CommerceHub (CHUBA and CHUBK)

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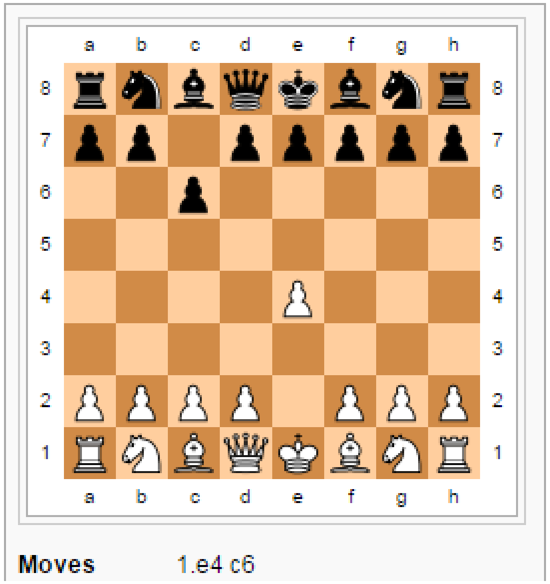
About Caro-Kann Capital LLC

- General Partner of Caro-Kann Capital Fund LP, a private investment partnership.
- Launched in March 2015.
- Focus on small and mid-cap companies undergoing extraordinary corporate events and / or experiencing rapid changes in their shareholder bases and compounders.

Caro-Kann Defense

Caro-Kann Defense

- Chess defense against the king's pawn opening.
- The opening is named after the English player Horato Caro and the Austrian player Marcus Kann who analyzed it in 1886.*
- Caro-Kann Defense is more solid and robust than many alternatives and, thus, Black enjoys a significantly smaller chance of losing.
- However, due to a strong position and pawn structure, Caro-Kann Defense results in a strong likelihood of Black winning later.



* Wikipedia. The graphic display (http://en.wikipedia.org/wiki/Caro%E2%80%93Kann_Defence)

CommerceHub: Introduction

Capital Structure at a Glance

CHUB: Capital Structure, ths $	
Actual S/O	43,148
Dilutive impact from SARs and options (both exercisable and not exercisabe)	1,943
F/S S/O (including options outstanding but *not* exerciseable)	45,091
Share price, $	$17.00
Market Cap	**766,541**
Debt	10,000
DE	0
Debt + DE	**10,000**
Cash	4,044
EV	**$772,497**

CHUB: What We Like (1)

	What We Like	Importance	Comments
1	**Long Growth Runway**	●	Growth runway is likely to be 5 – 10 years if not longer driven by secular e-commerce growth, increasing penetration of dropshipping, and new customer sign ups.
2	**Strong Moat**	●	Strong moat based on powerful network effect (~50 suppliers and ~10,000 suppliers).
3	**SaaS Company at Non-SaaS Valuation**	●	CHUB trades at 10x – 15x discount (not a typo!) to SaaS companies with similar growth profiles.
4	**Excellent Product with Compelling Customer Value Proposition / Product**	●	CommerceHub provides retailers and suppliers with mission critical software at a reasonable price that allows seamless integration and interactions that enable dropship.

CHUB: What We Like (2)

	What We Like	Importance	Comments
5	**Excellent Margins**	●	~80% gross margin and ~40%+ EBITDA (after SBC) margin in core dropshipping business.
6	**Upside Optionality**	●	CHUB is developing the 2nd business (Brands Initiative) which is currently small (~$10M in revenue) and losing money. But it has tremendous potential.
7	**CEO-Founder Is at the Helm & Incentives Are Aligned**	●	Founder Frank Poore returned to the company few years before the spinoff. Shortly before the spinoff CEO received an option grant which would make them a 5% shareholder (less under the Treasury method).
8	**Ultra Low Customer Acquisition Costs**	●	10% of revenue is spent on Sales & Marketing vs. 30%+ typical for SaaS companies.

Why Does This Opportunity Exist?

	Mispricing Factor	Importance	Comments
1	**Recent Spin-Off**	●	CHUB was spun off from Liberty Ventures, one of Dr. Malone's entities in July 2016.
2	**Complicated Accounting for Stock-Based Compensation**	◕	Arcane accounting rules overstated "true" level of stock-based compensation prior to the spin off. Historical "economic" SBC is "overstated" by ~$25M - $30M.
3	**Second Start-Up Business Masks How Strong the Core Business Is**	●	A new business (Brands Initiative) is masking true revenue growth rate and margin profile of CHUB's core dropshipping business.

Multiple factors contribute to CHUB's mispricing

CommerceHub: Brief History

CommerceHub History

Date	Event description
1997	Frank Poore and Richard Jones found CommerceHub
1999 – 2000	CHUB lands QVC as a customer; business model established
2010	Liberty acquires CommerceHub

Frank Poore
(Source: CommerceHub website)

Richard Jones
(Source: CommerceHub website)

CommerceHub Customer Value Proposition: Dropshipping SaaS

What Does CHUB Do?

- CHUB provides SaaS dropshipping to retailers and their suppliers for a fee when a consumer buys goods online.
- This bring up a question: *what is dropshipping?*
- Dropshipping is only relevant when we are talking about e-commerce.

CommerceHub
Keep Growing

Traditional E-Commerce Fulfillment Model: Flow of Goods

Dropshipping Fulfillment Model: Flow of Goods

Why Is Dropshipping Important?

Dropshipping benefits everybody in the ecosystem!

Dropshipping creates a bit more of a level playing field in the world where e-commerce's importance is growing.

