

May 7, 2008

Event: Reports Q1 Results; Lowering Target to \$4.00/sh, from \$5.70/sh; Maintain “Buy” Rating.

Ali Mogharabi

310-689-2218

amogharabi@brileyco.com

Summary

Q1 revenues of \$37.6MM, which included only \$4.9MM in WowWee revenues during a seasonally weak quarter, were below our \$39.3MM estimate. With lower WowWee revenues and aggressive investments in WowWee sales and distribution, OPMR reported a loss of \$0.32/sh and EBITDA of -\$2.7MM. However, OPMR management provided what we believe to be a strong revenue guidance of \$230MM - \$250MM for FY '08, versus our initial estimate of \$228.8MM. We note that management's EBITDA guidance of \$10MM - \$12MM, was lower than our \$17.2MM estimate. FY '08 appears to be an investment year for OPMR, as it continues to plant the seeds for much stronger WowWee top-line growth in FY '09 and beyond. There were no surprises during the quarter in the payments segment. Due to the weaker than expected Q1 and management's lower EBITDA guidance, we adjusted our numbers accordingly. While strong sales of WowWee may drive total sales to \$230MM+, WowWee's aggressive sales and marketing campaigns throughout the year will compress margins. We now estimate FY '08 EBITDA of \$11.5MM, and net loss of \$0.20/sh.

With lower EBITDA, we lowered our valuation of OPMR to \$4.00/sh, from \$5.70/sh. We use the sum-of-parts method to value the stock – 5x EBITDA for payment processing and 7x EBITDA for WowWee; plus net cash of \$36.8MM. We note that a favorable resolution regarding the DoJ investigation represents upside to our valuation. Lastly, management maintained that it continues to be contacted by parties interested in acquiring Optimal Payments, which we believe may be valued \$2.00/sh - \$3.00/sh. We maintain our “Buy” rating as our new target represents a 36% upside.

Optimal Group Inc.

Nasdaq: **OPMR**

Rating: **Buy**

Sector: Business Services

Price Target:	\$4.00
Price:	\$2.95
Float:	21.7
Shares Out:	25.1
Market Cap:	\$74.1
52 Wk High:	\$9.18
52 Wk Low:	\$2.61
Average Volume:	66k
Enterprise Value:	\$31.8

*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(A)</u>	<u>37.6</u>	<u>(1.23)</u>
FY '07(A)	\$123.3	\$(1.51)
Mar. Q1 '08(A)	\$31.3	(0.32)
Jun. Q2 '08(E)	51.1	(0.22)
Sep. Q3 '08(E)	66.6	0.06
Dec. <u>Q4 '08(E)</u>	<u>81.6</u>	<u>0.25</u>
FY '08(E)	\$230.5	\$(0.20)

Analyst Certification & Additional Disclosures are Included in Appendix A

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Company Description

OPMR specializes in payment processing and consumer electronics. The Company's two business segments include Optimal Payments and WowWee. Prior to the passage of the UIGEA bill in 2006, OPMR also handled online gaming transactions. 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 at a price of \$8.81. We upgraded OPMR to "Buy" on November 11, 2007 at a price of \$4.15.

