



Dreamscape Networks Limited (DN8.ASX)

Established web business embarking on Asian expansion

Event:

- We initiate coverage on Dreamscape Networks (DN8).

Investment Highlights:

- DN8 is a leading provider of domain name registration, hosting, and solutions products and services.** Strong growing, cash generative business with no debt, seeking to execute on growth in higher margin pillars.
- Effectively captured a **leading market share in Australian domain names (~30%)** and consequently a focal point for SMEs trying to build an online presence.
- The company's standing as a market leader in domain names means DN8 is in pole position for **upsell opportunities to higher value added services from its growing online products solutions**, including hosting and a range of bespoke online services.
- DN8 has effectively repositioned itself as a full-service affordable option** with a focus on customer care to improve retention and reduce churn, after having grown share and captured scale effectively since formation, using a low cost model.
- Domestic growth to come in all three pillars.** Continued upsell into higher value products will support strong growth in the Hosting and Solutions pillars.
- DN8 is preparing earnestly for expansion into Asia**, primarily targeting five English speaking countries including Singapore, Hong Kong, Indonesia, Malaysia, Philippines, with an **estimated addressable market of ~\$10B**. Even a modest slice of this incipient market would provide a significant boost to revenue for the company.
- The recent acquisition of Singapore based Vodien Group gives DN8 a significant foothold in the region, and launches **DN8 into number one for domain hosting in Singapore and number 2 in .sg domains**.
- A series of acquisitions during the year will add significantly to growth, with an **incremental pro forma \$5M FY18e EBITDA contribution**. Vodien gives DN8 a significant foothold in Singapore, while Net Logistics and Enetica will bolster the domestic business.

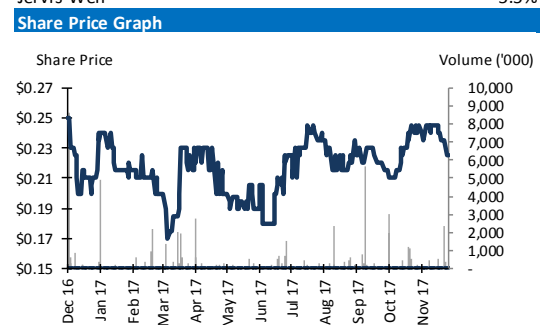
Earnings and Valuation:

- We forecast **FY18e NPAT of \$4.0M, and \$4.9M in FY19e, and EPS of 1.1cps and 1.3cps**, respectively.
- We have a derived a DCF valuation of \$0.32/share**, using a 15% WACC and terminal growth assumption of 2.5%. We forecast almost 30% top line growth in FY18e as the business folds in a number of acquisitions, reverting to ~10% growth in the two years thereafter.

Recommendation:

- We initiate coverage with a Buy recommendation and a 12-month price target of \$0.32, in line with our DCF valuation.**
- Catalysts for the share price** include: 1) increased end user numbers; 2) increased average booking per user (ABPU); 3) continued upsell into higher value products from DN8's significant domain name market share; 4) progress on the execution of Asian expansion; 5) further acquisitions.

Recommendation	Buy			
Previous	N/A			
Risk	High			
Price Target	\$0.32			
Previous Target	N/A			
Share Price (A\$)	\$ 0.225			
ASX Code	DN8			
52 week low - high (A\$)	0.17-0.26			
Capital structure				
Shares on Issue (M)	388			
Market Cap (A\$M)	87			
Net Cash/(Debt) (A\$M)	18			
EV (A\$M)	70			
Options, rights (M)	33			
12mth Av Daily Volume ('000)	261			
June end (A\$M)	2017a	2018e	2019e	2020e
Sales	46.4	59.6	66.1	73.2
EBITDA, underlying	4.5	8.5	10.0	10.3
NPAT, underlying	2.1	4.0	4.9	5.1
EPS diluted (cps)	0.63	1.05	1.28	1.33
PER x diluted	35.6	21.4	17.6	17.0
EV/EBITDA x	15.5	8.2	7.0	6.7
Board				
Mr Peter James				Non-Executive Chairman
Mr Michael Malone				Non-Executive Director
Mr Evan Cross				Non-Executive Director
Mr Mark Evans				Managing Director & CEO
Mr Gavin Gibson				Executive Director & COO
Major Shareholders				
Bluegeko Holdings Ltd				36.4%
Cloudsafe Holdings Ltd				24.3%
Alvin Chiang				5.5%
Jervis Wen				5.5%



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The analyst owns no DN8 shares.

Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) hold no DN8 shares.

Cranport Pty Ltd owns 2,700,000 DN8 shares.

This report was prepared by Foster Stockbroking.



Dreamscape Networks Limited (DN8)

