

Tuesday, May 21, 2019 | special comment

## R22 – Promising company from Polish TMT

Current price: PLN 19.20

**R22 PW; R22.WA | TMT, Poland**

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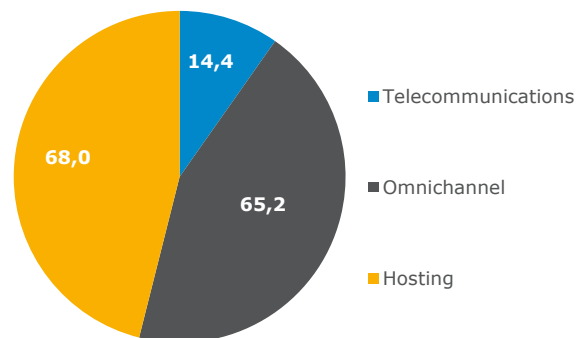
**R22 is a group of companies offering omnichannel communication services, SMS marketing and is one of the largest companies on the hosting and domains market in Poland. During one and a half year of presence on the WSE, R22 increased its turnover by >70%, made many acquisitions, especially in the hosting segment, went beyond Poland taking over a number of Romanian entities, has a wide portfolio of clients (including Eurocash, Smyk, T-Mobile, Media Markt). The company is currently listed on EV/EBITDA proforma'19 = 9.0x and P/E proforma'19 = 18.6x, however, it is growing dynamically (we estimate organic growth of 13-14% on the EBITDA line in 2019). R22 wants to double the scale of business and gain a leading position in the hosting market in Central & Eastern Europe within 2 years carrying out further acquisitions (two countries besides Poland and Romania still in 2019). The integration of hosting companies under one brand will result in cost synergies and increases of prices of offered services. The group is an attractive target for takeover for global players. We note that home.pl, comparable to H88 (hosting company of R22 Group) was taken over by the 1&1 Group in 2015 @EV/EBITDA=16.0x. The index implies a valuation of PLN 320-380 million for the hosting segment, which is slightly lower than the company's EV, with the hosting segment generating less than 60% of the entity's earnings. The risk factors for R22 are fast M&A development and quite high indebtedness of the company. The management, however, has a good track record in consolidating the hosting market in Poland, which increases the probability of successful acquisitions of companies in the region.**

### Activity profile

The R22 Group is a holding of technology companies, created in 1999. The companies offer: hosting & sales of domain

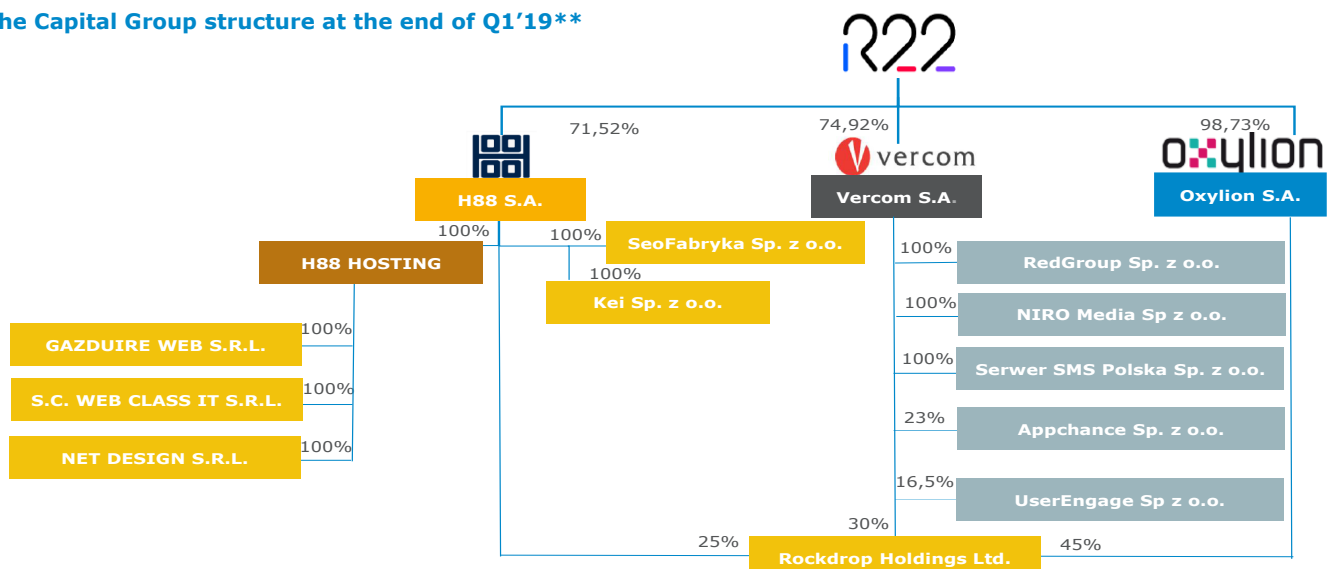
services (H88 Group), automatic and omnichannel contact with mass recipients through platforms provided in the SaaS formula (Vercom Group) and telecommunications services such as Internet access and VoIP (Oxylion). Hence, R22 segments turnover within: (1) hosting, (2) omnichannel communication services, and (3) telecommunications. Segments accounted for 49%, 42% and 9%, respectively, of turnover in Q3 2018/2019\*. R22 has a base of >250 thousand clients (2.4x increase from Q3 2016/2017\*), which are mainly private enterprises - 80% of them are business clients from the SME sector. The company also works with large business clients (ie IKEA, Eurocash or Rossmann). The Group develops through organic activities and acquisitions (over a dozen transactions in the last three years). R22 entered the Romanian market in 2018 as a result of the takeover of hosting companies. After further acquisitions in May 2019, R22 is a leader on the Romanian market with a total share of 25% and >50 ths. additional clients. R22 also invested in the software house Appchance and User.com associated with marketing automation, of which 75% customers come from outside Poland.