1. Retailers benefit from wider assortment of SKUs without carrying inventory
   - Thanks to dropshipping retailers can dramatically <u>expand their SKU assortment</u> from ~100K in a store to millions on a website – virtual inventory
   - Virtual inventory does not have to be stored in a warehouse => <u>no storage costs and no working capital</u> tied up in inventory.
   - <u>No CapEx</u> spent on bigger warehouses.

2. Customers benefit from *wider selection*.

3. Customers benefit from getting their orders *faster*.

4. Retailers and consumers benefit from less shipping costs.

5. Supplier benefits because it becomes easier to get "shelf space".

CommerceHub Customer Value Proposition

	Element	Importance	Comments
1	**Solving a complex supply chain and integration challenge**	●	CHUB SaaS solutions enable retailers to interact seamlessly with suppliers while ensuring great end customer experience. This is a non-trivial task.
2	**Continuous Onboarding of Suppliers**	●	- Retailers always drop some suppliers and sign new ones. - Onboarding suppliers takes lots of time from retailers and costs money. - CHUB takes care of that.

Go to Market and Customer Acquisition Strategy

1. CHUB operates ***two-sided platform business***. Two sides are retailers and suppliers.

2. CHUB acquires *only* retailers and has acquired ~50 to date.

3. Retailers bring their suppliers (~10,000) to the platform. If a supplier wants to do business with a retailer and participate in a dropshipping program, such supplier will join CHUB's platform.

4. This results in ***extraordinarily low customer acquisition costs*** (CAC) (~10% of revenue). It is way cheaper to acquire ~50 customers than ~10,000!

Notable Retail Clients

CommerceHub: Business Model

Revenue Model: 3 Revenue Streams

	Mispricing Factor	Comments
1	**Base Subscription Fee**	- 25% - 27% of annual revenue. - Paid by both retailers and suppliers. - The exact amount depends on the number of connected trading partners.
2	**Usage Fees**	- ~68% of annual revenue. - Paid by both retailers and suppliers. - Usage fees are charged per transaction and end up ~50 basis points of GMV. Subscription fees + usage fees end up ~75 basis points of GMV => very affordable.
3	**Set-Up and Implementation Fees**	- 5% - 7% of annual revenue. - One-time in nature.

Multiple factors contribute to CHUB's mispricing

Recurring Revenue Model with a *Twist*

- CHUB has a recurring revenue model similar to many other SaaS companies.

- However, there is a *wonderful twist*: CHUB usage revenue will be increasing with every new e-commerce transaction that involves dropshipping.

- Thus, unlike many other SaaS companies, *CHUB does not have to sign any new customers in order to keep growing* (though we expect that CHUB will keep signing more and more customers).

CHUB Is Uniquely Levered to E-Commerce Growth

CommerceHub: Growth Outlook

CommerceHub Faces Massive Tailwinds

1. Total e-commerce growth.

2. Increasing wallet share (*i.e.*, increasing penetration of virtual inventory and dropshipping among existing customers).

3. Signing up additional retailers and suppliers.

4. International expansion.

Growth Driver #1: E-Commerce Growth

- E-commerce ex-Amazon has been growing in the low teens:
  - 2012 – 11.8%
  - 2013 – 10.8%
  - 2014 – 12.8%
  - 2015 – 13.8%

- We expect this long-term trend to be secular and to continue for many years.

Growth Driver #2: Increasing Dropshipping Penetration among Existing Customers (aka Wallet Share)

- Many retailers have virtual inventory and dropship penetration of less than 10%.
- Long-term retail customers have a wallet share between 30% and 50%.
- Closing this gap is CommerceHub’s opportunity.

Growth Driver #3: Signing Up Additional Retailers and Suppliers

- CommerceHub currently serves ~50 retailers
- Plan is to focus on top 500 retailers in the U.S. as they represent ~90% of e-commerce
- We believe that current 50 retailers are among the largest players in the industry
- Thus, as CHUB signs up more retail customers, revenue per retailer is likely to decline holding penetration level constant

Customer Count

CHUB Customer Count	2014	2015	1Q 2016	2Q 2016	3Q 2016	4Q 2016	2016	1Q 2017
Customers	8,599	9,559	9,619	9,726	9,930	10,094	10,094	10,801
Growth, %		*11.2%*	*8.1%*	*5.8%*	*6.6%*	*5.6%*	*5.6%*	*12.3%*

- 2015 vs. 2014 comparisons are affected by the acquisition of Mercent in January 2015. *More on this later*.

- The decelerating growth in 2016 was mostly caused churning ex-Mercent customers as opposed to issues within the core dropship offering. *More on this later*.

