CentralNic Group

Core internet infrastructure consolidator

Initiation of coverage

Software & comp services

With four acquisitions in FY19, CentralNic is a leading buy and build player in the domain name space, focused on consolidating a fragmented market. It offers a broad range of internet services, including reseller services, where it is the number two provider globally, as well as internet services to corporates and SMEs. Supported by underlying organic growth (6% company estimate), CentralNic has grown at a revenue CAGR of 69% from 2014–19 and has attractive cash flow dynamics with near 100% cash conversion and 92% repeat revenues. Q120 was in line with expectations and management has yet to see a material impact from COVID-19. The company is valued on an FY20 EV/EBITDA of 9.1x and a P/E of 15.7x, a 55% discount to its peer group, with our DCF indicating further share price upside. M&A should bring CentralNic's multiples down further.

Year end	Revenue (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/18	56.0	7.4	5.83	0.0	18.5	N/A
12/19	109.2	8.9	5.94	0.0	18.2	N/A
12/20e	202.5	18.9	6.87	0.0	15.7	N/A
12/21e	214.4	23.4	9.05	0.0	11.9	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Investment case: Market leader in growth markets

CentralNic operates in a growing low-value, high-volume technology-enabled global market (total addressable market c US$30bn) where clients typically pay annual subscriptions upfront (c 100% cash conversion). Customers tend to be very sticky, and the longer they stay, the stickier they become (92% repeat revenues). CentralNic operates a leveraged 'buy and build' model, with organic growth (c 6% pa) supplemented by M&A to offer a range of domain registry and related internet services to SMEs and corporates (number two domain-name reseller globally).

Resilient, M&A-driven business model

In FY19, CentralNic completed four acquisitions, with revenues almost doubling from US$56.0m in FY18 to US$109.2m. The business is profitable, with strong cash flow generation supporting US$75m of net debt at 31 December 2019. With the step change largely driven by the acquisition of Team Internet, Q120 revenues were US$56.4m (US$226m annual run-rate) and reported adjusted EBITDA of US$8.1m demonstrates CentralNic's defensive growth credentials. While no material impact on the business from COVID-19 has so far been reported, we do expect slower growth in Q2, with a subsequent recovery in performance in H220.

Valuation: Organic upside supported by M&A

Despite an impressive historical growth track record (five-year revenue CAGR of 69%), being a resilient business with 90%+ recurring revenues and offering a proven management team with significant M&A experience, CentralNic continues to trade at a material discount to its global peers. Its shares trade on an FY20e P/E of 15.7x, a 55% discount to our global peer group, with our DCF highlighting further upside. As CentralNic consolidates a fragmented market of sub-scale, cash generative business, we expect M&A to bring multiples down further.

19 June 2020

Price	**86.0p**
Market cap	**£162m**
	£1.26/US$
Net debt (US$m) at 31 December 2019	75.0
Shares in issue	188.8m
Free float	46.1%
Code	CNIC
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(4.0)	40.5	28.8
Rel (local)	(11.6)	17.4	49.3
52-week high/low		95.0p	40.0p

Business description

CentralNic Group is a leading global domain name services provider, operating through three divisions: Reseller (number two globally); Corporate; and SME. Services include domain name reselling, hosting, website building, security certification and website monetisation (added at the end of 2019).

Next events

Capital markets day	24 June 2020
H120 interim results	September 2020

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Investment summary

Investment case: Consolidating fragmented markets

CentralNic supplies the tools needed for businesses to develop their online presence, providing domain names, hosting, websites, email, website security, brand protection and online domain monetisation services. CentralNic is the number two domain-name reseller globally (second only to Tucows, with 36,000 web host and ISP reseller partners) and number one in the new top-level domains (nTLDs) market, with over 40% market share of nTLDs by volume (ntldstats.com). Following the acquisition of Team Internet, CentralNic is now also the market leader in domain monetisation (similartech.com). The group supplements organic growth with a leveraged 'buy and build' model, completing four acquisitions in FY19, largely financed by a €90m bond issue, with a pipeline of acquisition opportunities ahead.

Management's operational strategy is to benefit from structural market growth to build its underlying domain registry customer base, diversifying its revenues through the cross-selling and upselling of services. This is supplemented by an acquisition strategy focused on consolidating a fragmented market, particularly targeting secondary markets where competition is less intense and acquisition multiples are commensurately lower.

Through this strategy, management is targeting US$1bn of revenues by FY23, with a substantial contribution from future M&A anticipated.

The group's key investment characteristics include:

- **Low-price, critical service:** as part of the core internet infrastructure, domain names are low-cost acquisitions for both corporates and individuals. They are essential to an online presence for corporate and marketing purposes and, as such, largely immune to economic downturns.
- **US$30bn market:** management estimates the domain name registry market to be c US$5bn, with a further US$25bn market for domain-related internet services (a US$30bn total addressable market) . The market is fragmented, served by smaller independent companies, providing the opportunity for CentralNic to gain market share. There are c 367m domain names registered, with c 100m held by domain name investors but the vast majority, c 267m, are owned by individuals or companies for their own use.
- **High-growth:** CentralNic has delivered a five-year revenue CAGR of 69% between 2014 and 2019, supplementing organic growth (estimated by management to be c 6%) supported by M&A. CentralNic delivers at least one service to c 40m domains – cross-selling and upselling will be important drivers of future growth.
- **Subscription-based, recurring revenue model: r**ecurring revenue was 92% of total revenues in FY19, with approximately 80% of the group's revenues derived from recurring annual fees from customers acquired in years prior to 2019. CentralNic's clients pay an annual fee in advance for each domain owned. Once a domain has been acquired and an online brand has been built around that domain, it becomes increasingly unlikely over time that any given domain will be retired, making the revenue increasingly recurring in nature.
- **Highly predictable renewal rates:** 79% of .com domain names renew each year, increasing to over 95% for older, established domain names. Other domains, although not as well-established as .com, demonstrate similar renewal trends. The low churn nature of mature domains supports a strategy focused on M&A over organic client acquisition.
- **High customer stickiness:** customer retention is high (> 99% in any given year) as across the industry the effort to change supplier is prohibitive and the cost benefit marginal for all but the

heaviest users. On this basis, once CentralNic acquires a customer, unless service levels fall to a very low level, customers are unlikely to leave.

– **Leveraged model:** to support growth, management expects to use a mix of cash, equity and debt. As at 31 December 2019, CentralNic had net debt of US$75m with US$26.2m of gross cash, representing a debt/equity ratio of 1.6x for FY19 (FY18: 0.3x) and FY19 net debt/EBITDA of 4.2x (FY18: 0.2x), falling to 1.9x for FY21.

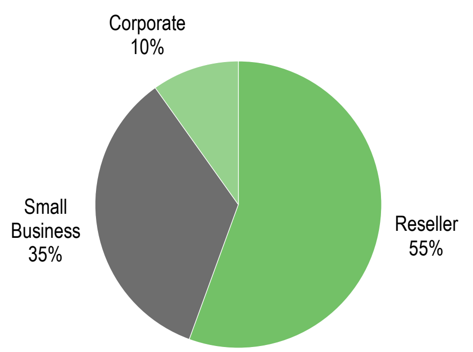
Financial summary: FY19 results, a transformational year

CentralNic reported its FY19 results on 27 April 2020, together with a Q120 update.

The group reported a 95% increase in FY19 revenues to US$109.2m (FY18: US$56.0m), driven by acquisitions. Recurring revenues represented 92% of this total (FY18: 90%). Gross profits rose 65% to US$42.8m (FY18: US$25.9m), with reported adjusted EBITDA climbing 96% to US$17.9m (FY18: US$9.1m). The cash balance at year end was US$26.2m (FY18: US$23.1m) with net debt of US$75m (FY18: US$2.1m).

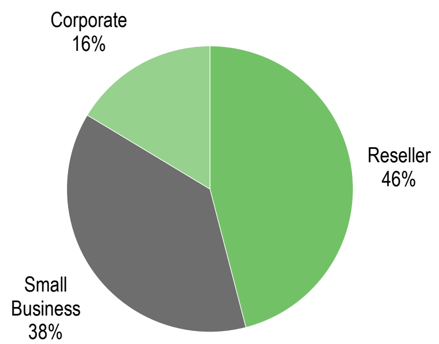
FY19 was a transformational year for CentralNic, as the four acquisitions completed mean that, as well as doubling the group's revenue run-rate, pro forma revenues from selling domain-related software and services now come close to matching pro forma domain sales revenues. By customer type, the direct channels of Small Business and Corporate revenues together (45% of FY19 revenues) are coming closer to matching the indirect Reseller revenues (55% of FY19 revenues) (Exhibit 1). Diversification of its revenue streams remains a core strategic goal, with management looking to expand sales of value-added domain-related software and services.

Exhibit 1: FY19 revenues by customer



Source: CentralNic

Exhibit 2: FY19 gross profit by customer



Source: CentralNic

Q120 revenues of US$56.4m (US$226m annualised revenue run-rate vs the group's pro forma revenues of US$198.2m disclosed in November) highlight the impact of the acquisition of Team Internet on the group. These results also demonstrate CentralNic's defensive growth credentials, reporting adjusted EBITDA of US$8.1m (14.4% EBITDA margin) despite the onset of COVID-19. For H120, we forecast revenues of US$99.1m, reflecting a visible slowdown in Q220 over Q120 (implied Q2 revenue of c US$43m) due to the more pronounced impact of the COVID-19 pandemic, potentially affecting Team Internet's ad-driven revenues. We then expect growth gradually to pick up again in H220, assuming a continuing global recovery from COVID-19, with revenues of US$103.4m (+4.3% H2/H1). We estimate H120 EBITDA of US$14.6m, representing a 14.7% margin, with an uptick in margin to 15.5% in H220 delivering EBITDA of US$16.1m. We forecast a small fall in net debt to US$73.9m as at 30 June 2020 from US$75m at 31 December 2019.

