Zacks Small-Cap Research

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Net Element Inc. (NETE-NASDAQ)

NETE: Adjusting Numbers to Reflect Today's Reverse Stock Split

Using an industry average of EV to GM of 6.2X we believe the stock could be worth $3.70 per share by year-end if NETE could reach profitability.

Current Price (05/24/16)	$2.80
Valuation	**$3.70**

OUTLOOK

Net Element is a software and services company, in global online payments. It operates a merchant processor in the US with and attractive offering from Aptito and a mobile payment processor in primarily in Russia. We expect revenues to grow another 24% this year without portfolio acquisitions and for losses to decrease. Investors are also expecting a reverse stock split in June to remain in compliance with NASDAQ. The company burns about $300,000 per month in cash and we believe breakeven operations could stop the equity dilution.

SUMMARY DATA

52-Week High	**$6.90**
52-Week Low	**$0.60**
One-Year Return (%)	**-56.7**
Beta	**0.57**
Average Daily Volume (sh)	**412,185**
Shares Outstanding (mil)	**11.4**
Market Capitalization ($mil)	**$31**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**3**
Insider Ownership (%)	**31**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**179**
Earnings Per Share (%)	**N/A**
Dividend (%)	**0**
P/E using TTM EPS	**N/M**
P/E using 2015 Estimate	**N/M**
P/E using 2016 Estimate	**N/M**
Zacks Rank	**N/A**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Internet Commerce**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	4.8 A	4.9 A	6.0 A	5.4 A	21.2 A
2015	5.5 A	6.9 A	12.7 A	15.1 A	40.2 A
2016	11.3 E	12.1E	12.5 E	13.9 E	50.0 E
2017					56.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.78 A	-$0.25 A	-$0.48 A	$0.01 A	-$1.86 A
2015	-$0.36 A	-$0.64 A	-$0.43 A	-$0.22 A	-$1.54 A
2016	-$0.11 A	-$0.12 E	-$0.11 E	-$0.10 E	-$0.49 E
2017					-$0.35 E

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

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WHAT'S NEW

10:1 Reverse Split Effective Today

We are putting out this update, to reflect the revised share count due to the reverse split in our estimates and model. There are no other changes.

Q2 2016 Forecast

In Q2 we are looking for revenues of $12.2 million versus $6.9 million an increase of 75%. Non-GAAP net loss should be similar to Q1 at a loss of $0.12 versus a loss of $0.64 a year ago.

2016

The estimated non-GAAP EPS loss per share for 2016 now calculates to $0.49 per share.

2017

The estimated non-GAAP EPS loss per share for 2017 now calculates to $0.35 per share.

INVESTMENT THESIS

- Net Element is growth company in the payments industry that should benefit from the adoption of mobile and online payments in the US and Russia and ultimately globally.
- Its Aptito product line provides differentiation and value-added services to its generic card processing business. It recently rolled out new product for retail establishments after being heavily focused on restaurants. This business should increase margins as well as aid sales efforts by improving price/performance and customer stickiness.
- The company has an increasingly robust platform to create a global payment system complete with merchant from end and should be able to expand geographically.
- We believe the company could grow to $50 million in revenues in 2016 through a combination of internal growth, acquisitions and change in revenue recognition.
- If NETE achieves our forecasts without further common stock dilution than that already predicted and no incremental debt, we believe its common stock could be worth $3.70 per share based on an industry average valuation of approximately 6.2xs enterprise value to gross margin.