Growth Driver #4: International Expansion

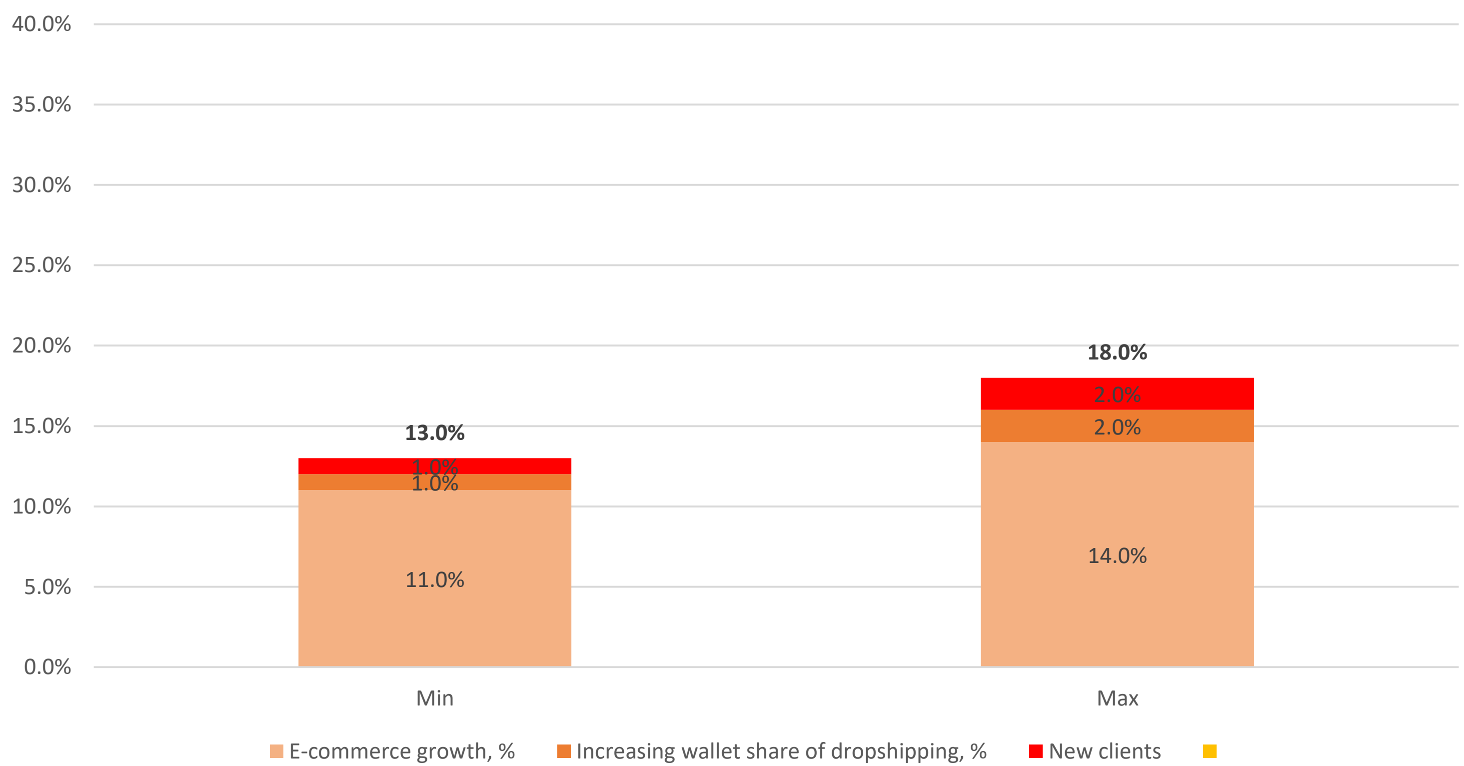
- International expansion can present significant growth opportunities for CommerceHub and dramatically expand total addressable market.

- We are not including any potential growth from international expansion into our analysis.

CommerceHub: Growth Outlook: Putting It All Together

- We think that CHUB can grow its dropshipping revenue by 13% to 18% per annum for many years. We are not modelling CHUB's international expansion.

CommerceHub Projected Growth Drivers, %



CommerceHub: Expanding Moat

Sources of Moat

CHUB has two sources of moat: switching costs and network effect

Switching costs

- Similar to many other SaaS players whose offerings have become imbedded into business and operating processes of their clients.
- However, there is always a risk that someone else will come up with a better mouse trap.

Network effect

- A stronger moat.
- More difficult to disrupt.

Moat: Network Effect

	Network Effect	Importance	Comments
1	**Big Network**		~50 retailers and ~10,000 suppliers.
2	**Attraction is increasing**		Every joining retailer and/or supplier makes the network even stronger.
3	**Economies of scale of onboarding**		• If 10 retailers want to onboard a new supplier, they would do 10 times collectively. • If all of them are CommerceHub's customers, onboarding will happen only once => massive collective savings and CHUB would retain some of them.
4	**Incredibly low customer acquisition costs (CAC)**		• Network effect makes CAC incredibly low. • CHUB Dropshipping business is growing 17% - 18% with S&M at ~10% of revenue while most peers are spending ~30% to achieve the same level of revenue growth.

CommerceHub: Customers and Churn

Retailer Churn: Minimal

We were able to identify very few retail customers who left CommerceHub

Over the years CHUB lost very few customers:

Circuit City

- Well, Circuit City had a good reason … it went bankrupt.

Target

- Target decided to go with an in-house solution several years ago.

Smaller Retailers

- CHUB lost some smaller retailers who did not ramp up their dropshipping business. Exact number and names are unknown.

Supplier Churn

Supplier churn is significant but it is what benefits CommerceHub

- Suppliers do not leave CommerceHub on their own will.

- However, if a retailer terminates a supplier (e.g., SKUs do not generate enough sales), such supplier would stop being CHUB's customer.
  - Higher churn than among retailers.

