

GMO Internet Inc. (“GMO”) is a leading internet infrastructure and financial service provider in Japan. The company was founded by Chairman and President Masatoshi Kumagai in 1991, and started offering internet access and server management services in 1995. The company has acquired various internet service businesses over the years and built a dominant position as an internet infrastructure provider:

- The company has about 90% market share as an internet address domain registrar in Japan.
- It is the largest server/cloud service provider, with 56% market share by number of contracts.
- It is the largest SSL security provider. (SSL is the cryptographic protocol that allows secure internet traffic and enables internet commerce.)
- GMO is also the largest online FX broker by trading volume, and
- Also one of the largest online payment service providers, with over 4.9 trillion Japanese Yen (about 44.2 billion USD) of annual transaction value in Japan.

The majority of these internet infrastructure services generate stable recurring profits. The Japanese government’s policy of targeting a national cashless payment/cash payment ratio of 40% by 2025, from the current 18%, has been a huge tail wind for the company’s payment processing business. Accordingly, its payment processing value has grown over 20% annually in the past 5 years. The growth trend likely continues, given that the cashless ratio in Japan was as low as 18% as of 2018, compared to 44% in the U.S. and 95% in South Korea.

GMO has a market capitalization of ¥188 billion, with a strong balance sheet: the cash and cash equivalent balance is ¥168 billion versus about ¥160 billion debt. As seen in many internet service providers, their businesses enjoys recurring cash income and requires no major capital expenditures. The company announced a 15 billion JPY share buyback program (7.9% of the outstanding shares) for the year 2020.

Leveraging its knowledge and expertise in the internet infrastructure and online brokerage businesses, GMO entered two new businesses in 2017, establishing a cryptocurrency exchange and a crypto-mining effort. Effective April 2017, Japan became one of the first countries to legalize cryptocurrency payments and transactions. GMO’s cryptocurrency exchange, GMO Coin, became one of the first eleven FSA registered exchanges. Launching a cryptocurrency exchange business required limited investment for GMO, as it has the largest online FX exchange platform in Japan, with an annual transaction value of 759 trillion JPY (6.8 trillion USD). GMO Coin annual transaction value grew exponentially, from 5.1 trillion JPY (46 billion USD) to 9.3 trillion JPY (83.8 billion USD) in 2019.

On the other hand, GMO’s mining business went through a difficult time in 2018, when the price of cryptocurrency declined significantly. GMO wrote down the most of its mining equipment investment in 2018 and moved its mining facility from Northern Europe to the United States where the company found a partner who offered lower electricity and facility cost for mining. Because the company no longer carries the depreciation cost of that mining equipment and operating expense declined, the company’s mining operation turned profitable despite further deterioration in the mining environment in 2019, when the Bitcoin mining hashrate grew 1.8x year-over-year even as the price remained flattish** . The

company's mining facility generated 169PH/s mining power (0.15% mining power market share) as of December 2019.

GMO, currently trading at a Price to trailing earnings multiple of 18x times, and with no net debt, appears undervalued. The company's internet infrastructure business, which is positioned to benefit from the Japanese society shifting towards cashless payments, will likely generate lower-teen percentage earnings growth. The company's cryptocurrency business is still small, representing only 3.8% of its operating profit, and easily ignored in valuation of the company. That, however, offers a very low-priced call option for the cryptocurrency exposure. If and when cryptocurrency comes to be broadly accepted as a financial asset or currency, GMO's current cryptocurrency annual trading value of 9.3 trillion JPY will likely grow further; in success mode, this could easily be by orders of magnitude. One may compare that level of activity with that of its fiat currency FX trading value, which was 759 trillion JPY in 2019.

GMO has a track record of entering in the very early period of newly developing industry sectors and of building a dominant position as the industry develops. The year that GMO started internet access and server management service, the word "internet" won Keyword-of-the-year in Japan, and the following year, in 1996, the first portal website, Yahoo! Japan, was launched. In 1996, the internet penetration was only 4.6% and a national survey disclosed that 48.5% of respondents said they would not use the internet in future, while only 3.3% of respondents said they would use internet within a year¹. This is very similar to the earlier view on Bitcoin: one survey conducted in October 2017 in Japan confirmed only 5.3% of respondents said they have owned Bitcoin in the past².

*Sourced from GMO Payment Gateway presentation book. Cashless ratio =credit card and debit card transaction value ratio to Household final consumption expenditure.

**Sourced from Blockchain.com. The average daily price of Bitcoin declined slightly from USD 7610.12 to USD7365.98 in 2019 while the Bitcoin average daily hashrate grew from 36,032.5 PH/s to 65,267.3PH/s. Theoretically, the number of mining reward coin per 1PH/s declined by 45%yoy.

1. The population ratio of those who use internet in the past year. Ministry of Internal Affairs and Communications <http://www.soumu.go.jp/johotsusintokei/statistics/statistics05b1.html>
2. Macromill Bitcoin Survey Japan, October 2017.

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