The Company strongly denies the allegations referenced in the complaint. A motion to dismiss on jurisdictional as well as substantive grounds has been filed and is pending a hearing. Representatives of both parties have been deposed in anticipation of the motion to dismiss which is scheduled to be heard **sometime in 2014**.

RISKS

- The company is losing money and may not be able to reach profitability or become cash flow positive
- The company is involved in a lawsuit with former management in Russia.
- The company has recently restructured operations and there is no assurance these efforts will be successful.
- The Russian mobile payment market is still in its infancy and there is no assurance the country will adopt this method to pay for goods and services.
- The merchant acquirer market in the US is competitive and larger companies have an advantage due to economies of scale.

INSIDER TRADING AND OWNERSHIP

Major Holders

Kenges Rakishev, Chairman of the Board

Nurlan Abduov owns K-1 Holding, Beno Distribution Ltd. and is located in Kazakhstan.

Michael Zoi owns 14% of Net Element, down from over 50% in the past few months. Michael was the former Chairman and CEO of Net Element's predecessor company. Additionally since 2007 he has been the CEO of Openfilm LLC, founded Enerfund, LLC in 2006, has been the managing member of TGR Energy LLC. and co-founded Ener1 Group Inc., holding company of Ener1 Inc.

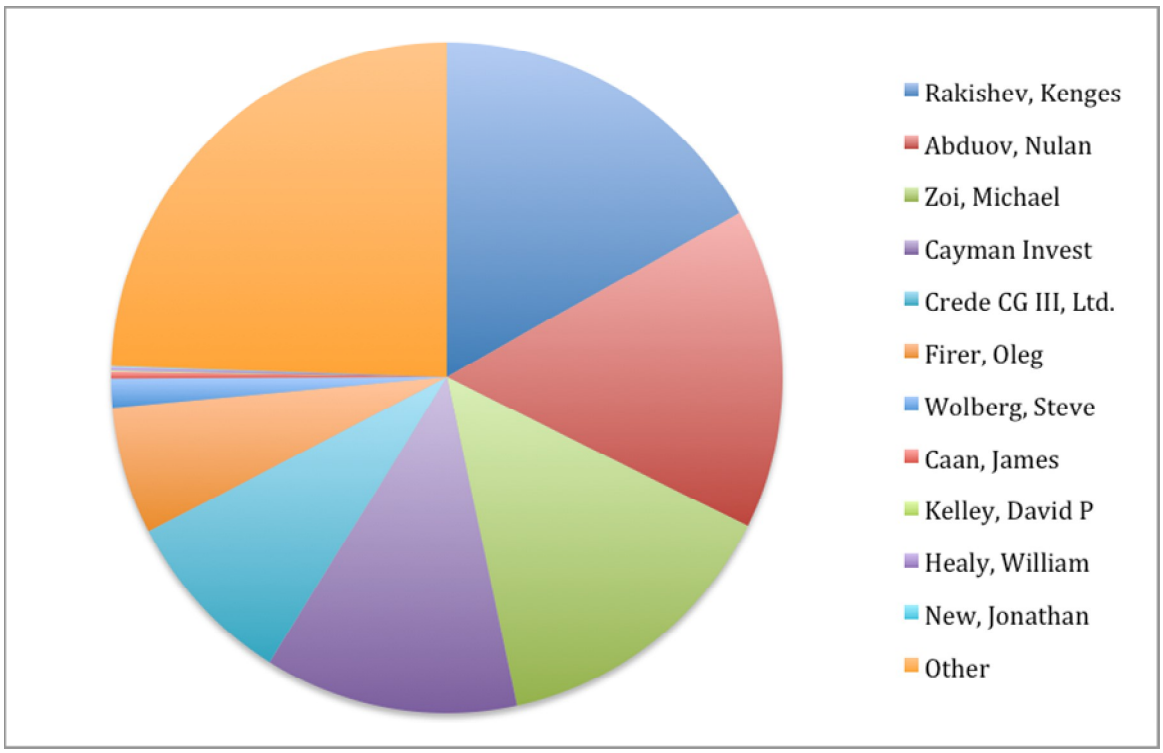
Cayman Investments is also the holder of a $11.2 million convertible note that converts to 15% of the outstanding shares of Net Element on March 15, 2015. It does not accrue interest before the maturity date. Its Managing Director is Anvar Mametov.

Terren Peizer owns **Crede CG III**.

Oleg Firer is CEO of Net Element and a director.

Steve Wolberg, James Caan, William Healy and David Kelley are board members.