Overall, Team Internet is expected to be a major contributor to FY20e performance, with our revenue estimate of US$202.5m implying an 85% y-o-y increase and EBITDA of US$30.7m (a

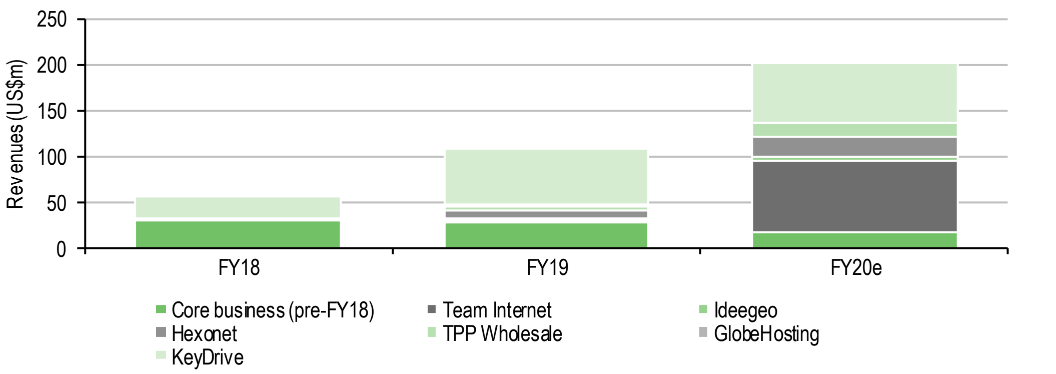
15.1% margin). For FY21e we forecast growth to normalise with revenues of US$214.4m (6% growth) with a slight softening of margins to 14.9% to get to our EBITDA forecast of US$32.0m.

Growth: Market growth plus cross-selling plus M&A

Management estimates the group's organic growth to be c 6%. We believe that this remains sustainable in the medium term from a simplistic bottom-up analysis. Although the underlying growth rate of domains appears to be slowing (Exhibit 14), to the end of 2019 it was in the range of 3–5%. To this we would add an additional 2–3% sales growth from cross-selling of additional services to existing customers, with a final layer of growth from M&A.

Looking at growth from a top-down perspective, management is targeting sales of US$1bn by FY23. Building from the pro forma revenue number of US$198m disclosed at the time of the Team Internet acquisition, and being relatively generous on organic growth at c 10%, suggests FY23 organic revenues of up to c US$300m. This implies that CentralNic will need to acquire US$700m of revenues over the next four years and suggests a revenue CAGR to 2023 of c 50% using the US$198m pro forma revenue number as a starting point. Based on this analysis, organic growth remains a supporting actor, with M&A-driven consolidation centre stage.

Exhibit 3: Contribution of acquisitions to 2018 to group revenues



Source: CentralNic, Edison Investment Research. Note: Assumes 6% annual organic growth post-acquisition.

Subscription-based, repeat revenues with high cash conversion

Given the obstacles to switching suppliers in the domain industry, customers tend to be very sticky, meaning client wins from other suppliers are relatively rare and customer losses are limited too. In this respect, the dynamics of the sector favour M&A-driven growth over organic growth.

For its domain name business (c 92% of its FY19 revenues), CentralNic's clients pay an annual fee in advance for each domain owned. Once a domain has been acquired and an online brand has been built around that domain, it becomes increasingly unlikely over time that any given domain will be retired, making the revenue increasingly recurring in nature.

Given this dynamic, customer renewal rates are highly predictable, depending on domain, segment and customer maturity and range from c 65–90%. In particular, 79% of .com domain names renew each year, increasing to c 95%+ for older, established domain names. Other domains demonstrate similar renewal trends, with churn decreasing significantly with customer ageing.

With annual subscriptions paid in advance, CentralNic enjoys high cash conversion (pre-tax), typically approximately 100% for any given year (adjusted EBITDA/operating cash flow), though on a quarterly basis, the percentage does vary.

Team Internet adds domain name monetisation

In December 2019, CentralNic acquired Team Internet, a leading provider of monetisation services for domain investors, from Matomy Media Group for a total consideration of US$48m in cash, c 4x FY19 EBITDA. Team Internet reported FY19 revenue of US$74.0m (US$66m for the 12 months to 30 June 2019) and adjusted EBITDA of US$12.3m (adjusted EBITDA of US$8.7m for the 12 months to 30 June 2019). The acquisition was financed by a €40m tap issue to the existing July 2023 senior secured bond and is expected to be earnings enhancing and significantly accretive in FY20.

Team Internet represents a significant change in business mix, bringing an ad-funded revenue stream to the group. Team Internet's main business, ParkingCrew.com, is a highly automated (c US$1.6m revenues per employee) domain name monetisation service, with the majority of revenues derived from mobile. It is important to the group's strategy, as it opens CentralNic up to a new constituency, namely, domain name investors. Team Internet sells advertising on inactive domain names owned by investors that attract referral traffic from search engines, working with c 35,000 customers on 22m domains worldwide. When businesses close and their domain names are acquired by investors, former customers continue to visit those domains; this represents a valuable target audience for competitors, reached through advertising provided by Team Internet. This represents a new business area for CentralNic.

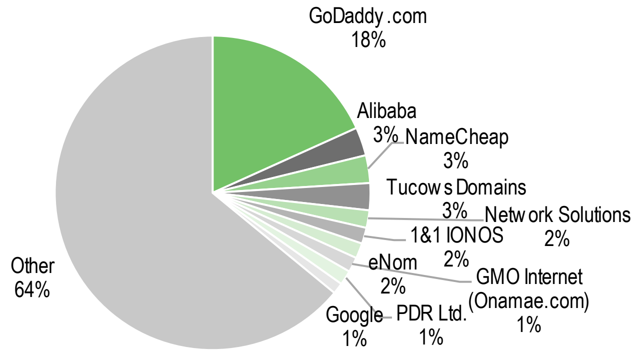
Market: Highly fragmented, US$30bn market

Management estimates the domain name market to be worth c US$5bn annually, with a further US$25bn pa market for domain-related internet services. There are c 367m domain names registered, with c 100m held by domain name investors for resale but the vast majority, c 267m, are owned by individuals or companies for their own use. CentralNic currently has c 13% penetration of the internet services offerings market (the group supplies at least one service to 40m of 367m domains), which is highly fragmented and ripe for consolidation.

Such a fragmented market leads to intense price competition in certain segments (eg .com reselling), while higher margins are available in other sections of the industry. The fragmented, imperfect market can even lead to retail pricing for the same domain varying from below cost to mark-ups of over 200% across different vendors. The TLD .com is still by far the largest TLD, with the unit volume of .com sales increasing every year.

CentralNic's strategy is to focus on secondary geographical markets, focusing on country code top-level domains (ccTLDs), nTLDs and emerging markets, with a relatively weaker position in .com (19% of FY19 revenues) and the US (22% of FY19 revenues). These markets and products are smaller individually, but collectively significant, with faster growth and better margins than the more mainstream products in developed territories.

Exhibit 4: Top 10 global domain name registrars (by domains registered)



Source: Edison, data from domainnamestat.com

In this context, Verisign (the .com registry), Tucows (leading reseller platform), GoDaddy (SME focused) and R22 (CEE focused), although CentralNic's closest listed peers, are not really direct competitors to CentralNic. Many of its closest competitors are either private (eg NameCheap), divisions of larger internet or telecoms businesses (1&1 Ionos) or owned by private equity (HgCapital's team.blue).

Valuation: Material discount to global peers

Despite an impressive historical growth track record (five-year revenue CAGR of 69%), being a resilient business with over 90% recurring revenues and offering a proven management team with significant M&A experience, CentralNic continues to trade at a material discount to its global peers.

Excluding Verisign from our analysis (due to its rich rating reflecting its exclusive rights to .com), CentralNic's core peers trade on 2.9x current year (FY1) EV/sales and 2.7x FY2. In terms of P/E, looking at the overall mean (ex Verisign) indicates P/E multiples of 35x FY1 and 28x FY2, although lifted by GoDaddy's high multiples.

CentralNic shares trade on an FY20e (FY1) sales multiple of 1.4x and a P/E of 15.7x, a c 50% discount to the average peer group sales multiple and a c 55% discount to the average P/E multiple. Potential value accretive acquisitions would bring CentralNic's multiples down even further.

Looking at the net present value (NPV) of future cash flows, we derived a value of 110p per share, c 27% upside to the current share price of 86p.

Valuation catalysts

Factors behind CentralNic's low relative valuation include: 1) the group's relatively small scale; 2) reliance on M&A to supplement market growth; 3) concerns over the group's debt-funded model; and 4) a relative lack of knowledge of the company and the underlying market.

We would expect key catalysts for share price progression to include increasing investor familiarity with the business, better understanding of CentralNic's growth story, demonstration of the group's ability to deleverage through operating cash flow and continuing market consolidation through M&A.

By consolidating a highly fragmented industry landscape, the group is attempting to build a portfolio of businesses, acquired at low/reasonable multiples, and subsequently achieve synergies through cross-selling and cost efficiencies. As CentralNic builds investor credibility and scale, we would expect the peer group discount to narrow and close.

Company description: Leading domain name vendor

CentralNic is a developer and operator of software platforms providing internet services to customers in almost every country in the world. CentralNic supplies the tools needed for businesses to develop their online presence, providing domain names, hosting, websites, email, website security, brand protection and domain monetisation services. CentralNic is the number two domain-name reseller globally and number one in the nTLD market with over 40% market share of nTLDs by volume (https://ntldstats.com/backend).

CentralNic was established in 2000, as a successor organisation to NomiNation, a company founded in 1995. CentralNic listed on AIM on 2 September 2013 and since listing has continued to grow through a combination of organic growth and M&A, delivering a revenue CAGR of 73% since IPO (2013–19). Prior to the acquisition of Team Internet in December 2019, CentralNic's main business was the development and management of software platforms to allow businesses to buy internet domain names, essential for websites and email addresses. The Q419 acquisition of Team Internet brings domain monetisation to CentralNic's armoury. CentralNic employs c 328 staff.