Full Year Ended 30 June

Profit and Loss A\$M					Financial Metrics				
	2017a	2018e	2019e	2020e		2017a	2018e	2019e	2020e
Sales revenue	46.4	59.6	66.1	73.2	Sales growth %	8%	28%	11%	11%
Operating Costs	41.0	51.1	56.2	62.9	EPS growth %	nm	66%	22%	4%
EBITDA	4.5	8.5	10.0	10.3	EBITDA margin	10%	14%	15%	14%
D&A	1.3	1.4	1.5	1.6	EBIT margin	7%	19%	20%	19%
EBIT	3.1	7.1	8.5	8.7	Gearing (ND/ND+E)	255%	nm	nm	nm
Net Interest exp / (income)	0.0	-0.4	-0.5	-0.8	Interest Cover (EBIT/net int)	nm	nm	nm	nm
Profit before tax	3.1	7.5	9.0	9.4	Average ROE %	nm	nm	88%	33%
Tax exp / (benefit)	1.0	3.4	4.1	4.4	Average ROA %	11%	19%	17%	13%
Underlying NPAT	2.1	4.0	4.9	5.1	Wtd ave shares (M)	300	384	384	384
Non-recurring items	16.1	0.0	0.0	0.0	Wtd ave share diluted (M)	333	417	417	417
NPAT reported	-13.9	4.0	4.9	5.1					
EPS, underlying diluted (cps)	0.63	1.05	1.28	1.33					
Cashflow A\$M					Valuation multiples				
	2017a	2018e	2019e	2020e		2017a	2018e	2019e	2020e
EBITDA	4.5	8.5	10.0	10.3	P/E x	35.6	21.4	17.6	17.0
Change in WC	2.3	2.6	4.8	5.4	EV/EBITDA x	15.5	8.2	7.0	6.7
Tax paid	-1.0	-3.4	-4.1	-4.4	EV/EBIT x	22.1	9.8	8.2	8.0
Share-based expense	0.0	0.0	0.0	0.0	EV/sales x	1.5	1.2	1.1	0.9
Other	0.0	0.0	0.0	0.0	Dividend yield %	0%	0%	0%	0%
Net interest	0.1	0.4	0.5	0.8					
Operating Cashflow	5.8	12.0	15.8	17.2	Valuation		A\$M	A\$/share	
Purchase of PP&E	-1.7	-3.8	-3.6	-1.8	NPV	108.2	0.26		
Development costs	0.0	0.0	0.0	0.0	Net cash (debt)	17.7	0.04		
Investing Cashflow	-6.3	-3.8	-3.6	-1.8	Cash from options*	6.3	0.02		
Equity proceeds	25.0	0.0	0.0	0.0	Equity value, DCF	132.2	0.32		
Proceeds from borrowings	0.0	0.0	0.0	0.0	Shares and rights	387.8			
Repayment of borrowings	0.0	0.0	0.0	0.0	Options and warrants	24.6			
Other	-17.6	0.0	0.0	0.0	Diluted shares used*	412.4			
Financing Cashflow	7.4	0.0	0.0	0.0	WACC	15%			
Net cash flow	7.0	8.2	12.2	15.4	Terminal growth rate	2.5%			
					<i>*Includes options in-the-money at valuation</i>				
Balance Sheet A\$M					Assumptions				
	2017a	2018e	2019e	2020e		2017a	2018e	2019e	2020e
Cash	17.7	25.9	38.1	53.5	ABPU, \$	148	169	175	180
Receivables	3.4	3.9	4.3	4.8	Users, 000s	359	411	441	476
PPE	3.1	5.5	7.6	7.7					
Intangibles	3.6	3.6	3.6	3.6					
Other	4.1	4.1	4.1	4.1					
Total Assets	32.0	43.1	57.8	73.8	Shares on issue		M		
Accounts payable	3.0	2.0	2.6	3.4	Ordinary shares	387.8			
Deferred Revenue	31.8	35.8	40.3	45.4	Options	30.3			
Debt	0.0	0.0	0.0	0.0	Performance Rights	2.5			
Other	0.6	4.0	4.0	4.0	Fully Diluted Shares	420.6			
Total Liabilities	38.9	42.2	47.4	53.3	Substantial shareholders		Interest		
Reserves and capital	12.9	12.9	12.9	12.9	Bluegeko Holdings Ltd	36.4%			
Retained earnings	-21.3	-13.3	-3.8	6.4	Cloudsafe Holdings Ltd	24.3%			
Other Equity	1.2	1.2	1.2	1.2	Alvin Chiang	5.5%			
Total Equity	-6.9	0.8	10.3	20.5	Jervis Wen	5.5%			

Source: Foster Stockbroking estimates.



COMPANY BACKGROUND

- DN8 is a leading provider of domain name, hosting, and online services and solutions to enable businesses and consumers to establish and grow their online presence.
- DN8's main brand is Crazy Domains, the market leader for .au Domains.
- DN8's products and services are subscription based for durations between one and ten years with an average term of two years.

Brief Company History

- The company was founded in 2000 in Perth as a domain name provider. In 2002, DN8 introduced its first hosting and solutions products. The CheapDomains.com.au brand was launched in 2005 as a mid-segment brand for domains, hosting, hosting and solutions.
- The Crazy Domains brand was launched in 2007 targeting the low cost domain name segment of the market. Supporting products in hosting and solutions were also introduced at this time.
- Over the course of the next three years, Crazy Domains quickly grew to become the market leading .au domain provider in Australia with 20% of .au market share.
- In 2012, the business relocated its head office from Perth to Dubai for expansion into the UK and Indian markets. An additional office was opened in Kiev with a focus on design, development, and system administration to support the international expansion.
- The company consolidated its customer service locations to a single technical support and customer care centre in Cebu, Philippines. At the same time, DN8 embarked on a strategy shift to customer care and retention over winning market share from its traditional low cost differentiation strategy. The company continues to work on repositioning from a low cost provider to an affordable online services provider with premium service for SMEs.
- DN8 listed on the ASX in December 2016, as it prepared to expand into English speaking Asia including in Singapore, Hong Kong, Indonesia, Malaysia, and Philippines.
- During 2017, the company made a number of acquisitions including Net Logistics, Vodien Group, and Enetica Group.

Suite of Products

- The company is organised into three core segments (or Pillars): Domains, Hosting, and Solutions, and offers more than 30 products and services across these segments. DN8 also provides packages incorporating products and services from each of the three segments.

Figure 1: DN8 Pillars and Suite of Products and Services

Domains	Hosting	Solutions
Domain Names	Website Hosting	Website Builder
Domain Backorder	Email Hosting	Traffic Booster
Domain Transfers (2)	DNS Hosting	Email Marketing
Domain Certification	Servers	Search Ads
Private Registration	Email Exchange	Web Design (2)
Domain Services (4)	Hosting Services	Logo Design
Directory Listing	SSL Certificates	Email Protection
		Site Protection
		Web Analytics
		Fax to Email
		Advanced Support
Packages		
	Online Startup	
	Business Builder	
	Ultimate Empire	

Source: Company.

1. Domains

- Domain Names are typically the entry point for consumers and businesses establishing a web presence. DN8 is an accredited Registrar for ~500 Top Level Domains (e.g. .com, .net, .org). DN8 has 892,000 registered .au domains and 1.59 million registered domains (at June 2016).
- DN8 is one of the market leaders in Australian domains, with approximately 30% of local market share, and a similar proportion of new local market share.
- DN8 also offers Domain Products and services including registrations, backorder, transfers, certification, domain services, private registration and directory listing. This segment is targeted especially at small businesses and consumers.

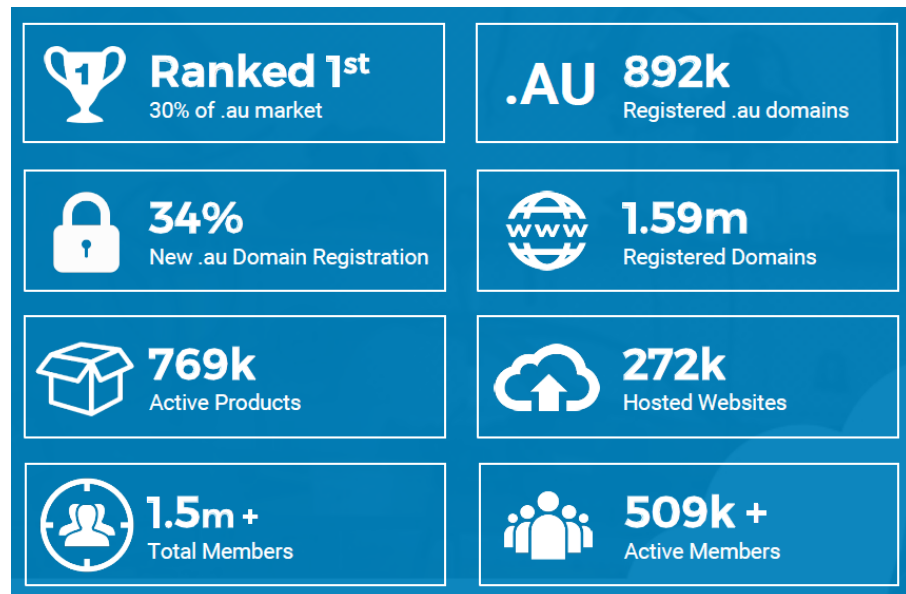
2. Hosting

- Hosting is the natural progression from domain name registration for consumers establishing a web presence. It comprises two major products in web hosting and email hosting. Hosting is the physical storage location of a website and email, and related data centres. DN8 currently hosts approximately 273k websites and 530k email mailboxes (at June 2016).
- DN8 offers hosting products and services including web, email, and domain name system hosting products and physical storage location of websites and email in data centres. DN8 also provide email exchange and SSL Certificates.