- However, such "supplier turnover" allows CommerceHub to deliver its unique value proposition: to remove onboarding burden and hassle from retailer' shoulders.
  - *Supplier churn benefits CommerceHub!*

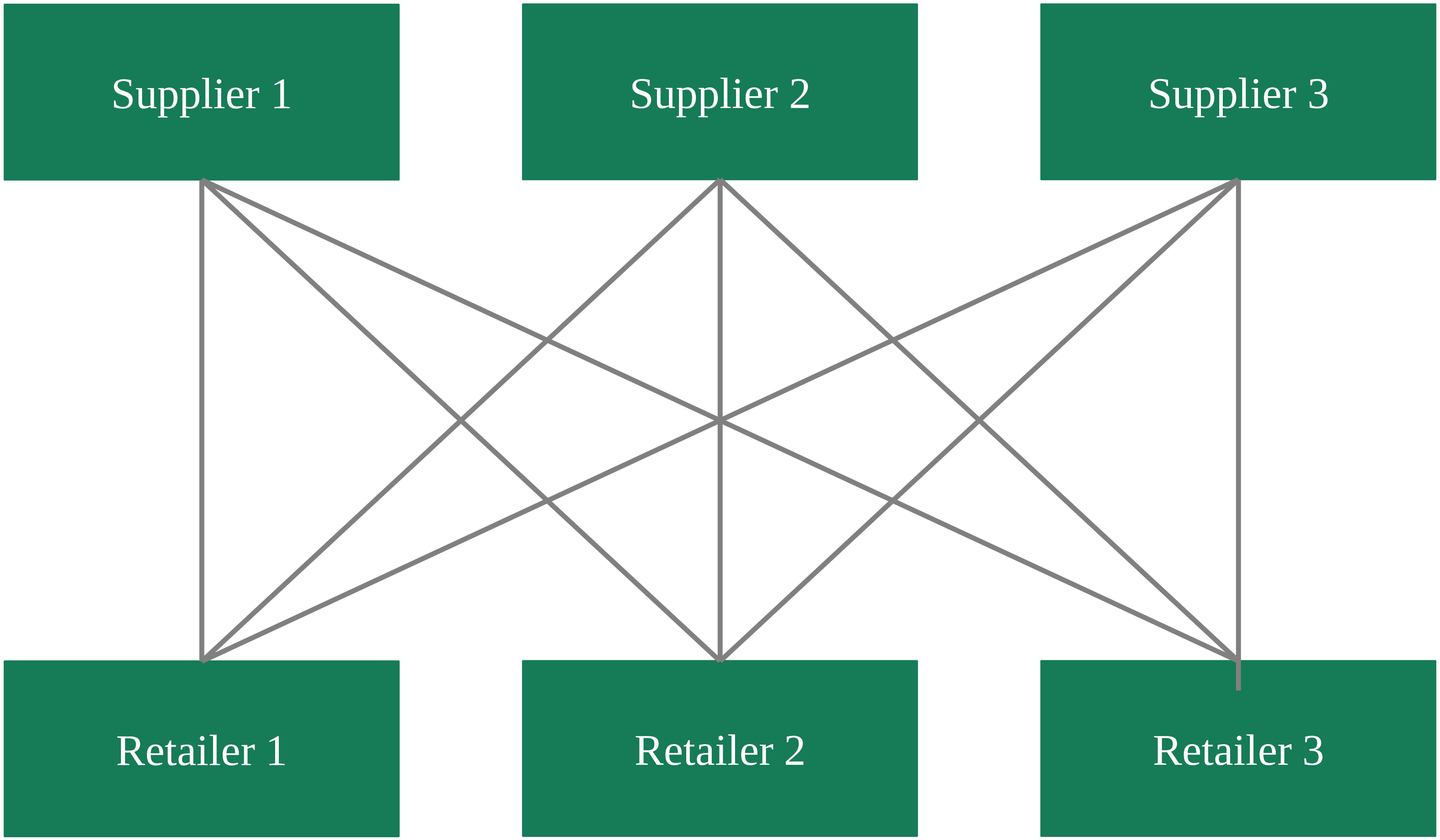
CommerceHub: Competition

CommerceHub Dropshipping Offering: Competition

	Competition	Comments
1	**Traditional legacy on-premise solutions**	Point to point architecture => difficult and expensive to maintain and update
2	**In-house solutions**	No benefits of scale => expensive => only largest retailers can build solid in-house solutions
3	**Other SaaS players**	No SaaS players have dropshipping solutions that can meet requirements of large retailers.