The company has been highly acquisitive, having bought 11 businesses since IPO, including four in 2019. In total, the business has spent c US$207m on acquisitions since IPO, with the rate of acquisitions increasing in 2019 with US$79m of acquisitions completed, largely funded by its listed bond issue. As a result, revenue has increased from US$4.1m in FY13 to US$109.2m in FY19. Pro forma revenues for the group were US$198m (trailing 12-month revenue estimate as at November 2019, including Team Internet and all FY19 acquisitions). The proforma adjusted EBITDA estimate for the same periods is US$31.8m, indicating a margin of 16.0%.

The business offering has changed over time but in FY19, there were three core divisions:

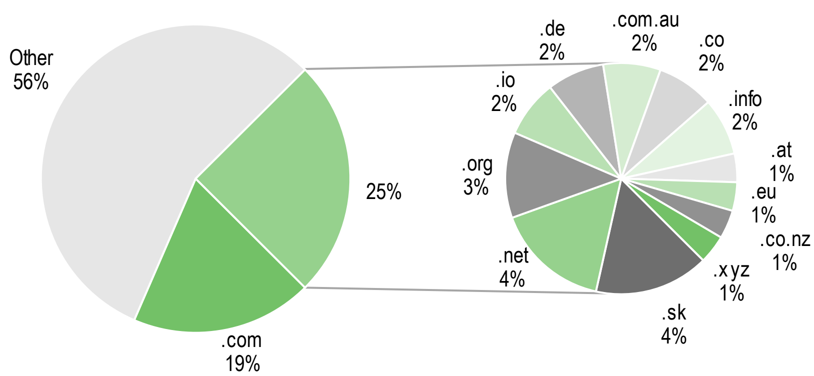
- **Reseller (56% of revenue, 46% of gross profit, 32% gross margin):** CentralNic is one of the leading internet domain name reseller platforms globally, supplying names to over 29,000 customers, including all of the world's largest domain name retailers. With divisional revenue of US$60.7m in FY19, the average revenue per reseller customer was c US$2,100.
- **Small Business (35% of revenue, 38% of gross profit, 43% gross margin):** CentralNic provides domain names and value-added services such as hosting of websites and email to more than 340,000 small businesses through subscriptions. With divisional revenue of US$37.8m in FY19, the average revenue per SME was c US$111.
- **Corporate (10% of revenue, 16% of gross profit, 65% gross margin):** CentralNic manages the domain portfolios of 1,000 corporate clients as well as other value-added services such as administering portfolios of domain names and domain name monitoring to defend against online abuse of brands. With divisional revenue of US$10.8m in FY19, the average revenue per corporate customer was c US$10,800.

From FY20, we expect CentralNic to report domain monetisation (ie Team Internet) as the group's fourth segment, as it targets a separate customer class (domain name investors), as well as offering an advertising-driven (mobile-led) business model.

The group reported a 95% increase in revenues in FY19, with full-year contributions from the KeyDrive and Globe Hosting acquisitions (completed in FY18) and part-year contributions from TPP Wholesale, Hexonet and Ideegeo, completed in FY19 (the contribution to FY19 from Team Internet was minimal as it completed on 24 December 2019, one week before year end). Recurring-type revenues represented 92% of this total (FY18: 90%). Significant new client wins included .blog, the ccTLD .bh and resellers MarkMonitor, ZDNS, and Automattic. The group successfully integrated its FY18 acquisitions, delivering operational efficiencies and savings of c US$1m. The four acquisitions completed during FY19 expanded and strengthened CentralNic's core offering, with Team Internet representing a strategic expansion into domain monetisation, serving a new global domain name investor client base.

During FY19, CentralNic's customer base grew by c 45% from 255,300 to 370,000. Customer concentration is low, with the largest single customer representing only c 5.1% of FY19 revenues. Domain name sales and services represented 92% of CentralNic's revenue in FY19, with the long tail of domains (each contributing less than 1% of group revenues) accounting for 60% of overall domain revenues (Exhibit 5 below). Factoring in Team Internet's revenues in FY20, domain sales will represent a swiftly falling majority of group revenues. Diversification of CentralNic's revenue streams remains a core strategic goal, with management looking to further expand the group into value-added domain-related software and services.

Exhibit 5: FY19 revenue by domain name



Source: CentralNic, Edison Investment Research

Operational performance overview

Given the difficulties of switching suppliers in the domain industry, customers tend to be very sticky, meaning client wins from other suppliers are relatively rare and customer losses are limited too. Despite this dynamic, CentralNic continued to win customers from its competitors due to a focus on expert service, close collaboration with clients, and feature rich, flexible and automated technology.

In the Reseller segment, significant customer wins in FY19 included registry service contracts for the TLDs .blog, .gay, .music, .build, .luxury, .bond and .BH. CentralNic ended FY19 with over 40% of the total nTLD market by volume (more than the next five competitors combined) (ntldstats.com). Major resellers recruited in FY19 included Automattic, MarkMonitor, ZDNS and Telenor. As a result of these new client wins, combined with acquisitions, over the course of FY19, CentralNic's domains under management grew by c 90% to 25.5m (FY18: 13.5m).

In the retail sector, the Internet Corporation for Assigned Names and Numbers (ICANN), the regulatory body, awarded CentralNic a bulk transfer of 0.68m domain names from a former registrar that had lost its accreditation. With this addition, together with customer wins and acquisitions, CentralNic's retail business grew from 2.0m to 2.3m domains under management (15% y-o-y growth).

In CentralNic's Corporate segment, domains under management increased from 137,000 to 154,000 in 2019 (+12%), with an increase in client demand as well as new client wins.

Exhibit 6: Divisional breakdown

	Number of customers	FY19 revenue (US$m)	Y-o-y growth %	Average revenue per customer (US$)	Gross margin %	Renewal rate
Reseller	>29,000	60.7	122.4	2.09	32	70–90%
Small Business	>340,000	37.8	55.9	0.11	43	60–80%
Corporate	>1,000	10.8	140.2	10.76	65	93–99%
Total	>370,000	109.2	95.0	0.30	39	-

Source: CentralNic, Edison Investment Research. Note: Table excludes Team Internet, which has an additional c 35,000 customers.

Divisional breakdown: Reseller segment

The Reseller segment comprises CentralNic's Reseller business and its Registry business. As one of the world's leading domain name reseller platform businesses, CentralNic supplies domain names to more than 29,000 reseller clients (FY18: 5,000). Clients include all of the world's largest domain name retailers, as well as a number of major tech corporations. Significant client wins included Automattic, MarkMonitor and ZDNS, with annual renewal rates typically varying between 70% and 90%.

The group is a world leader in its Reseller segment, with revenue growth of 122% to US$60.7m in FY19 (FY18: US$27.3m) and gross profit rising 53% to US$19.6m (FY18: US$12.9m). However, gross margin fell to 32% in FY19 (FY18: 47%) as a result of blending lower-margin acquisitions with CentralNic's higher-margin core business. This segment operates platforms for resellers such as registrars, hosting companies and telcos. It operates under the brands Key-Systems, Hexonet, PartnerGate, TPP Wholesale and Toweb, and is the second largest global business by volume. To complement its domain name business, the group is starting to sell in-demand services such as Microsoft Office 365 and AWS hosting, supporting future growth. CentralNic's Reseller business is second ranked globally (after Tucows).

CentralNic's Registry Solutions business operates a platform for registries of country-codes (ccTLDs) and nTLDs. With over 115 TLDs using its registry platform, CentralNic's Registry Solutions business is the leading registry provider for nTLDs, finishing 2019 with over 40% market share of nTLDs by volume.

Divisional breakdown: Small Business segment

CentralNic's Small Business segment is a rapidly growing challenger business, emerging from a field of largely domestic and regional competitors to become an increasingly influential global player. CentralNic provides domain names and value-added services (by way of a subscription model) to more than 340,000 small businesses around the world, leading to substantial recurring revenues.

To avoid head-to-head competition, management tends to avoid core Western markets, preferring to focus on higher margin, higher growth geographies and customer types, not well served by larger competitors. The segment specialises in customers buying large quantities of domain names and country-code domains, and upselling other domain-related services to these customers.

FY19 revenues rose 56% to US$37.8m (FY18: US$24.2m), while gross profit increased from US$9.9m in FY18 to US$16.1m in FY19.

Divisional breakdown: Corporate segment

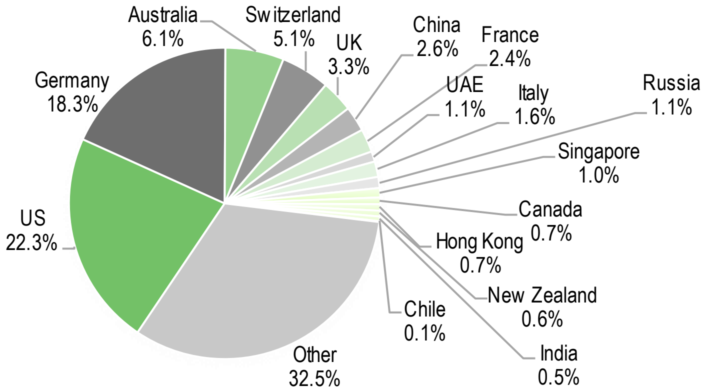
As part of its Corporate offering, CentralNic services large corporations that view domain names as a form of intellectual property similar to trademarks, which must be secured and protected by brand owners. CentralNic manages the domain portfolios of over 1,000 corporate clients, including Fortune 1000 companies and household brand names. Many of these companies buy several thousand domain names to protect their brands from being compromised, relying on CentralNic to advise them and to ensure that domains are renewed at the appropriate time, preventing the risk of substantial reclaim costs.

CentralNic's Corporate segment is a relatively new business and still seeing rapid growth, with revenues growing 140% in FY19 to US$10.8m (FY18: US$4.5m). Gross profits rose from US$3.2m in FY18 to US$7.0m in FY19, with margins falling to 65% in FY19 versus 72% in FY18, reflecting more sustainable margins for this business moving forward.