Jonathan New is CFO of Net Element.



Source: Company and SEC Filings

PROJECTED INCOME STATEMENT & BALANCE SHEET

Forecasts

Q3 2014

For the quarter ending September 30, 2014 we are looking for revenues of $6 million versus $6.5 million in 2013, down 8%. Some of the decline is due to the restructuring Russia that was done last last year. In the quarter, there was a very large stock based compensation expense that will show up in G&A, which will result in a much larger loss that in Q2. As a result we expect operating expenses to increase to $7.6 million instead of a more normalized $3 million. With a decrease in interest expense, we expect a GAAP loss per share of $0.14, and a non-GAAP loss of $0.04. Due this award of stock to the CEO, we expect the share count to rise to 45.6 million primary share and 54.5 million shares fully diluted.

2014

In 2013 the company generated $18.7 million in revenues with only three quarters of the Unified Payments acquisition. That alone should add between $4 and $5 million to revenues in 2014. We are expecting the company to end the year with $22.8 million in revenues versus $18.7 million last year, up 21%. The company could show a loss of $13.7 million or GAAP loss of $0.35 per share and non-GAAP loss of $0.21.

2015

After all the restructuring in 2014, we believe in 2015 Net Element should be able to focus and grow its revenues organically as well as through judicious acquisition of portfolios. The Russian operations should recapture lost business and thrive as it markets its new products and the market for mobile payments grows. We are forecasting revenues of $28 million next year up 28%. This includes growth of 20% for the credit card business, and an almost doubling of the Russian business to $3 million. We think this is possible because of the small base the company is coming from as well as the CEO's experience in previously growing Unified Payments to $67 million in two years. 2015 operations should still result in non-GAAP losses but that should be reduced to $0.14 per share or $0.16 GAAP EPS. We expect the primary share count for the year to be up 17% to 45.6 million from 39 million in 2014. Fully diluted shares should be 54.5 versus 47.9 million.

Q3 Financial Changes

As part of the makeover of the company, the CEO is working to restructure the debt to create a sustainable business. Since the last quarter was reported a number of changes have been made to reduce debt while diluting shareholders.

On September 11, 2014, the company awarded Oleg Firer 1.4 million restricted share of common stock. Added to the 1.4 million shares of stock he acquired by selling Unified Payments to Net Element last year he now owns 2.85 million shares of Net Element.

On September 17, 2014, the company exchanged $15,876,860 in notes, owned by a subsidiary of Crede Capital Group, for common stock. This added 3.5 million shares to the outstanding. Terren Peizer owns Crede Capital.

On September 23, 2014, the company's Russian subsidiary, TOT Money renewed and increased its line of credit with Alpha-Bank to the equivalent of $11 million to support growth in Russia and the Commonwealth Independent States.

All of these actions taken together have increased the primary shares outstanding to 45.7 million from the 32.2 million reported at the end of Q2 on June 30, 2014. It has increased the fully diluted share count to 56.4 million. It has also reduced the debt from $17.1 million to less than a million dollars.

