

November 7, 2007

Event: Upgrading to "Buy" (from "Neutral") with a \$6.00/sh Price Target.

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Summary

Based on the Company's proven management team, acquisition of WowWee, strong balance sheet and attractive valuation, we are upgrading OPMR to "Buy" (from "Neutral") with a \$6.00/sh price target. The stock may become cheaper and more attractive today as the Company disappointed the Street with its Q3 results reported last night. We note that on the earnings call, management did announce a share buyback program of up to 5% of the Company's shares (or 1.3MM shares).

OPMR shares have declined 53% since we downgraded the stock to "Neutral" on May 14. The decline was driven by lack of growth in the Company's non-gaming business and what we believed to be further legal and financial risks associated with the UIGEA bill. However, after the announcement of what we believe to be an accretive acquisition of WowWee (a Hong Kong based developer and marketer of robotics, toys and electronic products) for \$65MM, OPMR can once again experience top-line growth while increasing total cash generated, in our opinion.

We believe the stock is now cheap, trading at only 3.7x FY '08 EBITDA (excluding the \$40MM in cash that remains at risk to be claimed by the DoJ). Our \$6.00/sh target is based on a sum-of-parts valuation – 5.0x EBITDA for OPMR's payment processing operations and 7.0x EBITDA for the newly acquired WowWee business.

Optimal Group Inc.

Nasdaq: **OPMR**

Rating: **Buy**

Sector: Business Services

Price Target:	\$6.00
Price:	\$4.15
Float:	21.7
Shares Out:	25.6
Market Cap:	\$106.1
52 Wk High:	\$9.94
52 Wk Low:	\$4.10
Average Volume:	218k
Enterprise Value:	-\$17.0

*In millions except per share data and volume

<u>Estimates</u>		<u>Rev.</u>	<u>EPS</u>
Mar.	Q1 '07(A)	\$30.1	\$(0.24)
Jun.	Q2 '07(A)	28.0	0.05
Sep.	Q3 '07(A)	27.6	(0.02)
Dec.	<u>Q4 '07(E)</u>	<u>27.8</u>	<u>(0.03)</u>
	FY '07(E)	\$113.5	\$(0.22)
Mar.	Q1 '08(E)	NA	NA
Jun.	Q2 '08(E)	NA	NA
Sep.	Q3 '08(E)	NA	NA
Dec.	<u>Q4 '08(E)</u>	<u>NA</u>	<u>NA</u>
	FY '08(E)	\$230.9	\$0.12

Analyst Certification & Additional Disclosures are Included in Appendix A

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Highlights

Confidence in management's ability to execute. On Sept. 27 OPMR announced that it will acquire WowWee for \$65MM (\$55MM in cash and \$10MM payable in shares), with the transaction likely to close in Q4 '07. Although WowWee's business is very different from OPMR's payment processing operations, we believe management can grow this business as demonstrated by the success it had with the payment processing and online gaming businesses (in addition to successful development and sale of the self-checkout business). The Company's strategy is to strengthen WowWee's "Robo" brand and diversify its revenues by applying its technology to non-toy consumer products with a variety of utility and entertainment functions. Management is also demonstrating confidence in its own ability to execute as it announced a stock buyback of up to 5% of shares outstanding (or approx. 1.3MM shares).

Anticipate top-line and cash flow growth for WowWee. In terms of numbers, according to OPMR, WowWee is EBITDA positive; however, it experienced an 11% Y/Y revenue decline in 2006. The decline in revenues also put pressure on its EBITDA margin, as it declined to 4% in 2006 (from 21% in 2005). We believe such decline was due to lack of new products. In our opinion, with OPMR's ability to more easily market and distribute WowWee's electronic gadgets, WowWee can allocate its resources more towards product development, which can drive top-line growth again in 2008 and beyond.

