

The NAGA Group

Software
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Making efforts towards Naga Group 2.0

NAGA Group has largely completed its restructuring (initiated in April 2019) aimed at cost savings and increased focus on its only profitable product, Naga Trader. Restructuring costs, coupled with market and regulatory headwinds, resulted in weak H119 results. Despite the above, NAGA has maintained its FY19 guidance and expects to see the benefits of its repositioning in FY20. Meanwhile, Fosun Group (NAGA's major shareholder) has agreed to inject €5m new funding into the company.

Restructuring and downturn in sales hamper results

NAGA reported a significant drop in H119 EBITDA to a €4.6m loss vs a €2.2m profit in H118 as a c€1.6m y-o-y reduction in operating costs following the restructuring (despite still being burdened with one-off severance payments) did not offset a 79% downturn in revenues to €1.7m. Lower revenues were driven by a 71% drop in brokerage fees on the back of lower market volatility and the new European Securities and Markets Authority (ESMA) regulation, as well as the lack of revenues from NDAL (NAGA's business partner). H2 trading has seen an improvement and hence NAGA has confirmed its FY19 guidance for a slight decline in brokerage sales and significant drop in EBITDA and net income. It expects that the full effects of the recently completed restructuring will be seen in FY20.

Capital injection from Fosun

NAGA's main shareholder, the Chinese conglomerate Fosun Group, has agreed to provide €5m of new capital to the company, €3m of which will be granted in the form of senior loans and €2m in a convertible note. Management highlights that the funds will support NAGA's re-launch after restructuring, while we note its importance for NAGA's liquidity (cash was €1.3m at end-H119 vs net cash outflow of €2.3m). Fosun will also increase its stake in NAGA by c 17pp, becoming its majority shareholder. Meanwhile, NAGA has focused on improving its core product, Naga Trader, and expansion into South-East Asia. NAGA confirms it will continue to work with NDAL on the NAGA Exchange and NAGA wallet products.

Valuation: Reflecting recent challenges

Following a c 60% share price decline since the announcement of the restructuring in April 2019, NAGA trades at a 1.4x FY18 EV/sales multiple. Given NAGA's short operating history, blockchain and fintech companies still in the ramp-up phase may be the most appropriate comparators.

Historical financials

Year end	Revenue* (€m)	EBIT (€m)	PBT (€m)	EPS** (€)	P/E (x)	Yield (%)
12/15	0.6	(0.8)	(0.8)	(15.6)	N/A	N/A
12/16	3.2	(6.4)	(6.5)	(131.6)	N/A	N/A
12/17	14.1	(1.9)	(2.1)	(0.1)	N/A	N/A
12/18	17.7	(4.8)	(5.0)	(0.1)	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 €0.65
Market cap €26m

Share price graph



Share details

Code	N4G
Listing	Deutsche Börse Scale
Shares in issue	40.2m
Last reported net cash at 30 June 2019	€1.3m

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-advisors may gain significant traction in Germany.
- Ongoing expansion to Asia may boost sales.
- Completed restructuring may improve results in FY20.

Bear

- Significant decline in revenues and earnings.
- The company's liquidity may be dependent on funding from its majority shareholder, Fosun Group.
- Uncertainties in the capital market, especially in the cryptocurrency space.

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Impact of restructuring costs and drop in sales

In H119, NAGA's total performance declined to €2.0m from €8.6m in H118, affected by a significant drop both in brokerage sales and revenues from services. The former decreased 71% y-o-y to €1.3m due to lower market volatility in the period as well as ESMA regulations launched in July 2018 (which introduced new leverage restrictions for retail clients trading in CFDs). At end-June 2019, NAGA managed assets of €13m, which represents a decline from €15.8m at end-December 2018. This is despite the increase in customer base to 22.4k from 20.2k at end-December 2018 (the number of customers who keep funds in their accounts). Importantly, revenues from services decreased to €0.3m from €3.4m as the company did not generate any sales from advisory services to NDAL, its business partner, which raised US\$50m in an initial coin offering (ICO) conducted in December 2018. After reporting €1.7m in write-offs on receivables from NDAL in FY18 (see more details in our last [update note](#)). NAGA confirms it will continue to work with NDAL on the NAGA Exchange and NAGA wallet products (receivables from NDAL were €2.1m at end-H119).

EBITDA was negative €4.6m vs positive €2.2m in H118 as cost reductions in conjunction with the restructuring process did not offset a significant decline in sales. Having said that, following recent restructuring measures, NAGA was able to reduce its operating expenses by €1.6m to €6.8m, assisted by a €1m fall in R&D expenses to €0.6m (after the company decided to postpone the development of the NAGA ecosystem). Personnel expenses decreased only slightly to €2.4m from €2.8m despite reduced headcount, affected by one-off severance and indemnity payments. As a result, NAGA's net loss reached €6.7m in H119 (vs €15k in H118).

