Applied Investment Management (AIM) Program

AIM Class of 2019 Equity Fund Reports
Fall 2018

Date**: Friday, September 14th | **Time:** 2:15 P.M. | **Location: R.W. Baird Road Trip

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These student presentations are an important element of the applied learning experience in the AIM program. The students conduct fundamental equity research and present their recommendations in written and oral format – with the goal of adding their stock to the AIM Equity Fund. Your comments and advice add considerably to their educational experience and is greatly appreciated. Each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A.

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Quotient Technology Inc. (QUOT)
September 14, 2018

Matthew Tully — Domestic Technology

Quotient Technology Inc. (NYSE: QUOT) is a provider of an industry-leading digital marketing platform that drives sales by delivering targeted coupons and personalized ads to consumers using proprietary and licensed data. Quotient has built a network of consumer-packaged goods (CPG) companies, retailers, and shoppers that are all connected through their core platform, Retailer iQ. Quotient Technology's operations are broken down into two segments: Promotion (74%) and Media (26%). Within the Promotion segment, revenues are divided amongst digital print (21%), Retailer iQ (41%), and specialty retail (12%). Quotient Technology derives all of its revenue from the United States but has production offices off-shore. They have office locations in Los Angeles, Cincinnati, New York, London, Paris, and Bangalore, India. Quotient Technology Inc. was founded by Steven R. Boal in May 1998 and is headquartered in Mountain View, CA.

Price ($):	15.65
Price Target ($):	18.08
52WK H-L ($):	17.85 - 10.35
Market Cap (mil):	1,488
Insider Holdings	16.6%
Avg. Daily Vol (mil):	0.4
Yield (%):	0.0
ESG Rating	A

Beta:	1.46
M-Term Rev. Gr Rate Est:	27.0%
M-Term EPS Gr Rate Est:	15.0%
Debt/Equity:	38.7%
Debt/EBITDA (ttm):	11.3
WACC	10.6%
ROA:	-4.3%
ROE:	-4.2%
ROIC:	-5.2%

FY: Dec	FY 2017	FY 2018E	FY 2019E	FY 2020E
Revenue (Mil)	322.7	398.1	516.0	650.0
% Growth	17.3%	23.4%	29.6%	26.0%
Oper Inc	-14.52	-6.29	16.80	30.00
% Growth	26.4%	56.7%	306.1%	41.8%
Op Margin	-4.5%	-1.6%	3.3%	4.6%
EPS	-$0.16	-$0.17	$0.08	$0.21
EBITDA	9.9	19.7	46.8	66.0
Adj. EBITDA	47.6	59.3	82.8	106.0

Recommendation

Quotient Technology, formerly Coupons.com, completed its IPO in March of 2014 and has evolved into a leading marketing platform for CPGs and retailers. Quotient's clients consist of over 700 consumer packaged goods (CPG) companies including Procter and Gamble, Kellogg's, Clorox, Dr. Pepper Snapple, and General Mills and retail stores including Target, Walgreens, CVS Pharmacy, Jewel-Osco, and Kroger. Quotient's reach to clients is also extensive. There are currently over 70M shoppers (up from 40M at 2016FY end and up from 60M at 2017FY end) registered with programs that are powered by Retailer iQ and 20M average monthly visitors to the Coupons.com website (listed as a Nielsen top 100 web property). Since 2014, Quotient has reported a three-year sales CAGR of 13%. This growth is due to CPGs transitioning more of their $225 billion annual marketing spending towards digital channels instead of the offline channels used in the past. On their 2Q earnings call, management touched on moving away from the specialty promotions and digital print operations as they have seen sales decline consistently in past years. They want to direct their attention towards the Retailer iQ and media operations, which saw 57.2% and 34.5% YoY growth in 2017, respectively. As of 2Q2018 these two segments made up 72% of revenue and experienced a combined 40% YoY growth rate. To help expand the media operations, Quotient acquired Ahalogy in June 2018 for $20 million. Ahalogy is an influencer marketing firm that pulls data from ~5,000 premium content creators across the web. The influencer marketing industry is expected to reach $10 billion by 2020, up from ~$3 billion in 2017. With Retailer iQ continuing to add customers, CPGs shifting more marketing dollars towards digital promotions, and Quotient's shift of focus, it is recommended that Quotient Technology, Inc. be added to the AIM Equity Fund with a price target of $18.08, representing an upside of 15.5%.

Investment Thesis

- **Integrated Solution with New Media Focus.** Quotient Technology has completed the four phases they deemed necessary to complete prior to building their media platform. Currently Quotient can offer a broader suite of products and now they intend to capitalize on the retailer specific media market, which U.S. Brand Activation Marketing forecasts to be ~$20 billion in

2019. The integrated solution including promotion, media, and data is referred to as a "packaged campaign". The packaged campaigns are exclusive agreements with retailers for its shopper data, and in return Quotient can leverage that data to run CPG media campaigns on the retailer's website/mobile app and social media. QUOT currently has four packaged campaigns. Running the data, media campaigns, and promotions all on a single platform will generate a greater ROI for Quotient's clients.

- **Demand Greater Than Supply.** The consumer demand for digital coupons on the Quotient platform continues to exceed the supply of coupons. The total amount of transactions has grown at a 3-year CAGR of 29% and is expected to continue. This is due to the fact that CPGs are still spending the majority of promotion dollars through offline channels such as TV, mail, newspapers, free samples, etc. According to an industry report by NCH Marketing Services, in 2016 digital coupons represented less than 1% of total U.S. CPG coupon distribution volume, but accounted for almost 12% of total U.S. CPG coupon redemptions. As CPGs continue to increase spending on digital coupons, transactions on the Quotient platform will increase as well.
- **Retail E-Commerce Sales Trend.** Quotient has solved the harder problem of influencing consumers online to redeem coupons offline at the retailer. It will be much easier to influence buyers with promotions as retailer sales online continue to grow. According to the 2Q2018 U.S. Department of Commerce quarterly report, E-Commerce sales now make up 9.6% of total retail sales (15.2% YoY growth).