Geographical analysis

CentralNic is a global business providing services to clients in almost all countries around the world. In FY19, the main geographic sources of revenue by customer location were:

Exhibit 7: FY19 revenue breakdown by customer location



Source: CentralNic

Particularly as a result of the acquisition of KeyDrive in FY18, the importance of Germany has increased from 4% of revenue in FY16 to 18% in FY19. Conversely, the importance of the US, the home market for GoDaddy, has reduced from 34% of revenues in FY16 to 22% in FY19.

Management estimates the domain name market to be worth c US$5bn annually, with a further US$25bn pa market for domain-related internet services. There are c 367m domain names registered, with c 100m held by domain name investors for resale but the vast majority, c 267m, are owned and actively used by individuals or companies.

Track record: Organic growth supplemented by M&A

At its IPO in 2013, CentralNic's main business was as a registry service provider of domains, providing the Domain Name System (DNS) infrastructure and distributing domain names on behalf of registry operators, including two country codes, .LA and .PW. CentralNic had won the exclusive distribution rights to 60 nTLDs like xyz and bar, and IPO-ed with an initial plan of rapidly gaining market share with these new products.

CentralNic has been highly acquisitive. Between FY14 and FY19, the company has announced acquisitions totalling c US$207m, of which US$79.4m was spent in FY19 alone. Exhibit 8 shows the dates and consideration payable for the group's post-IPO acquisitions.

Exhibit 8: Proven M&A track record

Date	Target	Consideration (US$m)	Historic sales (US$m)	Sales multiple	Adj. EBITDA multiple	Country	Description
Dec-19	Team Internet	48.0	74.0	0.6x	3.9x	Germany	Domain name monetisation
Aug-19	Ideegeo	3.4	4.2	0.8x	5.7x	NZ	Domain name reseller (retail)
Aug-19	Hexonet	11.4	19.4	0.6x	8.8x	Germany	Domain name reseller
Aug-19	TPP Wholesale	16.6	12.7	1.3x	5.7x	Australia	Domain name reseller
Sep-18	GlobeHosting	3.0	1.0	3.0x	6.1x	Rom/Brazil	Hosting
Aug-18	KeyDrive	55.0	58.3	0.9x	8.2x	Germany	Domain name reseller
Aug-17	SK-NIC	34.7	5.5	6.3x	9.9x	Slovakia	ccTLD domain registry
Jan-16	Instra	26.9	14.8	1.8x	8.5x	Australia	Domain name registrar
Feb-15 & July-15	dnsXperts	0.2	0.4	0.5x	-	Germany	Domain name services
Jun-14	Internet.BS	7.5	4.3	1.7x	-	Bahamas	Domain name registrar (retail)
Jan-14	DomiNIC GmbH (asset acquisition)	-	-	-	-	Germany	Domain name workflow management software
Total FY19		79.4	110.3	0.8x	6.0x		
Total FY14–19		206.7	198.8	1.8x	7.1x		

Source: CentralNic, Edison Investment Research

CentralNic's acquisition strategy is focused on consolidating a fragmented market, particularly targeting secondary markets where competition is less intense and acquisition multiples are commensurately lower. Management has used acquisitions to acquire new talent and technology as well as customers and revenues, with acquisitions being integrated into the group, although, importantly, retaining their brand independence and continuing to focus on their established markets.

Cost synergies have been realised by consolidating technology platforms and support functions, but principally through platform convergence. New businesses are integrated into CentralNic's existing two core platforms, CentralNicRegistry and RRP Proxy, freeing up development resource to focus on new projects and services.

As we have noted, customers are very sticky in the domain business given high levels of automation and high switching costs, with transfers between providers amounting to a small proportion of all transactions. This customer stickiness, combined with the high value and quality of earnings of existing customer books, makes the domain industry a very attractive and relatively low risk industry in which to acquire businesses.

As well as enjoying full year contributions from KeyDrive (completed on 2 August 2018) and GlobeHosting (completed on 6 September 2018) in FY19, CentralNic also completed four acquisitions. However, the acquisition of Team Internet was only completed on 24 December 2019, so it had minimal impact in FY19 but will have a major impact in FY20.

All four FY19 acquisitions were of companies with similar dynamics to CentralNic's existing businesses: recurring revenues, strong customer retention and high cash conversion.

- **TPP Wholesale (1 August 2019)** – CentralNic acquired the Sydney-based business for a total consideration of A$24m (US$16.6m). TPP Wholesale is the leading domain name and hosting reseller platform in Australia and New Zealand, a carve out from ARQ, a listed Australian group. Standalone revenues and adjusted EBITDA for FY18 were A$17.0m and A$3.9m, respectively. On completion, TPP Wholesale had c 14,000 reseller customers with 840,000 domains under management, including 19% of all .com.au registrations. Through the acquisition, CentralNic has also started to offer Amazon Web Services and Microsoft Office 365.
- **Hexonet (7 August 2019)** – CentralNic acquired Hexonet, a leading international platform for resellers of domain names, for up to €10.0m (US$11.4m). Hexonet has operations in Canada

and Germany, where it is based close to CentralNic's existing German business. Hexonet sells domain name subscriptions directly and via more than a thousand resellers in over 110 countries, managing over 3.8m domains on its proprietary software platforms. In 2018, Hexonet's revenues were c US$19.4m, with EBITDA of c US$0.9m. Hexonet was delivered by the seller with ongoing cost reductions over €0.3m compared to its 2018 cost base. In addition, CentralNic filled vacancies budgeted at €0.3m (c US$0.4m) with staff from Hexonet.

- **Ideegeo (7 August 2019)** – CentralNic acquired international domain name retailer Ideegeo for US$3.4m in cash, a multiple of 5.8x trailing adjusted EBITDA. Ideegeo is the operator of retail website iwantmyname.com, a leading innovator in domain names sales to retail customers, with 180,000 domains under management. Following the acquisition, CentralNic has started to deploy Ideegeo's design solutions across its retail websites, to improve ease of use. Ideegeo's revenues were c NZ$6.2m (c US$4.2m) for the year to 31 March 2019, with adjusted EBITDA of NZ$0.9m (c US$0.6m).
- **Team Internet (24 December 2019)** – CentralNic acquired Team Internet, a leading provider of monetisation services for domain investors, from Matomy Media Group, for total consideration of US$48m in cash, 3.9x FY19 EBITDA. Team Internet reported revenue of US$74.0m and adjusted EBITDA of US$12.3m for FY19.

Management intends to continue to make further acquisitions across existing business areas as well as in potential new business areas. Since IPO, the company has moved from a net cash position to a net debt position (FY19: US$75m), with growth largely funded by debt (€90m raised in FY19 through a listed bond issue). In the near future, with further debt issuance likely to be constrained, management has indicated that it will consider the most appropriate funding at that time, be that cash (from the balance sheet or by way of a placing), share exchanges, equity or debt.

Team Internet: Expansion of CentralNic's footprint

On 24 December 2019, CentralNic acquired Team Internet, a leading provider of monetisation services for domain investors, from Matomy Media Group. The business was founded in 2010, with a majority stake being acquired by Matomy in June 2014. Team Internet reported FY19 revenue of US$74.0m (US$66m for the 12 months to 30 June 2019) and adjusted EBITDA of US$12.3m (adjusted EBITDA of US$8.7m for the 12 months to 30 June 2019). CentralNic acquired Team Internet for a total consideration of US$48m in cash, 3.9x FY19 EBITDA. The acquisition was financed by a further debt raise of €40m of senior secured bonds with a coupon of 7% above three-month Euribor and is expected to be earnings enhancing and significantly accretive in FY20.

Team Internet's main business, ParkingCrew.com, is a highly automated (c US$1.6m revenues per employee) domain name monetisation service, with the majority of revenues derived from mobile. It sells advertising on inactive domain names owned by domain name investors that attract traffic. It therefore represents a new business area for CentralNic. The advertising inventory is attractive to competitors to the defunct businesses that historically used the domain names before they were acquired by domain investors.

Investors typically buy domain names and resell them at a profit to new businesses wishing to use them. Team Internet supports domain name investors as its ad-services offer a natural yield on domains, mitigating the cost of investing in the subscription of the domain name, prior to an anticipated profit on sale of the domain name.

There are many opportunities to identify and invest in domain names as renewal rates on .com domain names are c 79%, meaning that 21% of registered .com domains become available to investors each year. Management estimates that c 100m domain names are held by investors, which represents c 27.6% of total TLD registrations of 362.3m (Verisign, Exhibit 12), implying a healthy potential inventory, albeit the attractiveness of domain names vary significantly. Management estimates that roughly half of the 100m investor-held domain names use a monetisation service of some kind, with competitors including GoDaddy (CashParking), Sedo (Sedo Parking) and Voodoo.com (Voodoo Parking) among others. Team Internet places ads on 22m domain names that are owned by 35,000 domain name owners.

Team Internet splits the advertising revenue earned with the advertising engine through which the advertiser books the ad. From its share, Team Internet pays the majority (the exact percentage is based on multiple factors like the quality of traffic) to the domain name investor, retaining a small portion to run the platform. Based on 22m domain names, Team Internet's reported revenue of US$74m (51 weeks to 24 December 2019), implies average revenue per domain name for Team Internet of c US$3.36.

Exhibit 9 shows Team Internet's financial history while owned by Matomy.

Exhibit 9: Team Internet's financial history

US$m	27 weeks to 31/12/14	31/12/15	31/12/16	31/12/17	31/12/18	51 weeks to 24/12/19
Revenue	22.6	54.3	63.3	105.4	75.6	74.0
Growth y-o-y		140.3%	16.6%	66.5%	(28.3)%	(2.1)%
Adjusted gross profit	N/A	N/A	19.3	30.3	21.4	-
Margin			30.5%	28.7%	28.3%	-
Adjusted EBITDA			14.8	24.5	14.2	12.3
Margin			23.4%	23.2%	18.8%	16.6%

Source: Matomy company accounts, CentralNic press release.

