CENTRALNIC GROUP PLC

The Google Proxy

CentralNic Group PLC (CNIC), is a global internet services company, very well positioned in the Business Digital Services space. It exhibits an enviable defensive growth profile, with highly predictable and visible recurring sales revenues, enhanced by a track record of value accretive acquisitions. CNIC is now in strong market positions, being No.1 in Europe and No.2 Globally in its core Reseller business.

CNIC's recent acquisition of the German web services company Team Internet AG (TI), clearly demonstrates how CNIC can utilise industry knowledge, combine this with its financial firepower, and significantly grow its business profitably while creating shareholder value. This acquisition is likely to be c40% earnings enhancing in Yr1, and was bought on only 4.5x historic EV/EBITDA, both figures highlight CNIC's business acquisition skills which augur well for the future.

The TI acquisition brings in domain name monetisation services to CNIC. This is a highly profitable and specialist activity, but the key positive is that TI gives CNIC a foothold in the huge online advertising market worth around US$300bn annually, around 10x larger than the global domain name and web services markets, and a business area in which tech giants such as Google operate. Importantly, CNIC is also a strategic partner of Google, and Google is one of CNIC's largest customers.

Due to the above, one could view CNIC as an early investment proxy for Google.

- **CNIC, A Defensive Growth model**. CNIC's main business activity is that of selling annual subscriptions to businesses worldwide for their email and website domain names. Important for investors to recognise that this is a highly defensive growth model - which during even very difficult economic times - is likely to deliver strong, reliable growth as email and websites services are the last area where any business cost cutting would occur. Further, the relatively low cost of these subscriptions, makes renewal highly predictable.
- **Organic Growth plus M&A Drives Economic Value**. CNIC's organic revenue growth rate is around 6% annually, but this is significantly enhanced by the on-going and to date value enhancing, bolt-on acquisition strategy. CNIC is acting as an industry consolidator in what is still a very fragmented market.
- **High Quality Business Acquisitions**. Importantly, CNIC is acquiring very high quality businesses, TI being a good example, with its revenue per employee at US$1.6m, comparable to leading tech companies such as Alphabet (Google) and Facebook. TI also brings CNIC into the domain name monetisation market, which is a highly technical activity and gives CNIC exposure to the huge online advertising market, estimated to be worth around US$300bn annually, some 10x larger than the global domain name and web services markets we believe.
- **Four Main Customer Types**. CNIC's sales revenues are derived from subscription sales paid by four main customer types; industry resellers, small businesses, corporate customers and domain name investors. So a broad spread of largely uncorrelated customer types.
- **Valuation**. With the TI acquisition included in our financial forecasts, which mainly impacts CNIC's FY-2020 and beyond, it can be seen from the Summary Financials table on page three, that we forecast a strong double-digit compound annual growth rate (CAGR) over the period 2018-2022E across all CNIC's key metrics.

EQUITY RESEARCH

Wednesday 8th January 2020

PCL Classification & Overview

Objective: **Growth**

CentralNic Group Plc (CNIC) is a London-based, AIM-listed global internet services company, which derives its sales revenues from selling annual subscriptions to businesses for their email and website domain names.

CNIC has customers in most countries around the world and importantly, has a very reliable and predictable recurring revenue profile. Making bolt-on acquisitions to complement CNIC's organic growth rate is an important part of the growth strategy.

Company Details

EPIC: **CNIC.L**

Share Price: **92p**

Index & Sector: **FTSE AIM, Software and Computer Services**

No. of Shares & Free Float: **185.7m, 97%**

Market Capitalisation: **£156m**

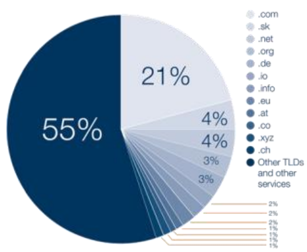
Next Results Due: Trading Update, **Feb-2020**

Source: CNIC PLC , Pello Capital Forecasts.