RISKS

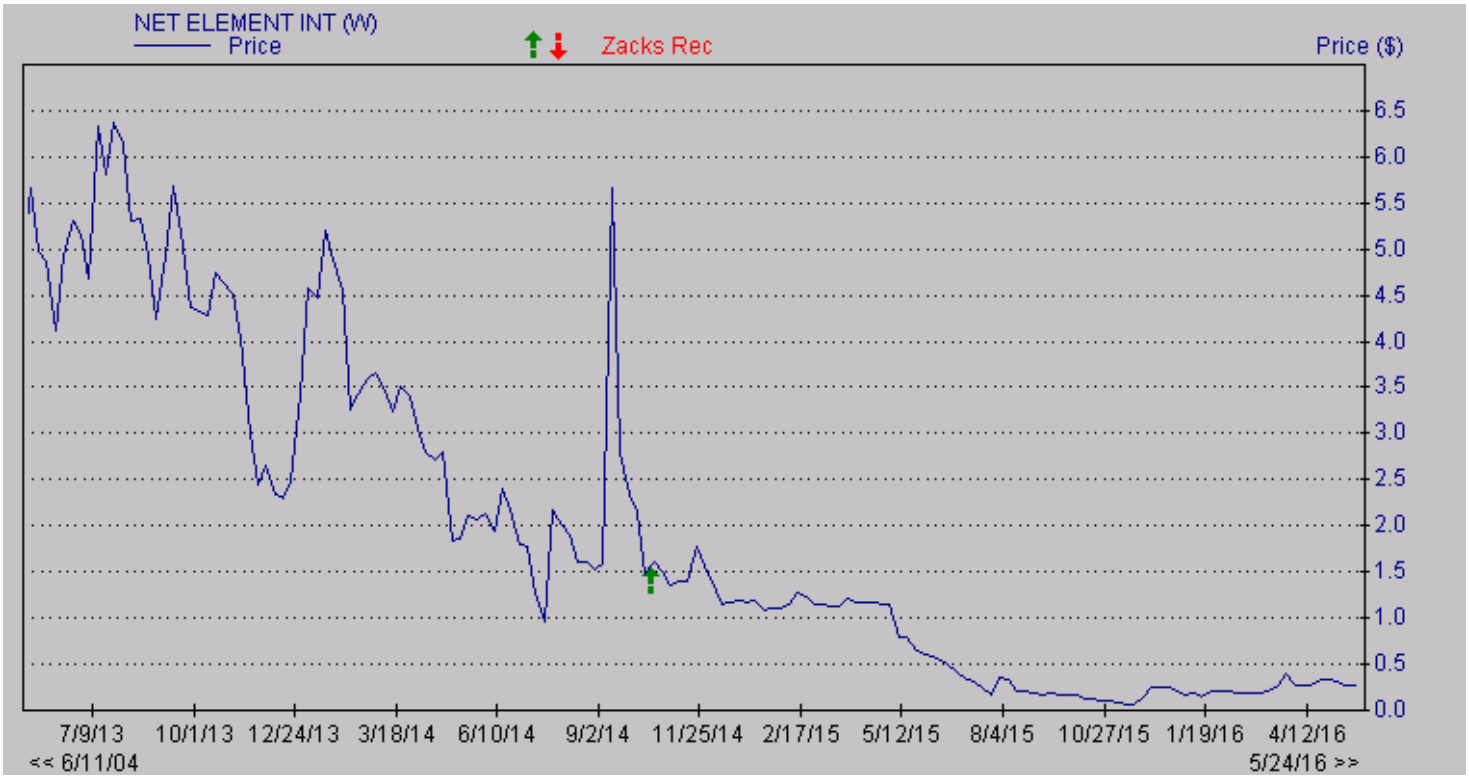
- The company has a new financial arrangement that is dilutive to common shareholders. It is uncertain if the company will be able to make accretive investments with these funds and shareholders may suffer further dilution.
- The company is losing money and may not be able to reach profitability or positive cash flow.
- The company is involved in a number of lawsuits with former management and business partners.
- The Russian mobile and online payment market is still in its infancy and there is no assurance the country will adopt this method to pay for goods and services. In addition due to oil prices and political turmoil, retail sales in Russia have declined and this could affect payment volumes.
- Future acquisitions may not be successfully integrated operationally or technologically. Purchased portfolios may not yield expected profits.
- The merchant acquirer market in the US is competitive and larger companies have an advantage due to economies of scale.
- Operations in Russia and the United Federation face considerable political risk and may be prohibited from certain financial transactions by governments.
- Currency, particularly the ruble, has fluctuated dramatically and could affect reported earnings and operations.