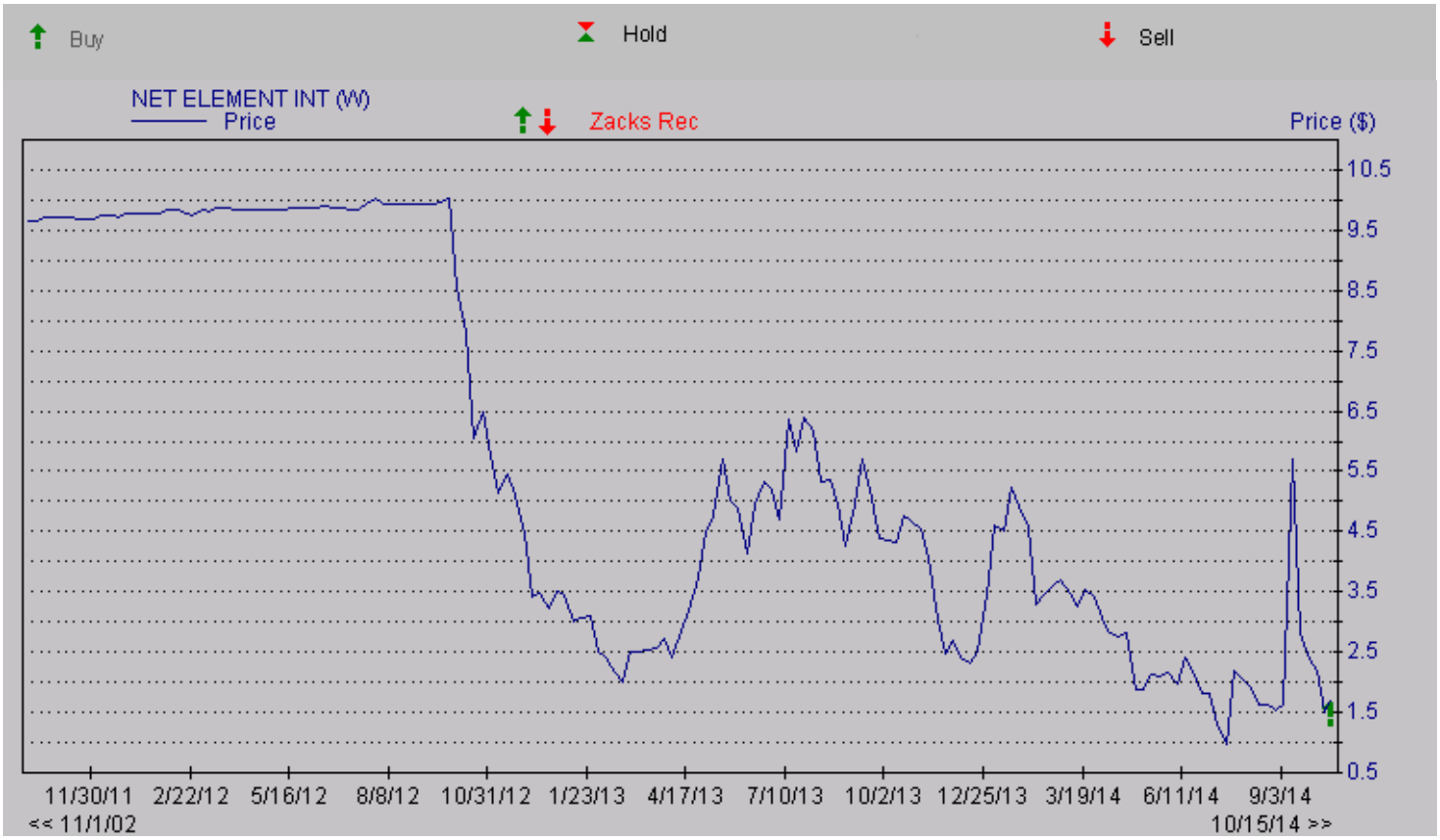
INCOME STATEMENT

card processing	$0.0	$4.6	NA	NA	$4.1	$4.6	$5.5	$6.5	NA	$20.7
					NM	-0.6%	NA	NA		NA
e payments	0.9	1.0	NA	NA	0.5	0.3	0.5	0.5		1.8
revenues	0.0	0.0	NA	NA	0.0	0.0	0.0	0.0		0.0
evenues	0.9	5.6	6.5	5.8	4.8	**4.9**	**6.0**	7.0	18.7	**22.8**
-yr Growth					457.9%	-12.4%	-8.0%	21.7%		21.4%
and expenses:										
f revenues	0.3	4.1	4.6	4.3	3.5	3.3	6.0	7.0	13.4	19.9
Margin	0.6	1.5	1.9	1.4	1.3	1.6	1.5	1.8	5.4	6.1
Sales	68.3%	26.3%	28.7%	24.9%	27.1%	31.9%	25.0%	25.0%	28.7%	26.9%
us one-time						25%				
	2.8	3.5	2.9	19.0	3.1	2.5	7.1	2.5	28.2	15.3
ion for loan losses	0.4	5.8	0.5	0.9	0.1	(1.5)	0.0	0.0	7.6	(1.4)
ciation and amortization	0.0	0.6	0.8	0.8	0.6	0.6	0.5	0.5	2.2	2.2
me charges	0.0	11.2	0.0	0.9	0.0	0.0	0.0	0.0	12.1	0.0
perating expenses	3.5	21.1	4.3	21.5	7.4	1.6	7.6	3.0	50.1	19.6
om operations	(2.6)	(19.6)	(2.4)	(20.1)	(2.5)	(0.1)	(6.1)	(1.3)	(44.7)	(9.9)
om operations ex-one time	(2.6)	(8.4)	(2.4)	(19.2)	(2.5)	(1.3)	(6.1)	(1.3)		(11.1)
st expense, net	(0.1)	(0.9)	(1.0)	(0.9)	(1.1)	(1.8)	(0.5)	(0.5)	(3.0)	(3.7)
expense	(0.1)	(0.0)	(0.1)	0.0	(0.0)	(0.0)	0.0	0.0	(0.2)	(0.0)
me charges	0.0	0.0	0.0	0.0	0.0	3.2	0.0	0.0	0.0	3.2
non-operating expenses	(0.2)	(0.9)	(1.1)	(0.9)	(1.1)	1.4	(0.5)	(0.5)	(3.1)	(0.6)
om continuing operations before income vision	(2.9)	(20.5)	(3.4)	(21.0)	(3.6)	1.3	(6.6)	(1.7)	(47.9)	(13.7)
e tax provision	0.0	0.0	0.0	(0.2)	0.0	0.0	0.0	0.0	(0.2)	0.0
ate	0%	0%	0%	1%	0%	0%	0%	0%	0%	0%
om continuing operations	(2.9)	(20.5)	(3.4)	(21.2)	(3.6)	1.3	(6.6)	(1.7)	(48.1)	(13.7)
ss (income) attributable to the ntrolling interest	(0.2)	0.6	0.3	0.5	0.0	0.0	0.0	0.0	1.1	0.0
tinued operations:										
om operations of discontinued entities	(0.4)	(0.3)	(0.4)	(0.0)	0.0	0.0	0.0	0.0	(1.0)	0.0
n sale of assets of discontinued ions	0.0	0.0	(0.3)	0.0					(0.3)	0.0
discontinued operations	(0.4)	0.0	(0.7)	(0.3)	0.0	0.0	0.0	0.0	(1.3)	0.0