### Revenues proforma in 2018 (PLN m)



Source: R22, Dom Maklerski mBanku

### The Capital Group structure at the end of Q1'19\*\*



Source: R22, Dom Maklerski mBanku

\* the Group has shifted financial year from 01/07 to 30/06, \*\* excluding Exit Agreement's effects in H88 from TCEE Fund III S.C.A.

## Capital Group at the end of Q1'19

Segments	Name of entities	Date of incorporation	30/06/2017	31/12/2017	30/06/2018	31/12/2018	31/03/2019
Telecommunications	Oxyllon S.A.		99.16%	97.73%	97.73%	98.73%	98.73%
Omnichannel communication	Vercom S.A.		61.69%	67.72%	74.92%	74.92%	74.92%
	RedGroup		61.69%	67.72%	74.92%	74.92%	74.92%
	NIRO Media Group		61.69%	67.72%	74.92%	74.92%	74.92%
	SerwerSMS Polska	03-03-2017	61.69%	67.72%	74.92%	74.92%	74.92%
	User.com	16-10-2018				12.37%	12.37%
	Appchance	31-10-2018				17.23%	17.23%
Hosting	H88 S.A.	21-04-2016	60.76%	60.76%	71.52%	71.52%	71.52%
	H88 Holding S.A.	04-08-2016	60.76%	60.76%	71.52%	71.52%	71.52%
	ICONIC	04-10-2016	60.76%	60.76%	71.52%	71.52%	71.52%
	ICONIC Sp.k.	04-10-2016	60.76%	60.76%	71.52%	71.52%	71.52%
	Domeny.pl*	04-10-2016	60.76%	60.76%			
	Active 24*	25-01-2017	60.76%	60.76%			
	Serveradmin*	08-11-2017		60.76%			
	Bright Group*	08-11-2017		60.76%			
	Seofabryka	09-02-2018			71.52%	71.52%	71.52%
	Kei.pl	22-05-2018			71.52%	71.52%	71.52%
	H88 Hosting S.R.L	06-08-2018				71.52%	71.52%
	Gazduire Web	27-08-2018				71.52%	71.52%
	S.C. WEB CLASS IT	15-10-2018				71.52%	71.52%
	NET DESIGN	15-10-2018				42.91%	42.91%

\* subsidiaries of H88 (100% shares)