Valuation

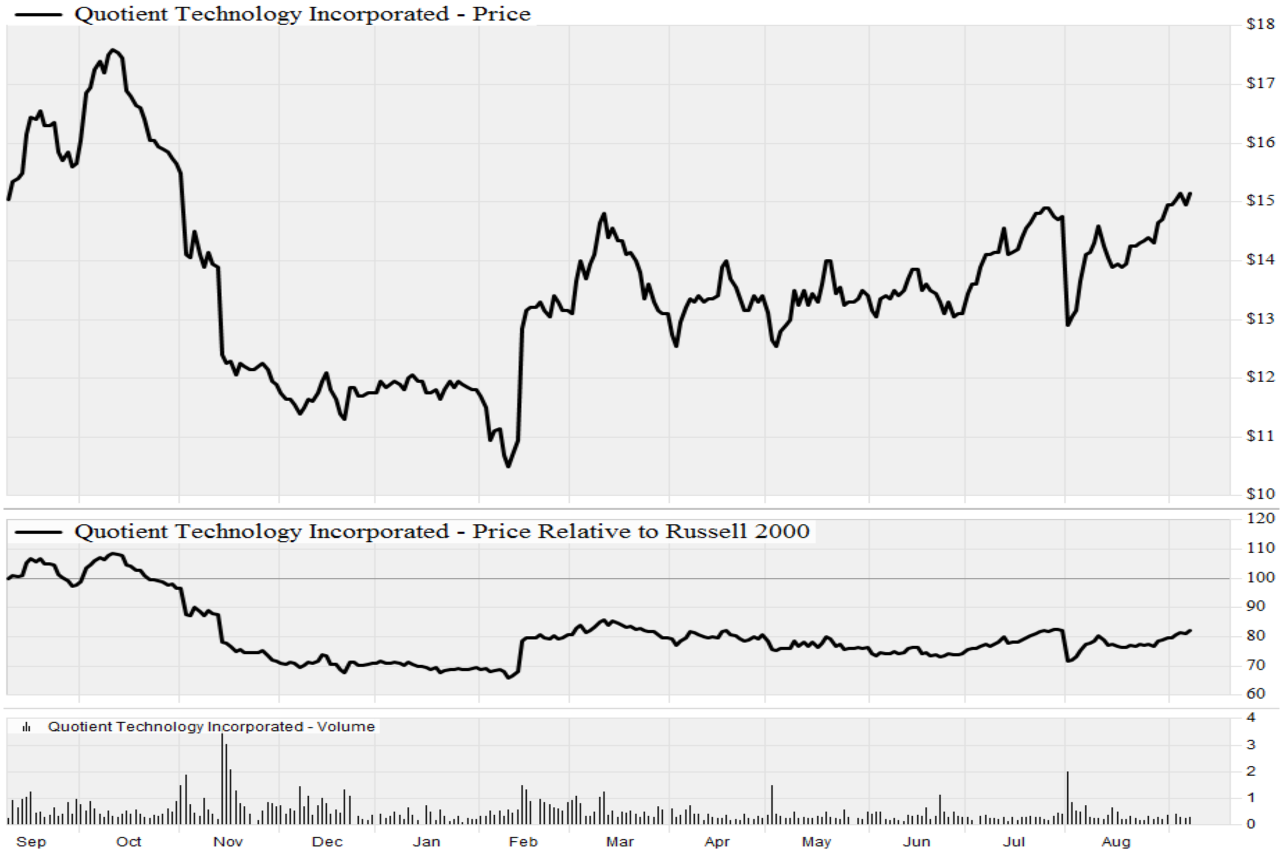
To reach an intrinsic value for Quotient Technology, a five year DCF model was constructed. Using the discounted cash flow model with a terminal growth rate of 2.00% and a WACC of 10.56%, an intrinsic value of $18.19 was reached. A sensitivity analysis with a terminal growth rate ± 0.5% and WACC ± 1.0% ranged from $15.83-21.54. Additionally, a P/S multiple valuation was calculated. Using a 2019E sales of $516 million and utilizing a peer average P/S mutplie of 3.43x, resulted in an intrinsic value of $18.60 Finally, an EV/EBITDA multiple valuation was conducted. Using a 2019E adjusted EBITDA of $82.8 million and a target EV/EBITDA multiple of 15.5x, an intrinsic value of $17.19 was reached. Weighing the three models 60/20/20 resulted in a price target of $18.08, representing a 15.5% potential upside. QUOT does not pay a dividend.

Risks

- **Dependence on Data-Rights Agreements.** Retailer iQ, Quotient Insights and QMX are powered in part by data that QUOT obtains from their partners. The data-rights agreements that govern QUOT's access to the data are extremely complex and must be renewed periodically. If QUOT is unable to renew these rights or violates any of the obligations under the agreements, they could lose access to retailer data, hence making Retailer iQ and Quotient Insights less valuable.
- **Competitive Threats.** Due to the size of the promotional market, new coupon distribution channels could emerge with superior technology to QUOT. This would force Quotient Technology to spend more in R&D which would hurt their operating margins.
- **Still Underwater.** Quotient Technology has incurred net losses since its inception and yet they are continuing to invest in their business. If they are unable to gain efficiencies soon and maintain profitability, the share price will decline.

Management

Mir Aamir joined Quotient Technology in 2013 and has served as the President and CEO since 2017. Prior to starting at Quotient, Mr. Aamir was the president of customer loyalty and digital technologies at Safeway, Inc. He also held a position as senior vice president focusing on marketing strategy, data & analytics, and pricing during his tenure at Safeway, Inc. Lastly, Mr. Aamir has also held various positions at Procter & Gamble and Citicorp in Asia.