INCOME STATEMENT

Dollars in Millions	2014				2014							
	Q1 2015 31-Mar	Q2 2015 30-Jun	Q3 2015 30-Sep	Q4 2015 31-Dec	Q1 2016 31-Mar	Q2 2016E 30-Jun	Q3 2016E 30-Sep	Q4 2016E 31-Dec	2014	2015	2016E	2017E
North America Transaction	$5.2	$6.3	$7.8	$8.1	$7.9	$8.0	$7.5	$8.2	$19.3	$27.39	$31.55	$34.08
Yr-over-yr Growth	26.4%	37.1%	41.4%	58.3%	51.7%	27.6%	-4.2%	1.1%	30.6%	41.7%	15.2%	8.0%
Credit card cost of service	4.6	5.5	6.5	7.0	6.7	6.9	6.5	7.1	15.9	23.5	27.0	28.6
Gross margin	0.6	0.8	1.3	1.2	1.2	1.1	1.1	1.1	3.4	3.9	4.5	5.5
Gross margin %	11.1%	13.1%	17.1%	14.3%	15.3%	14.0%	14.0%	14.0%	17.6%	14.2%	14.3%	16.0%
Mobile payments	0.4	0.3	2.8	5.6	2.0	2.3	3.0	3.5	1.9	9.0	10.8	13.0
Yr-over-yr Growth		-2.2%	470.2%	NM	448.9%	594.8%	7.3%	-37.0%	-52.8%	385.5%	19.3%	20.0%
Cost of Service	0.0	0.0	2.8	5.3	1.8	2.1	2.8	3.2	0.0	8.1	10.0	11.9
Gross Margin	0.349	0.3	0.0	0.216	0.178	0.2	0.2	0.3	1.9	0.9	0.8	1.0
Gross margin %	96.2%	95.5%	1.3%	3.9%	8.9%	7.5%	7.5%	7.5%	100%	10.2%	7.8%	8.0%
PayOnline	-	0.3	2.1	1.4	1.4	1.8	2.0	2.2	0%	3.8	7.4	8.5
Yr-over-yr Growth	-	NA	NA	NA	NA	NA	-2.6%	52.1%	NA	NA	95.0%	15.0%
Online Solutions Cost of Service	-	0.0	1.5	0.9	0.9	1.2	1.3	1.5	0.0	2.4	4.9	5.5
Gross Margin	-	0.3	0.6	0.5	0.5	0.6	0.7	0.7	0.0	1.4	2.5	3.1
Gross margin %		100.0%	29.0%	37.9%	35.1%	34.0%	34.0%	34.0%	NA	38.1%	34%	36.0%
Total revenues	5.5	6.9	12.7	15.1	11.3	12.1	12.5	13.9	**21.2**	**40.2**	**49.8**	**55.6**
Yr-to-yr Growth	14.4%	40.6%	110.3%	179.3%	103.2%	75.2%	-1.4%	-8.0%	13.0%	89.8%	23.7%	11.6%
Costs and expenses:												
Cost of revenues	4.6	5.5	10.7	13.2	9.4	10.2	10.5	11.7	15.9	34.0	41.9	46.0
Gross Margin	0.9	1.4	2.0	1.9	1.9	1.9	2.0	2.2	5.3	6.3	7.9	9.6
% of Sales	16.7%	20.8%	15.5%	12.7%	16.7%	15.7%	15.6%	15.5%	25.1%	15.6%	15.9%	17.2%
G&A	2.6	3.2	2.8	5.0	2.4	2.6	2.6	2.7	11.4	13.6	10.2	11.3
Provision for loan losses	0.0	0.1	0.3	0.2	0.3	0.1	0.1	0.1	(1.2)	0.6	0.6	0.6
Depreciation and amortization	0.4	0.6	0.9	0.6	0.9	0.9	0.9	0.9	2.4	2.5	3.6	3.6
Total operating expenses	3.1	3.9	3.9	5.9	3.6	3.5	3.5	3.6	12.6	16.8	14.3	15.4
Loss from operations	(2.2)	(2.5)	(1.9)	(3.9)	(1.7)	(1.6)	(1.6)	(1.5)	(7.2)	(10.5)	(6.4)	(5.9)
Loss from operations ex-one time	(2.2)	(2.5)	(1.9)	(3.9)	(1.7)	(1.6)	(1.6)	(1.5)	(8.4)	(10.5)	(6.4)	(5.9)
Interest expense, net	(0.1)	(1.3)	(1.6)	(0.6)	(0.2)	(0.2)	(0.2)	(0.2)	(3.7)	(3.6)	(0.7)	(0.7)
Other expense	0.0	(0.0)	(0.0)	(0.0)	(0.0)	0.0	0.0	0.0	(0.2)	(0.1)	(0.0)	(0.0)
Gain on asset disposal	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gain on change in conversion derivative	0.0	2.0	(1.1)	(27.9)	0.0	0.0	0.0	0.0	0.0	(26.9)	0.0	0.0