CNIC Share Price Chart

Source: London Stock Exchange

Top Ten Revenue Suffixes



Source: CentralNic Plc

Research Analyst & Pello Capital contacts:

Ben Maitland, CFA UK Society

CENTRALNIC PLC, AN IMPRESSIVE DEFENSIVE GROWTH MODEL

Defensive Growth Stacks Up, For Many Reasons

CNIC's sales revenue growth model is one which exhibits many characteristics which we like. We detail a number of these characteristics below and explain some in more detail in subsequent pages. Thus;

- **Highly Visible and Predictable Sales Revenues**. CNIC has a highly visible and predictable sales revenue profile for domain name subscription sales, which account for around 90% of the Group's total sales revenues. Predictability of these sales revenues is made easier by the fact that renewal rates for subscriptions are highly predictable, usually between 65% and 95% depending upon the domain name, the industry and the maturity and scale of the customer.
- **Cash Conversion Rates Near 100%**. Looking at cash flow, CNIC's pre-tax cash conversion rate, i.e the proportion of reported sales in a period which end up as cash flow in that same period, is close to 100%, as most annual subscriptions are paid in advance. The concept of credit, i.e debtor days, does not really exist in this business. In fact cash conversion was 110% over the H1-19 period, due to the upfront nature of subscription payments.
- **Broad Customer Base.** A broad and largely uncorrelated customer base consisting of industry resellers such as Go-Daddy (NASDAQ:GDDY), CNIC's second largest customer, small businesses, large corporate customers and domain name investors. These customers are usually quite 'sticky' due to the fact that switching costs between domain names and domain name suppliers is quite high in relation to the subscription rate, and switching is time consuming.
- **Organic Growth, Plus M&A**. CNIC's mid single-digit organic revenue growth rate is backed up by to date, its value enhancing, bolt-on acquisition (M&A) strategy. Total revenue growth was over 200% for example between H1-19 and H1-18 and we expect an average total sales growth rate, i.e compound average growth rate (CAGR) over the coming four years 2018-2022 of around 39%, as shown in the Summary Financials table.
- **M&A Brings in New Activities**. Acquisitions drive total revenues higher, but also deliver new types of revenue streams from different activities, but still within the Consumer Digital Services space. Related services and activities include domain name monetisation activities brought in with the TI acquisition.
- **Synergies Drive Margins Higher**. Acquisition synergies are continually flowing, albeit the timing of such synergy benefit can be hard to predict, but are likely to drive margins higher at both the gross and EBITDA level.
- **Debt Issuance and Payback Possible**. High revenue predictability and on-going margin progression has allowed CNIC to issue quoted bond securities (i.e quoted debt) at relatively low rates of interest (7% Coupon above EURIBOR), thus giving it greater firepower to makes acquisitions, as has just been demonstrated with the TI acquisition. Further, with the positive cash flow profile exhibited by CNIC, debt can be paid down rapidly. For example, post the issuance of EUR 50m and EUR 40m senior secured bonds in July and December 2019, CNIC's Net Debt / Adjusted EBITDA ratio is likely to be around 4.3x at December 2019 on an actual basis, but this is likely to fall to 2.6x by December 2020 and to 2.2x by December 2021. These are very acceptable debt coverage ratios and compare favourably with CNIC's Debt Covenant stipulation of "no higher than 6x" Net Debt / Adjusted EBITDA.
- **Debt Issuance Proceeds, Usage**. The proceeds of CNIC's two debt issuances during H2-19 have and will be used to repay more expensive debt, and finance the four acquisitions cited below.

  (i) Sydney-based business TPP Wholesale for EUR13.2m.

  (ii) Hexonet group for EUR7.9m.

  (iii) Ideegeo transaction amounting to EUR 3.1m.