Source: FactSet

Peer Valuation

Name	Ticker	Market Cap (mil)	P/S19E	P/CF	EV/EBITDA19E	P/B
Quotient Technology Inc	QUOT	1,488	2.9	36.8	24.3	3.8
Shutterstock, Inc.	SSTK	1,899	2.6	17.0	11.7	5.3
TrueCar, Inc.	TRUE	1,341	3.1	71.3	22.0	4.1
IAC/InterActiveCorp.	IAC	16,190	3.4	25.3	14.7	6.8
Boingo Wireless, Inc.	WIFI	1,410	4.6	15.8	13.0	13.2
Groupon, Inc.	GRPN	2,210	0.8*	9.9	5.7	8.1
Peer Averages		4,610	3.4	27.8	13.4	7.5

*Not Included in Relative Valuation

Source: Bloomberg

Peer Fundamentals

Name	Ticker	Revenues	ROE (%)	ROA (%)	Debt/Equity (%)	5 Yr Sales CAGR (%)
Quotient Technology Inc	QUOT	322.7	-4.2	-4.3	38.7	18.0
Shutterstock, Inc.	SSTK	557.1	5.6	3.1	0.0	22.5
TrueCar, Inc.	TRUE	323.2	-12.2	-9.4	9.3	23.0
IAC/InterActiveCorp.	IAC	3,307.2	14.2	5.8	82.0	5.8
Boingo Wireless, Inc.	WIFI	204.4	-19.8	-4.9	13.7	17.8
Groupon, Inc.	GRPN	2,843.9	6.2	0.9	93.3	0.3
Peer Averages		1,447.1	-1.2	-0.9	39.7	13.9

Source: Bloomberg

Innospec Inc. (IOSP)
September 14, 2018

Elizabeth Wolfe Domestic Materials

Innospec Inc. (NASDAQ: IOSP) is a leader in developing and manufacturing fuel additives, oilfield chemicals, personal care, and other specialty chemicals. They operate through four business segments: Fuel Specialties (40% of FY17 revenue), Performance Chemicals (32%), Oilfield Services (23%), and Octane Additives (5%). The Fuel Specialties segment focuses on improving fuel efficiency and reducing harmful emissions. Performance Chemicals aids in personal care products like hair and skin cleansing and sun care. Oilfield Services produces chemical solutions for fracking and oil production. Finally, Octane Additives is the world's only producer of tetraethyl led (TEL) for automotive gas. IOSP operates primarily in the UK (48% of revenues) and the US (40%) but also sells in 23 other countries around the world. IOSP was founded in 1998 and is headquartered in Englewood, CO.

Price ($):	76.10
Price Target ($):	102.75
52WK H-L ($):	83.2 - 54.1
Market Cap (mil):	1,878
Insider Holdings	1.65%
Short Interest	1.93%
Avg. Daily Vol (mil):	0.06
Yield (%):	1.14%
ESG Rating	BBB

Beta:	1.21
M-Term Rev. Gr Rate Est:	6.42%
M-Term EPS Gr Rate Est:	13.38%
Debt/Equity:	27.85%
Debt/EBITDA (ttm):	1.25x
WACC	10.56%
ROA (%):	4.58%
ROE (%):	8.21%
ROIC (%):	6.33%

FY: December	2017A	2018E	2019E	2020E
Revenue (Mil)	1,306.80	1,455.10	1,623.22	1,812.18
% Growth	47.93%	11.35%	11.55%	11.64%
Oper Inc	129.70	131.88	164.63	193.79
% Growth	18.74%	1.65%	19.89%	15.05%
Op Margin	9.93%	9.06%	10.14%	10.69%
EPS	$2.52	$3.83	$4.86	$5.75
P/E (Cal)	28.02x	20.08x	15.82x	13.37x
EV/EBITDA	9.86x	9.75x	8.02x	6.87x

Recommendation

Through its three core businesses IOSP has positioned itself to be a well-diversified, leading player in the specialty chemicals industry. These segments are backed with innovative technology and have grown at a five-year CAGR of 9.8% from FY13-17. Their innovation is what has set the firm apart from competitors in the highly fragmented, niche markets they serve. Historically, the company has put an emphasis on R&D which was visible through their 19.11% YoY growth in FY17. This R&D spending went towards developing new solutions, such as Iselux and Statsafe, two of their leading products. With products like these, IOSP has been able to secure ~10% of the market share in each of their core businesses. The cadence of innovation and expansion carries through to IOSP's M&A activity as well. Following the fall of oil prices in 2014, Innospec sought out and acquired Independence Oilfield Chemicals to expand their Oilfield segment. Due to their fortunate timing, IOSP was able to complete this acquisition for only $100M. Within the first year of purchase this investment broke even and now provides 23% of IOSP's annual revenue. A paradigm shift is underway in the oilfield business as an environmentally conscious mindset is applied to traditional drilling and Innospec is poised to continue its growth in this blossoming market. That said, management has its eye on not only expansion within oilfields, but across all of their core segments as secular tailwinds remain intact. The Performance Chemicals and Fuel Specialties are expected to track in the GDP +1-2% growth range organically. With a history of innovative products as well as skilled management backing the company, it is recommended that Innospec Inc. be added to the AIM Equity Fund with a price target of $101.77, which represents a 33.74% upside.

Investment Thesis

- **Expansion Initiatives.** IOSP's management has stated a number of global initiatives that will be implemented in the coming years. The first of these, expected to roll out in mid-2019, are Drag Reducing Agents (DRA). These are additives that go into the pipeline to reduce bottlenecking. Globally, the DRA TAM is ~$500M and is expected to grow 8% annually. Innospec already has relationships in place with a number of pipeline companies that will allow them to seamlessly enter this new market. Also, IOSP recently started construction on a new plant in Texas to focus on the production of DRAs allowing the firm to transition quickly into this growing market.

Another initiative in place is related to the International Maritime Organization's (IMO) 2020 plan. The IMO is the UN's body responsible for the safety and environmental impact of the shipping sector. Their 2020 plan states that there will be a global sulfur cap of 0.5% on marine fuels, reduced from 3.5%, by 2020. Fortunately for IOSP their products specialize in sulfur reduction in fuel which positions them to benefit from these new regulations. The initiatives stand to accelerate IOSP's organic growth profile over the long-term.