Legacy Software Solutions

Multitude of Point-to-Point Connections



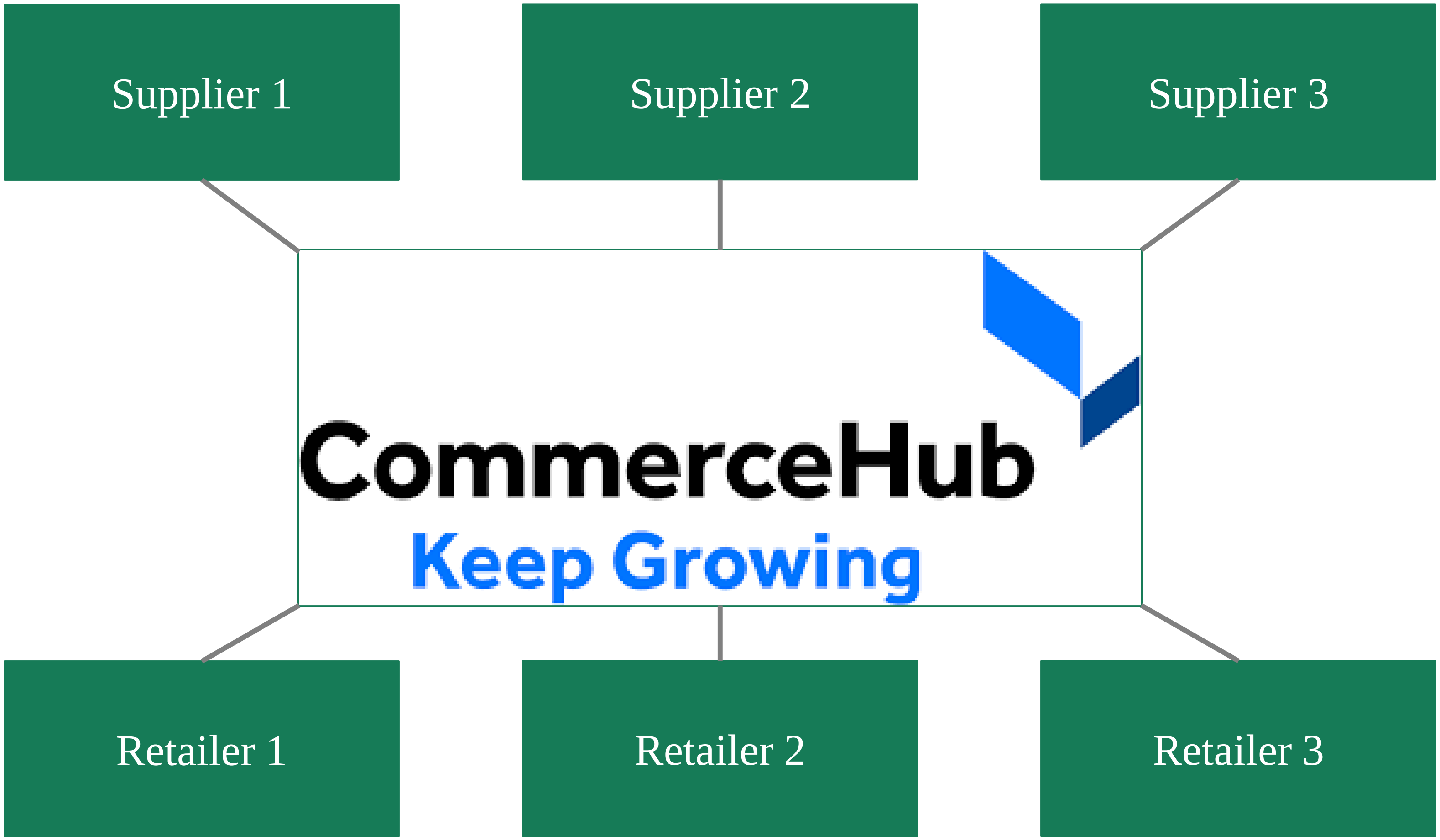
Dropshipping Competition: Traditional Legacy On-Premise Solutions

Legacy on-premise solutions have multiple disadvantages.

- Tend to focus on fulfillment automation within a single facility and among a small network of trading partners
- Require time and technical expertise to configure, deploy and maintain
- Adding new trading partners is time-consuming and requires technical expertise
- Architecture: multitude of point-to-point connections between retailers and suppliers instead of a network of connections that CommerceHub has built
- Any updates pushed by a retailer must be installed *by every single supplier*
- Reasons above can make on-premise legacy solutions prohibitively expensive for small suppliers.

CommerceHub Dropshipping SaaS Offering: Infrastructure

This is a true network!



Dropshipping Competition: In-House Solutions

- Expensive to develop
  - Only *very few* very large retailers have done it and can do it in the future.

- The pain point of onboarding suppliers is not eliminated and must be done in-house.

Dropshipping Competition: Other SaaS Providers

- We are not aware of any SaaS player that can do what CommerceHub does for *both* retailers and suppliers *at scale*.

Dropshipping: “Perceived” Competitors

SPS COMMERCE

channeladvisor®

Dropshipping Competition: Other SaaS Providers – "Perceived" Competitors

- There are **"perceived" competitors** that are *not* competing with CommerceHub:
  1. SPS Commerce (ticker: SPSC)
  2. Channel Advisor (ticker: ECOM)

- Retailers do not use or use in a *de minimis* way SaaS provided by SPSC and ECOM. Only suppliers do.
  - Even if a supplier is using SPSC SaaS offering, a retailer will be using CHUB SaaS or its own in-house solution. If a retailer is using CommerceHub offering, a supplier will have to use both SPSC and CHUB SaaS offerings.

- We believe that this usage point is not fully appreciated by market participants as a number of companies use the term "dropshipping" differently than CommerceHub does and therefore create an appearance of comparability.

CommerceHub: Brands Initiative

CommerceHub for Brands (aka Brands Initiative)

What Is Brands Initiative?

- Effectively a startup within CommerceHub.
- Brands Initiative enables consumer brands manage their direct sales through marketplaces and other Internet / social platforms more effectively.
- Think of Brands Initiative SaaS offering as a master catalogue that a brand would update only once and it syncs with all direct channels that a brand is using for its direct sales (there are more functions but we highlight the most prominent).

Brands Initiative: Brief History

- January 2015 – CommerceHub acquired Mercent for ~$20M.
- Mercent was providing a software solution for brands that would allow them to create one central product catalogue that would be linked to various websites, marketplaces, etc.
- Mercent had revenue of ~$10M at the time of the acquisition.
- Hence, CHUB acquired Mercent for ~2x revenue which is very low => well done!