Optimal Group Inc.
B. Riley & Co.
(310) 966-1443

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	Q1-Mar	Q2-Jun	Q3-Sep	Q4-Dec	FY 2006	Q1-Mar	Q2-Jun	Q3-Sep	Q4-Dec	FY 2007	Q1-Mar	Q2-Jun(E)	Q3-Sep(E)	Q4-Dec(E)	FY 2008(E)
Revenues	\$ 101.4	\$ 75.7	\$ 15.7	\$ 89.4	\$ 181.4	\$ 52.4	\$ 52.2	\$ 53.3	\$ 33.9	\$ 191.9	\$ 30.1	\$ 28.0	\$ 27.6	\$ 37.6	\$ 123.3	\$ 31.3	\$ 51.1	\$ 66.6	\$ 81.6	\$ 230.5
Transaction processing	63.2	50.3	10.9	54.5	95.9	25.5	24.5	26.4	18.5	94.9	18.7	18.1	17.4	24.5	78.7	19.4	31.8	40.9	49.5	141.6
Selling, general and administrative	18.4	29.0	11.4	24.4	44.6	12.0	14.6	15.0	6.0	47.6	7.7	5.8	7.6	10.6	31.7	12.6	20.1	18.9	19.2	70.8
Service cost inventory write down	-	-	-	2.9	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Amortization of intangibles	1.5	2.7	0.3	2.5	8.6	3.0	3.1	3.1	3.0	12.1	3.1	3.2	3.1	4.6	14.0	4.8	4.0	4.0	4.0	16.8
Amortization of property and equipment	-	-	0.6	1.8	2.2	0.4	0.4	0.4	0.4	1.5	0.3	0.3	0.2	1.1	1.9	1.1	0.3	0.3	0.3	2.1
Stock-based compensation	-	-	-	5.7	22.4	-	0.3	0.7	0.7	1.7	6.0	0.0	0.0	0.2	6.3	0.6	-	-	-	0.6
Research and development	1.2	1.3	-	1.5	2.4	0.8	0.8	0.8	0.9	3.4	0.7	0.6	0.6	1.4	3.3	1.6	1.3	1.3	1.3	5.3
Operating leases	1.2	1.6	1.0	3.3	4.1	0.4	0.4	0.4	0.3	1.5	0.2	0.3	0.3	0.4	1.2	0.4	0.3	0.3	0.3	1.3
Restructuring costs	-	1.0	0.1	0.9	3.6	-	-	-	1.6	1.6	-	-	-	-	-	-	-	-	-	-
Foreign exchange loss	0.1	(0.0)	0.3	(1.0)	1.3	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Impairment losses	-	-	-	-	8.7	-	-	1.9	-	1.9	-	-	-	22.6	22.6	-	-	-	-	-
Income (loss) from continuing operations	\$ 15.8	\$ (10.1)	\$ (8.9)	\$ (7.2)	\$ (12.3)	\$ 10.4	\$ 8.176	\$ 4.6	\$ 2.5	\$ 25.7	\$ (6.6)	\$ (0.3)	\$ (1.5)	\$ (27.7)	\$ (36.2)	\$ (9.2)	\$ (6.7)	\$ 0.9	\$ 7.1	\$ (8.0)
Investment income	3.1	1.8	1.0	1.6	4.1	1.3	2.2	2.4	2.5	8.4	1.9	1.6	1.5	0.8	5.8	0.4	1.3	1.3	1.3	4.2
Gain on sales of interest in FireOne	-	-	-	-	30.4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Earnings from continuing operations before income taxes and non-controlling interest	18.9	(8.3)	(8.0)	(5.6)	22.3	11.7	10.4	7.0	5.0	34.1	(4.7)	1.3	(0.0)	(26.9)	(30.4)	(8.8)	(5.5)	2.2	8.3	(3.8)
Income tax provision (recovery)	9.6	(2.9)	(3.2)	1.2	11.0	2.5	1.9	(3.1)	(0.2)	1.1	0.8	0.1	0.4	4.7	6.0	(0.7)	-	0.4	1.7	1.4
Earnings from continuing operations before non-controlling interest	9.3	(5.3)	(4.7)	(6.8)	11.3	9.2	8.6	10.1	5.2	33.0	(5.5)	1.2	(0.4)	(31.6)	(36.4)	(8.0)	(5.5)	1.7	6.7	(5.1)
Non-controlling interest	-	-	-	-	4.2	2.1	2.0	1.4	1.4	6.9	0.2	-	-	-	0.2	-	-	-	-	-
Earnings from continuing operations	\$ 9.3	\$ (5.3)	\$ (4.7)	\$ (6.8)	\$ 7.1	\$ 7.1	\$ 6.5220	\$ 8.7	\$ 3.8	\$ 26.1	\$ (5.7)	\$ 1.2	\$ (0.4)	\$ (31.6)	\$ (36.5)	\$ (8.0)	\$ (5.5)	\$ 1.7	\$ 6.7	\$ (5.1)
Earnings from discontinued operations	\$ -	\$ -	\$ (1.4)	\$ (6.6)	\$ (6.3)	\$ (2.7)	\$ (2.8)	\$ (2.5)	\$ (1.0)	\$ (9.0)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
(Loss) gain on disposal of net assets from discontinued operations, net of income taxes	\$ -	\$ -	\$ -	\$ 4.2	\$ (0.2)	\$ -	\$ -	\$ (4.3)	\$ -	\$ (4.3)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net income	\$ 9.3	\$ (5.3)	\$ (6.2)	\$ (8.3)	\$ 6.6	\$ 4.4	\$ 3.691	\$ 1.9	\$ 2.8	\$ 12.8	\$ (5.7)	\$ 1.2	\$ (0.4)	\$ (31.6)	\$ (36.5)	\$ (8.0)	\$ (5.5)	\$ 1.7	\$ 6.7	\$ (5.1)
EPS	0.63	(0.35)	(0.41)	(0.46)	0.03	0.19	0.16	0.08	0.12	0.54	(0.24)	0.05	(0.02)	(1.23)	(1.51)	(0.32)	(0.22)	0.07	0.26	(0.20)
EPS Diluted	0.60	(0.35)	(0.41)	(0.45)	0.02	0.17	0.14	0.08	0.11	0.50	(0.24)	0.05	(0.02)	(1.23)	(1.51)	(0.32)	(0.22)	0.06	0.25	(0.20)
EPS from continuing operations	0.63	(0.35)	(0.32)	(0.34)	0.31	0.30	0.28	0.37	0.16	1.10	(0.24)	0.05	(0.02)	(1.23)	(1.51)	(0.32)	(0.22)	0.07	0.26	(0.20)