3. Solutions

- The Solutions segment offers a wider range of targeted solutions and services for businesses to compete in an online environment.
- DN8 Solution include website builder, traffic booster (search engine optimisation), email marketing, search advertisements, web and logo design, web analytics, site protection and email protection, and fax to email.
- DN8 also provides bundled services in the form of packages incorporating elements from the three core segments.
 - Online Startup – focused on getting the customers online through the core products of domain, email, and web hosting. With this bundled service, DN8 allows for a cost effective and simple solution to create an instant online presence.
 - Business Builder – targeted towards established or ambitious customers seeking to build, maintain, and market their website.
 - Ultimate Empire – includes all products and services to establish and promote web presence consisting of the basics above and adding a raft of products and services to enhance and optimise online presence.

Figure 2: DN8 Segments and Suite of Products and Services



Source: Company at 30 June 2016.

Domains and Hosting the engine room of the business

- The Domains and Hosting pillars make up almost 90% of FY17a revenue, and provide a significant platform for DN8 to continue growing its online solutions pillar. Although it makes ~10% contribution to Bookings, Solutions is a higher margin business than Domains, and has the opportunity for more rapid growth in this promising part of the business.

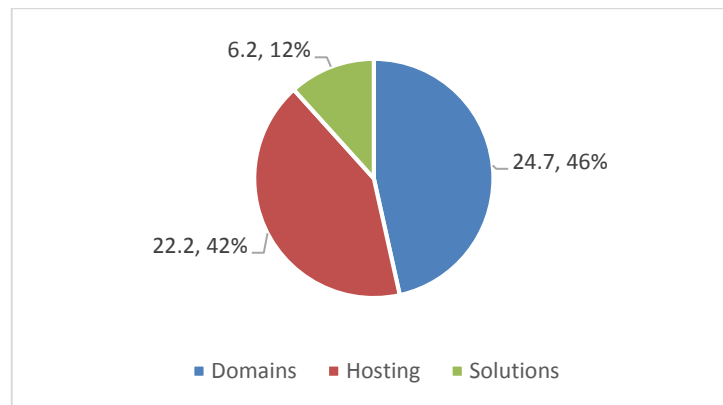


Figure 3: Total Bookings, by Pillar

Bookings, A\$M	FY16a	FY17a	Growth, %
Domains	24.5	24.7	1%
Hosting	19.6	22.2	13%
Solutions	5.8	6.2	7%
Total	49.9	53.1	

Source: Company.

Figure 4: FY17a Bookings Breakdown, by Pillar, A\$M



Source: Company.

INDUSTRY OVERVIEW – GLOBAL OPPORTUNITIES, COMPETITIVE MARKETPLACE

- DN8 operates in a competitive global online products and services industry. DN8’s primary product and service offering consists of domain name, hosting and online solutions products and services. These industries are characterised by a number of large players with leading share, followed by a fragmented and long tail of much smaller players.
- As at June 30 2016, there are estimated to be just over 331 million domains across all Top Level Domains (TLDs) globally, an increase of 13% from June 30 2015. New gTLDs drove the majority of this growth moving for 5.9 million domains to 21.3 million, showing an increase of 261% year to year. US web domain name sales is an estimated US\$2B industry with 3.8% CAGR in the past five years (IBIS, November 2016).
- There are nearly 171 million active websites on the internet and the number of email mailboxes is expected to exceed 2.7 billion by 2017. The online presence market is driven by a large number of factors but most notably relies on population, internet usage and the business sector with SMEs accounting for the majority of volume within the business area. Internet hosting services in Australia is an estimated \$0.5B with 3.6% CAGR in the past five years (IBIS, April 2017).

DN8 Market Position

- The Domain and Hosting industries are made up of numerous competitors with significant global participants operating in each market, alongside smaller, local competitors in each country.
- Dreamscape Networks is the leading Domain brand in Australia for .au Domains with a 30% market share as at June 2016. In New Zealand the Group has a 10% market share. In the United Kingdom the Group has a 1% market share and in India the Group has a 2% market share.
- With the recent Vodien Group acquisition, DN8 is the leading hosting provider in Singapore, and second for .sg domains in this location. We view DN8’s leading share in Australia and Singapore as a distinct competitive advantage with scale benefits in trying to monetise its customer base through upsell to higher value products.
- In terms of new Domain registrations, the Group led the .au Domain industry in FY2016 with 34% market share. In New Zealand the Group had .nz new registration market share of 15%. The Group has a 1% new registration market share in the United Kingdom and a 3% market share in India.

Figure 5: DN8 Market Position and Opportunities



Source: Company.



Australia and New Zealand

- The Australian and New Zealand top level domain industry is mature. The .au ccTLD space has grown 2.12% FY2015 to FY2016 from 2.97 million domains to 3 million. Through FY2016 the industry saw on average 47 thousand new .au registrations per month.
- In Australia, there is opportunity for DN8 to capitalise on the fact that a majority of SMEs (~60% of Small to Medium Businesses with 0-4 staff, ABS) do not currently have a web presence, but ~40% want to increase their online presence (auDA survey).
- DN8 can also capitalise on significant opportunities within the email hosting space with 78% of the market using a free email provider and 49% noting it was their only email address. 27% used an ISP-provided email with 11% using that address exclusively. Only 8% used their own domain-based email. This highlights an opportunity to convert users into a professional email address tied to a registered domain name.
- DN8 also view the biggest opportunity for growth within the Australian market is with the proposed release of .au registrations at the second level. This would allow customers to register yourdomain.au rather than yourdomain.com.au. In February 2015 the auDA Board agreed that the introduction of these registrations would:
 - make available domain names which are shorter, more appealing and more memorable;
 - give Australians more choice in deciding what domain name to register;
 - respond to market demand;
 - be more attractive to natural individuals than the current option, id.au;
 - strengthen the “.au brand” in a globally competitive market;
 - add value to all three main categories of users – Registrars and resellers, registrants and ultimate users of the .au domain name system.
- .nz had 662k domain names as at June 30 2016 up 2.4% from 645k June 30 2015.

