

The NAGA Group

Software
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Further ecosystem expansion delayed

NAGA Group initiated a restructuring process in April 2019 and will now focus on its only profitable product, Naga Trader. For FY19, the company guides to a substantial decrease in revenues from advisory services to Naga Development Association (NDAL). This is accompanied by a €1.8m value adjustment on receivables from NDAL in FY18. This is the result of weak market conditions (particularly in cryptocurrencies), according to the company. Consequently, the targeted expansion of a complete NAGA ecosystem will be postponed.

Earnings affected by higher costs and one offs

NAGA Group reported 25% y-o-y growth in revenues to €16.1m in FY18 despite a decline in trading volumes, driven by the expansion of the customer base of NAGA Markets. At the same time, NAGA recognised several one-off items, including a €1.8m value adjustment on receivables from NDAL. NAGA also incurred higher personnel expenses (€6.8m vs €2.7m in FY17) following the consolidation of Hanseatic Brokerhouse Securities (HBS) and marketing spending (€1.8m vs €0.2m in FY17). As a result, NAGA generated a significant decrease in EBITDA (€0.3m versus €2.9m in FY17) and a higher net loss (€4.1m vs €2.2m in FY17) and thus missed its guidance of a slight year-on-year decline.

Weaker performance triggering optimisation

NAGA's restructuring measures are aimed at cost savings of 60–70% vs FY18, with first effects expected to be visible in 2020. This is accompanied by Yasin Qureshi, the company's co-founder and largest shareholder, moving from the management board to a newly created advisory board on 30 April 2019. In FY19, NAGA anticipates a slight decline in brokerage revenues (following the weaker business activity in Q119) and a substantial decrease in revenues from NDAL. In addition, NAGA expects restructuring costs will weigh its results down and guides to a significantly lower EBITDA and net income in FY19 vs FY18. NAGA remains confident it will be able to complete the turnaround without additional capital measures.

Valuation: Reflecting negative newsflow

The recently initiated restructuring and lower than expected FY18 results and subdued FY19 guidance have triggered a further share price decline. The company's shares are trading at an FY18 EV/sales ratio of 2.2x. 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 (€)	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
12/18	17.72	(4.82)	(4.96)	(0.10)	N/A	N/A

Source: NAGA Group. Note: *Total performance as reported by the company. ** Based on 50,000 shares in 2015, 50,001 in 2016 and 21,000,048 shares in 2017.

Price €0.97
Market cap €39m

Share price graph



Share details

Code	N4G
Listing	Deutsche Börse Scale
Shares in issue	40.2m
Last reported net cash as at 31 December 2018	€3.7m

Business description

The NAGA Group is a fintech start-up in social trading with a flagship product Naga Trader and its own cryptocurrency (NAGA Coin). Headquartered in Hamburg, the company acquired Hanseatic Brokerhouse Group in early 2018, now rebranded to Naga Brokers.

Bull

- Social trading and robo-advisers may gain significant traction in Germany.
- German fintech companies may benefit from Brexit.
- Ongoing restructuring may improve results in FY20.

Bear

- Significant decline in revenues from services to NDAL.
- Subdued short-term earnings outlook due to restructuring measures.
- Uncertainties in the capital market, especially in cryptocurrency space.

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Financials: Burdened by higher opex and one offs

NAGA's revenues increased 25% y-o-y to €16.1m in FY18, in line with the company's forecast of a year-on-year sales growth. Brokerage revenues reached €8.1m (up by 24% y-o-y) coupled with the expansion of NAGA Markets' (NAGA's online broker) customer base by c 25.7k. At the same time, however, trading volume decreased from €42bn to €36bn due to lower market volatility through the year and new ESMA regulations, which introduced new leverage restrictions for retail clients trading in CFDs. At end-2018, NAGA Group managed customer assets of €15.8m vs €10.6m at end-2017. Revenues from services increased 27% y-o-y to €8.0m in 2018, which included €7.6m generated on sales to NDAL, the company's business partner. NDAL raised US\$50m in an initial coin offering (ICO) (conducted by NAGA last December) and is responsible for the development of the NAGA Coin, NAGA Wallet and NAGA Exchange. Together with revenues from activated programming services of €1.6m, NAGA's total performance stood at €17.7m in FY18, up 26% y-o-y.