EPS from continuing operations - Diluted	0.60	(0.35)	(0.32)	(0.33)	0.28	0.27	0.25	0.34	0.15	1.03	(0.24)	0.05	(0.02)	(1.23)	(1.51)	(0.32)	(0.22)	0.06	0.25	(0.20)
EPS from discontinued operations	-	-	(0.10)	(0.33)	(0.29)	(0.11)	(0.12)	(0.29)	(0.04)	(0.39)	-	-	-	-	-	-	-	-	-	-
EPS from discontinued operations - Diluted	-	-	(0.10)	(0.32)	(0.25)	(0.10)	(0.11)	(0.26)	(0.04)	(0.35)	-	-	-	-	-	-	-	-	-	-
Weighted Shares Outstanding	14.7	15.1	14.9	20.3	22.9	23.3	23.7	23.7	23.8	23.6	23.9	23.9	23.7	25.6	24.2	25.1	25.1	25.1	25.1	25.1
Weighted Diluted Share Outstanding	15.6	15.1	14.9	20.4	25.3	26.0	25.8	25.6	24.4	25.4	23.9	24.4	25.6	25.6	24.2	25.1	25.1	27.0	27.0	26.1
Total Depreciation & Amortization	1.5	2.7	0.9	4.3	10.8	3.4	3.4	3.5	3.3	13.6	3.4	3.5	3.2	5.7	15.9	5.9	4.3	4.3	4.3	18.9
EBITDA	17.4	(6.4)	(7.6)	5.7	34.4	13.8	11.9	10.7	8.2	44.5	2.8	3.3	1.7	0.7	8.5	(2.7)	(2.4)	5.2	11.4	11.5
% of Revenues																				
Transaction processing	62%	66%	69%	61%	53%	49%	47%	49%	55%	49%	62%	65%	63%	65%	64%	62%	62%	61%	61%	61%
Selling, general and administrative	18%	38%	73%	27%	25%	23%	28%	28%	18%	25%	26%	21%	28%	28%	26%	40%	39%	28%	23%	31%
Income (loss) from continuing operations	10%	-13%	-57%	-8%	-7%	20%	16%	9%	8%	13%	-22%	-1%	-6%	-74%	-29%	-29%	-13%	1%	9%	-3%
Earnings from continuing operations	9%	-7%	-30%	-8%	4%	13%	12%	16%	11%	14%	-19%	4%	-1%	-84%	-30%	-26%	-11%	3%	8%	-2%
Growth Y/Y																				
Total Revenue	160%	75%	21%	470%	103%	54%	29%	19%	-45%	6%	-43%	-46%	-48%	11%	-36%	4%	82%	141%	117%	87%
EPS	181%	-159%	-10%	-5%	-184%	634%	-76%	1773%	117%	266%	-187%	-81%	-105%	-897%	-247%	35%	-559%	-496%	-120%	-87%
Selected Balance Sheet Data																				
Cash and cash equivalents	9.62	9.62	4.21	62.94	98.24	121.85	139.09	138.55	103.92	103.92	123.05	126.85	133.09	47.19	47.19	45.70	43.85	47.51	64.14	64.14
Accounts receivable	9.01	5.81	4.79	7.12	11.35	5.57	7.69	6.95	5.60	5.60	4.23	8.34	5.19	18.51	18.51	13.40	14.76	16.78	16.14	16.14
Long-term receivables	-	-	-	3.67	3.53	2.70	2.94	3.20	3.14	3.14	2.81	1.39	0.81	-	-	-	1.39	0.81	0.81	0.81
Restricted cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Goodwill and other intangible assets	3.93	4.40	10.52	68.53	117.09	114.68	112.07	107.63	106.04	106.04	106.25	102.88	100.36	153.07	153.07	148.14	148.14	148.14	148.14	148.14
Accounts payables and accrued liabilities	6.67	7.13	5.57	21.87	26.71	15.77	21.72	24.30	21.40	21.40	17.45	17.64	18.98	47.08	47.08	40.33	42.31	43.26	49.58	49.58
Total shareholder equity	133.47	119.46	113.29	176.68	203.29	209.88	212.05	214.83	219.38	219.38	219.75	220.97	220.62	201.71	201.71	193.91	185.74	187.46	194.12	194.12
Other Financial Data																				
Market share price	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95	\$ 2.95
Market cap	45.9	44.5	44.1	60.3	74.8	76.6	76.1	75.4	72.1	75.0	70.4	72.0	75.4	75.5	71.3	74.1	74.1	79.7	79.7	76.9
Enterprise Value	-58.2	-41.2	-23.7	-43.8	-31.5	-34.1	-42.8	-55.5	-62.1	-59.2	-45.6	-44.7	-47.7	23.9	19.7	31.8	39.1	38.7	22.1	19.3
Net cash and cash equivalents per share	6.69	5.68	4.54	5.09	4.19	4.26	4.61	5.12	5.49	5.28	4.86	4.78	4.81	2.02	2.14	1.68	1.39	1.52	2.13	2.21
Tangible value per share	8.6	7.9	7.6	8.6	8.0	8.1	8.2	8.4	9.0	8.6	9.2	9.1	8.6	7.9	8.3	7.7	7.4	6.9	7.2	7.4
EV/Sales	-0.6	-0.5	-1.5	-0.5	-0.2	-0.2	-0.2	-0.3	-0.4	-0.3	-0.3	-0.3	-0.4	0.2	0.2	0.3	0.3	0.2	0.1	0.1
EV/EBITDA	-3.3	6.4	3.1	-21.7	-1.2	-1.0	-1.1	-1.4	-1.7	-1.7	-1.6	-1.9	-3.0	2.8	2.3	10.9	-14.3	50.3	1.9	1.7
P/E	4.9	-8.4	-9.3	-8.9	10.5	6.5	-8.5	-121.5	2.9	2.9	5.8	9.6	-58.2	-2.0	-2.0	-1.9	-1.6	-1.7	-13.0	-15.0
P/Book	0.3	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4