Conservatively, we have assumed no top-line growth for WowWee in 2007 and only 7% in 2008, which results in total FY '08 revenues of \$125.2MM. After looking at other major toy companies (which on average generate a 15% EBITDA margin), we have assumed a 7.5% EBITDA margin (significantly discounted given lack of information available) for WowWee, which results in \$9.3MM EBITDA in 2008. From a valuation standpoint, we are seeing toy companies trading at 7.0x EBITDA. After applying a 7.0x multiple to WowWee's 2008 EBITDA, we believe WowWee can be valued at \$65.3MM or \$2.46/sh (based on an estimated 26.5MM total OPMR shares outstanding after the acquisition). We note that the Company has not yet provided additional financial information on WowWee, and we do not expect any numbers from management until the closing of the deal, likely in 2 – 3 weeks.

Adjusted payment processing and total Company estimates. In the meantime, we have also adjusted our OPMR payment processing estimates, as the Company reported disappointing Q3 results, which included revenues of \$27.6MM and EPS of \$(0.02), compared with our \$29.2MM and \$0.08 revenue and EPS estimates, respectively. The Street was expecting \$28.9MM in revenues and EPS of \$0.04.

Given lack of growth during the past four quarters and the announced WowWee acquisition, we are not anticipating much top-line growth in payment processing going forward. We have lowered our 2007 and 2008 payment processing revenue estimates. In addition, we now look for higher SG&A expenses going forward (more comparable to Q1 – Q3) as we believe the Company will have to more aggressively market its legacy payment processing business to generate some growth. We now estimate \$7.0MM - \$8.0MM in quarterly SG&A (higher than our previous \$5.5MM - \$6.0MM estimate range).

In terms of overall payment processing margin expansion, we continue to expect an improvement, but to a lesser degree as the lower margin card-present transactions will remain a significant part of the overall payment processing business. We now expect \$7.8MM in FY '08 EBITDA for OPMR's payment processing business.

Whether management will divest the payment processing business or not remains unclear. However, if it is sold (which may take place after the online gaming and DoJ issues are resolved), we believe the business could be valued at \$54.7MM (7x FY '08 EBITDA) or \$2.06/sh, which represents \$0.60/sh upside to our valuation of the entire Company. In our opinion, such a multiple is applicable after the removal of the online gaming overhang, as the Company may more easily attract merchants and establish relationships with banks, driving top-line growth. We also note that comparable companies are trading at 9.0x forward EBITDA.

We estimate \$230.9MM in total blended revenues in 2008. In addition, we have modeled \$17.1MM in EBITDA and EPS of \$0.12 for 2008. Depending on this deal's closing date, Q4 '07 revenues from WowWee could increase total OPMR revenues in 2007. We have noticed that on average, toy companies generate more than 30% of their annual revenues in Q4 (or Dec. quarter), due to the Holiday season.

Valuation. OPMR's balance sheet, post-acquisition, remains strong. The Company will have approx. \$68.1MM in net cash (or \$2.57/sh). Excluding the \$40MM (\$1.51/sh) which we believe may be at risk, OPMR's cash balance is \$1.06/sh. We note that our \$6.00/sh valuation of the Company is based on this assumption, which means that depending on the outcome of the online gaming issue, there could be additional upside to our valuation. We have used the sum-of-parts method to value OPMR - 5.0x EBITDA for payment processing operations and 7.0x EBITDA for the newly acquired WowWee business; plus net cash of approx. \$48.3MM. Lastly, in our opinion, the strong balance sheet and continuing operation of the cash flow positive payment processing business, combined with the accretive WowWee acquisition, limit further downside of this stock.

Company Description

OPMR specializes in payment processing and operates two business segments: FireOne (online gaming payment processing) and Optimal Payments (non-gaming payment processing). It charges merchants a percentage of each transaction amount. OPMR's FireOne also provides an e-wallet service (virtual online account), referred to as FirePay, for which customers pay a fixed fee for every deposit. We initiated coverage of OPMR with a "Buy" rating on July 20, 2006 at a price of \$11.72. We downgraded OPMR to "Neutral" on May 14, 2007.