Source: R22, Dom Maklerski mBanku

## M&A activity

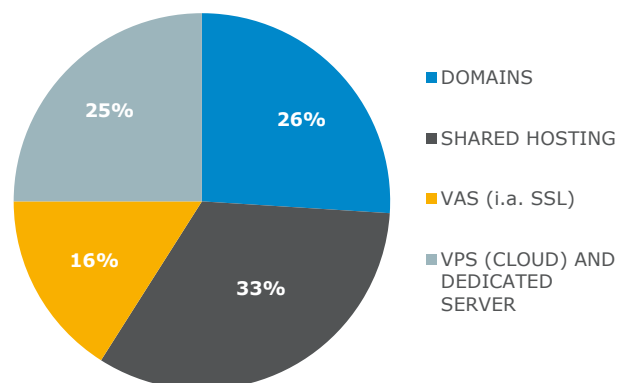
From 2015 to Q1 2019, the R22 Group executed a number of acquisitions, the most in the Hosting segment.

- In 2016, the company acquired 60.76% shares in H88 S.A, H88 Holding, Iconic, Iconic Sp.k. and Domeny.pl. In 2017, the company acquired Active24, Serveradmin and Bright Group. On 6<sup>th</sup> July 2017, Active24 made a deal of purchasing the Bright Group. Afterwards, H88 acquired 100% shares in the following companies: Domeny.pl, Active24, Serveradmin and Bright Group. In 2018, Seofabryka, Kei.pl & H88 Hosting were acquired. The acquisition of Seofabryka, which offers SEO and SEM services, has been an important element of added value in hosting area. Kei.pl has free resources in server rooms and a team of IT programmers. R22 also made first foreign acquisitions in 2018, taking over three Romanian companies: Gazduire Web, S.C Web Class IT and Net Design. In May 2019, 100% shares in another three entities were purchased: SC Top Level Hosting, Rospot and HostVision for a total amount of EUR 4.2 million. We estimate that the takeover took place @ approx. 7.5-8.0x EV/EBITDA.
- In the Omnichannel Communication segment, Niro Media Group was acquired in 2015, and SerwerSMS two years later. The first one deals with performance marketing and the second one offers SaaS services for mobile channel (platform providing SMS, MMS, Voice VMS). In October 2018, R22 covered 12.37% of UserEngage shares (a dynamically growing company in the segment of MarTech solutions, which strengthened the portfolio of tools within the segment) and 17.23% of Appchance (present in the mobile area).

## Hosting Segment

R22 conducts hosting business through H88 Group. The Group consists of two Polish companies - SeoFabryka, Kei.pl as well as three Romanian companies - Gazduire Web, Web Class IT and Net Design. H88 provides server space and services in the field of data transmission security, sales and maintenance of SSL certificates (guaranteeing confidentiality and data integrity) in the subscription model and registration of Internet domains around the world. The segment generates revenues through shared hosting and VPS (hosting in the cloud), sale of Internet domains and through additional services, so-called VAS (Value Added Services), such as SSL certificates, SEO & SEM (search engine optimization) and anti

## Share in the revenues of the Hosting Segment in the



Source: R22, Dom Maklerski mBanku

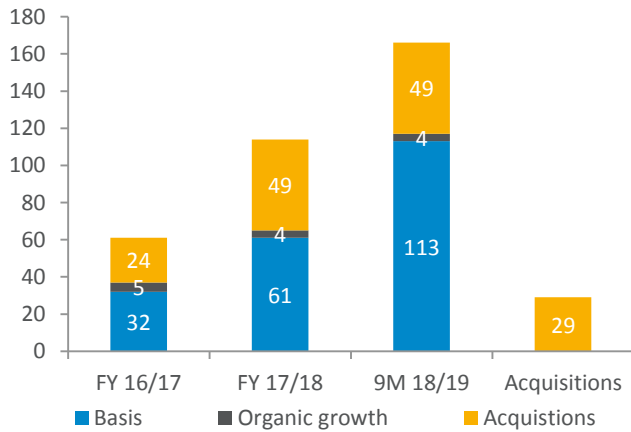
-DOS protection (automatic protection against digital attacks). H88 emphasizes the high quality of customer service and, if possible, an individual approach, which it seeks to distinguish on the market. Shared hosting generates the largest share of the hosting segment revenues (about 1/3 of turnover). Domains and VPS as well as dedicated servers are at a similar level (about 1/4 of turnover). In 9M 2018/2019, revenues on the Romanian market accounted for >20% of the total revenues of the H22 group.