One-time charges	0.0	0.0	0.1	27.7	0.0	0.0	0.0	0.0	1.0	27.7	0.0	0.0
Total non-operating expenses	(0.1)	0.7	(2.6)	(0.8)	(0.2)	(0.2)	(0.2)	(0.2)	(2.9)	(2.8)	(0.7)	(0.7)
Pretax operating income (loss)	(2.2)	(1.8)	(4.5)	(4.8)	(1.9)	(1.8)	(1.8)	(1.7)	(10.1)	(13.3)	(7.1)	(6.5)
Income tax provision	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Operating Loss	(2.2)	(1.8)	(4.5)	(4.8)	(1.9)	(1.8)	(1.8)	(1.7)	(10.3)	(13.3)	(7.1)	(6.5)
Minority interest	0.0	0.0	0.0	(0.1)	0.0	0.0	0.0	0.0	0.0	(0.1)	0.0	0.0
Discontinued operations:												
Loss from operations of discontinued	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loss on sale of assets of discontinued									0.0	0.0	0.0	0.0
Total discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net loss	(2.2)	(1.8)	(4.5)	(4.9)	(1.8)	(1.8)	(1.8)	(1.7)	(10.2)	(13.4)	(7.1)	(6.5)
Preferred dividend	0.0	(0.5)	(0.6)	(0.4)	0.0	0.0	0.0	0.0	0.0	(1.6)	0.0	0.0
Net loss to common stock	(2.2)	(2.3)	(5.1)	(5.3)	(1.8)	(1.8)	(1.8)	(1.7)	(10.2)	(15.0)	(7.1)	(6.5)
Foreign currency translation gain (loss)	(0.1)	(0.1)	(0.2)	0.1	(0.0)	0.0	0.0	0.0	(1.1)	(0.3)	0.0	0.0
Comprehensive loss	(2.3)	(1.9)	(5.3)	(5.0)	(1.9)	(1.8)	(1.8)	(1.7)	(11.3)	(15.3)	(7.1)	(6.5)
Earnings ex-one time charge	(2.3)	(3.8)	(3.5)	(2.9)	(1.6)	(1.7)	(1.7)	(1.6)	(11.2)	(12.6)	(7.1)	(6.5)
Stock-based compensation	0.6	0.6	0.6	2.5	0.4	0.4	0.4	0.4	4.3	4.3	1.4	1.4
Adjusted Non-GAAP Earnings	(1.6)	(3.2)	(2.9)	(2.1)	(1.3)	(1.4)	(1.3)	(1.2)	(6.9)	(9.8)	(5.7)	(5.1)
Yr-to-yr Growth	-54%	174%	32%	-6056%	-23.1%	-57.7%	-55.5%	-41.3%	-64%	42%	-42%	-10%
GAAP EPS	**($0.51)**	**($0.38)**	**($0.78)**	**($0.52)**	**($0.17)**	**($0.16)**	**($0.15)**	**($0.14)**	**($2.74)**	**($2.10)**	**($0.61)**	**($0.45)**
Loss per share - discontinued	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Non-GAAP EPS	**($0.36)**	**($0.64)**	**($0.43)**	**($0.22)**	**($0.11)**	**($0.12)**	**($0.11)**	**($0.10)**	**($1.86)**	**($1.54)**	**($0.49)**	**($0.35)**
Yr-to-yr Growth					-69%	-82%	-74%	-54%	173%	-17%	-68%	-28%
Share outstanding (new)	4.6	5.0	6.9	9.5	11.3	11.5	11.9	12.2	3.7	6.4	11.7	14.6
Yr-to-yr Growth	0%	8%	49%	106%	145%	131%	74%	29%	31%	72%	83%	25%
Fully diluted shares (new)	6.07	6.78	9.00	12.79	12.76	13.65	14.55	15.44	4.6	8.7	14.1	16.1
Yr-to-yr Growth	0%	12%	48%	111%	110%	101%	62%	21%	24%	87%	63%	14%

HISTORICAL STOCK PRICE

A chart that reflects the reverse stock split that occurred at midnight May 24, 2016 is not yet available.



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