FY17 revenue growth was strong due to competitive changes resulting in a significant amount of revenue moving to Team Internet, the only platform scalable enough to monetise the additional supply without delay. In the following months, as the monetisation market settled down, compliance rule changes meant that Team Internet focused on traffic quality to ensure the revenue base remained robust, resulting in a dip in revenues for the 12 months ended 30 June 2019 (US$66m revenues, US$8.7m adjusted EBITDA). Prior to completion of the acquisition, CentralNic carried out detailed due diligence on the success of these quality initiatives. On completion, last 12 months' revenue had risen to US$74m and EBITDA had increased to c US$12.3m, reducing the acquisition multiples to 0.65x sales and 3.9x EBITDA.

The acquisition of Team Internet delivers a mobile-led, ad-driven business and opens up a new constituency to CentralNic, namely domain name investors. Management believes there are potential revenue synergies from selling Team Internet's services via CentralNic's global infrastructure, with limited cost synergies. However, revenue synergies from selling Team Internet's domain monetisation services to CentralNic's existing customers are likely to be limited as management estimates that only roughly 1% of pre-existing domain names are investor-held.

Outlook: Expanding services offering

Although management did not note any material slowdown due to COVID-19 in its Q120 update (27 April 2020), we remain cautious over a slowing of business formation as global lockdowns ease, with the risk of an associated slowdown in the registration of new domain names and websites to below the historical average. On this basis, we forecast revenues of US$99.1m for H120, reflecting a slowdown in Q220 over Q120 due to the impact of the COVID-19 pandemic, potentially affecting Team Internet's ad-driven revenues. We then expect growth to gradually pick up again in H220, assuming a continuing global recovery from COVID-19, with revenues of US$103.4m (+4.3% H2/H1).

The group remains acquisitive, with a pipeline of identified acquisition targets. However, in the near future, as further debt issuance is likely to be constrained, management has indicated that it will consider the most appropriate funding at that time, be that cash (from the balance sheet or by way of a placing), share exchanges, equity or debt. This has the potential to raise margins.

In FY20 and beyond, management intends to increase cross-selling and up-selling across the group to raise the proportion of additional services it sells to customers. Services offered include hosting, website building, security certification, domain monetisation, Office 365 sales and support and online brand protection. The group has also been investing in strengthening its core management team, to ensure the business is able to continue to scale and integrate future acquisitions successfully, with the appointment of Tracey Hickling as chief people officer and Robbie Birkner as head of the reseller division.

Industry background

The DNS (Domain Name System)

The DNS is part of the core infrastructure of the internet, maintained by distributed databases, which allows software such as browsers, search engines, email clients and website developers to build programmes.

Every computer on the internet has a unique numeric address or internet protocol (IP) address, a string of numbers that would be problematic to remember. To make it easier to use the internet and find a website quickly and easily, the DNS was invented. The DNS translates the IP address (the string of numbers) into a unique alphanumeric address, the domain name, a better classification system for people, which is much easier to recall.

A domain name is the unique set of characters used to identify the address of a website on the internet or the sender of an email sent via the internet. The domain name is all the characters between the protocol sign (say, https://) and the first slash in a web address. For example, in https://www.edisongroup.com/company/centralnic-group/2679/ the domain name is edisongroup.com. A domain name consists of labels that are separated by dots. The extension or suffix, ie .com in the above example, is referred to as the TLD, which helps to identify the type of website that the domain name represents.

There are number of different types of TLD name extensions including the most familiar and popular generic top-level domains (gTLD) meant for general purposes, ccTLD to represent specific countries and generic nTLDs, meaning new top-Level Domains, like .xyz and .online, launched in recent years.

Generic top-level domains

Originally, there were seven gTLDs, namely .com, .edu, .gov, .int, .mil, .net and .org, with the use of .edu, .gov, .int and .mil restricted such that they can only be used by organisations involved in that specific category. As such, along with other gTLD names, such as .coop, .jobs and .tel, they are also referred to as sponsored top-level domain names.

Exhibit 10: CentralNic-distributed generic top-level domains (gTLDs)

.art	.ceo	.forum	.kred	.protection	.security	.uno
.baby	.college	.frl	.love	.quest	.site	.website
.bar	.coop	.fun	.luxury	.realty	.space	.wiki
.basketball	.cyou	.gay	.monster	.reit	.storage	.xyz
.best	.desi	.gent	.observer	.rent	.store	
.blog	.design	.host	.online	.rest	.tech	
.bond	.fans	.icu	.ooo	.rugby	.theatre	
.cam	.feedback	.ink	.press	.saarland	.tickets	

Source: CentralNic

Country code top-level domains

Country code top-level domains (ccTLD), eg .uk, are generally reserved for countries with that specific country code. At the end of 2019, there were 305 ccTLDs, having grown from 240 at the end of 2010.

Exhibit 11: CentralNic-distributed country code top-level domains (ccTLDs)

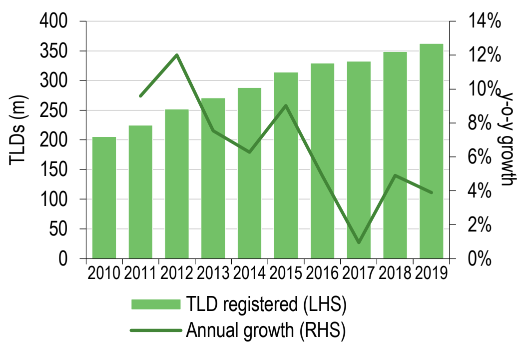
.pw, Palau	.bh, Bahrain	.fo, Faroe Islands
.dm, Dominica	.vg, British Virgin Islands	.sk, Slovakia
.fm, Federated States of Micronesia	.gd, Grenada	.la, Laos
(albahrain idn) .البحرين, Bahrain		

Source: CentralNic

Domain name growth trends

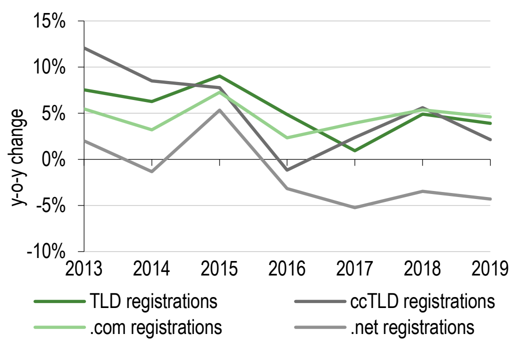
Verisign produces a quarterly report called The Domain Name Industry Brief that produces statistics on the industry. In its March brief, Verisign reports that there were 362.3m TLDs registered worldwide as at 31 December 2019, representing growth of 3.9% y-o-y and a 0.7% increase over Q319. Exhibits 12 and 13 highlight the long-term domain name trends, showing how the total number of TLDs has changed since December 2012.

Exhibit 12: Long-term TLD growth trend



Source: Edison, data from Domain Name Industry Brief

Exhibit 13: Domain registration growth trend



Source: Edison, data from Domain Name Industry Brief

It is interesting to note that despite the introduction of new generic top-level domains (ngTLDs), where growth has been more volatile (growth of 200%+ in 2015, 94% if 2016, falling to 16% in 2018 and 23% in 2019), .com registrations have grown continuously despite their relative maturity.

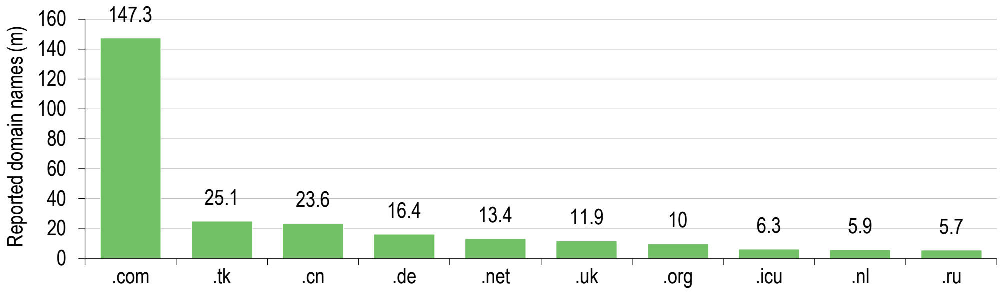
The domain name industry value chain

We summarise below the principal participants in the domain name industry value chain.

The Internet Corporation for Assigned Names and Numbers (ICANN) is an American multi-stakeholder group and non-profit organisation responsible for managing the development and architecture of the domain name space and is responsible for the authorisation of domain name registrars. ICANN's mission is 'to help ensure a stable, secure and unified global Internet'. ICANN helps coordinate and support the unique identifiers across the world.

Registry operators are the organisations responsible for the management, administration, promotion and distribution of all domain names registered in a TLD, including the creation and allocation of the domain names. They are responsible for maintaining the master database, ie the registry, of all domain names, operating the TLD's authoritative name servers and the zone file that enables the conversion of domain names to IP addresses. Their main interaction is with the domain name retailers who request the addition, deletion or modification of domain names to/from a registry, in response to requests from their own customers (registrants). Each TLD has a registry operator: Verisign is the registry operator of the largest gTLD, ie .com, as well as the .net TLD.

Exhibit 14: Largest TLDs by number of reported domain names (Q120)



Source: Edison, data from Domain Name Industry Brief, Q120

Registry service providers help to manage the technical operations of the registry operators. In return for running the technical operations, the registry service provider will retain a share of the revenue earned by the registry operator.

Registrars are organisations, accredited by ICANN or individual country code registries, through which the end customers (registrants) register domain names. Effectively, they are the retailers of domain names. There are hundreds of accredited registrars round the world and unlike the registry operators, their relationships with a particular TLD are non-exclusive. Registrars pay ICANN an annual accreditation fee in addition to a fee for every domain name registration and renewal.

The largest global registrar is GoDaddy.com with approximately 18% global market share of registered domain names according to Domain Name Stat. GoDaddy.com works with 410 TLDs and has 74.5m registered domain names, of which c 72% are .com, c 6% are .net and c 6% .org. GoDaddy's largest competitors are Alibaba (2.9%), Namecheap (2.9%) and Tucows Domains (2.8%), with all other companies, including Network Solutions and 1&1 Ionos, each holding less than 2% market share. This is a highly fragmented market.

