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Long: Minds + Machines (MMX.L) - 4.70p

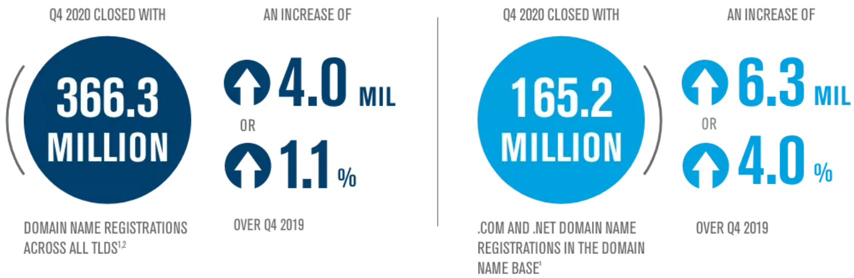
Minds + Machines is a London listed registrar of domains. While there is .com and .net, there is also .beer and .xxx.

The pitch is this:

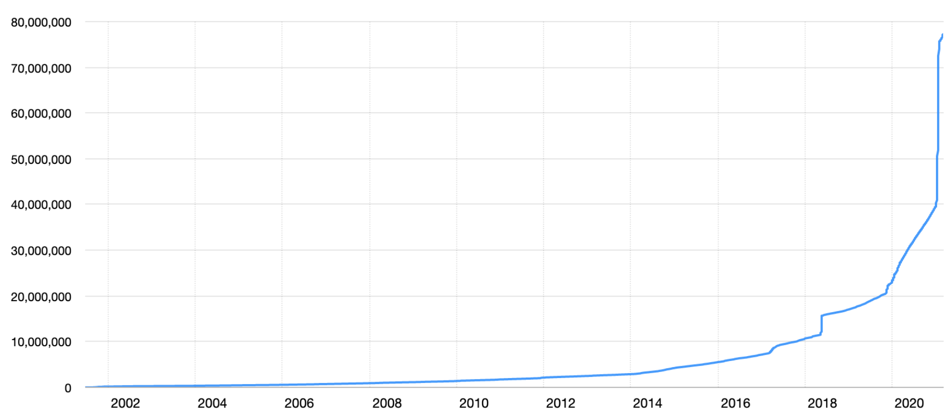
- The market doesn't know who new management is.
  - MMX acquired ICM in 2018. Now ICM's management is running the show. ICM made 4 domains work profitably and are now reworking MMX's 32. The retired ICM founder is buying shares hand-over-fist for the first time in 2 years, after selling his entire stake in 2019. This is even after suing the company and settling in January.
- The market thinks that a loss in domains under management shrinks the business.
  - It's a question of the quality of revenue streams. As DUM grew in the last few years, ARPD shrank. New management shed 19% with no loss in contribution. I also track DUM via public data vs ICANN fees and find a profitable business in its core.
- The market does not understand the size of the opportunity at hand when legacy .xxx domains expire.
  - The company offers brands the ability to block their domains on the .xxx gTLD. The original product had a 10-year lifespan and ends in December 2021. This version is more expensive and comprehensive. This should flow straight to the bottom line net of commissions.
  - I also take a random sample of 7,141 brand names using a python script to get details on brandname.xxx. Of that, there are 5,097 with invalid urls or no blocked domain. 2040 with their brand blocked under the original 2011 product, and only 4 using the new version. The 2,000 are easy pickings come december. The 5,000 and any other brands that have been invented since 2011 are the opportunity beyond that.

The backdrop of the industry and macro is solid

Ultimately the company profits when people register domains. Domain registration coincides with global internet usage which is up and to the right over the last 20 years. There are now 366M registered domains on the internet.



The vast majority are .com and .net properties, which Verisgn owns the rights to. ICANN has begun to create new domains, including .info and /bibz, but branching out into more specific use cases like .yoga and .wedding. The chart below demonstrates the preponderance of these new TLDs (referred to as gTLDs).