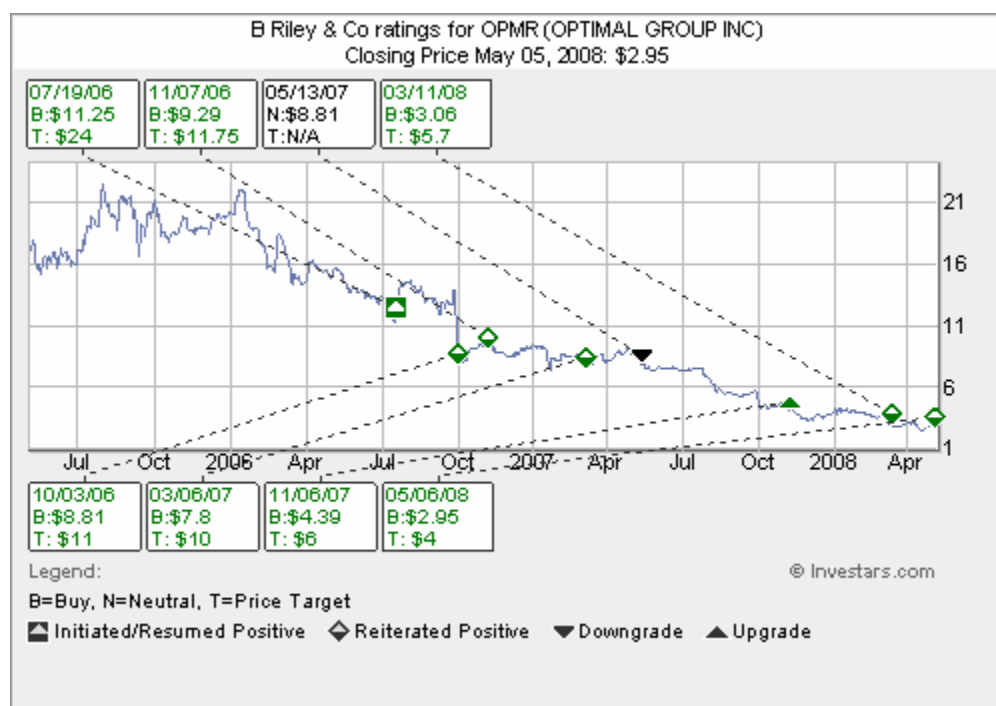
APPENDIX A

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.
- B. Riley & Co., LLC makes a market in the securities of the company covered in this report.
- 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 Mar 31, 2008				% with Investment Banking Relationships*	
Rating	Number of Companies	Percent of Total		Number of Such Companies for Each Rating	Percent of Total for Each Rating
Buy	65	73.0%	Buy	0	0.0%
Neutral	24	27.0%	Neutral	0	0.0%
Sell	0	0.0%	Sell	0	0.0%
TOTAL	89	100.0%	TOTAL	0	0.0%

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

- Possible prohibition of online gambling in the U.S. represents a significant risk to OPMR's business as FireOne helps generate more than 70% of OPMR's total EBITDA, while the topline accounts for only 50% of OPMR's total revenues.
- 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 Optimal Payments and FireOne businesses.