Taking into account the successful acquisitions (inc. Romanian ones in May 2019), the group has approx. 195ths. hosting clients, nearly 360ths. domains and grows dynamically (vs.+61ths. Clients&130ths.domains in 2017/18)

The Group reports an increase in the price index of both hosting and domains, which allows to mitigate the impact of increasing payroll costs on results. ARPU LTM in hosting amounted to PLN 222 in 9M'18/19, it was higher by almost 13% after 9 months .

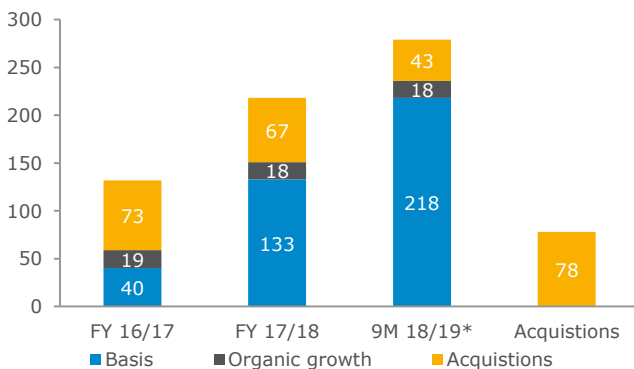
The domain's ARPU index also shows an increase, PLN 65 in 9M'18/19 (about +5% vs. ARPU in 2017/18). The segment reports a stable churn rate: 17.8% in the hosting area and 25.9% in domains.

**Number of customers - hosting ('000)**



Source: R22, Dom Maklerski mBanku

**Number of domains ('000)**

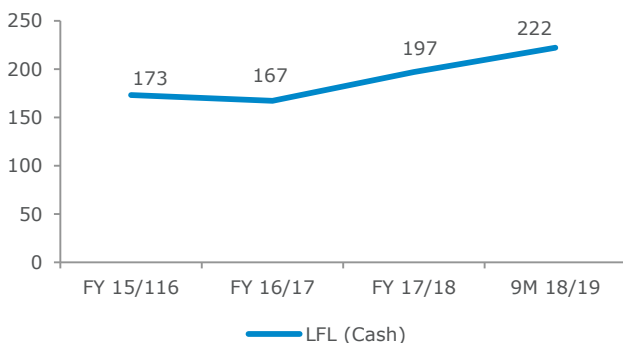


\* including 23.5 thous. Domains in the promotion for PLN 0

**The hosting market**

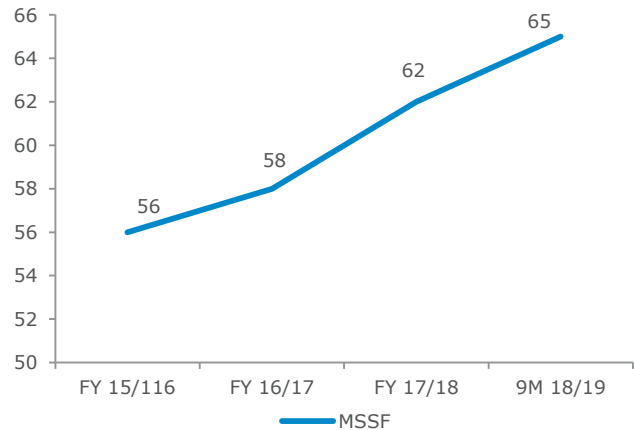
According to Global Web Hosting Market Share 2016, the value of the Polish hosting market amounts to approximately \$400 million per year. Poland ranks eighth in Europe and thirteenth in the world in terms of the size of the hosting market. The competitive advantage over the countries results

**ARPU LMT – hosting**



from high price competitiveness and the quality of services offered. The value of the Internet domain market (the segment of the hosting market) in Poland is estimated @PLN 240 million (data of March 2017). There are three main players in Poland: Home.pl, Nazwa.pl and H88, which