- **The Turn Towards Clean.** Society has shifted their views to focus on "clean" and "chemical free" products. This change in customer preference has served as a driver for IOSP, carrying through to products like shampoo and gasoline. The solutions in their Performance Chemicals segment allow various products like shampoo to function normally without harsh chemicals. Additionally, Fuel Specialties serve a similar role in reducing emissions in a wide range of fuels. This shift towards "cleaner technologies" has made its way into emerging markets like China and India, offering a larger global TAM for IOSP. This movement is expected to not only continue worldwide but also grow and adapt; IOSP is well positioned to benefit from these changes.
- **Increasing E&P Investments.** According to the World Oil Outlook, on an annual basis upsteam investments into E&P is estimated at $328B. This market shows a favorable long-term macro environment as over 100 oil rigs have been added domestically since September 2017. IOSP products will benefit from this, creating a tailwind for the company until 2025 when US oil is expected to peak. IOSP has a strong precense in the Permian as well as the Anadarko. Their products reduce the loss of mud when drilling and improve the quality of the oil. Over the mid-term, IOSP will benefit from the recent increased capital investments into E&P.

Valuation

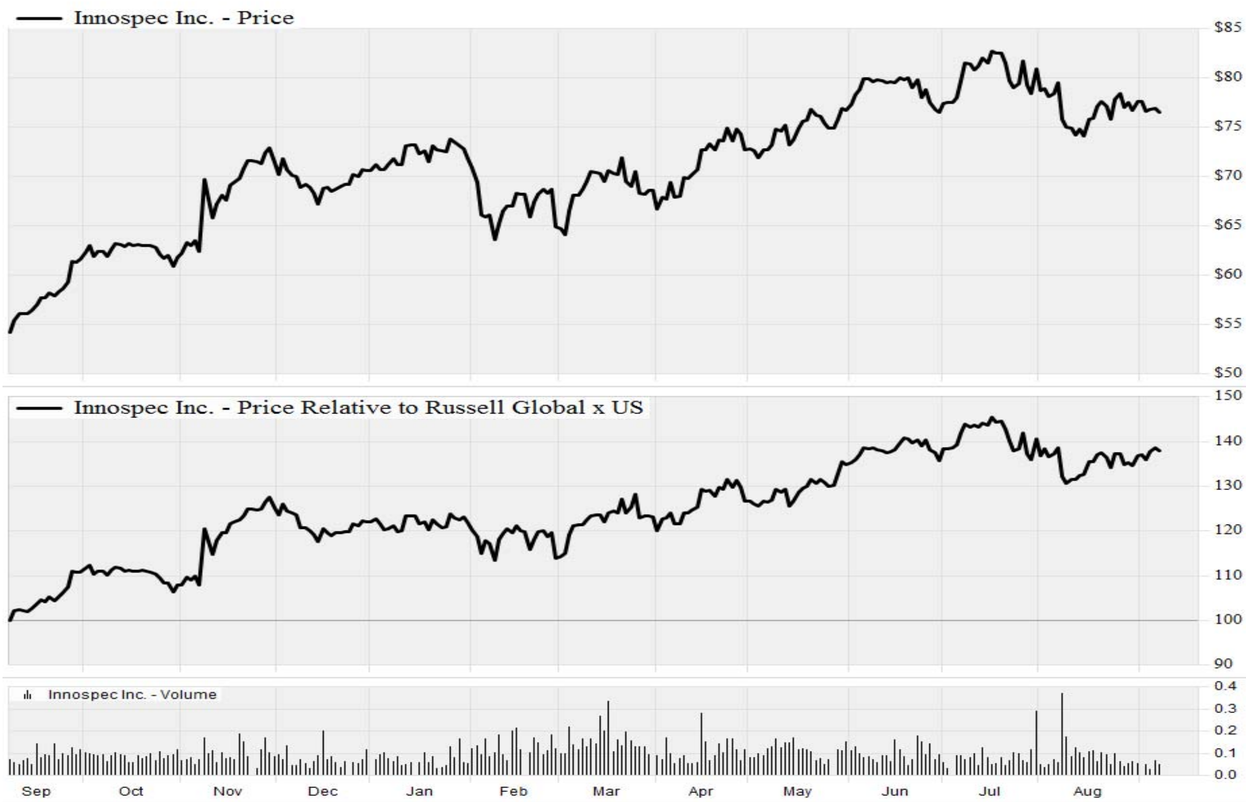
In order to reach an intrinsic value for Innospec Inc., a five year DCF model was constructed. Using a terminal growth rate of 2.0% and a WACC of 10.56%, an intrinsic value of $103.22 was reached. Next, a P/E multiple valuation was created using a peer average of 25.54x and a 2018 EPS of $3.83. An intrinsic value of $97.90 was reached. Additionally, an EV/EBITDA multiple valuation was calculated. A peer average EV/EBITDA multiple of 13.64x was used, resulting in an intrinsic value of $106.18. By weighting the three models 60/20/20, a price target of $102.75 was reached resulting in a 35.02% potential upside. IOSP currently pays out a yearly dividend in excess of 1%.

Risks

- **Environmental Regulations.** IOSP's operations could be negatively impacted by environmental regulations that govern the global chemical industry. REACH is an example of a regulator; this organization oversees the products manufactured and marketed in Europe. Regulations put in place by REACH mandate all companies submit documents containing detailed information on their chemical products and the potential impact these could have on the environment.
- **Raw Material Exposure.** Price fluctuations and the supply of raw materials could affect the product costs and operations of IOSP. Innospec uses a number of raw materials, like ethylene and cetane improvers in its manufacturing and blending processes.
- **Fluctuating Oil Prices.** A large portion of IOSP's revenue is tied to oil and natural gas prices, though changes in price are out of Innospec's control. For example, shifts in supply and demand for oil, weather conditions, and political unrest among others can contribute to fluctuations.