Verisign is basically a regulated monopoly today with prices dictated by ICANN. In 2019 the price cacp of $8 was lifted on .org, which they previously owned. .net and .com have contracts expiring in the next 4 years. There's no doubt that they will be renewed, but there also exists the possibility that price caps are lifted. If that is the case, there may be much greater legitimate use of gTLDs.

gTLDs today are a mixed bag. There are some extremely narrow use cases (.rodeo) but some that have become seen as legitimate (.app, .io). There is a higher spam coincidence (5% vs .05%) compared to the old guard. Yet legitimate usage continues to rise, either as primary domains or as alternate pathways to main sites (http://mx666.vip/ being advertised just redirects to the main betting site on .uk). Additionally there is much more room for registrars to decide prices.

The business <u>can</u> be great

Registrars like MMX fundamentally own annuities with some variable costs associated in marketing, upkeep, and management. Looking at Verisign's margins brings a tear to my eye.

Key Statistics

Valuation Ratios		10-Yr Median Returns		10-Yr Median Margins	
P/E	26.9	ROA	18.2%	Gross Profit	82.2%
P/B	-15.8	ROE	-43.3%	EBIT	58.7%
P/S	17.3	ROIC	80.5%	Pre-Tax Income	49.4%
EV/S	18.4	**10-Year CAGR**		FCF	55.5%
EV/EBITDA	26.8	Revenue	6.4%	**Capital Structure**	
EV/EBIT	28.3	Assets	-3.2%	Assets / Equity	-2.2
EV/Pretax	31.1	FCF	17.7%	Debt / Equity	-1.7
EV/FCF	33.9	EPS	4.3%	Debt / Assets	0.8

Verisign

Key Statistics

Valuation Ratios		10-Yr Median Returns		10-Yr Median Margins	
P/E	19.7	ROA	-8.0%	Gross Profit	69.8%
P/B	1.0	ROE	-9.0%	EBIT	10.0%
P/S	4.5	ROIC	-15.6%	Pre-Tax Income	-45.2%
EV/S	4.1	**10-Year CAGR**		FCF	-253.0%
EV/EBITDA	20.9	Revenue	51.7%	**Capital Structure**	
EV/EBIT	29.1	Assets	37.6%	Assets / Equity	1.2
EV/Pretax	17.6	FCF	-	Debt / Equity	-
EV/FCF	71.7	EPS	-	Debt / Assets	-

Minds + Machines

MMX will never be that attractive but the business model is the same, just at a smaller scale. As a result they're going to pay more in marketing/commission since their assets are of lower quality and fixed costs are going to have a greater impact. In theory though, this is best-in-class.

So why do we want to own this over Verisign? To me the risk/reward is more attractive. The market may see this with a chance of 0-ing, but I don't think that's in the cards here. So the risk floor is not as low as the stock is pricing in. On reward, at a market cap of £42M and EV of £37M, I think that the company is trading at over 10% FCF yield and has indicated their intention to return that to shareholders.

The business <u>is</u> attractive

MMX owns 32 generic Top Level Domains (gTLDs) and will make money for every registered website. An overview of the industry is on the last page, showing the pathways available to do so.

In 2018 they acquired ICM, the owner of .xxx, .porn, .adult, and .sex. According to Stuart Lawley, ICMs' founder and ex-CEO, the original plan was to lump these in with MMX's original 28 and to find a buyer for the 32 due to the deep pockets flooding the market, making acquiring and operating more domains hard to do. The value of the portfolio is very real, since these are essentially annuities that track internet usage. The asset value will be better understood in April given that another portfolio of gTLDs will be auctioned.

A buyout seems likely, but is not something we need to bank on. ICM, with their 4 domains, was profitable at 7m in sales and 3.5m in net income. What we know about MMX today is that they're generating 6m in operating cash flow on 17m in revenue but that, due to the accounting procedure in recognizing revenue vs receipts, 3 deals were misstated, leading to the departure of the company's prior CEO and CFO. It's most likely that these deals surrounded the company's sales in China in the .vip domain, which has seen registrations drop since new management has begun to purge those low-value registrations. The CEO today is Tony Farrow, the CEO of ICM prior to its acquisition.