**ARPU domains\*\***

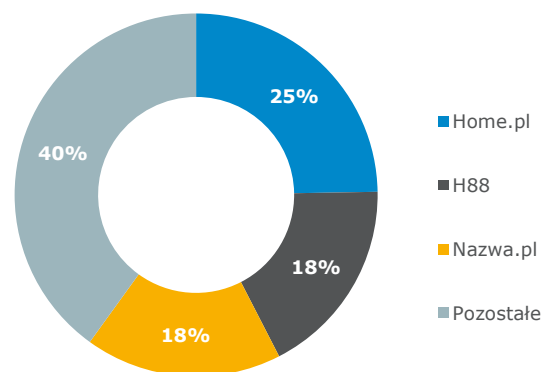


\*\*ARPU excluding free domains

Source: R22, Dom Maklerski mBanku

account for 60% of the domain market, and the rest is divided (share of 25%, 18% and 18%, respectively). A price pressure can be observed on the domain market. Continuous promotions are common as there is a group of users for whom the price is the main migration reason. In the years 2007-2012, a very dynamic increase in the number of .pl domains was observed. In 2016 however, this figures improved by only +0.8% y/y. Despite the decline in the number of domains with the .pl extension, the market should continue to grow. Currently, .pl domains constitute about 75% of active domain names, and the rest are functional domains (com.pl, info.pl) & regional domains (waw.pl and kalisz.pl). Customers are more and more interested in registration of industry extensions such as cafe, .bank, .hotel, .mobile. By February 2019, about 36 ths. of new domains were registered with non-standard extensions, i.e.. .line, .xyz, .site, .cloud, .app, .shop, .tech, .club, and .art. According to the National Domain Registry NASK report (Q4 2018), the total number of names in the domain was 2.6 million (+11 ths. names vs. Q3).

**Structure of domains market in Poland**



Source: R22, Dom Maklerski mBanku

**Consolidation of the global hosting market**

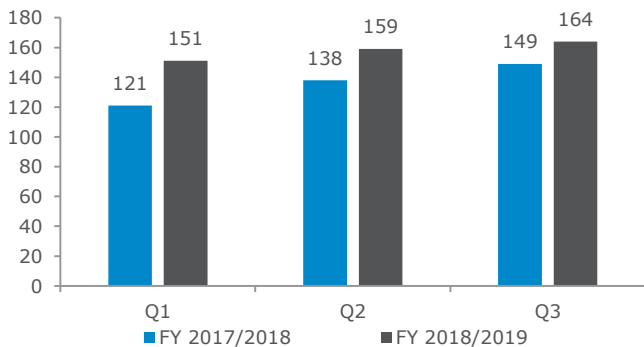
The global hosting market is in the consolidation and ownership changes phase. One of the most important transactions on the Polish market was the acquisition of the market leader in 2015 - Home.pl - by the largest provider of internet services in the world - 1&1. The transaction amounted to PLN 640 million (EUR 150 million). At that time, the entity generated approximately 40 million EBITDA, which implies 16.0x. The American company GoDaddy took over Host Europe, which operates on the European market in

2016 for EUR 1.69 billion (about 11.0x EBITDA). In Poland, only Home.pl has market links with global players, and nazwa.pl & H88 do not belong to any global capital groups. There is also a continuous consolidation in Poland: Home.pl bought az.pl in recent years, and Nazwa.pl bought o12.pl. H88 made a number of acquisitions, as we mentioned earlier.