Management

Patrick Williams has been President and CEO of Innospec Inc. since 2009 and has been with the company since 2005. Prior to this, he worked at Starreon Corp. whose main customers were diesel companies. Ian Cleminson is the CFO of IOSP. He has been in this role since 2006 and has worked at Innospec since 2002. He was previously employed at BASF PLC, a specialty chemicals manufacturer. The average tenure of executive members at IOSP is 8 years.



Peer Fundamentals

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	LTM EBITDA Margin
Innospec Inc.	IOSP	1,306.8	8.54	4.77	28.25	12.60
KMG Chemicals, Inc.	KMG	333.4	14.91	4.59	302.95	24.80
NewMarket Corp.	NEU	2,198.4	35.05	12.16	100.21	16.00
Cabot Corp.	CBT	2,717.0	17.00	7.50	61.30	17.10
Stepan Company	SCL	1,925.0	13.32	6.48	39.29	11.60
Peer Averages		1,793.5	20.07	7.68	125.94	17.38

Source: Bloomberg

Peer Valuation

Name	Ticker	Market Cap (mil)	P/S	P/E	EV/EBITDA	P/B
Innospec Inc.	IOSP	1,878	1.35	17.82	11.47	2.29
KMG Chemicals, Inc.	KMG	1,192	2.78	39.80	14.22	2.99
NewMarket Corp.	NEU	4,529	2.01	16.41	17.38	8.21
Cabot Corp.	CBT	3,940	1.28	23.69	14.13	3.40
Stepan Company	SCL	1,979	1.03	22.26	8.82	2.60
		2,910	1.78	25.54	13.64	4.30

Source: Bloomberg

PetIQ, Inc.

September 14, 2018

Jack Senft | Domestic Healthcare

PetIQ, Inc. (NASDAQ: PETQ) develops, manufactures and distributes pet medications for dogs and cats in the United States, Canada and Europe. The company produces medicines to help treat arthritis, thyroid, diabetes, pain treatments, heartworm preventatives and antibiotics. Also offering over-the-counter supplies, such as flea and tick control products, which comes in the form of medicated dog treats, spot on treatments, and collars. In addition, PetIQ offers health and wellness products, typically dog treats for dental and nutritional supplements. The company is composed of the following subsidiaries: VetIQ, PetAction Plus, Advecta PetLock Plus, and TruProfen. Operating in retail stores such as WalMart and Target, the company has about 40,000 retail pharmacy locations. PetIQ was founded in 2010 and has headquarters in Eagle, Idaho.

Price ($):	$39.10
Price Target ($):	$48.00
52WK H-L ($):	$17.03 - $41.89
Market Cap (mil):	1,002.00
Insider Holdings	0.87%
Avg. Daily Vol (mil):	643,526.6
Yield (%):	0.0
ESG Rating	-
Short Interest	7.30%

Beta:	0.59
M-Term Rev. Gr Rate Est:	13.4%
M-Term EPS Gr Rate Est:	17.1%
Debt/Equity:	26.3
Debt/EBITDA (ttm):	6.52
WACC	6.27%
ROA (%):	-3.14
ROE (%):	-6.49
ROIC (%):	-7.95

FY: Dec	2017A	2018E	2019E	2020E
Revenue (Mil)	266,687	490,091	560,902	640,537
% Growth	33.24	83.77	14.45	14.20
Oper Inc	13289	25802	36767	44236
% Growth	1793.02	94.16	42.49	20.32
Op Margin	4.98	5.26	6.55	6.91
EPS*	($0.26)	$1.49	$2.16	$2.62
P/E (Cal)	-	26.3	18.1	14.9
EV/EBITDA	32.5	22.9	18.7	13.4

A Husky Recommendation

PetIQ is a leading provider of products and services to the retail pet channel, that was only previously available from vet clinics. Since 2011, PETQ has seen a net sales CAGR of about 54%, while the pet medicine market has seen a growth CAGR of only about 7% during that same time period. This growth has been driven by the company being one of the few national ventrinary clinic operators, as well as offering pet owners a choice with affordability and convenience. The company is well-positioned to capitalize on the secular changes in consumer purchasing of pet-related items. Within the past year, PETQ has successfully launched Advecta and Petlock, which are flea and tick preventatives for cats and dogs. The company has also began to sell their MINTIES treats in Target, which has gained solid traction and shows initiative towards product inovation. Management believes that there is a $39.4 billion total addressable market, composed of $20.8 billion in vet services and $8.6 billion of vet products. This market is potetially underserved by ~$10 billion, providing an opportunity for PetIQ. The company is planning on opening more than 1,000 pet wellness centers by 2023, where ~75% of the forecasted EBITDA is expected to be genereated. The overall pet market it is expected to be $105 billion by 2022, representing a 4% CAGR. One of the largest catalysts for the pet market is the idea of humanizing animals, largly driven by millennials. Looking on the longer-term horizon, PetIQ is looking to implement their "Follow the Pets" strategic plan, which is the idea of building out veterinary service networks to help reach a total sales goal of $1 billion and EBITDA margin of ~15% by 2023. All in all, PETQ is in a great position with double digit growth, equating to substantial returns and it is recommedned that it should be added to the AIM Equity Fund with a potential 23% upside.

Fetching a Thesis

- **Ruffing up the E-commerce Industry.** E-commerce is a fast-growing industry and PetIQ is increasing their exposure in this area. In 2011, the company only had ~7% market share for e-commerce, but reported a ~5% increase in 2017, resulting in a ~12% market share. Their share is anticipated to increase since PETQ partnered with Chewy.com in July 2018 to help with the growth of their pet prescription products. With these products representing the highest growth segment of the business, their inventories are slowly coming back to a normalized level in 2Q after a slower than expected 1Q. This push towards increasing the inventory levels comes from their drive to increase e-commerce sales.