Mercent: Rationale for Acquisition

CommerceHub acquired Mercent for its technology and not its customer base

- CommerceHub wanted to get Mercent’s technology
- CommerceHub was not interested in Mercent’s customers who are mostly smaller e-commerce players
- Ex-Mercent customers fall into two groups:
  1. Self-service customers
  2. Managed services clients

Mercent's Two Groups of Customers

One is attractive and one is not

- Self-service customers
  - Use SaaS offering & little human element
  - Little handholding
  - => Highly scalable & high gross margins => fundamentally attractive business

- Managed services clients
  - Still use SaaS offering but lots of service are provided by ex-Mercent / CommerceHub employees
  - Lots of handholding
  - => Less scalability and lower gross margins => fundamentally less attractive business

What CommerceHub Is Doing with Ex-Mercent Business?

- CommerceHub wants to focus on self-service clients.
- CommerceHub wants to focus on bigger clients.
- Thus, many legacy clients are not “desirable” customers and CommerceHub is *intentionally* churning them.
- Brands Initiative has already got some impressive clients wins: Mattel and Adidas

Brands Initiative Makes Consolidated Financials Look Weaker

One needs to analyze dropshipping business separately from Brands Initiative

- Revenue growth is lower.
- Gross margin is lower.
- EBITDA margin is lower and EBITDA is lower.

Brands Initiative's Impact on Revenue Growth

- Brands Initiative generates ~$9.5M to $10M of revenue which is similar to what Mercent was generating at the time of the acquisition.
- Dropshipping business is growing 17% - 18% y-o-y.
- But consolidated revenue is growing "only" 11% because of Brands Initiative impact.
- Observers are likely not understanding Brands Initiative's impact on financials and may be extrapolating lower consolidated revenue growth rates on dropshipping business growth rate.

Brands Initiative's Impact on Gross Margin

- Core dropshipping business had a gross margin ~80% in 2014.
- Brands Initiative / ex-Mercent business had 30% - 50% gross margins in 2015 (our best estimate) due to managed services clients.
- We do not see any fundamental changes in the dropshipping business now vs. 2014 when dropshipping business had ~80% gross margin.

Brands Initiative's Impact on EBITDA margin and EBITDA

- This is more difficult to estimate due to very limited disclosures. But we will do our best.

- Brands Initiative is losing money but the exact amount is not disclosed.

- Other than public company costs and standalone company infrastructure we do not see why core dropshipping business should be operating with lower EBITDA margin now than in 2014 (*i.e.*, the last year before CHUB acquired Mercent).

- In 2014 CHUB had EBITDA margin ex-SBC of 59.9%.

Brands Initiative: Strategic and Financial Importance

- CommerceHub has a potential to build its second sizable business.
- Brands Initiative mitigates the risk of retailers and thus CommerceHub being disintermediated by brands going to consumer directly.

CommerceHub: Management, Alignment, and Executive Copmensation

Executive Compensation

Executive Compensation Strikes Us As Quite Reasonable; See Discussion of 2016 Option Grant on the Next Slide

Francis Poore	2014	2015	2016
President and Chief Executive Officer			
Salary	354,775	369,048	385,457
Bonus			
Stock Awards			
Option Awards			12,177,842
Non-Equity Incentive Plan Compensation	197,340	165,973	150,000
All Other Compensation	12,723	15,951	66,923
Total	**564,838**	**550,972**	**12,780,222**

Mark Greenquist	2014	2015	2016
Chief Financial Officer and Treasurer			
Salary			175,000
Bonus			
Stock Awards			
Option Awards			1,653,999
Non-Equity Incentive Plan Compensation			85,723
All Other Compensation			48
Total	**0**	**0**	**1,914,770**

Bob Marro	2014	2015	2016
Chief Financial Officer and Treasurer			
Salary	218,938	248,968	
Bonus			
Stock Awards			
Option Awards		1,224,000	
Non-Equity Incentive Plan Compensation	92,997	99,499	
All Other Compensation	12,723	15,951	
Total	**324,658**	**1,588,418**	**0**

Richard Jones	2014	2015	2016
Chief Technology Officer			
Salary			279,857
Bonus			
Stock Awards			
Option Awards			3,549,353
Non-Equity Incentive Plan Compensation			90,300
All Other Compensation			15,948
Total	**0**	**0**	**3,935,458**

Eric Best	2014	2015	2016
Chief Strategy Officer			
Salary		224,170	
Bonus			
Stock Awards			
Option Awards		587,520	
Non-Equity Incentive Plan Compensation		68,738	
All Other Compensation		12,075	
Total	**0**	**892,503**	**0**

2016 CEO Options Grant

- Shortly before the spinoff CEO Frank Poore received a massive stock options grant.

