



Dreamscape Networks Limited (DN8.ASX)

Update flags declining domestic market and costs uptick

Event:

- Trading update; 1H18a EBITDA guidance; Quadra Hosting assets acquisition.

Investment Highlights:

- DN8 announced a trading update, and expects 1H18 adjusted EBITDA to be in the range of \$2.8-\$3.2M (1H17a \$5.2M, FSBe \$4.2M), with the decrease due to cost inflation and weak conditions in domestic domain and hosting.
- Personnel, marketing and administrative costs for 1H18 are expected to increase \$2.5M, or 27% on 1H17a (\$9.4M), primarily as a result of SE Asia expansion. Although in line with budgeted spend, marketing costs will be \$1.3M higher than pcp, as the company increased marketing spend in SE Asia. Similarly, personnel costs increased \$0.9M on pcp as part of the Asian expansion.
- Domestic conditions are declining, and DN8 expects a reduction in overall bookings in 1H18 for the underlying business of ~6% on the last half. By contrast, Singapore acquisition Vodien performed strongly, with 20% bookings and EBITDA growth over five months of ownership.
- The company has brought forward its office consolidation with a new centralised Singaporean head office and closure of its offices in Perth and Dubai.
- In January the company acquired Quadra Hosting assets from Net Quadrant Pty Ltd for consideration of \$2.5M. The company's third bolt on acquisition should bolster domestic web hosting with 95% of business derived from dedicated hosting; full integration into DN8 is expected by 31 March.
- DN8 expect the acquisition to be EPS accretive in FY18e (five month contribution) and full benefits to be realised in FY19e. DN8 management estimates \$150k of operational cost savings in the first full year of ownership and minimal additional capex to operate the business.
- Incremental \$1.35M revenue and \$0.8M pro forma EBITDA should support the domestic hosting business. Quadra's dedicated hosting clientele of ~3,500 customers yield a more attractive ABPU (\$350p.a.) and life time value (~\$2,300) than in the existing domestic business (ABPU of \$148p.a. and ~\$750 LTV).
- DN8 will release 1H18 results on 22 February along with FY18e guidance.

Earnings and Valuation:

- We have revised our earnings and now forecast FY18e NPAT of \$2.6M (previously \$4.0M), and \$4.1M in FY19e (\$4.9M), and EPS of 0.7cps and 1.1cps, respectively (1.1cps and 1.3cps), as a result of weaker domestic conditions and higher costs in FY18e.
- We have decreased our valuation to \$0.29/share (previously \$0.32) in line with our updated DCF valuation.

Recommendation:

- We maintain our Buy recommendation with a decreased price target of \$0.29 (previously \$0.32), in line with our DCF valuation. We note the recent price pullback, and are of the view a near term opportunity exists due to this reaction.
- 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		Buy			
Risk		High			
Price Target		\$0.29			
Previous Target		\$ 0.32			
Share Price (A\$)		\$ 0.135			
ASX Code		DN8			
52 week low - high (A\$)		0.135-0.26			
Capital structure					
Shares on Issue (M)		388			
Market Cap (A\$M)		52			
Net Cash/(Debt) (A\$M)		8			
EV (A\$m)		45			
Options, rights (M)		33			
12mth Av Daily Volume ('000)		252			
June end (A\$M)		2017a	2018e	2019e	2020e
Sales	46.4	58.8	65.8	73.4	
EBITDA, underlying	4.5	6.5	9.0	11.2	
NPAT, underlying	2.1	2.6	4.1	5.7	
EPS diluted (cps)	0.63	0.68	1.05	1.46	
PER x diluted	21.4	19.9	12.9	9.2	
EV/EBITDA x	7.7	5.3	3.9	3.1	

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	36.4%
Cloudsafe Holdings	24.3%
Alvin Chiang	5.5%
Jervis Wen	5.5%
Australian Ethical Investment	5.1%

Share Price Graph



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The analyst does not own DN8 securities.

Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) do not own DN8 securities.

Cranport Pty Ltd owns 3,217,586 DN8 shares.

This report was prepared by Foster Stockbroking.