

The NAGA Group

Software
12 November 2018

Further development of the ecosystem

NAGA Group continues to ramp up volumes on its NAGA Trader platform, while eliminating commission expenses through the acquisition of Hanseatic Brokerhouse (HBS). Recent developments in the NAGA ecosystem include the introduction of an AI-based robo-advisor, the launch of the beta version of NAGA Exchange (together with an analytical tool called NAGA Guard), as well as the introduction of NAGA Card. The business remains in its early stage with the majority of products (except NAGA Trader) yet to generate meaningful revenues.

Trading activity growth and services to NDAL

NAGA Group has reported a positive EBITDA at €2.2m in H118 (vs a negative €1.2m in H117) and was close to reaching its break-even point at the net income level, posting a minor €15k loss in H118. This was driven by the rise in brokerage revenues (up 23.7% to €4.6m), largely on the back of higher activity on the NAGA Trader platform, but also the €3.4m of service revenues from Naga Development Association (NDAL), which did not occur in H117. Excluding these service revenues (where the visibility on future occurrence is limited), NAGA's EBITDA loss would stand at €1.2m in H118. Earnings were negatively affected by the HBS acquisition, which posted a €417k loss from the moment of first consolidation (February 2018).

Still expecting a slightly lower FY18 EBITDA vs FY17

NAGA Group has reiterated its FY18 guidance disclosed during the FY17 results publication and continues to expect a considerable increase in brokerage revenues and a slight decline in EBITDA on the back of higher marketing and personnel expenses. We believe that the brokerage business in H218 may be assisted by a potential continuation of the increased market volatility experienced in October, which may drive trading volumes (similar to the trend seen early this year). Future marketing spend will be associated, among other things, with the HSV partnership and the co-operation with Sky Media (€1.8m according to the company).

Valuation: Partial share price rebound

As NAGA Group's share price has not fully recovered from the downward trend since the beginning of the year, its shares current trade at a 4.9x EV/sales on LTM figures as at end-June 2018. Blockchain and fintech companies that are still in the ramp-up phase may be the most appropriate comparators, given NAGA's short operating history.

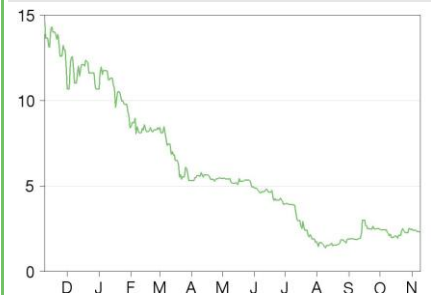
Historical financials

Year end	Revenue (€m)	EBIT (€m)	PBT (€m)	EPS* (€)	P/E (x)	Yield (%)
12/15	0.60	(0.77)	(0.78)	(15.60)	N/A	N/A
12/16	3.23	(6.40)	(6.49)	(131.60)	N/A	N/A
12/17	14.11	(1.90)	(2.10)	(0.14)	N/A	N/A

Source: NAGA Group accounts. Note: *Based on 50,000 shares in 2015, 50,001 in 2016 and 21,000,048 shares in 2017.

Price €2.39
Market cap €96m

Share price graph



Share details

Code	N4G
Listing	Deutsche Börse Scale
Shares in issue	40.2m
Last reported net cash at 30 June 2018	€6.8m

Business description

The NAGA Group is a fintech start-up in social trading with its own cryptocurrency (NAGA Coin) and two flagship products: NAGA Trader (for securities trading) and NAGA Virtual (for in-game items trading), a joint venture with the Deutsche Börse. Headquartered in Hamburg, the company acquired Hanseatic Brokerhouse Group, now rebranded to NAGA Brokers.

Bull

- The major stakeholder Fosun may be successful in bringing NAGA to the Chinese market.
- German fintech companies may benefit from Brexit.
- Social trading and robo-advisor may gain significant traction in Germany.

Bear

- Recent crackdown on cryptocurrency trading may have adverse effect on NAGA.
- NAGA's business model may be copied by Silicon Valley tech giants.
- Competition is likely from existing players in finance and gaming.