BALANCE SHEET

!	30!Jun!14	Mar.!31,!2014	Dec.!31,!2013	%!Change Dec!June
Current!assets:	!	!		
Cash	$1,271,716!	$777,031!	$126,319!	907%
Accounts!receivable,!net	4,374,431	6,492,892	10,619,289	>59%
Advances!to!aggregators,!net	4,246	1,023,039	1,109,538	>100%
Prepaid!expenses!and!other!assets	831,058	737,683	834,025	0%
Total!current!assets	6,481,451	9,030,645	12,689,171	>49%
			!	
Fixed!assets,!net	63,234	115,002	137,267	>54%
Intangible!assets,!net	3,052,847	2,488,225	2,964,424	3%
Goodwill	6,671,750	6,671,750	6,671,750	0%
Other!long!term	308,299		!	
Investment!in!affiliate	0	0	46,113	>100%
Total!assets	16,577,581	18,305,622	22,508,725	>26%
			!	
	!		!	
Current!liabilities:	! !	!	!	
Accounts!payable	2,609,509	$2,887,403	$3,190,215	>18%
Deferred!revenue	158,012	267,705	239,398	>34%
Accrued!expenses	2,713,911	2,816,992	3,484,963	>22%
Short!term!loans	256,402	7,421,795	8,478,810	>97%
Notes!payable!(current!portion)	98,493	1,566,423	3,816,093	>97%
Due!to!related!parties	318,301	318,300	1,451,357	>78%
Total!current!liabilities	6,154,628	15,278,618	20,660,836	>70%
			!	
Notes!payable!(non>current!portion)	16,635,581	19,634,348	17,255,531	>4%
Total!liabilities	22,790,209	34,912,966	37,916,367	>40%
	!		!	
STOCKHOLDERS'!DEFICIT	! !	!	!	
Preferred!stock!	0	0	0	0%
Common!stock!	3,836	3,233	3,229	19%
Paid!in!capital	116,455,522	104,804,856	103,486,144	13%
Stock!subscription	>2,320,102	149,707	329,406	>804%
Accumulated!other!comprehensive!income!(loss)	990,531	1,112,748	>170,550	>681%
Accumulated!deficit	>121,176,387	>122,524,155	>118,930,828	2%
Noncontrolling!interest	>166,028	>153,733	>125,043	33%
Total!stockholders'!deficit	>6,212,628	>16,607,344	>15,407,642	>60%
Total!liabilities!and!stockholders'!deficit	$16,577,581!	$18,305,622!	$22,508,725!	>26%
Net!Cash	$598,520		($13,619,941)	>104%
Current!Ratio	1.1		0.6	71%
Quick!Ratio	1.1		0.6	71%
Total!Debt	!!!!!!17,052,375		!!!!!!22,522,981	>24%
Debt/TA	104%		138%	>24%

HISTORICAL ZACKS RECOMMENDATIONS



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