Asia

- Asia represents a very large opportunity for small business domain name registration and hosting services. The company estimates 25% domain growth in a populous region with relatively low internet penetration at opportunity from a very large SME base.
- **Singapore:** The .SG ccTLD space has increased from 175k domain names in FY15 to 179k in FY2016. The region currently has 4.7m Internet users which is predicted to grow 3% CAGR through to 2020. With 179,000 domain names and 472,000 businesses, only 39% would have a .SG web presence.
- **Hong Kong:** The Hong Kong domain space has shown rapid growth within the last year, increasing 56% from 281,077 at the end of FY15 to 439,355 as of June 30 2016. A population of 7.3 million and 1.2 million registered businesses.
- **Malaysia:** Malaysia's .my domain has displayed growth of 5.1%, reaching 319,200 domain names at the conclusion of FY2016.
- **Indonesia:** Indonesia is reported to be the fastest growing nation in the world when it comes to internet usage with a predicted ~215m users expected to come online by 2020 representing ~19% CAGR from 2015. At the conclusion of FY15 the Indonesian domain space currently had just short of 190k registered domain names growing 34% from 142k.



- **India:** India has an estimated population of 1.2B but only there are approximately 100 million people online in India, or less than 10% of the population, and estimate a growth rate of people coming online around ~1000%. DN8 has 2% share in this geography.
- .IN domains are very popular in India and around its geographical area and showed a growth of 7.3% from FY15 to FY16 reaching a total of 2.1 million domain names.

Europe and the United Kingdom

- The European ccTLD market is estimated at 68.4 million domains growing 2% from 67.3 million. It is reported that 50.2% of domain owners within Europe have registered the ccTLD related to their location, 38% have legacy gTLDs, 9.2% foreign ccTLDs and 2.6%. New gTLDs showing a strong affinity for in country representation.
- The UK market has seen a slowdown in growth since the release of .UK domains at the second level, meaning you can now register yourdomain.uk instead of yourdomain.co.uk. Growth from FY15 to FY2016 was 1% to reach a total of 10.67 million domains as of June 30 2016.

Regulatory Environment and Structure

- The Internet Corporation for Assigned Names and Numbers (ICANN) is the governing body responsible for maintaining databases of online namespaces. ICANN maintains policies applying to domain names and governs the domain space for country code domains.
- Registries and Regulatory Bodies operate at the wholesale level.
 - A Registry is the wholesaler of domain names and is responsible for the management of the domain registry and interacting with the Reseller Level to accredited Registrars. A Registry applies policies and procedures which have been established by the Registry itself, or by the linked governing body.
 - For specific domain name spaces, separate regulatory bodies have been established. They are typically government endorsed and responsible for the creation, maintenance, and enforcement of policies and procedures applying to the Registry, the Registrar and the end users of a domain name.
- Registrars operate at the Reseller level and are permitted to resell domain names from the Registry to the Customer at the retail level. DN8 operates at this stratum. A Registrar needs accreditation from each respective domain space in order to resell a particular domain name. Certain Top Level Domains (TLDs) have specific requirements to be eligible for accreditation, including technical requirements, in country presence, minimum industry experience, set costs or financial commitments; provision of business plans as well as general compliance with policies and procedures.
- At the retail level, there are three main groups of participants.
 - Customers or end users operating the domain name and using it to connect to their website, email, and associated services.
 - Retail Resellers not otherwise eligible for accreditation as a Registrar.
 - Affiliates, who are associated entities of Registrars to enable

**DOMESTIC RETENTION, GLOBAL SCALE BUILDING****Establishing an Australian presence, growing scale**

- The company initially focused on domestic scale building using a strategy of low cost differentiation. Easily recognised brands including Cheap Domains and Crazy Domains quickly captured a leading share of the Australian domestic market, particularly for cost conscious individuals and SMEs.
- From humble beginnings, the company grew organically to capture 20% of the .au domain name market share in its first decade and has grown to ~30% in the following seven years.

Folding Value Added Services into the Portfolio

- Having established scale in the domestic domain name market, DN8 has undergone a strategy refocus, to reduce customer churn, improve retention and drive ABPU growth through value added upsell.
- With a critical mass of domain name entry points for customers, the company has so far effectively added a range of value added services to the portfolio, with hosting services the obvious evolutionary step from domain name registration.
- The next step from this is to a suite of specialist online products and services, including website builder, traffic booster (search engine optimisation), email marketing, search advertisements, web and logo design, web analytics, site protection and email protection, and fax to email.
- We are of the view scale enables greater upsell opportunity into higher margin value added services.

Scale Supplemented by Acquisition Trail

- DN8 has made a number of acquisitions in CY17, including Net Logistics, Vodien Group, and most recently Enetica Group. A summary of the acquisitions is provided in the figures below.

Figure 6: DN8 Recent Acquisitions

Date	Name	Customers	Domain Names	Consideration, A\$M
31-Mar-17	Net Logistics	4,500	negligible	2.55
22-Jun-17	Vodien Group	27,000	52,000	29.7
24-Oct-17	Enetica Group	15,000	70,000	4.457
	Total	46,500	122,000	36.707

Source: Company announcements, Foster Stockbroking estimates.

Figure 7: DN8 Acquisition Analysis

Name	FY18e Bookings A\$M	FY18e EBITDA, A\$M	Sales multiple	EBITDA multiple	Comment
Net Logistics	2.5	0.8	1.0x	3.2x	Domestic Hosting acquisition
Vodien Group	9.0	3.2	3.0x	8.4x	Singapore's no. 1 hosting provider, no. 2 .sg domain provider Singapore; 20% mkt share, ABPU of A\$360
Enetica Group	2.2	0.9	1.4x	3.4x	Hosting accounts for 76% revenue; domains account for remainder
Total	13.7	4.9			

Source: Company announcements, Foster Stockbroking estimates; Vodien Group to make eleven month contribution in FY18e, Enetica to make an eight month contribution in FY18e.

**Vodien Acquisition Offers Singapore Foothold in Asian Expansion**

- We have attempted to size the addressable market for DN8's Asian expansion utilising a bottom up approach and assumption as to potential ABPU from the potential customer base of SMEs.
- We have included the five English speaking Asian countries DN8 is targeting in its expansion, namely Hong Kong, Indonesia, Malaysia, Philippines, Singapore.
- We have included only SMEs due to the strategic focus towards this segment by DN8.
- We have assumed an ABPU of \$100 per customer for estimating the addressable, factoring down on the most recent ABPU of \$150 to account for lower revenue opportunity in developing markets.

Figure 8: Addressable Market, Asian Expansion

	Hong Kong	Indonesia	Malaysia	Philippines	Singapore	Total
SMEs, millions	0.33	58	0.9	0.9	0.4	60.5
ABPU, \$	\$100	\$100	\$100	\$100	\$100	\$100
Total Market, \$M	\$33	\$5,800	\$90	\$90	\$40	\$6,053

Source: Hong Kong Trade and Industry; Cooperatives and SME Ministry Indonesia; Ministry of International Trade and Industry Malaysia; Department of Trade and Industry Philippines; Department of Statistics Singapore.