**Omnichannel Communication**

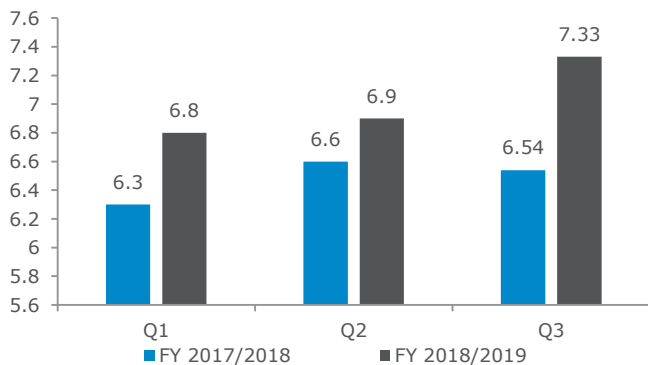
R22 operates in the Omnichannel Communication segment through the Vercom Group, which includes 5 companies - RedGroup, Niro Media, SMS Polska Server, Appchance (software house, specializing in the field of mobile technologies) and UserEngage (marketing automation platform). The group provides tools that automate omnichannel communication with recipients. The segment offers platforms for handling, preparation, processing and automatic sending of mobile messages and emails in the form of SaaS service and Big Data usage. The mobile messages are sent via SMS, MMS, VMS, Push, Chatbot Messenger, WhatsApp and Viber. Revenues from SaaS platforms accounted for approx. 90% of the turnover of the entire segment. The operations of the Vercom Group are strongly dependent on the terms of cooperation with telecom operators (T-mobile Group, Orange, Play and Polkomtel). The Vercom Group has a wide portfolio of clients, ie Eurocash, Ikea, Media Markt, Smyk, PLL LOT, Vectra, OLX.pl, Payback, Raiffeisen Bank, PolskiBus, Neckermann, Rossmann and T-mobile. In Q3 2018/19, a module for sending mobile push messages was launched. The tool enables the integration of e-mail, PUSH and SMS channels and creation of automatic mailing scenarios, which allows to optimize the budget for promotion and personalization of communication. The number of clients in the omnichannel segment is growing and in Q3 2018/19 the increase was particularly noticeable in the SME area.

**Number of customers - Enterprise**



Source: R22, Dom Maklerski mBanku

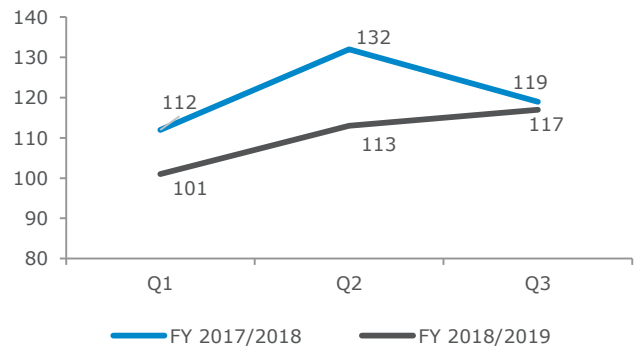
**Number of customers - SME ( `000 units)**



Source: R22, Dom Maklerski mBanku

Vercom Group started the reconstruction of ARPU in H1 2018/19 while improving profitability in the SME segment (optimization of the offer & introduction of invoices), which is reflected in ARPU that increased in Q3 2018/19 to the level of PLN 117 from PLN 113 q/q, although it should be slightly lower seasonally. The company expects an increase of income from subscriptions in periods.

**Monthly ARPU (PLN) of SME segment (without subscription and performance marketing)**



Source: R22, Dom Maklerski mBanku

Vercom was rewarded for, among others 'Best in Cloud - ComputerWorld (2017)' and 'Financial Times Top 1000 - as one of the six companies from Poland (2017)'.

**Telecoms segment**

The telecommunications segment generates revenues in areas related to Internet access, which offers additional services, ie television or telephone (mainly B2C) and VoIP (Voice over Internet Protocol) - voice transmission based on data transmission over the Internet, which includes VoIP services together with virtual headquarters. The company also offers additional services - queuing & virtual conference rooms. This segment has more than 1,600 transmitters, which are located mainly in Lower Silesia and the Podkarpackie Voivodeship.

**The medium term plans**

R22 wants to develop further through acquisitions. The goal of H22 is to become the leader on the Central and Eastern European market. In the coming year, the Group expects 2-3 acquisitions, focusing on Poland, Romania and the Central & Eastern European countries. In the near future, the company wants to achieve a 30% share in the Romanian market and enter the hosting market in another two countries. R22 is willing to conduct acquisitions at approx. 8-9x, but the Management says that on today's consolidating market it is becoming more and more difficult, therefore transactions at the ratios >10.0x are also possible. R22 takes over mature entities, often encountering organizational barriers in the further development of the business.

In addition, the R22 medium term plans include:

- **Hosting:** R22 plans to integrate the hosting segment under one brand, which will influence the group's recognition. In our view, this change will also affect the price level and generate cost synergies.
- **Omnichannel Communication:** Vercom plans to carry out activities aimed at increasing ARPU and margin in 2019, among others by continuing to introduce minimum subscription fees for platforms access. The company continues to develop the EmailLabs and Redlink platforms in the area of analytics & big data and plans to introduce new push messages (sent from the apps). Vercom is also working on the Reopen platform (real time marketing platform using machine learning & big data).