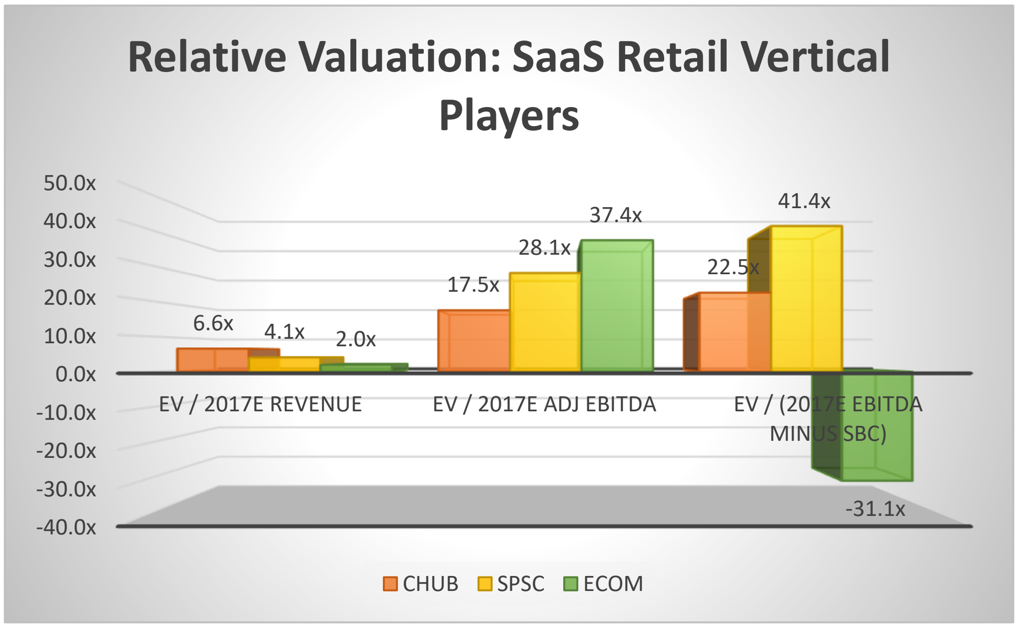
- Details:
    - ~2.3M options
    - Strike = $16.34
    - This option grant can make CEO ~5% owner (less if one uses the Treasury method)

- We view it as a solid tool to align CEO incentives with shareholders' interests.

CommerceHub: Valuation

CHUB: Relative Valuation

Relative Valuation at a Glance: SaaS Retail Vertical



Comments

1. CHUB metrics include both core Dropshipping Business and Brands Initiative business.

2. CHUB trades at a higher EV/Revenue multiple, which is well deserved give its higher EBITDA margin.

3. CHUB trades a 10x – 20x turn discount on EV/EBITDA. We adjusted CHUB EBITDA for capitalized software expenses.

4. CHUB trades at a massive 15x+ turn discount on EV/(EBITDA minus SBC).

5. CHUB is growing its revenue at a rate comparablele to SPSC and ECOM .

CommerceHub: Valuation

A Few Methodology Notes

- Few sellside analysts who cover the stock lump Dropshipping Business and Brands Initiative together.
  - We DISAGREE.

- SOTP valuation is the best approach:
  - Dropshipping Business should be valued separately.
  - Brands Initiative should be valued separately.

- We treat stock-based compensation as a true expense.

- We treat capitalized software as a true expense.

Dropshippig Business: Let’s Reconstruct Dropshipping Financials

CHUB: Dropshipping Model Only, ths USD	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Dropshipping Revenue	30,000	37,761	50,761	65,761	77,092	90,969	106,434	123,463	141,982	161,860
y-o-y growth, %		*25.9%*	*34.4%*	*29.6%*	*17.2%*	*18.0%*	*17.0%*	*16.0%*	*15.0%*	*14.0%*
Dropshipping gross margin, %				80.1%	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%
Dropshipping gross profit, %				52,664	61,674	72,775	85,147	98,770	113,586	129,488
y-o-y growth, %					*17.1%*	*18.0%*	*17.0%*	*16.0%*	*15.0%*	*14.0%*
Difference btw revenue growth and EBITDA growth, %					1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
Dropshipping EBITDA before SBC and Capitalized Software and Public Co	15,000	21,000	30,000	39,368	46,742	55,857	66,190	77,773	90,606	104,650
y-o-y growth, %		*40.0%*	*42.9%*	*31.2%*	*18.73%*	*19.50%*	*18.50%*	*17.50%*	*16.50%*	*15.50%*
margin, %	*50.0%*	*55.6%*	*59.1%*	*59.9%*	*60.6%*	*61.4%*	*62.2%*	*63.0%*	*63.8%*	*64.7%*
Public company costs						(5,000)	(7,000)	(7,250)	(7,500)	(7,750)
DS EBITDA minus Public Co Costs						50,857	59,190	70,523	83,106	96,900
Capitalized Software				(2,986)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)
DS EBITDA minus Public Company Costs minus Capitalized Software				36,382	43,742	47,857	56,190	67,523	80,106	93,900
y-o-y growth, %					*20.2%*	*9.4%*	*17.4%*	*20.2%*	*18.6%*	*17.2%*
margin, %				55.3%	56.7%	52.6%	52.8%	54.7%	56.4%	58.0%
Stock-based compensation (SBC)							(10,643)	(12,346)	(14,198)	(16,186)
SBC as % of revenue, %							10.0%	10.0%	10.0%	10.0%
DS EBITDA minus Public Co Costs minus Capialized Software minus SBC							45,547	55,177	65,908	77,714
y-o-y growth, %								*21.1%*	*19.4%*	*17.9%*
margin, %							42.8%	44.7%	46.4%	48.0%

Dropshipping Financials: Important Notes

- This is an art, not science, mixed with intelligent guesswork.
- Disclosure is very limited and we have to do this guesswork.
- None of these numbers may ever show up in CHUB's financials due to the way CHUB is reporting.
- We have stated our assumptions (in blue, highlighted in yellow) clearly. We welcome you to use own assumptions.
- In 3Q 2016 CHUB changed its accounting policies related to capitalization of software development. We *intentionally* did not incorporate the impact of such changes so that we have comparability to prior periods.

Dropshipping Financials: Note on Incremental Margins

- Our EBITDA margin forecast is likely to be very conservative given that the Dropshipping Business has ~70% - 80% incremental EBITDA margins.

Dropshipping Business: What’s It Worth?