- We estimate the size of the addressable market from these five countries alone is worth \$6B. If DN8 can capture a conservative 2% of market share, the incremental revenue of ~\$120M is very significant for DN8 revenue.
- We note the number of SMEs likely understates the true potential customer base to DN8, as DN8 targets small and micro businesses, as well as sole traders who are not always included in these data sets. We note the definition of SMEs varies across these jurisdictions.
- On the other hand, the ABPU assumption has some flexibility in range and DN8's \$150 ABPU in FY17a represents operations principally in mature, developed economies. This number might not be instantly achievable in all jurisdictions, particularly if DN8's initial strategy is to scale market share first. However we note potential upside if DN8 can successfully grow market share as well introduce higher value added products from initial sale.
- We also note the recent Vodien acquisition in Singapore ABPU is ~\$360 because of a higher proportion of higher value dedicated hosting products to customers.
- We have included upside and downside addressable market scenarios to reflect the sensitivity of the ABPU assumption.

Figure 9: Addressable Market, Scenarios

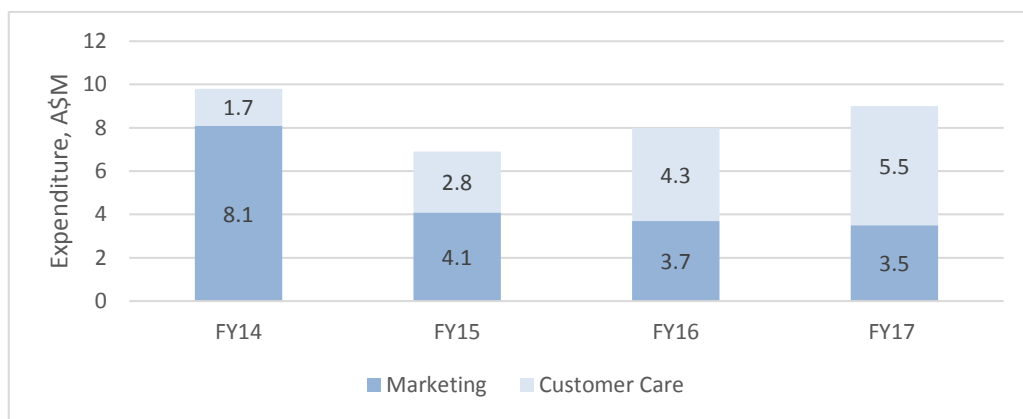
	ABPU, \$	Hong Kong	Indonesia	Malaysia	Philippines	Singapore	Total
SMEs, millions		0.33	58	0.9	0.9	0.4	60.5
Total Market, \$M, low	50	\$17	\$2,900	\$45	\$45	\$20	\$3,027
Total Market, \$M, high	200	\$66	\$11,600	\$180	\$180	\$80	\$12,106

Source: Hong Kong Trade and Industry; Cooperatives and SME Ministry Indonesia; Ministry of International Trade and Industry Malaysia; Department of Trade and Industry Philippines; Department of Statistics Singapore.

TECHNICAL SUPPORT AND CUSTOMER CARE – STRATEGIC DIFFERENCE FOR DN8

- DN8 has made a significant investment in technical support and customer care over the past 4 years, recognising that technical support, customer care and satisfaction are significant to both growth and retention for the ongoing business. Customer care spend as a portion of operating expenditure has grown as the company pivots towards an affordable service with full customer care strategy.
- In 2013, DN8 consolidated its customer service locations to a single technical support and customer care centre in Cebu, Philippines with a focus on best in world service. DN8 has realigned its strategy to focus on customer care and retention, having successfully focussed its efforts on growing market share and brand awareness in the early stage of its business.
- To date, DN8 has achieved a number of impressive technical support and customer care milestones in a notoriously difficult business silo. Notably, customer satisfaction has increased from 52% in September 2014 to above 90% in June 2017.

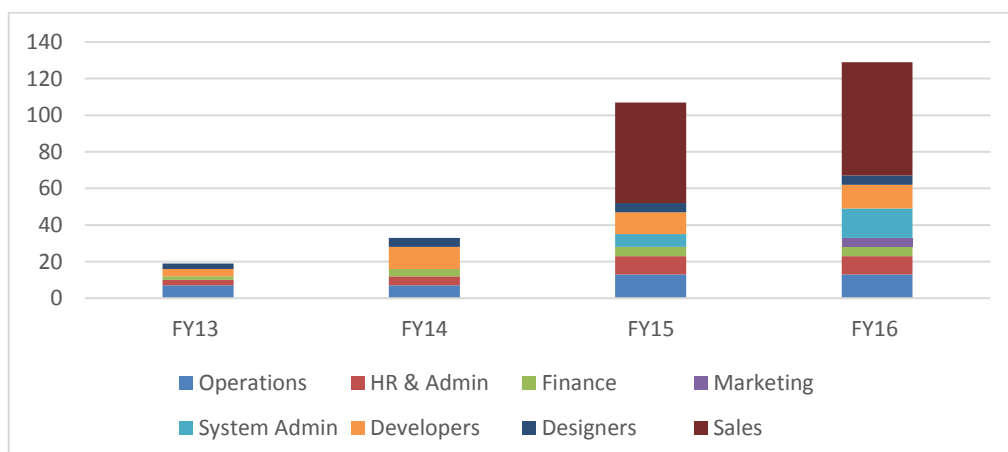
Figure 10: Marketing and Customer Care Spend



Source: Company reports, Foster Stockbroking estimates.

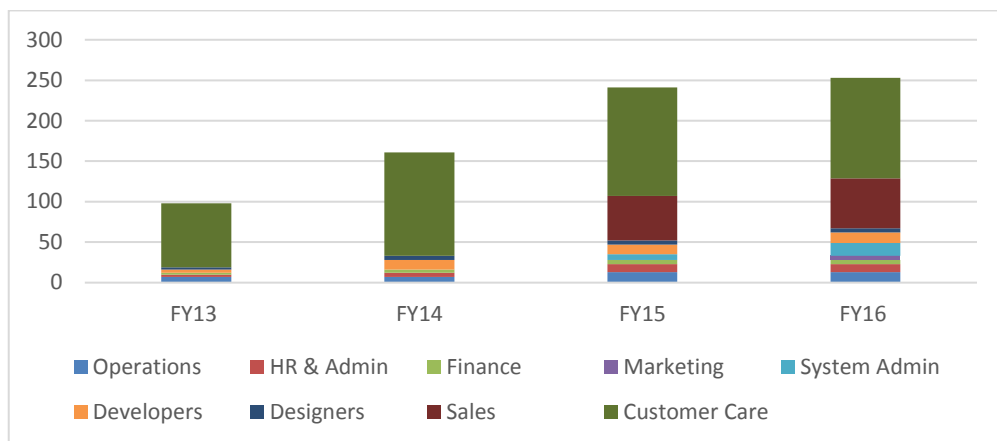
- Customer care staff headcount has increased from 70 in FY13 to 123 in FY16, with the most recent headcount number 400 for FY17. Accordingly the ratio of active members to customer care specialist has vastly improved from ~12,000 in FY13 to ~2,700 active members per customer care specialist in FY16.