  (iv) Team Internet AG, for up to US$ 48m (US$ 45m in cash, US$ 3m in shares)

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SUMMARY FINANCIAL FORECASTS AND RATIOS

The table below shows CNIC's possible growth profile between 2018A and 2022E with the newly completed TI acquisition included in our forecasts. Given the high number of acquisitions to date, a factor which may well continue in future too, the revenue and earnings growth rates in particular years are hard to predict, especially the timing of items such as synergy benefits. We therefore encourage investors to look at our estimated average growth rates over the period i.e the compound average growth rate (CAGR), which is a strong double digit figure across all of CNIC's key metrics.

CentralNIC Group Plc, Summary Financial & Ratios

Yr To December US$ millions	2018A	2019A	2020A	2021A	2022A	
Summary Financials						**4-YR CAGR**
Sales Revenues	56.0	108.0	190.0	199.0	209.0	39%
Growth Rate (Y/Y)	**91%**	**93%**	**76%**	**5%**	**5%**	
*Adj EBITDA	9.1	17.7	28.5	30.4	32.6	38%
EBITDA Margin(%)	**16.3%**	**16.4%**	**15.0%**	**15.3%**	**15.6%**	
Tax Rate	18.3%	23.0%	28.0%	28.0%	28.0%	
*Adj Net Profit	6.4	10.2	14.4	15.8	17.0	28%
*Basic, Adj EPS (US cents)	5.0	5.8	7.8	8.3	8.9	16%
*Basic, Adj EPS (UK pence)	3.8	4.5	6.0	6.4	6.9	16%
Valuation & Ratios						
EV/*Adj EBITDA (x)	20.7	15.7	10.0	9.0	8.1	
Net Debt/*Adj EBITDA (x)	0.2	4.3	2.6	2.2	1.7	
*Clean P/E (x)	21.8	18.8	14.1	13.2	12.4	
Dividend Yield (%)	-	-	1.1%	1.2%	1.2%	

Source: Pello Capital Estimates, CNIC Estimates, GBP/USD 1.30

**Adjusted (Clean) fingures exclude 'one-ou' and certain other items, giving clearer underluing figures.*
All ratios calculated on an actual basis, not pro-forma.

Key Points To Note;

Some 39% Sales Revenue CAGR. We forecast a 39% sales revenue CAGR over the period, with the first time inclusion of acquired company revenues influencing the growth rates in the years 2018-2020E mainly, and organic growth at our estimate of 5% thereafter. Importantly, more acquisitions are likely in the years after 2020, but we cannot predict the timing or scale of these at this point.

Adjusted EBITDA margins dip in 2020E. We expect the CNIC's Group's Adjusted EBITDA margin to peak in 2019E at 16.4%, but then to drop to around 15% in 2020E, mainly the result of the TI acquisition bringing in some lower margin businesses to the group, prior to synergy benefits. As cost and revenue synergies start to flow, this margin is likely to increase as shown.

Tax Rate Increasing. We expect CNIC's effective tax rate to increase to around 23% in 2019E and move up quite sharply thereafter to 28% as more of its sales revenues come from higher taxation regimes such as Germany.

Strong Double Digit Growth Profile. As can be seen from the 4-year CAGR figures, CNIC's growth profile is strong double digit, and this is highly reliable we believe.

Debt Coverage Ratio Improving Sharply. After peaking at 4.3x on an actual basis in 2019E, the debt coverage ratio Net Debt / Adj. EBITDA falls to 2.6x in 2020E and then to 2.2x in 2021E, we forecast.