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Financials: Higher trading volumes

NAGA Group's H118 revenues more than doubled to €8.1m from €3.7m in H117, supported by a 23.7% y-o-y increase in brokerage revenue to €4.6m (fulfilling management expectations), but also €3.4m of revenue from services related predominantly to the co-operation with NDAL. The latter is NAGA Group's business partner, which is developing several components of the NAGA ecosystem, including the NAGA Coin (NDAL conducted last year's ICO, raising US\$50m of proceeds), NAGA Wallet as well as the NAGA Card. In the past, NAGA Group has provided advisory services and trademark rights to NDAL in conjunction with the NAGA token sale and the development of the above-mentioned products. Trading volumes on the social trading app NAGA Trader were assisted by the particularly high market volatility at the beginning of the year (which usually translates into higher trade volumes in the CFD market). A similar effect might assist H218 results if the market volatility experienced in October persists throughout November/December. Together with the revenue from activated programming services (associated with the development of NAGA's products) at €0.5m (H117: €0.6m), total performance reached €8.6m.

NAGA's results were also supported by other operating income of €2.0m (vs €0.3m in H117), which was associated with the transfer of expenses to NDAL. We assume that the majority of other operating expenses (€2.4m compared with €1.0m in H117) represent corresponding costs transferred to NDAL. Commission expenses in H118 have diminished, following the acquisition of a 72.16% stake in HBS (consolidated from 1 February 2018) and should not be recognised in subsequent periods, as they were attributable to commissions paid by NAGA to HBS (recognised as revenue by the latter). The considerable increase in personnel expenses (€2.8m vs €1.2m in H117) was also mostly the result of HBS consolidation, as well as higher employee salaries. Marketing expenses in H118 went up to €1.1m vs €0.3m in H117 and the company is embarking on further promotional activities, such as the HSV partnership and co-operation with Sky Media, which will amount to c €1.8m for the 2018/19 football season, according to company.

Despite the higher operating costs and consolidation of the loss-making HBS (a €417k loss booked between February and June 2018, with a further €285k loss in January 2018 that was not consolidated), NAGA Group has reported a positive EBITDA at €2.2m (H117: negative €1.2m) and has almost reached its break-even point at the net income level, posting a minor loss of €15k (vs a loss of €3.9m in H117). However, this was largely attributable to the above-mentioned revenues from services provided to NDAL, where we have limited visibility in terms of recurrence of the income stream. Excluding these revenues, NAGA's EBITDA loss would come in at €1.2m (broadly in line with the loss recorded in H117). Also, it must be noted that the operating profit has not fully translated into a corresponding cash inflow yet, as cash flow from operations stood at a negative €0.6m in H118 (though improved from the negative €2.4m in H117). Meanwhile, investments (mainly in intangibles and financial assets) reached €1.7m in H118 (€0.9m in H117). Consequently, NAGA's cash position as at end-June 2018 stood at €6.8m (vs €8.7m at end-2017).

Exhibit 1: Financial results summary

€000s	H118	H117	Y-o-y change
Revenue	8,076	3,741	115.9%
<i>Brokerage revenue</i>	4,629	3,741	23.7%
<i>Revenue from services</i>	3,446	0	nm
Activated programming services (commissions)	474	589	-19.5%
Total performance	8,550	4,330	97.5%
Other operating income	2,000	305	nm
R&D expenses	(1,563)	(1,341)	16.6%
Brokerage expenses	(426)	(434)	-1.8%
Commission expenses	14	(1,576)	nm
Personal expenses	(2,846)	(1,245)	128.6%
Marketing and advertising expenses	(1,114)	(292)	281.5%
Other operating expenses	(2,418)	(993)	143.5%
EBITDA	2,197	(1,246)	nm
Amortisation	(2,253)	(2,384)	-5.5%
EBIT	(56)	(3,631)	nm
Net financial incomes (expenses)	(60)	(93)	-35.5%
Income (loss) before taxes	(116)	(3,724)	nm
Income taxes	101	(173)	nm
Net profit/(loss)	(15)	(3,897)	nm

Source: NAGA Group accounts, Edison Investment Research

NAGA's equity increased to €46.5m from €20.3m at end-2017 as a result of the HBS acquisition (settled in shares). At the same time, the company recognised goodwill on this transaction amounting to €17.8m (vs net asset value of HBS at the time of acquisition at €1.0m).