Figure 11: DN8 Head Count, excluding Customer Care staff



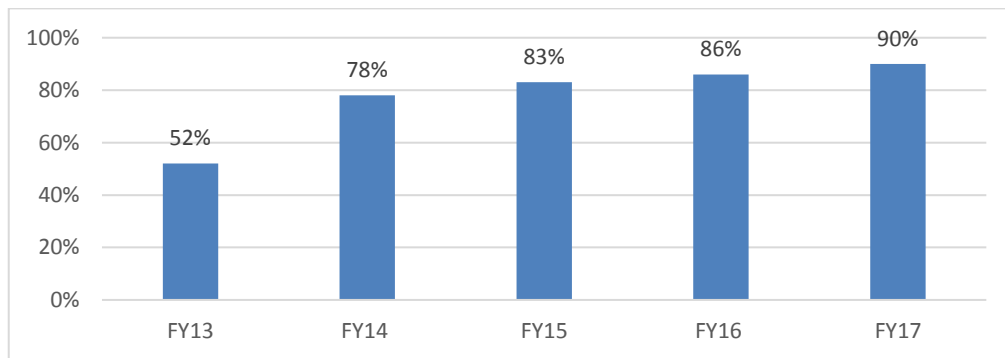
Source: Company reports, Foster Stockbroking estimates, FY17 not disclosed.

Figure 12: DN8 Head Count



Source: Company reports, Foster Stockbroking estimates, FY17 not disclosed.

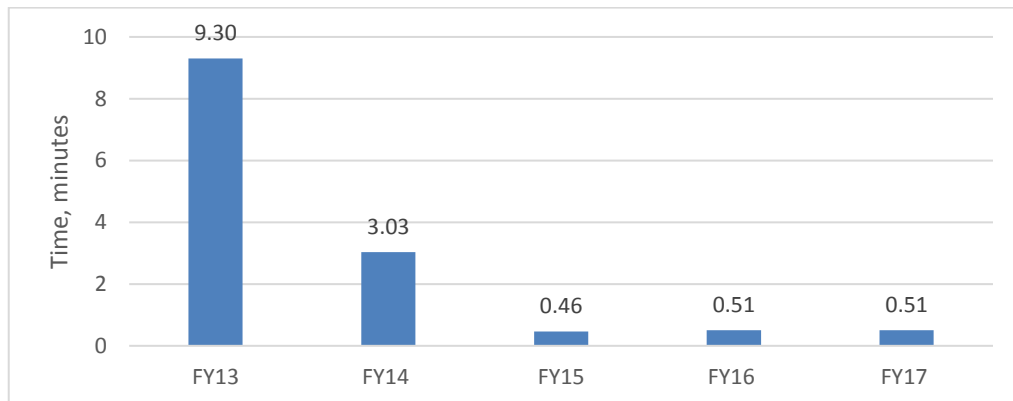
Figure 13: Customer Satisfaction



Source: Company reports, Foster Stockbroking estimates.

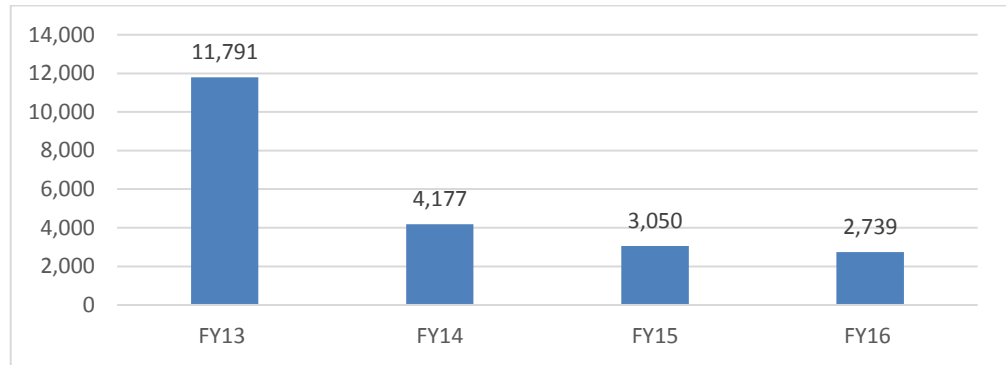
- The increased investment in customer care specialists has improved average speed of answer from 9.3 minutes in FY13 to 0.51 minutes in FY16. This improvement has helped increase customer satisfaction, above.

Figure 14: Customer Wait Time



Source: Company reports, Foster Stockbroking estimates.

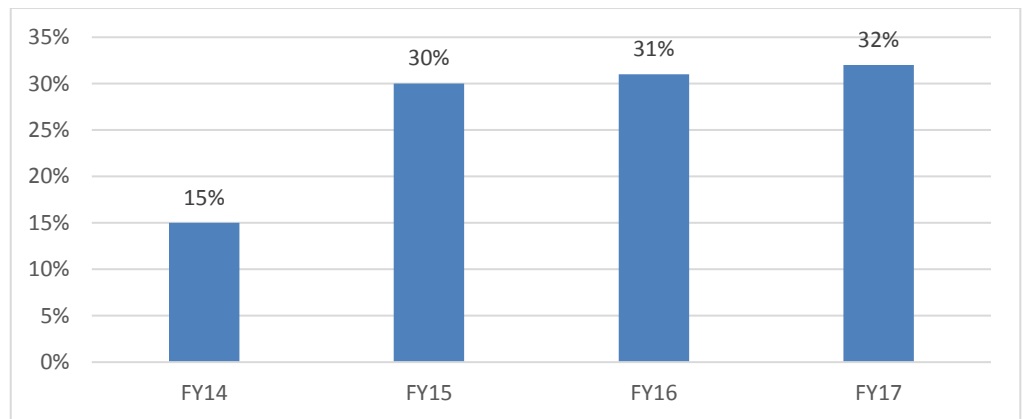
Figure 15: Active Members to Customer Care Specialists Ratio



Source: Company reports, Foster Stockbroking estimates, FY17 not disclosed.

- Improved customer satisfaction scores have directly reduced the churn rates and improved renewal rates, and therefore improved customer retention. Churn rates have steadily reduced from 1.9% per month in FY14 to 1.6% per month in FY16. The improvement in customer churn rate has led to an increase in customer lifetime to 5.2 years in FY16.
- Word of mouth referrals have grown significantly over the past three years, reflecting the increased investment and improvement in customer care and technical support.

