



Mossberg's Investor Digest

Idea Profile

Optimal Group Inc. (Nasdaq: OPMR)

DESCRIPTION:

Headquartered in Montreal, Optimal Group operates two segments, the WowWee Group and Optimal Payments segment. The WowWee Group designs and markets innovative robotic toys. The Optimal Payments segment provides credit card processing services.

KEY INVESTMENT CONSIDERATION:

Company is cash flow positive and stock is trading below its cash value – Adding the proceeds from the disposition of some of its payment processing assets (\$9MM) and subtracting the cash paid for a recent acquisition of a European toy distributor (-\$5.5MM) to the cash balance at the end of the quarter (\$51MM) equals a cash balance per share of approximately \$2.20. Cash should increase from the sale of the remaining payment processing assets and cash flow generation.

Next two quarters are the seasonally strong quarters – With approximately 80% of WowWee's revenue and cash flow generated during the second half of the year, WowWee is expected to generate \$110 million to \$120 million in revenue in 3Q & 4Q combined. The company expects to generate cash flow in the back half of the year, but has not given specific guidance. If we assume an operating margin range of 6% to 10% (conservative compared to what other toy makers generate), WowWee could generate \$7 million to \$12 million in operating income during the back half of '08.

CATALYSTS:

Divestiture of payment processing operations will simplify the story and potentially yield \$40 to \$50 million in incremental cash – The company expects the payment processing business to be sold over the next 12 months. While it's unlikely that the liabilities associated with this business will be assumed by the buyer, the divestiture of this business will make Optimal a pure play in the robotic toy business and simplify the story for new investors. It's estimated that the remaining payment processing business generates \$10 million to \$12 million in annual EBITDA. Assuming a conservative 4x to 5x multiple, the valuation of this business could be \$40 to \$50 million.

KEY RISKS:

Overhang related to potential liabilities of the payment processing unit – In late 2006, the U.S. government enacted the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), which imposed new obligations upon payment processors to block online gaming-related financial transactions. The company has been contacted and is cooperating with a voluntary request for information from the U.S. Attorney's office. Also, \$19 million of the company's funds were seized. These funds were in deposit with payment processors that are currently being investigated by the U.S. Attorney. The \$19 million is recorded as restricted cash on the company's balance sheet and not included in the

cash calculation in this report. Until this issue is resolved, the stock could languish at these levels.

Some perspective on the risk – Online payment processor Neteller(LSE:NLR), which at one time was the most widely used payment processor for online gambling in the U.S., settled with the DOJ and agreed to pay \$136MM in fines, including \$60 million that had already been ceased by the U.S. gov't. Unlike Optimal, which ceased possessing online gambling transactions prior to the act's passage, Neteller continued to operate for 3-4 months after the act was signed. By immediately ceasing operations, Optimal has not violated the act, and it's possible that the extent of the losses related to UIGEA could be limited to the \$19MM that have already been ceased. Also there is some talk that the UIGEA could be repealed, which would take the bite out of any fines the DOJ might impose.

VALUATION:

The current valuation places zero value on WowWee and essentially implies that the potential liabilities associated with the U.S. Attorney's office investigation exceed the entire value of payment processing business. While the value of the potential liabilities, if any, cannot be determined, it appears that the market is clearly assuming the worst case scenario. If we add up the unrestricted cash balance of \$50 million to the \$40-\$50 million in potential proceeds from the sale of the OPMR's remaining processing business, it equals \$90-\$100 million in cash. On top of that, WowWee ought to be worth at least the \$60 million that OPMR paid for it about a year ago. Adding this all up yields a stock price at least 2x to 3x the current valuation.

(Nasdaq: OPMR)	
Investment Data (as of 9/26/08)	
Recent Price	\$1.88
52-Week Range	1.77 - 6.15
Fiscal Year End	Dec
Dividend	N/A
Yield	N/A
Shares Outstanding	25.8 MM
Average Trading Volume (3 mos)	83,000
Market Capitalization	49 MM
Cash	51 MM
Long Term Debt	N/A
Enterprise Value (EV)	-1 MM
LT Debt/ Equity	0.6
Tangible BV/ Share	1.51
TTM Revenue	138 MM
P/ Revenue	0.4x
TTM EPS	-3.51
P/ EPS	N/A
TTM EBITDA	-1.9 MM
EV/ TTM EBITDA	N/A

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