- **Buddy's Bills Are Getting Cheaper.** Like a normal medical bill, medication and treatments for pets can also be expensive. In April 2018, the Fairness to Pet Owners Act was proposed, which is a bill that will make pet medications more affordable for pet owners. This legislation allows pet owners to have a choice on when and where to fill and pay for their pet's prescriptions, similar to what individuals do with a pharmacy. This bill puts PETQ in a great position as their business focuses more on retail sales. It is estimated that if even 5% of the market shifts from vet to retail sales, PetIQ will likely be able to capture the majority of that shift.
- **Wagging for Wellness Clinics.** With about 2,900 clinic locations and 29 regional offices, PETQ is looking to expand their wellness clinic platform by about 30%, adding another 1,000 wellness clinics by 2023. The company reported that over 1 million pets were treated in 2017, however this number is growing at a CAGR of ~35%. Management is predicting that this number will grow to about 6 million pets by 2023. As each location opens, management is estimating that each store generates $640k in revenue in 13-18 months. Expecting a completion date in 2023, over 20 locations have already opened between March and June 2018.

A Hounding Valuation

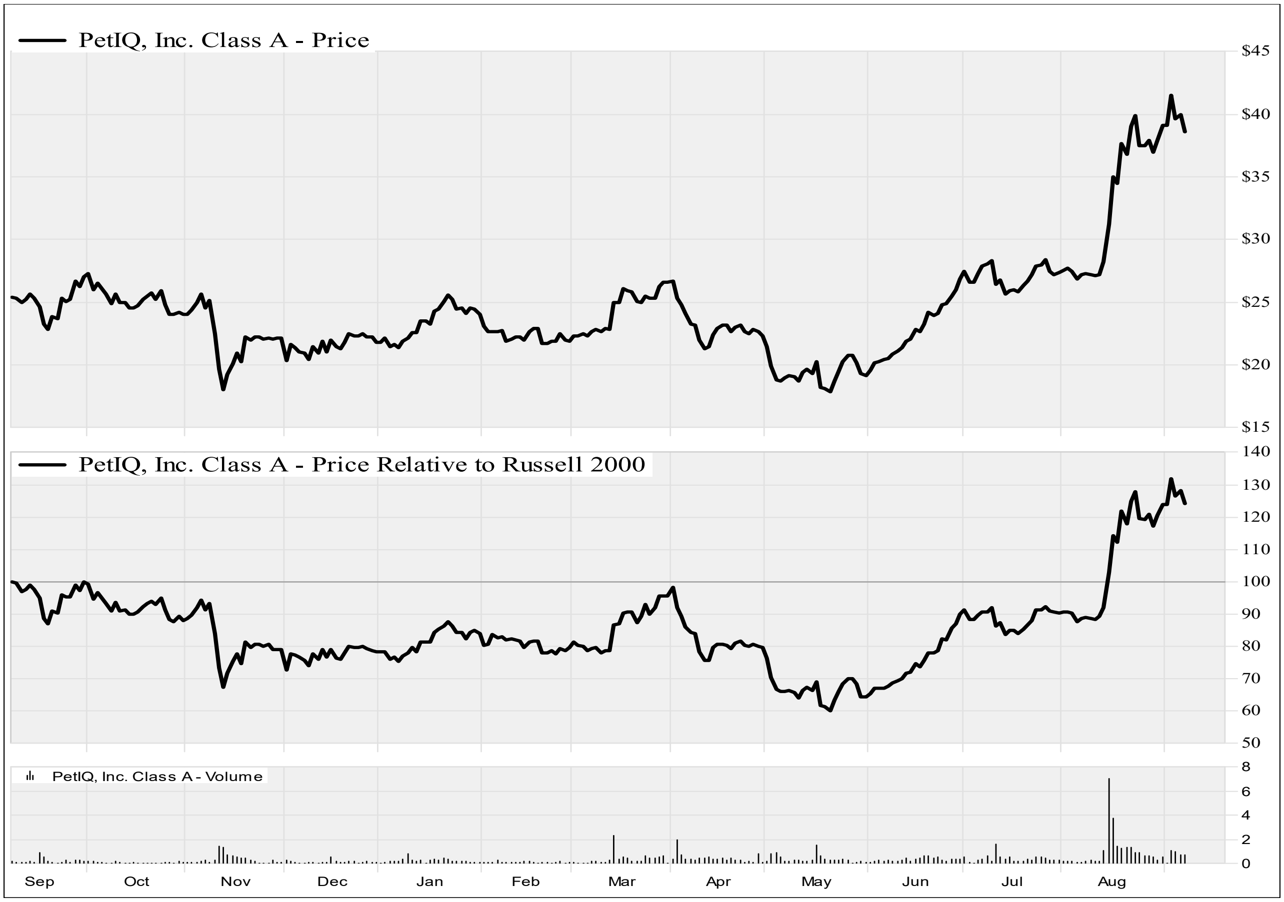
In order to reach an intrinsic value for PETQ, a five year DCF model was constructed. Using a terminal growth rate of 1.00% and a WACC of 6.27%, a price target of $48.29 was reached. A sensitivity analysis was calculated from the terminal growth rate and WACC, ranging from $40.32 - $53.12. Additionally, a P/E multiple valuation was calculated. Using the 2019E EPS and a peer average P/E mutplie of 35.01x, price target of $48.88 was calculated. With that, an EV/EBITDA multiple valuation was conducted using an average peer EV/EBITDA multiple of 26.61x, resulting in price target of $42.97. Lastly, a P/S multiple valuation was conducted with a peer multiple of 2.58x, a price target of $50.14 was reached. By weighing the four models 70/10/10/10, a price target of $48.00 was reached, resulting in a 22.76% potential upside. PETQ does not pay a dividend.

Risks – All Bark, No Bite

- **A Limited Number of Customers Account for Most Sales.** As with many suppliers, Walmart and Sam's Club accounted for ~30% and ~16% of PETQ's net sales in 2017. With that, their top three customers accounted for ~60% of sales in 2017. The company is mitigating this risk by diversifying their customers, where management is estimating that their top three customers will account for only ~45% of sales.
- **The Cone of Shame.** The company has incurred net losses in the past and it is possible that they may not be able to sustain profitability in the future. As PETQ competes with veterinarians, especially with the VIP Acquisition, the company may now have to incur addition costs such as marketing, promotions and other incentives to help keep up with the changing environment.
- **Pawing up Capitol Hill.** The Fairness to Pet Owners Act is looking to be approved in the future, but if the bill is vetoed, then this could pose a risk to the profitability of the business. The company is also under the regulation of the FDA, EPA, and the US Department of Agriculture. Failure to comply with any of these regulations could significantly hurt the company.