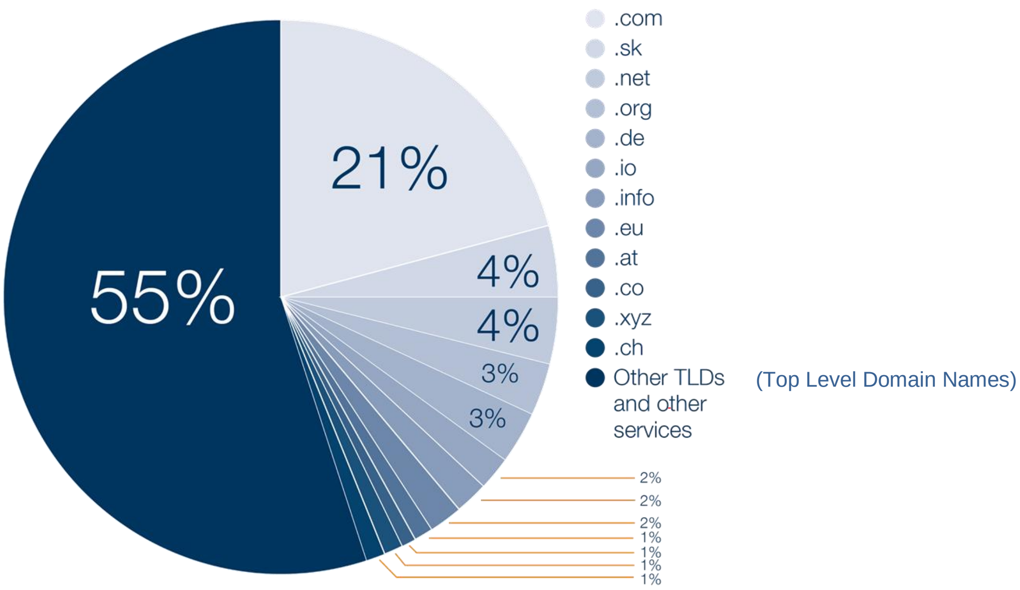
CNIC'S KEY BUSINESS ACTIVITIES

The chart below shows CNIC's top ten revenue suffixes by sales revenue. Importantly, all of these suffixes are owned by third parties, with the exception of .sk, which is exclusively managed by SK-Nic, owned by CentralNic Plc.

CentralNic distributes more than 1,000 different top level domains and the company's platforms supported approximately 18.6million domain names in 2018. Interestingly, there are around 340 million domain names in existence around the globe, and over 30% of these are held with smaller service providers which could be potential future acquisition targets for CNIC.

Another positive feature of CNIC's acquisition strategy is that of adding additional services for existing customers. Services such as hosting, website building, security certification and MS Office 365 are all now services which CNIC can offer to customers in addition to its domain name business.

CNIC Top Ten Revenue Suffixes By Revenue



Who are CNIC's Customers?

CNIC has four main customer types;

Resellers– such as GoDaddy (NASDAQ:GDDY), the world's largest domain name retailer with c77m domains. Prior to the TI acquisition, reseller revenues accounted for around 51% of CNIC's Group sales revenues. Gross margins for CNIC are in the early 30% bracket for this activity, with renewal rates between 85%-90%.

Small Business customers - typically hold a small number of domains, and also use services such as email hosting and website building. Gross margins here are in the early 40% bracket, with renewal rates between 65% - 85% usually.

Corporate Customers– usually large, multinational businesses such as Johnson & Johnson (NYSE:JNJ) who require to protect their brand names across all business lines and hold large domain name portfolios as a result. This is high gross mar-gin business for CNIC, in the mid 70% bracket with high retention rates of 90%-95% usually.

Domain Name Investors - this is the newest customer category for CNIC, and represents investors who buy and hold domain names, hoping to sell them at a profit in the future. The TI acquisition has brought this customer group into CNIC's focus. Gross margin here is likely to be around 40% here we believe, with retention rates between 60% - 90%.

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TEAM INTERNET AG, WHAT DOES THIS ACQUISITION BRING TO CNIC?

Team Internet (TI) is CNIC's fourth and largest acquisition during H2-19, the total purchase consideration being up to US$48m, some US$45m in cash and approximately US$3m in CNIC Consideration Shares (actual NOS issued was 3.91million). This acquisition rate may seem very high but there is good reason for this, mainly in the fact that it puts CNIC into a very strong market position, being the clear No.1 in Europe and No.2 Globally in terms of market share in its core Reseller business. Importantly, and as stated by CNIC's CFO Michael Riedl, these acquisitions "were opportunities that could not be missed" to give CNIC this strong market foothold, with the timing of business integration and synergies flowing in the coming years.