Extending product portfolio

NAGA Group continues to improve its product portfolio as it further develops the already launched applications along with introducing new ones, which add new features to the ecosystem. NAGA Trader is now supported by CYBO – a self-learning robo-advisor that uses AI in the investment decision-making process to automate trading activities. Within NAGA Wallet, the most important improvement applied is the 'NAGA Crypto-Beam' feature, which allows real-time exchanges between any cryptocurrency supported by the app. The company has also launched NAGA Card, which is a multicurrency (EUR, GBP, USD), prepaid card connected to the wire account, enabling international payments and cash withdrawals. The latest addition to the ecosystem is the cryptocurrency exchange, called NAGA Exchange, which was launched as a closed beta version on 2 November 2018. It is integrated with the NAGA Wallet accounts and extends the 'Crypto-Beam' feature, as it supports not only crypto-pairs but also fiat currencies. It will be connected with another of the company's innovations – NAGA Guard, which is a crypto-market monitoring tool. As it collects information from various exchanges, it is designed to provide first-hand, in-depth data on prices, liquidity and risk scores, along with wash-trading and fake-volumes alerts. The future product pipeline includes a wealth management tool and cash equity trading features.

Although all the products are interrelated and form one system, the entity structure behind the system is more complicated. According to company's management, the relatively new topic of cryptocurrencies was not precisely defined in German law at the time the ICO was conducted. As a result, NAGA decided (after a round of discussions with lawyers and auditors) to involve NDAL, an independent entity with no personnel or capital connections with the NAGA Group, for this purpose. NDAL is based in Belize, which has a legal framework that is more supportive of cryptocurrencies. NDAL was the entity that raised US\$50m in the ICO conducted last December and still functions within the ecosystem. It relies on NAGA Group's advisory services, as well as trademark rights, and uses long-term licences to operate NAGA Wallet and NAGA Exchange, products developed by Naga Technology (NAGA Group's subsidiary). NAGA Group, on the other hand, controls the revenue-generating entities, including NAGA Trader, NAGA Virtual, NAGA Markets, HBS, etc. It is also directly or indirectly the final beneficiary of all income generated in the ecosystem based on agreements with NDAL.

Valuation

Given NAGA's short-term operating history and business focus, blockchain and fintech companies still in the ramp-up phase may be appropriate comparators for valuation purposes. These companies are still young, small in scale and are often listed on exchanges with lighter regulatory burdens (such as OTC markets in the US). Although the company has reported positive EBITDA for the past twelve months, we continue to rely on the EV/sales multiplier, as it is less distorted by one-off items and consolidation effects. NAGA is currently trading at an LTM EV/sales ratio of 4.9x.

Following the downward trend that started in November 2017, NAGA's share price has levelled off in the €2.0–3.0 range. It is close to the IPO price level of €2.60, but below the sale price of the transactions conducted by management and supervisory board members in April and July 2018 (with a total volume of c €330k), which stood at around €5.90–5.95 per share.

In the long term as NAGA continues to grow its revenue base, the valuation of online brokers (eg IC Group and CMC Markets), fintech companies (Cinnober Financial Technology) or mobile social media and gaming apps (Momo and Gree) may provide good reference points.

Exhibit 2: NAGA Group peer comparison

Company name	Market cap Local ccy m	P/E (x)			EV/sales (x)			EV/EBITDA (x)		
		2018	2019	2020	2018	2019	2020	2018	2019	2020
IG Group	2,231.51	11.59	11.25	10.61	3.68	3.58	3.39	7.58	7.42	7.00
CMC Markets	347.97	11.25	8.54	7.53	1.73	1.59	1.53	6.37	4.92	4.37
Alpha FX Group	222.93	26.41	23.74	N/A	10.11	8.07	N/A	22.02	18.43	N/A
Cinnober Financial Technology	1,713.74	N/A	N/A	51.62	3.97	3.21	2.65	N/A	N/A	N/A
MyBucks	87.52	14.06	5.36	N/A	1.94	1.52	n/a	N/A	N/A	n/a
Gree	114,569.07	16.07	14.78	15.54	0.35	0.33	0.33	2.70	2.50	2.20
Momo INC	7,361.57	14.55	11.37	9.08	3.12	2.41	2.00	11.03	8.20	6.81
YY INC	4,331.55	1.36	1.16	0.99	0.20	0.16	0.14	1.05	0.76	0.63
Peer group average		13.61	10.88	15.90	3.14	2.61	1.67	8.46	7.04	4.20

Source: Thomson Reuters data as at 6 November 2018, Edison Investment Research

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