The Masters

McCord Christensen is the CEO and helped to cofound PetIQ in 2010 and was names as a Chairman of the board of directors in 2015. John Newland is the CFO and Corporate Secretary. Mr. Newland has served as the CFO since 2014. Will Santana is the Executive VP and has served as a director since the acquisition of Community Veterinary Clinics in 2018. Mr. Santana previously served as the CEO of VIP since 1997.



Source: FactSet

Peer Fundamentals

Name	Ticker	Revenues (ttm) (mil)	ROE	ROA	Debt/Equity	Est 5-yr NI Growth
PetIQ, Inc.	PETQ	267	-6.49	-3.14	26.3	
Central Garden & Pet Company	CENT	2,204	13.26	6.26	62.18	
Freshpet Inc.	FRPT	173	-3.79	-3.27	0.00	
PetMed Express	PETS	282	35.66	30.11	-67.34	
Nestle	NESN	91,227	11.39	5.48	30.09	
J.M. Smucker	SJM	7,511	18.07	8.51	59.41	
Heska Corporation	HSKA	127	5.87	4.59	0.00	
	Peer Averages	886	14.92	9.4	-1.7	--

Source: FactSet

Peer Valuation

Name	Ticker	Market Cap (mil)	P/S	EV/ EBITDA	EV/Sales (NTM)	PE
PetIQ, Inc.	PETQ	1,017	1.08	32.48	1.15	28.06
Central Garden & Pet Company	CENT	2,170	0.98	11.78	1.15	19.50
Freshpet Inc.	FRPT	1,340	4.18	68.48	4.24	-
PetMed Express	PETS	724	3.12	14.41	2.86	22.14
Nestle	NESN	244,900	2.89	15.30	3.06	36.12
J.M. Smucker	SJM	12,429	1.75	11.36	2.39	34.41
Heska Corporation	HSKA	764	6.41	38.34	4.41	62.89
	Peer Averages	52,313	3.22	26.61	3.02	35.01

Source: FactSet

iQIYI, Inc. (IQ)

September 14, 2018

Gregory Glaab — International Information Technology

iQIYI, Inc. (NASDAQ: IQ) engages in the provision of internet video streaming services of professionally produced and partner-generated content, as well as their own original productions. IQ is the largest online video streaming service provider in China with over 465Mil monthly active users (MAU) and 112Mil daily active users (DAU) on mobile and PC. The company operates out of four major business segments: online advertising (47% of FY 2017 revenue), membership services (38%), content distribution (7%), and other (8%). The company also operates a smart television streaming service, online books service, on-demand movie theatre experience and an entertainment-based social media platform called iQIYI Paopao. The company was founded by Yu Gong in November 2009 and is headquartered in Haidan District, China.

Price ($):	26.73	Beta (Cal)	1.22	FY: Dec (USD)	12/31/2016	12/31/2017	12/31/2018	12/31/2019
Price Target ($):	35.65	M-Term Rev. Gr Rate Est:	35.9%	Revenue (Mil)	1,691.47	2,571.44	3,577.65	4,958.48
52WK H-L ($):	46.23 - 15.3	M-Term EPS Gr Rate Est:	--	% Growth	99.9%	52.0%	39.1%	38.6%
Market Cap (mil):	19,108	Debt/Equity:	3.9%	Oper Inc	(419.88)	(584.92)	(808.74)	(696.05)
Insider Holdings	--	Debt/EBITDA:	9.3%	% Growth	8.7%	-39.3%	-38.3%	13.9%
Avg. Daily Vol (mil):	24.5	WACC (Cal)	13.8%	Op Margin	-24.8%	-22.7%	-22.6%	-14.0%
Yield (%):	0.0	ROA (%) (Cal):	-18.9	EPS*	(1.65)	(0.75)	(1.17)	(0.99)
ESG Rating	N/A	ROE (%) (Cal):	-15.7	P/S (Cal)	11.1	7.3	5.3	3.8
		ROIC (%) (Cal):	-15.5	P/FCF (Cal)	53.9	42.6	30.8	15.0

Recommendation

IQ completed their IPO in March 2018, spinning off of their parent company Baidu, Inc. (BIDU). In the two quarters since going public, the company has seen revenue grow 48.5% and 42.4% YoY due to MAU and premium membership growth. Since 2015, the company has added 108Mil MAU's and 54Mil DAU's. The company's premium membership service, grew 66% YoY in Q2, adding 6Mil new premium members within the quarter, increasing total paying members to 67Mil. The membership fee is $4.99 USD per month, giving the consumer exclusive content including, early access to shows, unlimited views of episodes, voting rights on talent shows, and reduced ads. Their release format for content, "freemium to premium", has been effective in enticing free customer to become paying members. According to guidance from company executives, IQ will continue to create their own content and not rely solely on other producers. Currently only 10% of the company's content is original; however, management has stated, their goal is to be between 30-40% within the next three years. This will play a key role in their overall projections of becoming profitable by 2021. In the Chinese video streaming sector, exclusive original content will be crucial for growth given that on average, paying royalties for content can cost twice as much as producing shows. Their two main competitors Tencent Video and Youku, rely heavily on outside sources and have not been proactive in producing original content. IQ is planning on investing a quarter ($625Mil USD) of their IPO cash on their own content. The company has shown they can produce quality content and compete with major producers by outperforming them in various awards. As for the content they do not produce, IQ has collaborated with foreign and domestic producers to obtain exclusive content at a fraction of the cost. For these reasons, it is recommended that iQIYI, Inc. be added to the AIM International Equity Fund with a target price of $35.65, an upside of 33.37%.