- **Telecommunications:** The company does not see the potential for growth in the telecommunications segment, however, it does not plan the disinvestment of the segment, as it generates some synergies with other segments. The Group is focused on maintaining the ARPU and a decrease in investment expenditures in the segment.

### Q3 2018/2019 results & the outlook for the next year

R22 has reported a significant increase in financial results in Q3 2018/19 (calendar Q1 2019). Revenues from sales amounted to PLN 37.3 million, EBITDA @PLN 10.0 million (ie +28.0% & +56.7% y/y, respectively). Due to the financial year, R22 will implement the IFRS 16 standard from July 1<sup>st</sup>, however the results are not comparable y/y due to the acquisition of three companies during the financial year. Assuming that the growth rate of the hosting segment is approx. 15%, we estimate the organic growth of the EBITDA result at 22-25% y/y.

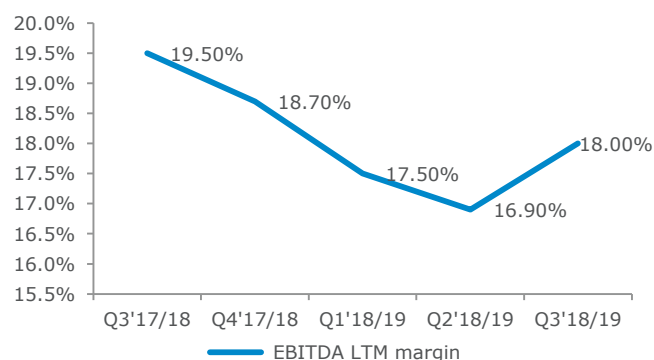
### R22 Group quarterly financial results\*

(PLN m)	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19
<b>Sales revenues</b>	<b>29.1</b>	<b>30.6</b>	<b>31.0</b>	<b>37.2</b>	<b>37.3</b>
Amortization and depreciation	2.3	2.1	2.6	2.9	2.9
External services	18.5	19.5	18.3	22.7	21.3
Costs of employee benefits	3.7	4.2	4.3	5.2	5.1
Use of materials and	0.3	0.3	0.5	0.8	0.6
Cost of goods sold	0.0	0.0	0.0	0.0	0.0
Taxes and charges	0.1	0.3	0.2	0.1	0.1
Other operating activity	-0.2	-0.1	0.0	-0.2	-0.1
<b>EBIT</b>	<b>4.1</b>	<b>4.1</b>	<b>5.3</b>	<b>5.5</b>	<b>7.1</b>
Margin	14.0%	13.4%	17.0%	14.7%	19.0%
<b>EBITDA</b>	<b>6.4</b>	<b>6.2</b>	<b>7.9</b>	<b>8.4</b>	<b>10.0</b>
Margin	21.9%	20.2%	25.5%	22.5%	26.8%
Net financial costs	-0.8	-0.6	-0.8	-1.1	-0.9
Share in profits of associates	0.0	0.0	0.0	0.0	-0.2
<b>Profit before taxes</b>	<b>3.3</b>	<b>3.5</b>	<b>4.5</b>	<b>4.3</b>	<b>6.0</b>
Income tax	-0.7	-0.7	-0.8	-1.1	-1.0
Minority interests	0.9	0.8	1.0	1.1	1.5
<b>Net profit</b>	<b>1.7</b>	<b>2.0</b>	<b>2.7</b>	<b>2.1</b>	<b>3.4</b>
Margin	6.0%	6.4%	8.8%	5.7%	9.1%

Source: R22, Dom Maklerski mBanku, \* calendar periods

By segment: EBITDA in hosting @PLN 5.82 million. According to the company, EBITDA proforma of the segment is growing at a rate of around 15% y/y. On the other hand, the omnichann communications segment reported an increase in EBITDA by 42% y/y (the result @PLN 3.3 million). This is a significant change after the decline in EBITDA by 9% y/y in H1 2018/19. The improvement of results is the result of introducing a series of optimization activities in the segment and renegotiation of contracts with some of the clients (the share of subscriptions in the settlements with some customers was introduced). EBITDA margin of the segment @21.2%, i.e. +4pp. y/y.