EBITDA decreased to €0.3m from €2.9m in FY17 and the net loss was €4.1m vs €2.2m in the previous year. This means earnings fell short of the company's guidance of a slight year-on-year decline. Dynamic growth in total performance and reduction of brokerage expenses on the acquisition of HBS were more than offset by higher operating costs and one-off items. Over FY18, NAGA's personnel expenses increased significantly to €6.8m from €2.7m, driven by an increase in headcount following the HBS acquisition (91.5 in full-time equivalents at end-2018 vs 22 at end-2017), higher salaries and an €0.5m management bonus payment attributable to FY17 performance. Marketing expenses reached €1.8m vs €0.2m in FY17 as the company embarked on new promotional activities, such as the HSV partnership and co-operation with Sky Media. The company previously highlighted that marketing expenses for the 2018/19 football season should reach c €1.8m and anticipates this will have a positive impact on its business in 2019.

One-off items included a value adjustment on receivables of €1.8m, predominantly an adjustment for doubtful receivables at €1.7m. We note that this write-off was booked on receivables from NDAL for NAGA's advisory services. This may come as a surprise given that NDAL collected the equivalent of US\$50m in the ICO in December 2017. We believe this write-off may be an indication that these proceeds are now largely exhausted, as they were already spent and/or because some part was held in cryptocurrencies and lost a significant part of its value. Moreover, NAGA recognised an €0.8m impairment charge on NAGA Virtual Software (an exchange for virtual goods), a former JV with Deutsche Börse that sold its 40% stake in the platform to NAGA in September 2018.

In FY18, the company's equity ratio increased to 96.2% from 79.7%, assisted by a sharp growth in equity to €119.5m from €20.3m. This follows the issue of c 11.8m shares in exchange for contributions in kind for the acquisition of HBS in February 2018. At the time, NAGA's shares traded at €8.10, which boosted the acquisition price to €95.4m (the transaction was entirely non-cash) as well as NAGA's equity. This has translated into a goodwill recognition of €94.7m. Importantly, NAGA's current share price is much lower at €0.97.

Operating cash flow was negative at €2.9m vs a negative €4.2m in FY17. NAGA's cash position decreased by 58% y-o-y to €3.7m at end FY18 from €8.7m due to a €3.7m decline in accounts payables (vs an increase of €1.3m in FY17) and €2.1m investments in intangible assets (vs €1.5m in FY17), which we understand resulted from the development of Naga Trader.

Exhibit 1: Financial summary

€000s	FY18	FY17	y-o-y change
Revenue	16,119	12,844	25.5%
Brokerage revenue	8,119	6,522	24.5%
Revenue from services	8,001	6,322	26.6%
Activated programming services (commissions)	1,595	1,266	26.0%
Total performance	17,715	14,109	25.6%
Other operating income	4,719	3,534	33.5%
Purchased services	2,899	3,248	-10.7%
R&D expenses	2,605	2,004	30.0%
Brokerage expenses	1,071	847	26.4%
Commission expenses	(29)	2,579	nm
Personnel expenses	6,819	2,699	152.6%
Marketing & advertising expenses	1,774	206	nm
Value adjustments on receivables	1,803	87	nm
Other operating expenses	5,220	3,096	68.6%
EBITDA	270	2,878	-90.6%
Amortisation	5,086	4,778	6.4%
EBIT	(4,816)	(1,900)	nm
Financial income	18	1	nm
Financial costs	161	205	-21.5%
Income (loss) before taxes	(4,959)	(2,104)	135.7%
Income taxes	447	71	nm
Deferred taxes	(1,307)	70	nm
Net profit/(loss)	(4,100)	(2,244)	82.7%

Source: NAGA Group accounts

Subdued outlook coupled with restructuring measures

In April 2019 NAGA announced it will restructure the group amid continued uncertainties in capital markets, specifically the cryptocurrency space. The company aims to improve profitability through cost savings of 60–70% compared to FY18. NAGA will now focus on the organic growth of its customer base and its profitable social trading platform Naga Trader. In addition, it will shift all operational tasks to the group's offices in Cyprus and reduce its operations and personnel in Germany and Spain. It is worth noting that management board member and the company's largest shareholder, Yasin Qureshi, moved from the management board to a newly created advisory board on 30 April 2019 and will focus on strategy, innovation, business development and M&A. As a result, the management board was reduced from three to two members: Benjamin Bilski, NAGA's co-founder, and Andreas Luecke, who is also a supervisory board member at HBS. The company hopes the restructuring measures will bring positive effects in FY20.