Resellers are organisations that are appointed by registrars to increase the distribution network. There are tens of thousands of these organisations around the world.

Registrants are the end customers, ie individuals or entities, such as corporates, that register a domain name and pay an annual subscription to use the domain name. Registrants do not own the domain name, merely holding the right to use the domain name until the subscription is renewed. The registrant may purchase the subscription from either the registrar or a reseller.

Management

Chairman: Iain McDonald. Iain is the founder of Belerion Capital, an investor and investment adviser in technology and e-commerce companies. Iain is also a non-executive director of various of his investee companies, as well as other technology companies such as The Hut Group and Boohoo.com. Previously, Iain was a top-ranked retail and e-commerce analyst and held positions in a number of UK investment banks. Iain graduated from the London School of Economics and Political Science, with a BSc in economics and economics history.

Chief Executive Officer: Ben Crawford. Ben Crawford has been CentralNic's CEO for 10 years. His former positions include founding president of Louise Blouin Media, where he integrated 11 acquisitions in three countries and personally managed relationships with the Chinese government; managing director of Sports Business Group; and executive producer of the official website of the

Sydney Olympic Games. He has an MBA from the Australian Graduate School of Management and a first-class honours degree from the University of Sydney.

Group Managing Director: Donald Baladasan. Don, a Chartered Management Accountant, has many years of experience as a Director of AIM listed companies. Over the years he has assisted both public and private businesses in restructuring, raising and managing several million pounds of equity and debt. Don has experience of integrating internationally acquired companies from a finance, governance and commercial perspective. Don founded Mataxis a consultancy that specialises in advising and partnering fast growing entities. During this time Don has operated as COO and CFO for businesses that have undergone rapid transformation. Prior to this Don was Head of Accounting Development at Stemcor, an international steel trader which at the time had operations in 46 countries. Don was integral in the integration of acquired business through this period of rapid growth which saw turnover double to in excess of £6bn. Don initially studied Medicine at Guy's Hospital before completing a BSc in Economics at CASS Business School. He was then awarded a place on the Financial Times graduate scheme where he trained as a Chartered Management Accountant. Don has held various finance and operational roles in blue chip businesses such as Pearson, WPP and BUPA. Don was CFO of CentralNic at the time of its IPO on AIM.

Chief Financial Officer: Michael Riedl. Michael Riedl was executive vice president and CFO of KeyDrive from 2011. He started his career with Roland Berger Strategy Consultants and subsequently was chief restructuring officer at Group Saint-Paul from 2004–07 before joining DZ Equity Partners in Frankfurt and then BIP Investment Partners where he worked on private equity opportunities with a focus on buyouts. Michael holds a bachelor's degree in computer science from James Madison University, US, a master of science degree in business administration from European Business School, Germany, and an LLM from Frankfurt School of Finance and Management. He is also a chartered management accountant.

Sensitivities

There are a number of factors that investors should bear in mind when considering investing in CentralNic:

- **Key person exposure:** we believe that CentralNic's share price and potentially its operations could be affected by the loss of key management, particularly Ben Crawford, CEO.
- **COVID-19 impact**: although management did not note any material slowdown due to COVID-19 in its FY19 results reported at the end of April 2020, the COVID-19 pandemic represents an evolving scenario that makes forecasting the next 12 months challenging. The business itself is largely digital, deriving over 90% of its revenues from recurring-type revenues and has already successfully transitioned to remote working. However, it has yet to be seen whether there will be a slowdown in business formation with the likely economic recession that follows global lockdowns, with an associated slowdown in the registering of domain names and websites compared to historical averages.
- **Industry growth:** management has indicated that CentralNic has seen organic growth over the past couple of years of c 6% pa on average, with lower growth in more mature Western markets and higher growth in the Far East and emerging markets. Our analysis of internet trends suggests that the underlying growth of the industry has slowed markedly since CentralNic's IPO in 2013, with growth of TLD registrations falling steadily from 7.5% in 2013 to 3.9% in 2019.
- **Acquisitions**: CentralNic has a track record of earnings-enhancing acquisitions and future growth (including management's target of achieving US$1bn of revenue by 2023) depends on continuing M&A. The success of the buy-and-build strategy hinges on the company's ability to

select the right acquisitions, maintain price discipline and retain a reputation as an attractive acquiror. While an acquisition strategy does bring inherent risk, each target further diversifies the group's revenue streams, reducing the risk of any single acquisition significantly affecting results.

- **Scale/rating**: pressure on management to pursue a more aggressive M&A strategy could increase as the size of company required to 'move the needle' rises or multiples re-rate upwards. M&A can deliver accelerated upside but also increases risk.
- **Interest rates and stock market rating**: the macroeconomic environment has been very supportive for CentralNic, with low interest rates and volatile stock market valuations. The environment would become more challenging if interest rates were to rise materially or were CentralNic's shares to be de-rated or lose their attraction as an acquisition currency.
- **Leverage**: following its 2019 bond issue, CentralNic has net debt of US$75m (as at YE19), with a debt/equity ratio of 1.6x for FY19 (FY18: 0.3x) and FY19 net debt/EBITDA of 4.2x (FY18: 0.2x). Although cash generation remains strong, this level of debt and leverage is higher than historically and CentralNic may need to demonstrate that it can manage and pay down this debt in FY20 and beyond before returning to the debt markets.
- **Foreign exchange risk:** CentralNic operates an international business and generates revenues in multiple currencies. However, we understand that there is a high degree of natural hedging in the business, particularly between its two principal currencies, the US dollar and the euro.

Financials

CentralNic listed on AIM on 2 September 2013 and since listing has continued to grow through a combination of organic growth and M&A. The company has been highly acquisitive, having spent c US$207m on 11 acquisitions since IPO, including four completed in 2019. As a result, revenue has increased from US$4.1m in FY13 to US$109.2m in FY19, delivering a revenue CAGR of 73% since IPO (2013–19). Pro forma revenues for the group (including all acquisitions) as at November 2019 were US$198m, with a pro forma adjusted EBITDA estimate of US$31.8m, a margin of 16.0%.

As CentralNic's business has evolved, the classification and reporting of business units has also evolved, with inconsistent disclosure of KPIs historically. Prior to FY18, CentralNic's reporting currency was sterling, but in FY19 the reporting currency was changed to US dollars, bringing it into line with CentralNic's principal trading currency and industry peers, with comparatives for FY18 also restated in US dollars. In this context, we will principally comment on FY18 and FY19 as well as our forecasts and underlying assumptions.

Q120 update and H120 estimates

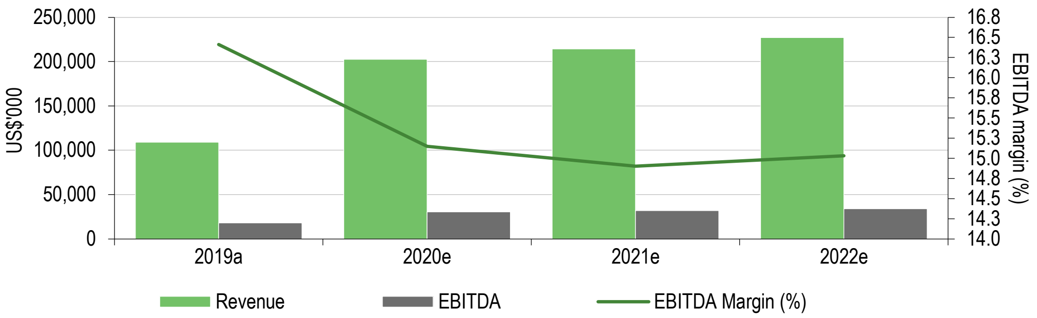
Q120 revenues of US$56.4m (US$226m annualised revenue run-rate) highlight the impact of Team Internet on the group. These results demonstrate CentralNic's defensive growth credentials, reporting adjusted EBITDA of US$8.1m (14.4% EBITDA margin) despite the onset of COVID-19. For H120, we forecast revenues of US$99.1m, reflecting a visible slowdown in Q220 over Q120 (implied Q2 revenue of c US$43m) due to the more pronounced impact of the COVID-19 pandemic, potentially affecting Team Internet's ad-driven revenues. We then expect growth gradually to pick up again in H220, assuming a continuing global recovery from COVID-19, with revenues of US$103.4m (+4.3% H2/H1). We estimate H120 EBITDA of US$14.6m, representing a 14.7% margin, with an uptick in margin to 15.5% in H220 delivering EBITDA of US$16.1m. We forecast a small fall in net debt to US$73.9m as at 30 June 2020 from US$75m at 31 December 2019.

Income statement: Impact of Team Internet, key assumptions

In its FY19 results, the group reported a 95% increase in revenues to US$109.2m (FY18: US$56.0m), with full-year contributions from the KeyDrive and Globe Hosting acquisitions (completed in FY18) as well as part-year contributions from TPP Wholesale, Hexonet and Ideegeo completed in FY19 (Team Internet's contribution to FY19 was minimal as it completed on 24 December 2019). Recurring-type revenues represented 92% of this total (FY18: 90%). Gross profits rose 65% to US$42.8m (FY18: US$25.9m), with reported adjusted EBITDA climbing 96% to US$17.9m (FY18: US$9.1m). The cash balance at year end was US$26.2m (FY18: US$23.1m) with net debt of US$75m (FY18: US$2.1m).

We have assumed organic growth of 6% across the business, based on management's estimate of organic growth, broadly in line with current TLD registration rates, though noting the declining trend (Exhibit 12). However, as the group moves away from domain registry services through cross-selling and moves into higher value-added services (ie hosting, websites, email, website security, brand protection and domain monetisation services), we believe we are being conservative in our growth assumptions. We have also backed out US$5.6m of revenues in FY20e, reflecting a one-off reversal of US$1.2m of intra-group revenues and US$4.2m to reflect a change in key contract terms, the reducing impact of which will also be seen in FY21e and FY22e.