CommmerceHub Dropshipping Business Valuation, ths USD	
2020E DS EBITDA minus Public Co Costs minus Capialized Software minus SBC	$77,714
Multiple	16.0x
EV	$1,243,424
Cash build up	$184,881
Debt + DE	10,000
Equity	$1,418,306
FD S/O as of now (including options outstanding but not exercisable)	45,091
Annual dilution	1.5%
2020E FD S/O	47,858
Target Dropshipping Business Value Per Share in 2020, $	$29.64

Dropshipping Businesses 2020 Valuation: Important Notes

- Exit multiple of EBITDA minus Capitalized Software minus SBC of 16x is justified for many reasons.

(1) We expect that even after 2020 CHUB will have a long growth runway.

(2) By 2020 CHUB's competitive position will be even stronger.

(3) This is the multiple *after* SBC and the implied multiple of Adjusted EBITDA (before SBC) which sellside always uses would be ~13.25x.

Brands Initiative: How Should We Value It?

There is no right answer.

	Valuation Approach	Comments
1	**Capitalize Losses Forever**	We estimate that Brands Initiative generates ~$4M to $8M of cash losses (including capitalized software) per year. We view this scenario as extremely unlikely.
2	**Losses for 2 Years, Failure & Subsequent Shutdown**	More realistic than #1 due to aligned incentive and Dr. Malone's involvement.
3	**Losses for 2 Year => Successful Business**	We view it as the most likely scenario. However, we cannot predict how successful this business will be. Can it be $20M in revenue? $30M? $50M? Can EBITDA margin be 25%? 35%? Any of this is possible.

We will go with #2 since it is more conservative than #3. #1 seems to be almost unrealistic.

As more data about Brands Initiative becomes available, one should revise valuation.

We tend to think that CHUB will build a very valuable business out of Brands Initiative.

Brands Initiative Valuation

- We are assuming $30M in losses over 2017 – 2019.
- This is despite current losses of less than $10M / year and management aspirational goals to get to breakeven or above in late 2018 or early 2019.

CommerceHub Brands Initiative Valuation, ths USD	
Brands Initiative Losses (notional, not discounted) before Shutdown	($30,000)
Value per Share, $	($0.63)

- We want to emphasize that we do NOT think that Brands Initiative has a negative value. We are using the negative value above as a thought experiment to show that CHUB is *still* a great investment despite this draconian approach.

CommerceHub Valuation: Putting It All Together

- We believe that 15%+ IRR is achievable through 2020.
- We also believe that 2020 will not be the end of CHUB story.
- Finally, we are assigning a small negative value per share to Brands Initiative while in reality we believe it would evolve into a successful, valuable business.

CommerceHub Valuation	
Dropshipping business value per share in 2020, $	$29.64
Brands Initiative value per share, $	($0.63)
CHUB Valuation	$29.01
	$17.00
Upside, %	70.6%
IRR (holding through 2020/12/31), %	16.2%

Risks

Key Risk: Overall Health of Retailers

- To thrive CHUB needs to be working in an environment where there are multiple retailers.
- Some CHUB's customers are weak (e.g., JCP, Sears).
- Other customers are strong (e.g., Home Depot, Costco).
- Note that we are not betting on brick-and-mortar retailers' revival. Not at all!
- We just need enough traditional retailers to stay in business.
- In fact, massive store closures would likely shift traditional retailers focus to e-commerce and dropshipping.
- Still overall health of retailers is the key risk.

Risk: Customer Concentration

- Two retail customers together with their suppliers accounted for more than 10% of CHUB's revenue each in 2016.
- The 3rd largest customer (most likely QVC) together with its suppliers accounts for ~7%
- Top 4 – 6 customers account for 5%+ each.
- At the very least top 6 customers account for 42% of revenue.
- ***Loss of any of them would be very detrimental***.

Note on Share Classes

Note on Share Classes

- There are two publicly traded classes of shares:
  - Class A shares (ticker: CHUBA)
    - Voting
  - Class C shares (ticker: CHUBK)
    - Non-voting
    - Usually trade at a small discount to CHUBA
- We prefer CHUBK as Dr. Malone has ~33% of voting power.

Questions and Further Inquiry

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Appendix

Note on Historical SBC and Why It Was Overstated (1)

- Until the spinoff transaction equity or equity-linked awards granted to CHUB's employees were **cash-settled** as opposed to share-settled.

- The difference is critical for all practical purposes. Let's use an example.

- In Year 1 a company grants RSUs to an employee that are worth $100. In Year 1 the company records $100 of SBC expense (we are assuming immediate vesting).

- The Company does very well in Year 2: sales are growing, customer count is rising, etc. The company grants RSUs worth $100 to the same employee in Year 2.

- However, the RSUs granted in Year 1 have increased in value due to the company's strong performance (that would be calculated by internal finance department). Let's say that they are now worth $140.

- Since RSUs are cash-settled, the company will record $100 of SBC expense due to new RSUs and $40 of "incremental" expense due to Year 1 RSUs increase in value => $140 of SBC in total.

Note on Historical SBC and Why It Was Overstated (2)

- Obviously, incremental $40 of SBC would not be viewed as a real economic expense if RSUs in question were share-settled.

- The same exercise would be repeated in Year 3 for both RSUs granted in Year 1 *and* RSUs granted in Year 2.

- The incremental "paper-only" SBC expense will keep accumulating over the years as long as the company performs well.

- This is exactly what happened with CHUB's SBC expense and this is exactly the reason why pre-spinoff SBC expense is grossly overstated.

Questions and Further Inquiry

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