Exhibit 1: Financial summary				
€000s	H119	H118	y-o-y change	
Revenue	1,672	8,076	(79.3%)	
Brokerage revenue	1,348	4,629	(70.9%)	
Revenue from services	323	3,446	(90.6%)	
Capitalised programming services	356	474	(24.9%)	
Total performance	2,028	8,550	(76.3%)	
Other operating income	184	2,000	(90.8%)	
R&D expenses	570	1,563	(63.5%)	
Brokerage expenses	751	426	76.3%	
Commission expenses	0	(14)	N/M	
Personnel expenses	2,409	2,846	(15.4%)	
Marketing & advertising expenses	1,079	1,114	N/M	
Other operating expenses	1,986	2,418	(17.9%)	
EBITDA	(4,583)	2,197	N/M	
Amortisation	2,190	2,253	(2.8%)	
EBIT	(6,774)	(56)	N/M	
Financial income	1	0	N/M	
Financial costs	2	60	N/M	
Income (loss) before taxes	(6,774)	(116)	N/M	
Income taxes	(82)	(101)	N/M	
Deferred taxes	0	0	N/M	
Net profit/(loss)	(6,692)	(15)	N/M	

Source: NAGA group accounts

Operating cash flow was an outflow of €1.7m vs an outflow of €0.6m in H118, resulting in a net cash outflow of €2.3m (vs €1.9m in H118). As a result, NAGA's cash position decreased to €1.3m from €3.7m at end-December 2018. In this context, we understand its future liquidity may be dependent on the €5m funding from Fosun Group (a Chinese investment company and NAGA's main shareholder), on which the companies agreed in August 2019 (see more details below).

NAGA maintains its FY19 forecast for a significant decline in EBITDA and higher net loss vs FY18. It still anticipates a slight decline in brokerage revenues in FY19 as it states that weak H119 figures should be partly offset by stronger performance in H219. NAGA highlights that new customer deposits recently increased to €3.5m (up by 50% compared with the monthly average in 2019),

while the monthly number of transactions increased 65% to 388k and trading volumes reached €4.6bn, up by 85%.

Focus on core product after restructuring

As of end-H119, NAGA has largely completed restructuring of the group, which it initiated in April 2019 amid continued uncertainties in capital markets (see more details in our last [update note](#)). Management highlights that the company has grown in many directions since its launch in 2015 but its activities were not streamlined, which led to high operating costs coupled with inefficient marketing and group structures.

The restructuring was thus aimed at reducing the operating costs by 60–70% compared with FY18 (when they amounted to c €22m). Management guides that the full effects of the restructuring measures will be visible in 2020. To date, NAGA has reduced its management board from three to two members, closed the offices in Spain, downsized the team in Germany and transferred its operational activities to Cyprus. NAGA anticipates further cost savings on marketing on expiration of its co-operation with Sky Media after the 2018/19 football season (c €1.8m as previously stated by the company).

As part of the restructuring, NAGA has focused on its core product, Naga Trader, by integrating its offering (CFDs, in-game items and cryptocurrencies) into one platform (which the company claims is almost complete). Currently, its flagship product is the auto-copy feature, which enables users to replicate the trading of top investors on the platform. NAGA plans to commence a new service that will allow users to trade directly in listed stocks in Q419 (although its launch has been postponed from August 2019). The development of other components of the original ecosystem seems to be on hold for now.

In parallel, the company has initiated its expansion into Asian markets, including Thailand, Malaysia, Indonesia and Vietnam, coupled with extending its team in these countries. NAGA expects that a rise in transaction volumes in these markets will be reflected in its results from FY20 (we understand that since May 2019, these markets contributed c €0.1m to H119 brokerage sales).

Fosun agrees to inject new capital

In October 2019, NAGA announced that its existing shareholder, Fosun Group, will provide the company with €5m of new funding, of which €3m will be granted in the form of senior loans and €2m in a convertible note. In addition, Fosun will acquire c 17.2% of the company's shares from former HBS shareholders (NAGA acquired the company in February 2018) and in turn become NAGA's majority shareholder. As part of the transaction, c 90% of NAGA's shareholders agreed to lock up their shares for three years and enter into a voting pool in the period (ie they will vote the same way).

We note that completion of the transaction is important for NAGA's business given its current cash position. Management acknowledges that NAGA was able to re-launch after restructuring, thanks to Fosun's investment and hopes its integration with the company will give it access to new markets and a new customer base. It is worth highlighting that Fosun has been NAGA's main investor in recent years. The company owned 34.5% of NAGA before IPO in July 2017 and still held c 30% of the company's shares at end-FY17 (no more recent data available). Notably, Fosun has a representative on NAGA's supervisory board.

Along with the Fosun news, NAGA's management announced that it intends to co-invest by acquiring shares from the same group of shareholders as Fosun.

Valuation

Since the restructuring announcement in April 2019, NAGA's share price has declined 60% to c €0.70. This 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. Having said that, we acknowledge that NAGA's lack of profits and turnaround stage limit the value of this comparison. The peer group includes online brokers (eg IC Group and CMC Markets), fintech companies (Cinnober Financial Technology) and mobile social media and gaming apps (Gree). These companies are still young, small in scale and 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 1.4x.

Exhibit 2: NAGA group peer comparison

Company name	Market cap	P/E (x)			EV/sales (x)			EV/EBITDA (x)		
	Local ccy m	2018	2019e	2020e	2018	2019e	2020e	2018	2019e	2020e
IG Group	£2,439	15.4	16.6	14.9	4.3	4.3	4.0	10.9	10.9	9.7
CMC Markets	£365	63.1	12.9	12.6	2.4	1.8	1.8	7.2	7.2	7.0
Alpha FX Group	£408	49.5	39.1	32.7	15.6	10.9	8.5	26.8	26.8	21.8
Cinnober Financial Technology	SEK1,947	N/A	N/A	N/A	5.1	N/A	N/A	N/A	N/A	N/A
Gree	¥129,351	37.3	31.3	28.0	0.6	0.6	0.6	6.8	6.8	6.0
YY INC	CNY5,227	9.2	16.3	12.0	N/A	N/A	N/A	N/A	N/A	N/A

Source: Refinitiv data as at 8 November 2019, Edison Investment Research

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