Figure 16: Word of Mouth Referrals

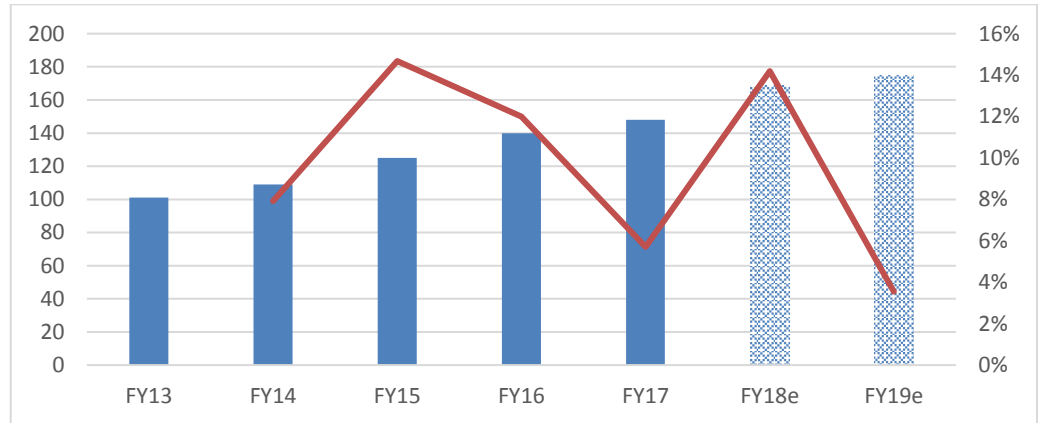


Source: Company reports, Foster Stockbroking estimates.

OPERATING METRICS

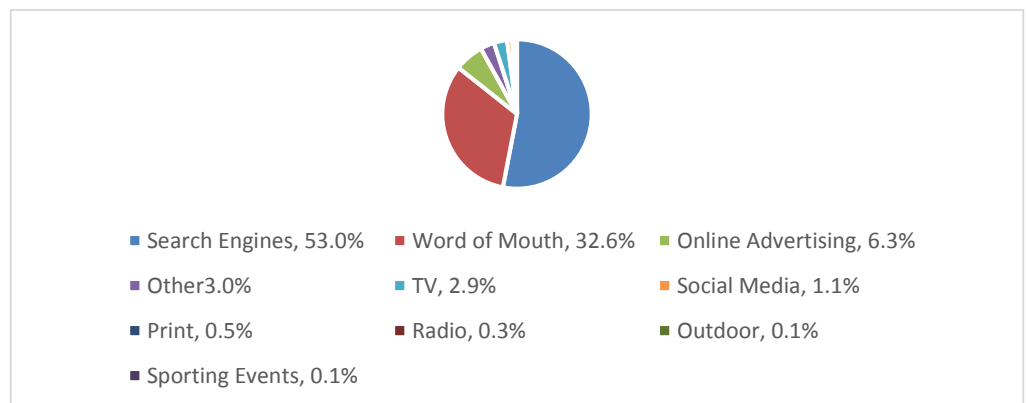
- The company has been growing average bookings per user steadily over its recent history. ABPU for FY17a was \$148, from ~\$100 in FY13. We forecast some uplift in ABPU as the company continues to focus on customer retention and reducing churn, as well as growing its higher margin online solutions business to help customers compete online. The Vodien Group acquisition will add higher ABPU customers due to the product mix of existing Vodien Group customers, with a high proportion of dedicated hosting customers.

Figure 17: Average Booking Per Users (A\$, LHS), Growth (RHS)



- The company reported \$24.7M in Domains bookings, which was up 0.8% on pcp.
- Bookings in the Hosting segment was \$22.2M in Fy17a and is the fastest growing and highest margin segment in the business. Bookings for Hosting were up 13% in FY17a.
- Solutions Bookings increased 7% to \$6.2M in FY17a. Solutions has a wide range of solutions and margins to the business.
- The business relies principally on search engines and word of mouth to source acquisitions.

Figure 18: Customer Acquisitions source



Source: Company reports, Foster Stockbroking estimates.

- The business experiences a monthly churn rate of 1.5%, or 20% per year with a majority due to natural attrition arising from the nature of its target market, i.e. microbusinesses failing within the first two years of being established. A key strategic focus of the business in recent years is customer retention and reduced churn, evidenced by its improved investment in customer support, improved customer wait times, increased customer satisfaction, and reduced churn.



BALANCE SHEET AND CASH FLOW

- The company had \$18M cash and no debt as at 30 June 2017.
- Operating cash flow is significant and robust. The business generated \$12M in cash in FY17a. The nature of the business model is cash is received upfront on a subscription basis for domain name and hosting services, which provides the company with a greater visibility in reinvesting for growth.

EARNINGS FORECASTS

- We forecast DN8's revenue to grow 28% in FY18e and 11% FY19e, driven by increased client numbers, increased seat numbers and increased revenue per seat. We have assumed the growth rate declines to 10% over the following three years thereafter.
- We view the domain name segment in Australia as relatively mature and forecast modest domain name bookings growth of 2% in the forecast time horizon. We note in the recent quarter DN8 has observed trading conditions suggest flat growth in this segment for the current financial year.
- We forecast higher bookings growth of 15% in the Hosting Booking in the near term, though this will be significantly greater in FY18e due to the contribution of the hosting segments from recent acquisitions. We forecast similar Bookings growth in the solutions business, as DN8 continues to launch new products (e.g. Website Launcher) and focus on this higher growing segment of the business.
- We forecast EBITDA of \$8.5M in FY18e and \$10.0M in FY19e. We note that recent acquisitions would have the potential to add \$4.9M in FY18e adjusted EBITDA, although the full contribution will not be recognised in FY18e as these acquisitions will require additional customer care improvements and opex to ensure uniformity in customer care and serviceability.
- We forecast reported NPAT of \$4.0M in FY18e, and \$4.9M in FY19e, and diluted EPS of 1.1cps and 1.3cps, respectively.
- We note the company's provides reporting on adjusted EBITDA in line with some industry peers (e.g. GoDaddy and Web.com) to aid comparability. The adjusted EBITDA includes the changes in deferred revenue and deferred costs related to upfront subscriptions from products sold on a subscription basis.
- Consistent with our usual treatment of subscription revenue companies we present the financials in line with a reported IFRS basis with revenue progressively recognised over the course of the subscription term.

PEER COMPARISON – UNDERVALUED AGAINST GLOBAL ENTERPRISE PEER GROUP

- We present listed enterprise domain, hosting, and online solutions peer companies in the figure below. We have selected peers from a range of Australian and globally listed businesses operating in each of the services offered by DN8.
- Domain name businesses include Melbourne IT, Verisign, GoDaddy, Web.com; hosting businesses include large operators such as TLS.ASX, AMZN, and also those mentioned as domain name businesses. Because of the diversity of the online solutions business a number of online products and services businesses make up the remainder of the listed peer group.



- The average peer EV/Sales multiple of 5.0x implies DN8 is undervalued, which is trading at ~1.2x forward revenue.
- The average peer P/E multiple of ~20s forward earnings suggests DN8 is fairly valued, which is trading at 20.2x forward earnings.