Exhibit 15: Revenue, EBITDA and margin progression



Source: CentralNic, Edison Investment Research

However, as management has disclosed a revenue target of US$1bn by FY23, even 10% organic growth would mean the majority of future revenues (c US$700m) would still need to be acquired. In our estimates, we have not allowed for any acquisitions, but would note that value accretive acquisitions should bring multiples down even further.

Gross margins in FY19 were 39.2% (FY18: 46.3%), but with the addition of Team Internet from FY20, we have assumed future blended gross margins of c 30%. Historically, EBITDA margins have been c 16% (FY19: 16.4%, FY18: 16.3%), but again, recognising a lower margin contribution from Team Internet, we have assumed group EBITDA margins of 15.1% in FY20, 14.9% in FY21 and 15.0% in FY22, leading to EBITDA estimates of US$30.7m in FY20 and US$32.0m in FY21.

Finally, again reflecting the impact of the acquisition of Team Internet on the group, we expect a higher tax rate than historically, due to the relatively higher tax rates in Germany, with the normalised tax rate rising from 25% of profits in in FY19 to 27% FY22.

Exhibit 16: Key financials							
Year end 31 December, IFRS, US$000	2019	2020e	y-o-y growth	2021e	y-o-y growth	2022e	y-o-y growth
Revenue	109,194	202,480	85%	214,406	6%	227,225	6%
Gross Profit	42,775	66,818	56%	70,754	6%	74,984	6%
EBITDA	17,921	30,670	71%	31,952	4%	34,156	7%
Normalised operating profit	16,615	31,815	91%	31,476	(1)%	32,964	5%
Profit Before Tax (norm)	8,935	18,936	112%	23,399	24%	25,188	8%
Profit Before Tax (reported)	(8,199)	9,482		13,773		15,381	
Reported tax	39	(5,043)		(5,171)		(5,628)	
Net income (normalised)	10,407	12,752	23%	17,055	34%	18,199	7%
Average shares outstanding (m)	175,084	185,516		188,546		188,546	
EPS – basic normalised (c)	5.94	6.87	16%	9.05	32%	9.65	7%
Revenue growth (%)	155.9	85.4		5.9		6.0	
Gross margin (%)	39.2	33.0		33.0		33.0	
EBITDA margin (%)	16.4	15.1		14.9		15.0	
Normalised operating margin (%)	15.2	15.7		14.7		14.5	
Capex	(15,495)	(3,037)		(3,216)		(3,408)	
Closing net debt/(cash)	74,998	69,967	(7)%	59,441	(15)%	46,196	(22)%

Source: CentralNic, Edison Investment Research

Cash flow: Strong underlying cash flow

The group is strongly cash generative, with net operating cashflow of US$16.3m in FY19 and US$20.9m in FY20 following completion of the acquisition of Team Internet, before rising further to US$21.8m in FY21 and US$24.4m in FY22.

Underlying cash flows are strong with customers typically pre-paying for services, resulting in positive working capital. This means that cash conversion (normalised operating profit/net operating cash flow) on an annualised basis is c 100% (FY19: 98%, FY18: 100%), although with some variance on a quarterly basis. The acquisition of Team Internet may impact the working capital position in the near term, with a consequential reduction in operating cash flows, but thereafter management expects cash generation and cash conversion to normalise.

Dividend policy: No dividend expected in the medium term

With its strong cash flow profile, CentralNic has the potential to pay dividends. However, with its focus on growth and acquisitions and current elevated levels of debt, we do not envisage a dividend in the medium term. As such, and as set out in the FY19 report and accounts, CentralNic's board considered but did not propose a maiden dividend for FY19 but remains committed to introducing a 'progressive and commercially prudent dividend policy' at the appropriate stage in the future.

Balance sheet: Leverage falling in FY20 and FY21

In terms of the balance sheet, at the end of FY19 CentralNic had gross cash of US$26.2m (FY18: US$23.1m) and net debt of US$75m (FY18: US$2.1m), including US$3.5m of pre-paid finance costs. This leads to a debt/equity ratio of 1.6x for FY19 (FY18: 0.3x) and FY19 net debt/EBITDA of 4.2x (FY18: 0.2x). We forecast net debt falling to US$70m in FY20 and US$59m in FY21, with net debt/EBITDA falling to 2.3x in FY20 and 1.9x in FY21.

The majority of CentralNic's debt was consolidated into a senior secured four-year bond, maturing in July 2023 offering a coupon of 7% pa above three-month Euribor (subject to a 0% floor), with interest payable quarterly. The proceeds were used to repay £20.5m of existing debt as well as to fund the acquisitions of TPP Wholesale (€13.2m), Hexonet (€7.9m) and Ideegeo (€3.1m). In Q419, a further €40m was placed by way of a tap issue to fund the acquisition of Team Internet in December 2019. The issue is intended to provide financial flexibility over the medium term to enable management to pursue its strategic growth objectives. The bond is listed on the Frankfurt Stock Exchange and the Oslo Stock Exchange.

Although a 7% coupon appears expensive in the current interest-rate environment, it is in line with the market and at a very similar level to another of our coverage companies, Media & Games Invest, a German company of similar size, following a 'buy and build' model with a bond listed in Stockholm.

Valuation

We have looked at CentralNic on the basis of peer valuations, cross-referenced against a more fundamental NPV basis.

Valuation: NPV

Firstly, looking at the NPV of future cash flows, we have derived a value of 110p per share, 27% upside to the current share price of 86p. This is based on an explicit forecast period from 2020–30, before adding a perpetuity calculation with a 2% terminal growth rate and using a WACC of 7.1%. We note the company's relatively high leverage as well as a relatively high cost of this debt. We show the sensitivity to different WACC assumptions in Exhibit 17.

Exhibit 17: Discounted cash flow sensitivity table (p/share)

		Terminal growth rate				
		1.00%	1.50%	2.00%	2.50%	3.00%
WACC	10.0%	46.0p	48.6p	51.5p	54.7p	58.4p
	9.0%	57.9p	61.4p	65.5p	70.2p	75.7p
	8.0%	73.3p	78.4p	84.5p	91.6p	100.1p
	7.1%	92.9p	100.6p	109.8p	120.9p	134.9p
	7.0%	94.1p	101.9p	111.3p	122.7p	137.1p
	6.0%	123.5p	136.1p	151.9p	172.1p	199.1p

Source: Edison Investment Research

Our forecasts and key valuation assumptions are set out in the table below:

Exhibit 18: Discounted cash flow – key assumptions

US$'000	2019	2020e	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
EBITDA	17,921	30,670	31,952	34,156	36,140	37,947	41,886	43,562	45,086	46,439	47,600	48,552
EBITDA – D&A	8,316	19,465	20,472	22,384	24,078	25,581	37,959	39,478	40,859	42,085	43,137	44,000
Tax	(40)	(10,353)	(7,685)	(8,191)	(8,427)	(9,521)	(14,128)	(14,693)	(15,207)	(15,663)	(16,055)	(16,376)
Working capital delta	6,661	-1,776	-5,341	-4,172	-2,761	-2,913	-3,044	-3,165	-3,276	-3,374	-3,459	-3,528
Free cashflow	14,937	7,337	7,446	10,021	12,890	13,148	20,788	21,620	22,376	23,048	23,624	24,096
Terminal value												486,967
Total cash flow	14,937	7,337	7,446	10,021	12,890	13,148	20,788	21,620	22,376	23,048	23,624	486,967
Effective tax rate	0.5%	53.2%	37.5%	36.6%	35.0%	37.2%	37.2%	37.2%	37.2%	37.2%	37.2%	37.2%
WACC	7.05%											
Terminal growth rate	2.00%											
	0	1	2	3	4	5	6	7	8	9	10	11
Discounted cash flows	14,937	6,854	6,498	8,169	9,816	9,354	13,815	13,422	12,977	12,487	11,956	230,235
Enterprise value	335,584											
Net debt	74,998											
Equity valuation	260,586											
Number of shares (m)	188.8											
Price per share (US$)	1.38											
Price per share (p)	109.76											
Current share price (p)	86.00											
Upside/(downside)	27.2%											

Source: Edison Investment Research

Valuation: Global peer group

As CentralNic is a global business that lacks directly comparable domestic peers, for the peer group we have taken a range of international companies with similar or overlapping businesses. We believe the closest peers are Verisign (US listed, much larger, exclusive rights to .com), GoDaddy (US listed, much larger, SME focused), R22 SA (Polish-based domain hosting, internet and telecoms services group), Endurance International (US-based owner of HostGator) and Tucows (Canadian domain reseller, particularly focused on US telecoms services).

We have also considered a small number of European software companies that, although not directly comparable, provide useful valuation reference points, especially given CentralNic's high levels of recurring revenue. These include: iomart (UK listed, web hosting and Internet security) and IMImobile (UK listed, mobile and software solutions).

Exhibit 19: Peer group valuations

Name	Year end	Share price (ccy)	Ccy	EV ($m)	Sales growth FY1 (%)	Gross margin FY1 (%)	EBITDA margin FY1 (%)	EBIT margin FY1 (%)	EV/ sales FY1 (x)	EV/ sales FY2 (x)	EV/ EBITDA FY1 (x)	EV/ EBITDA FY2 (x)	P/E FY1 (x)	P/E FY2 (x)
Verisign Inc	Dec-20	207.4	US$	24,612	2.3	85.7	70.2	N/A	19.5	18.4	27.8	25.8	37.1	34.5
GoDaddy Inc	Dec-20	78.5	US$	14,620	8.5	65.1	22.0	8.3	4.5	4.1	20.5	18.1	75.6	54.6
Endurance Int	Dec-20	3.7	US$	2,091	(2.4)	56.1	26.5	10.8	1.9	1.9	7.3	7.0	NM	NM
Tucows Inc	Dec-20	59.1	US$	729	0.3	N/A	15.1	N/A	2.2	2.1	14.3	12.4	45.5	31.8
iomart group PLC	Mar-20	351.0	GBp	555	8.0	61.0	38.5	21.8	3.9	3.9	10.2	10.2	21.0	21.5
IMImobile PLC	Mar-20	310.0	GBp	348	18.4	47.4	12.7	9.3	1.6	1.5	12.9	11.5	19.9	19.3
Mean (ex Verisign)					**11.7**	**57.4**	**23.7**	**13.9**	**2.9**	**2.7**	**12.7**	**11.4**	**35.0**	**28.0**
Mean					**10.4**	**63.0**	**30.4**	**13.9**	**5.2**	**4.9**	**14.8**	**13.5**	**35.4**	**29.1**
Median					**8.0**	**61.0**	**26.5**	**10.8**	**3.0**	**2.6**	**12.9**	**11.5**	**29.1**	**26.6**
CentralNic Group	Dec-20	86.0	GBp	279	85.4	33.0	15.1	11.0	1.4	1.3	9.1	8.7	15.7	11.9
CNIC Discount/(Premium) to Overall Mean (ex Verisign)									**52%**	**51%**	**28%**	**24%**	**55%**	**57%**

Source: Refinitiv. Note: Priced at 18 June 2020.