Team Internet AG (TI) - A Highly Profitable World Leader in Domain Name Monetisation

So What is Domain Name Monetisation?

Domain name investors account for around 30% of the 340 million domain names in existence globally, and these investors incur substantial holding costs as the domain names are subscription services. Domain monetisation essentially offsets these subscription costs with advertising revenues generated using specialist technology to place advertisements on the domain, with domain monetisation income being one of the key drivers behind domain renewal rates. The monetisation of domain names and domain name portfolios held by investors is a highly specialised business, in which TI is a global leader.

TI is a 10 year old, Munich based company which generates an impressive US$ 1.6m of revenue per employee per year, which is comparable to leading tech companies such as Alphabet and Facebook (Source: Statista 2019) and has had a long term business relationship with CNIC. This acquisition provides CNIC with significant bundling and cross-selling opportunities with TI's Big Data capability also likely to provide CNIC with valuable industry insights.

In the year to June 2019, TI reported revenues of US$66.7m and Adjusted EBITDA of US$10.6m, representing an Adjusted EBITDA margin of 15.9%, which is just below CNIC's FY-18 margin of 16.3%. The cash conversion rate was 96% over the period, with continuing double digit sales revenue growth, some 13% during Q3-19. The fact that CNIC has bought this business on a trailing multiple of only 4.5x last twelve months (LTM) EBITDA just highlights CNIC's business acquisition skills in our opinion.

Exposure to the US$300bn Online Advertising Market, and Peers with US$ Billion Market Capitalisations

One key aspect of the TI acquisition is that it gives CNIC a foothold in the vast online advertising market, valued at around US$ 300bn annually, which compares to the annual domain name global market, worth around US$ 30bn annually. Importantly, tech giants such as Google (NASDAQ: GOOGL), Verisign (NASDAQ: VRSN) and GoDaddy (NASDAQ: GDDY) are present in this market and exhibited market capitalisations of around US$930 billion, US$ 22bn and US$12bn respectively at 12 noon on 18 December 2019.

This compares to CNIC's market capitalisation of US$ 161million at 12 noon on 18 December 2019, which suggests to us that CNIC's market capitalisation and thus share price has strong growth potential in future as it gains greater scale in highly profitable growth markets currently occupied by its much larger peers.

STRENGTHS, WEAKNESSES, OPPORTUNITIES, THREATS (SWOT)

The headings below summarise some of the key SWOT factors as we see them, which are important for investors to consider.

Strengths

1. CNIC has a highly visible and predictable sales revenue profile.
2. A strong and highly experienced management team.
3. Organic sales revenue is enhanced by acquisition activity, which brings in new and complimentary business activities to the CNIC business portfolio.

Weaknesses

1. To grow by acquisition CNIC has had to issue debt, but debt serviceability is high.
2. With a high business acquisition rate, integration risks are prevalent and expected synergy benefits may not flow on time or at all.
3. The Consumer Digital Services industry is constantly changing, so CNIC must keep abreast of industry developments.

Opportunities

1. CNIC is still a relatively small player in its markets, with a high number of possible acquisition targets.
2. The online advertising market is worth around US$300bn according to CNIC, a market to which CNIC is now exposed and is around 10x larger than the domain name market.
3. CNIC is a global player, but has not yet reached all regions of the world.

Threats

1. Some of CNIC's competitors are very large and established businesses, who could engage in price competition in some or all of CNIC's markets.
2. CNIC must keep up with changing technologies around the world.
3. Other competitive threats could emerge which are as yet unknown to us.

Senior Contacts

	Corporate Broker	Consultant Research Analyst
Pello Capital Limited	Tim Sohal	Ben Maitland CFA UK Society

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