Figure 19: DN8 Listed Peer Comps

Company	Code	Market Cap, \$M	EV/Sales	P/E, x
Adslot	ADJ	45.8	3.5x	39.0x
Bulletproof	BPF	17.89	0.4x	nm
Dropsuite	DSE	31.78	11.9x	nm
Firstwave	FCT	57.87	8.0x	nm
Frontier	FDV	143.93	15.5x	nm
Field Solutions	FSG	10.91	1.4x	nm
Melbourne IT	MLB	424.2	2.5x	18.3x
Over The Wire	OTW	120.68	3.5x	17.5x
Telstra	TLS	40,972.41	2.0x	10.6x
Wellcom	WLL	167.73	1.1x	13.0x
		Average	5.0x	19.7x
Alphabet	GOOG		6.0x	20.9x
Amazon	AMZN		2.6x	73.6x
Endurance	EIGI		2.8x	nm
GMO Internet	9449		8.7x	22.9x
GoDaddy	GDDY		4.9x	117.5x
Microsoft	MSFT		5.4x	23.7x
Tucows	TCX		2.1x	23.2x
Verisign	VRSN		9.6x	26.9x
Web.com	WWWV		2.3x	7.3x
		Average*	5.1x	20.7x

Source: Companies, IRESS, Bloomberg, Foster Stockbroking estimates. * excludes outliers AMZN, GDDY.

**DN8 DCF VALUATION OF \$0.32/SHARE**

- As the company generates robust cash flow with high visibility, we have employed a DCF valuation method, and have derived a valuation of \$0.32 per DN8 share, employing a 15% WACC and terminal growth rate of 2.5%.
- We have included 24.6M options in our diluted share capital and the cash accruing from them, given these are all in-the-money at our DCF valuation.

Figure 20: DN8 DCF Valuation

Company Valuation	A\$M	A\$/share
Enterprise value	108.2	0.26
Net cash(debt)	17.7	0.04
Cash from options	6.3	0.02
Equity value, DCF (WACC 15%)	122.9	0.32
Shares	387.8	
Options and warrants	24.6	
Diluted shares used	412.4	

Source: Company, includes options in-the-money at valuation, Foster Stockbroking estimates.

Valuation Supported by Multiples

- Our DCF valuation is also supported by multiples analysis. Using a 2x EV/Sales multiple (60% discount to peers) yields an equity value of \$143.5M, or an equity valuation of \$0.33 per DN8 share.
- We note our DCF valuation implies a 30x forward P/E, which is at the upper end of the peer range, and reasonable given strong growth prospects for the business.

Figure 21: DN8 Multiples Valuation

	A\$M	A\$/share
Earnings, 1 yr forward	4.5	
P/E multiple	20.2x	
Equity Value, P/E	90.4	0.22
Sales, FY18e	62.9	
EV/Sales multiple	2.0x	
Equity Value, EV/Sales	143.5	0.35

Source: Foster Stockbroking estimates.

**INITIATE COVERAGE WITH BUY RECOMMENDATION, PRICE TARGET OF \$0.32**

- **We initiate coverage with a Buy recommendation and a 12 month price target of \$0.32, based on our DCF valuation.** The company is at the beginning of a high growth phase and has cemented itself as one of the leading providers of domain names in Australia, and is now looking to expand into foreign jurisdictions as well, having made the commercial decision to hub out of the quickly growing South East Asian hub of Singapore. Execution of its overseas expansion strategy to capitalise on the adoption of internet websites in these growing markets will be the key catalysts for the company's next stage of growth.
- We see the following as upcoming catalysts for the company: 1) increased end user numbers; 2) increased average booking per user; 3) continued upsell into higher value products; 4) execution of Asian expansion; 5) further acquisitions.



BOARD AND MANAGEMENT

- **Mr Peter James, Non-Executive Chairman.** Extensive experience at board and senior management level across a range of public and private companies in emerging technologies and e-commerce. Holds BA (Business, Computer Science), and a Member of the Australian Computer Society and a Fellow of the Australian Institute of Company Directors. Currently a director of Macquarie Telecom Ltd (MAQ.ASX), Nearmap Ltd (NEA.ASX), Dronesield Limited (DRO.ASX) and UUV Aquabotix Ltd (UUV.ASX). Previously a director of iiNet Limited (acquired) and chair of its Strategy and Innovation Committee.
- **Mr Michael Malone, Non-Executive Director.** Extensive experience at board and senior management level in the telecommunications industry. Founder and CEO of iiNet Limited. Chairman of Diamond Cyber. Founding Director and Chairman of auDA. Holds a BSc (Mathematics), Dip Ed. (Mathematics). Fellow of the Australian Institute of Company Directors and Australian Institute of Management. Current directorships include Superloop Limited (SLC.ASX), Seven West Media (SVM.ASX), SpeedCast limited (SDA.ASX), and NBN Co.
- **Mr Evan Cross, Non-Executive Director.** Extensive corporate finance experience in investment banking in Australia and the US and has held senior finance and executive roles in public and private companies in a wide range of industries including technology, healthcare, mining, and food and beverage. Current director of OpenDNA Limited (OPN.ASX); previously a director of Ephraim Resources Limited (EPA.ASX), Activistic Limited (ACU.ASX), Sun Biomedical Limited (DMX.ASX), MyFiziq Limited (MYQ.ASX).
- **Mr Mark Evans, Managing Director and CEO.** Mark has extensive corporate experience, including CEO of an international security countermeasures group, and extensive sales and marketing for a large private company.
- **Mr Gavin Gibson, Executive Director and COO.** Gavin has extensive technical expertise, including CTO for a number of IT companies, and has been involved with DN8 since inception. Current director of .au Domain Administration (au.DA).

RISKS

- Overall risks are high, given the early stage of customer adoption, pre-earnings stage of the business life cycle.
- **Management risk and key person risk.** The loss of key executives may cause the performance of the business to deteriorate and a loss of investor confidence
- **Technology risk.** Changes in technology may cause DN8's product and platform to become obsolete or less attractive than those of its competitors, causing it to lose customers
- **Competition risk.** DN8 operates in a competitive industry Existing or new competitors may offer more attractive products, which may erode DN8's earnings.
- **Customer risk** retaining existing customers and attracting new customers.
- **Security breach and data privacy risk.** DN8's products involve storage and transmission of clients' confidential and proprietary information, and unauthorised access to this information has the potential to cause brand damage, contract terminations, loss of clients, and adversely impact DN8's financial performance and operations.
- **Economic risk.** Any downturn in the US, Australian or other economies in which DN8 operate could cause lower business spending on the DN8 product.



- **Dilution risk.** Any further funding to grow the business might result in DN8 issuing equity causing dilution to existing DN8 shareholders.
- **Currency risk.** DN8 derives revenue in foreign currencies while the majority of its cost base is in AUD, and volatility in exchange rates can affect financial performance.



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