The peer table highlights a wide range of multiples applied to different business models, with Verisign, which has exclusive rights to the .com domains and consequently has 70% EBITDA margins, trading on almost 20x current year EV/sales.

Excluding Verisign from our analysis, CentralNic's core peers trade on 2.9x current year (FY1) EV/sales and 2.7x FY2. In terms of P/E, looking at the overall mean (ex Verisign) indicates P/E multiples of 35x FY1 and 28x FY2, although lifted by GoDaddy's high multiples.

CentralNic shares trade on an FY20e (FY1) sales multiple of 1.4x and a P/E of 15.7x, a c 50% discount to the average peer group sales multiple and a 55% discount to the average P/E multiple. Value accretive acquisitions would bring CentralNic's multiples down even further.

Factors behind CentralNic's low relative valuation include: high reliance on M&A to supplement otherwise relatively modest organic growth; concerns over the group's debt-funded growth model and the rapid pace of expansion; the limited free float; and a relative lack of knowledge of the company, given its major transformation over the last couple of years, and the underlying market.

We would expect key catalysts for share price progression to include increasing investor familiarity with the business, better understanding of CentralNic's growth story, demonstration of the group's ability to deliver on its growth targets as well as to deleverage through operating cashflow and continuing successful market consolidation through M&A.

By consolidating a highly fragmented industry landscape, the group is attempting to build a portfolio of businesses, acquired at reasonable valuation multiples and subsequently achieve synergies through cross-selling and cost efficiencies. As CentralNic builds investor credibility and scales up, we would expect the peer group discount to narrow and close.

Exhibit 20: Financial summary

	2018	2019	2020e	2021e	2022e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT	US$000	US$000	US$000	US$000	US$000
Revenue	55,991	109,194	202,480	214,406	227,225
Cost of Sales	(30,080)	(66,419)	(135,662)	(143,652)	(152,241)
Gross Profit	25,911	42,775	66,818	70,754	74,984
EBITDA	9,146	17,921	30,670	31,952	34,156
Normalised operating profit	8,820	16,615	31,815	31,476	32,964
Amortisation of acquired intangibles	(5,600)	(8,299)	(9,454)	(9,626)	(9,807)
Exceptionals	(6,362)	(5,957)	-	-	-
Share-based payments	(469)	(2,878)	-	-	-
Reported operating profit	(3,611)	(519)	22,361	21,851	23,157
Net Interest	(1,430)	(7,754)	(7,078)	(7,078)	(7,076)
Joint ventures & associates (post tax)	45	74	-	-	-
Exceptionals	-	-	(5,800)	(1,000)	(700)
Profit Before Tax (norm)	7,435	8,935	18,936	23,399	25,188
Profit Before Tax (reported)	(4,996)	(8,199)	9,482	13,773	15,381
Reported tax	(1,428)	39	(5,043)	(5,171)	(5,628)
Profit After Tax (norm)	7,435	10,343	12,752	17,055	18,199
Profit After Tax (reported)	(6,424)	(8,160)	4,439	8,603	9,753
Minority interests	5	64	-	-	-
Discontinued operations	-	-	-	-	-
Net income (normalised)	7,440	10,407	12,752	17,055	18,199
Net income (reported)	(6,419)	(8,096)	4,439	8,603	9,753
Basic average number of shares outstanding (m)	127,515	127,515	175,084	185,516	188,546
EPS – basic normalised (c)	5.83	5.94	6.87	9.05	9.65
EPS – diluted normalised (c)	5.56	5.77	6.68	8.79	9.38
EPS – basic reported (c)	(5.03)	(4.62)	2.39	4.56	5.17
Dividend (c)	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	75.3	155.9	85.4	5.9	6.0
Gross Margin (%)	46.3	39.2	33.0	33.0	33.0
EBITDA Margin (%)	16.3	16.4	15.1	14.9	15.0
Normalised Operating Margin	15.8	15.2	15.7	14.7	14.5
BALANCE SHEET					
Fixed Assets	132,321	217,544	214,878	206,614	198,250
Intangible Assets	127,267	206,055	198,620	191,138	183,603
Tangible and Right-of-use Assets	931	6,427	10,421	9,639	8,810
Investments & other	4,123	5,062	5,837	5,837	5,837
Current Assets	51,378	67,433	74,240	90,107	107,523
Stocks	3,906	491	506	1,072	1,136
Debtors	24,382	40,760	42,521	47,296	51,403
Cash & cash equivalents	23,090	26,182	31,213	41,739	54,984
Other	-	-	-	-	-
Current Liabilities	(62,443)	(78,767)	(78,796)	(78,849)	(78,906)
Creditors	(59,719)	(75,683)	(75,683)	(75,683)	(75,683)
Tax and social security	(452)	-	-	-	-
Short term borrowings	(2,272)	(3,084)	(3,113)	(3,166)	(3,223)
Other	-	-	-	-	-
Long Term Liabilities	(43,188)	(129,206)	(129,206)	(130,763)	(132,437)
Long term borrowings	(22,933)	(102,799)	(102,799)	(103,025)	(103,267)
Other long term liabilities	(20,255)	(26,407)	(26,407)	(27,739)	(29,170)
Net Assets	78,068	77,004	81,116	87,108	94,430
Minority interests	(5)	69	-	-	-
Shareholders' equity	78,063	77,073	81,116	87,108	94,430
CASH FLOW					
PBT	(4,996)	(8,199)	9,482	13,773	15,381
Depreciation and amortisation	5,926	9,605	11,205	11,480	11,773
Share-based payments	469	2,878	-	-	-
Working capital	7,783	6,661	(1,776)	(5,341)	(4,172)
Exceptional & other	2,650	7,680	7,078	7,078	7,076
Tax	(3,015)	(2,309)	(5,043)	(5,171)	(5,628)
Net operating cash flow	8,817	16,316	20,947	21,819	24,430
Capex	(4,920)	(15,495)	(3,037)	(3,216)	(3,408)
Acquisitions/disposals	(27,568)	(63,840)	(5,800)	(1,000)	(700)
Net interest	(682)	(1,970)	(7,078)	(7,078)	(7,076)
Equity financing	30,869	2,133	-	-	-
Dividends	-	-	-	-	-
Other	-	-	-	-	-
Net Cash Flow	6,516	(62,856)	5,031	10,526	13,245
Opening net debt/(cash)	8,667	2,115	74,998	69,967	59,441
FX	(1,374)	(10,976)	-	-	-
Other non-cash movements	1,410	949	-	-	-
Closing net debt/(cash)	2,115	74,998	69,967	59,441	46,196

Source: Company accounts, Edison Investment Research

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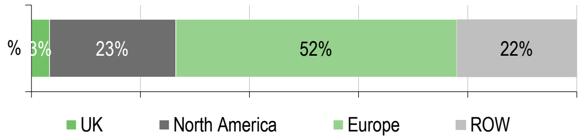
Revenue by geography



Management team

Chairman: Iain McDonald

Iain is the founder of Belerion Capital, an investor and investment adviser in technology and e-commerce companies. Iain is also a non-executive director of various of his investee companies, as well as other technology companies such as The Hut Group and Boohoo.com. Previously, Iain was a top-ranked retail and e-commerce analyst and held positions in a number of UK investment banks. Iain graduated from the London School of Economics and Political Science, with a BSc in economics and economics history.

CEO: Ben Crawford

Ben has a global business and corporate development background in complex internet-related businesses. Previous roles have included founding president of Louise Blouin Media, where he integrated 11 acquisitions in three countries, MD of SportBusiness Group and executive producer of the official website of the Sydney Olympic Games. Ben has an MBA from the Australian Graduate School of Management and a first-class honours degree from the University of Sydney.

CFO: Michael Riedl

Michael Riedl was CFO of KeyDrive from 2011–18. Prior to joining KeyDrive, Michael held managing positions in the private equity and ICT industries. He started his career with Roland Berger Strategy Consultants where he specialised in performance improvement programmes, before joining Group Saint-Paul in Luxembourg as its chief restructuring officer. Michael holds a bachelor's degree in computer science from James Madison University, US, a master's of science degree in business administration from European Business School, Germany, and a LLM from Frankfurt School of Finance and Management. He is also a chartered management accountant.

Group managing director: Don Baladasan

Don is an experienced finance director. He has assisted AIM-listed businesses in raising £25m of equity, in addition to leading M&A transactions and integrating international companies from a finance, governance and commercial perspective. Prior to joining CentralNic, Don was head of accounting development at Stemcor, an international steel trader. Don studied medicine at Guy's Hospital before completing a BSc in economics from CASS Business School. He was then awarded a place on the Financial Times graduate scheme where he trained as a chartered management accountant.

Principal shareholders	(%)
Inter.Services	18.74
Kestrel Investment Partners	16.03
Erin Invest & Finance (together with related holdings, Clevebeam and Jabella)	15.04
Gresham House	6.98
Schroder Investment Management	6.20
ChelvertonAsset Management	5.20
Herald Investment Management	4.72

Companies named in this report

Endurance International, GoDaddy, NameCheap, R22, Tucows, Verisign

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