However, NAGA highlights that unfavourable market conditions and economic uncertainties coupled with the ongoing restructuring process may have an adverse impact on its FY19 results. Due to weaker business activity in Q119, NAGA guides to a slight decline in brokerage revenues in FY19. The company states the trading volume and customer base is growing, with trading volumes expected to improve 50% y-o-y in FY19. NAGA anticipates EBITDA will decrease substantially, affected by lower revenues and restructuring costs despite the intended expansion into new markets outside the EU (for instance, Southeast Asia). We would like to underline that NAGA expects a significant decline in revenues from advisory services to NDAL, which seems to be an indication that product development within the Naga ecosystem will be lacklustre in the near term. Consequently, NAGA expects a higher net loss in FY19 vs FY18.

Product development highlights

In December 2018, NAGA agreed to cooperate strategically with Binance, one of the largest cryptocurrency platforms in the world as measured by trading volume. In the initial part of the cooperation, NAGA Group will enable Binance Coin (BNB) cryptocurrency holders to invest in products on Naga Trader without having to exchange their BNBs for a classic fiat currency

beforehand. In addition, Naga Trader can now be used to purchase all NAGA's investment products via a Bitcoin or Ethereum account (where these cryptocurrencies may act as base currencies) and customers may take short positions in cryptocurrencies. We estimate that the average daily traded value in the BNB cryptocurrency over the last three months was around \$354m.

In our last [update note](#) we discussed the remaining FY18 developments in the NAGA ecosystem, such as the introduction of an AI-based robo-adviser, the launch of the beta version of Naga Exchange (which went live in May 2019) and the introduction of Naga Card. It should be noted that p2pfx, NAGA's subsidiary that was supposed to launch its online FX/CFD peer-to-peer trading app by the end of 2017 or early 2018, did not conduct any business activities in 2018. NAGA states that this year it will develop a new cryptocurrency-trading platform and change p2pfx's name accordingly. We understand that NAGA intends to focus primarily on Naga Trader and will keep the investments in other components of the ecosystem (including products developed by NDAL) to a minimum amid the ongoing restructuring process. Having said that, NAGA intends to launch a new service called NAGA Stocks in August 2019, which will allow users to trade directly in listed stocks and aims to take some market share from traditional brokers.

Valuation

The downward trend in NAGA's share price started in November 2017 and was recently fuelled by the restructuring announcement, lower than expected FY18 earnings and subdued FY19 forecasts. The share price has levelled off around €1.0, which is below the IPO price of €2.60 and less than the sale price of the transactions conducted by management and supervisory board members in April and July 2018 (with the sale price range of around €5.90–5.95 per share and a total volume of c €330k).

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. The peer group thus includes online brokers (eg IC Group and CMC Markets), fintech companies (Cinnober Financial Technology) and mobile social media and gaming apps (Momo and Gree). 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). NAGA is trading at an FY18 EV/sales ratio of 2.2x.

Exhibit 2: NAGA group peer comparison

Company name	Market cap	P/E (x)			EV/sales (x)			EV/EBITDA (x)		
	Local ccy m	2018	2019	2020	2018	2019	2020	2018	2019	2020
IG Group	£2,197	9.7	13.8	14.3	3.1	3.8	3.7	6.2	8.6	8.8
CMC Markets	£278	48.1	12.6	10.0	1.7	1.4	1.3	14.6	6.3	5.2
Alpha FX Group	£276	33.7	30.7	N/A	10.0	8.1	N/A	23.1	20.1	N/A
Cinnober Financial Technology	SEK1,947	N/A	N/A	N/A	5.1	N/A	N/A	N/A	N/A	N/A
MyBucks	€12	N/A	N/A	N/A	1.8	N/A	N/A	6.0	N/A	N/A
Gree	¥125,476	25.9	30.0	28.1	0.5	0.5	0.5	3.5	6.3	5.5
Momo INC	CNY 7,307	15.6	12.5	10.3	0.1	0.1	0.0	0.2	0.2	0.2
YY INC	CNY5,706	9.9	14.2	10.7	N/A	N/A	N/A	N/A	N/A	N/A
Peer group average		23.8	19.0	14.7	3.2	2.8	1.4	8.9	8.3	4.9

Source: Refinitiv data as at 4 July 2019, Edison Investment Research

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