### Average EBITDA LTM margin in omnichannel communications segment in R22



Source: Dom Maklerski mBanku

The telecommunications segment delivered a stable EBITDA y/y @PLN 1.5 million. In Q3 2018/19, the company generated PLN 4.9 million of cash from the operating activities (PLN 25.7m LTM). At the end of Q3 2018/19, net debt amounted to PLN 64.3 million, the net debt/EBITDA ratio @2.0x.

### R22 results forecast

(PLN m)	2018 PF*	2019 PF**	2020
Sales	147.6	169.0	191.8
EBITDA	36.6	43.5	50.6
<i>hosting</i>	19.8	24.0	29.5
<i>omnichannel</i>	10.8	13.5	15.1
<i>telecommunications</i>	6.1	6.1	6.1
Net profit	8.1	14.3	17.4
Market cap	265.2	265.2	265.2
EV	346.2	392.0	363.8
EV/EBITDA	9.5	9.0	7.2
P/E	32.7	18.6	15.3

Source: Dom Maklerski mBanku, \*estimation \*\*including acquisitions from May'19

We expect the company to achieve a turnover of PLN 169.0 million in calendar year 2019 (PLN 160.7 million excluding acquisitions from May 2019, which means an increase in comparable turnover by 9% y/y). The EBITDA result (excluding the impact of IFRS 16) should amount to PLN 43.5 million (PLN 41.1 million excluding the impact of acquisitions from May 2019, ie >+12% y/y). The highest EBITDA increase is assumed in omnichannel communications due to before mentioned optimization activities. We estimate that the segment will generate PLN 13.5 million EBITDA revenue. Assuming the entire payment under the Exit agreement regarding the purchase of 28.48% of H88 from TCEE Fund III concluded in March 2019 and the payment for the takeovers of three Romanian entities, the net debt at the end of calendar year 2019 is estimated at approx. PLN 120 million, which implies 2.7x EBITDA proforma'19. The debt value does not include the purchase/dividend, which the company wants to carry out during the year. The debt value is quite high considering the company's plans. R22 wants to double the scale of its business within two years. We expect the group to take over entities generating a total EBITDA of at least PLN 15-18 million. Assuming the implementation of acquisitions @10x EBITDA ratio and purchase of majority packages (50% and one share), it should cost the company about PLN 75-90 million. The company announced that, in the first place, it wants to make acquisitions by financing them with a loan. In our opinion, the potential issue of shares cannot be excluded on large scale acquisitions.



**List of abbreviations and ratios contained in the report:**

**EV** – net debt + market value  
**EBIT** – Earnings Before Interest and Taxes  
**EBITDA** – EBIT + Depreciation and Amortisation  
**P/CE** – price to earnings with amortisation  
**MC/S** – market capitalisation to sales  
**EBIT/EV** – operating profit to economic value  
**P/E** – (Price/Earnings) – price divided by annual net profit per share  
**ROE** – (Return on Equity) – annual net profit divided by average equity  
**P/BV** – (Price/Book Value) – price divided by book value per share  
**Net debt** – credits + debt papers + interest bearing loans – cash and cash equivalents  
**EBITDA margin** – EBITDA/Sales

**OVERWEIGHT (OW)** – a rating which indicates that we expect a stock to outperform the broad market  
**NEUTRAL (N)** – a rating which indicates that we expect the stock to perform in line with the broad market  
**UNDERWEIGHT (UW)** – a rating which indicates that we expect the stock to underperform the broad market

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**ACCUMULATE** – we expect that the rate of return from an investment will range from 5% to 15%  
**HOLD** – we expect that the rate of return from an investment will range from -5% to +5%  
**REDUCE** – we expect that the rate of return from an investment will range from -5% to -15%  
**SELL** – we expect that an investment will bear a loss greater than 15%  
Recommendations are updated at least once every nine months.

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**Economic profits** – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

**Discounted Dividends (DDM)** – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

**NAV** - valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

**mBank S.A. did not issue any recommendations for R22 in the 12 months prior to this publication.**

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