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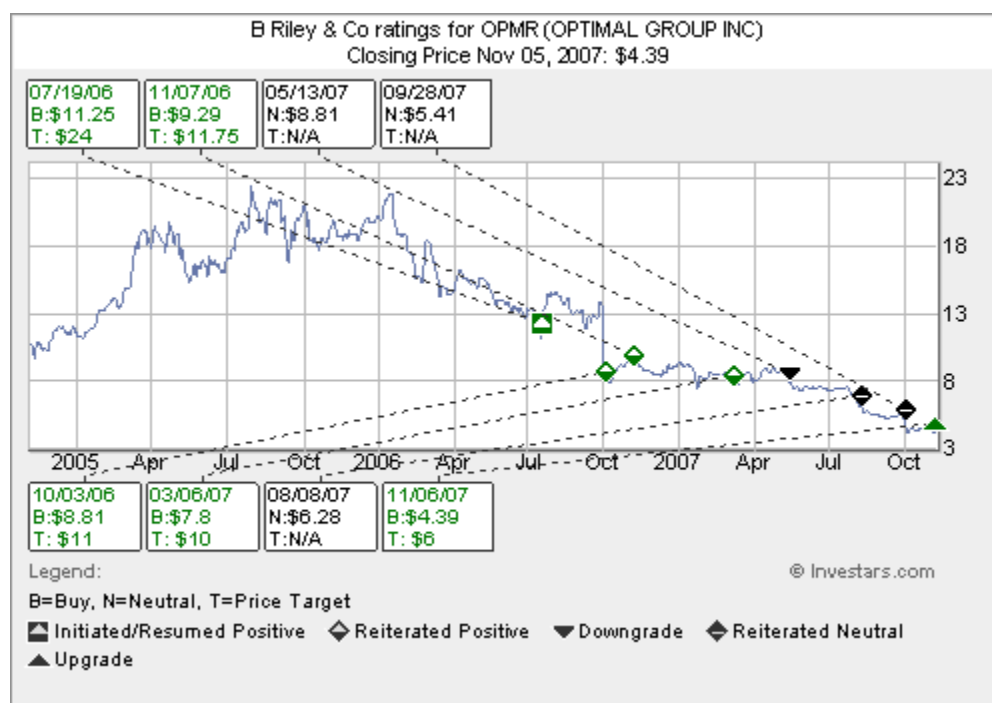
APPENDIX A

Analyst Certification

I, Ali Mogharabi, certify that this report reflects my personal beliefs about this company and that no portion of my compensation was, is or will be directly or indirectly related to the specific recommendations or views discussed in this report.

Disclosure Requirement

- B. Riley & Co., LLC does and seeks to do business with companies covered in its research reports.
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- A portion of this analyst's compensation is based on the investment banking activities of B. Riley & Co., LLC



Initiated on 07/19/06 with a "Buy" Rating and Price Target of \$24.00

Ratings Distribution as of Sep 30, 2007			% with Investment Banking Relationships*		
Rating	Number of Companies	Percent of Total	Rating	Number of Such Companies for Each Rating	Percent of Total for Each Rating
Buy	57	80.3%	Buy	1	100.0%
Neutral	14	19.7%	Neutral	0	0.0%
Sell	0	0.0%	Sell	0	0.0%
TOTAL	71	100.0%	TOTAL	1	100.0%

APPENDIX A

Explanation of B. Riley & Co., LLC's Rating System

- **Buy:** We generally expect "Buy" rated stocks to materially outperform both the S&P 500 and Russell 2000 as well as other stocks in their sector. Further, we believe that the potential reward relative to the potential risk is particularly attractive.
- **Neutral:** We generally believe "Neutral" rated stocks will perform roughly in line with the S&P 500 and Russell 2000 over the intermediate and long term.
- **Sell:** We generally expect "Sell" rated stocks to materially underperform both the S&P 500 and Russell 2000 as well as other stocks in their sector. Further, we believe that the potential reward relative to the potential risk is particularly unattractive.

Risks and Considerations

- Numerous players in both the Optimal Payments space and online gaming could intensify competition in the future. We believe the duration of OPMR's risk management system being a differentiator is limited.
- Possible macro-economic issues such as increasing oil and gas prices and a possible drop in consumer spending could have a negative impact on both payment processing and WowWee revenues.
- Based on decisions reached regarding Neteller and its violation of the gaming bill, OPMR may be liable to pay approx. \$40MM to the DoJ.