I also track .vip registrations and it is the only domain of MMX's with a significant portion of registrations from China (200,000/900,000). This rise also coincided with the decrease in ARPD from $10.9 in 2017 to just $7.7 today. Management is aware, taking action, and ultimately pushing MMX in the right direction: focusing on the incredible cash-generation capabilities on this small scale and bringing out true asset value.

One development that attests to that fact is the recent purchases by Stuart Lawley, who now owns ~5% of the company. Stuart lives in Florida (in the same neighborhood as Tony), has intimate knowledge of the domain business, and just settled a lawsuit with the company over the inflated DUMs and their role in ICM's acquisition. The most curious part of all of this is his serial posting on the LSE stock forums - only posting about MMX.

<u>Here's what I gathered from his 500 posts over the past few years:</u>

- It's possible that ICM was aware of the curiosities in the .vip domain but was given a timed offer of an additional $10m so chose to accept it.
- MMX had previous suitors but all were confused about .vip.
- The end goal for this company is to sell the portfolio to another bidder and that's what Tony Farrow is doing.
- This is his only stock holding.
- He has not owned shares since 2019, only buying (in size) after new management stopped in.

In any case, this isn't a great situation for any company to be in. It does seem possible that the scabs have been ripped off the business and, with maybe some more downside in DUMs, the business is headed in the right direction, especially considering the major catalyst that is December's expiration of original .xxx registrations. What allows me to invest in the company is the lack of debt, which should prove it difficult for this company to go bankrupt, and management from outside of the initial fold.

This business has great potential. Fundamentally they will own these gTLDs and outsource everything there is to it. All they have to do is pay ICANN and make decisions on pricing and marketing. Verisign, the owner of .com and .net, is regulated intensely but still boasts obscene 60% EBITDA margins. MMX won't get there, but the economics are basically the same on a much smaller scale. The major difference is that they have more decision making when it comes to pricing, worse assets (so must spend more on commission and marketing), and fixed costs will shine through at a higher rate.

This company still did 6m in CFO during COVID, did the same in 2019 when excluding a contract settlement, and has the ability to do even more with their new product, Adultblock. Fundamentally all this does is prevent registrations on the .xxx, .adult, .porn, and .sex domains, as well as any common letter permutations that would also violate the trademarks of brands. ICANN forced ICM to allow brands to block their trademarks for the 10-year period in 2011, when .xxx came online. Now that expires in December and they have created a more comprehensive offering by adding in 3 more domains. Think about how easy it is to simply stop a domain from being registered. All they have to do is outsource the marketing work and pay a commission to registries.

To give some context: in the original 2011 block period, over 60,000 brands blocked their brand.xxx domain. The company has only registered 2,000 to date. Some brands wont care to extend it, some don't exist. But overall the opportunity to add incremental $'s earned is immense. I sampled a list of brands I found online and found that 2,040 were using the original product and only 4 were on the new version - Adultblock. For example, google.xxx is blocked in the original wave but twitter.xxx, being a newer company, is now signed up for AdultBlock+.

If they achieve 20,000 sign-ups, at say $100 in yearly contribution post commission, that's $2m in earnings on top of a 6m core for a business at 42m market cap and 37m EV. Previous management has said that half of CFO will go to buybacks and wanted to institute a dividend. In this new regime I think the latter is more likely, given that is what major shareholders want (according to Lawley). **The core business is solid, recurring in nature, and constantly spits out 16% of the EV in cash. If new product launches are remotely successful, MMX is likely trading at 20% 2022 FCF yield.**

In summary:

- This is a cashflow machine if run correctly, even if assets are not the best (vs .com, .net). The majority of revenue is recurring.
- New management can run this correctly.
- Major vote of confidence form formerly bearish MMX insider, affirming management.
- Asset value is real and will be clarified in April.
- December 2021 is a hard catalyst for a step-up in revenue at a high level of cash flow contribution.

The Domain Industry