Investment Thesis

- **Conversion of Freeloaders to Premium.** Once experiencing the free subscription, consumers have shown they are willing to pay for the added benefits of the premium membership. In 2015, paid subscribers accounted for 3% of MAU's and 18.7% of total revenue. Estimates for 2018 indicate that paying subscribers will account for 17% of MAU's and 45% of total revenue. According to these estimates and management guidance, this equates to a CAGR of 42.45%, totaling 210Mil premium members, which will account for 32.5% of total MAU's by 2021. IQ has also seen the average time spent per MAU increase from 0.46 hrs per day in 2015 to an estimated 0.79 hrs in 2018.

- **Competitive Advantage in Content.** IQ continues to produce and obtain popular drama shows at a lower cost compared to their main competitor. IQ has seen a CAGR of 9.6% in new drama shows since 2015 while Tencent Video has a CAGR of -15.8%. In 2017 IQ spent $12.6Bil on content while Tencent Video spent over $13Bil. The company also has exclusive partnerships with foreign video streaming services such as Netflix (NFLX) and Nickelodeon where they exchange their original content instead of paying full copyrights royalties. Chinese millenials are the first generation in the country to have access to western content at a young age and have made NFLX series such as Stranger Things and Black Mirror gain popularity.
- **Increased Ad Sales per MAU.** IQ has seen their main revenue source continue to expand through brand partnerships and "in-feed" advertising, increasing the value of their non-paying users. iResearch estimates Chinese online video advertising spend to increase 20% in 2019. In 2016 and 2017 monthly online ad sales per non-paying MAU were $2.27 and $3.26, justifying the recent increase in monthly premium membership from $3.00 to $4.99. According to analyst estimates, monthly ad sales per free users will be $6.11 by 2020 and $6.90 in 2021. With this increase in ad sales per free users, IQ will have the flexibility to increase their premium membership fees in the coming years.

Valuation

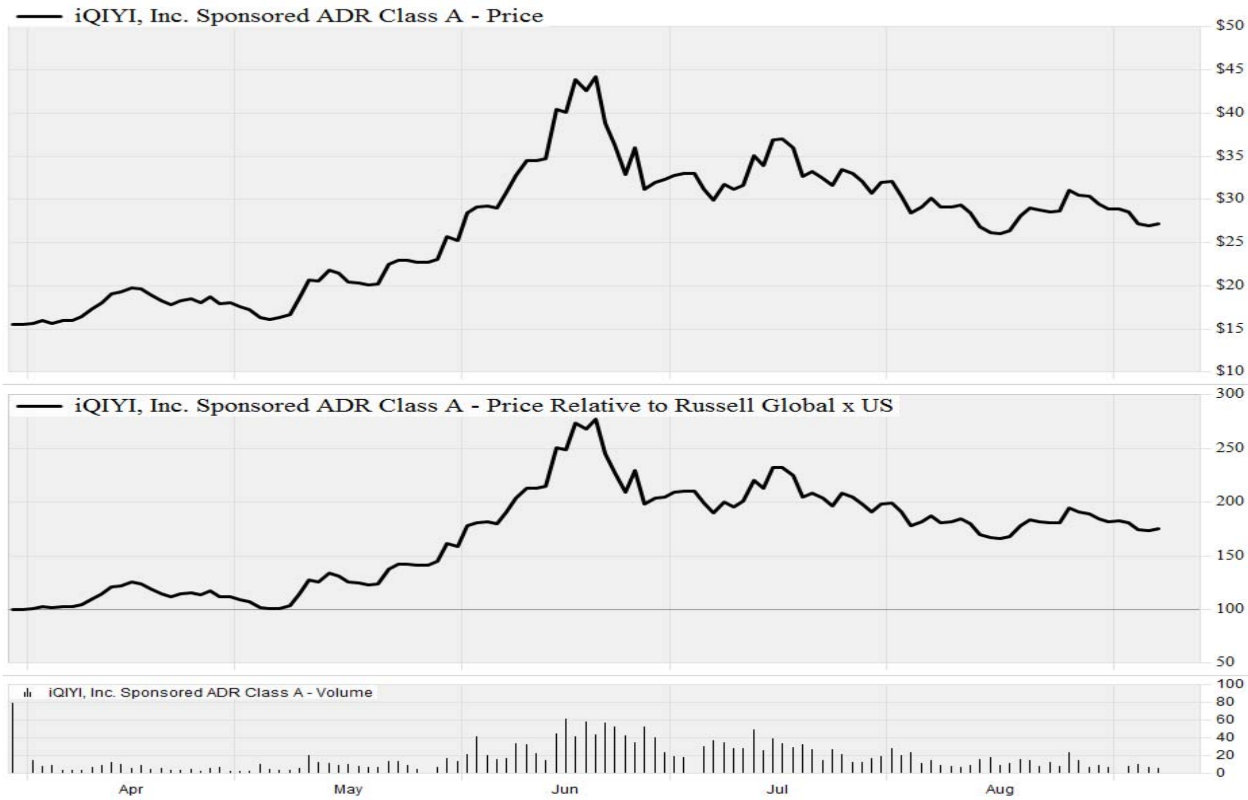
To reach an intrinsic value for IQ, a 5-year DCF was constructed with a WACC of 13.81%. Using a terminal growth rate of 2.25%, an intrinsic value of $33.41 was achieved. Additionally a peer average P/S mutliple was employed. Using 2018FYE of $24Bil RMB and LTM peer multiple of 7.68x, an intrinsic value of $39.01 was reached. Weighting each valuation 60/40, an intrinsic value of $35.65 was achieved, representing an upside of 33.37%. A narrow valuation model was used because other metrics had too aggressive upsides. The company currenlty does not pay a dividend.

Risks

- **Misgauged ROIC on Original Projects.** As we have seen with NFLX and other video streaming service companies, production costs can easily increase, deteriorating the ROIC of a project. Even though IQ has a healthy track record of assessing project budgets with shows like Rap of China, Mystic Nine, and Idol Producer, it is a risk that will continue to linger as IQ generates more original content.
- **Volatility.** Being a young security along with constant trade war threats between Trump and China, IQ has been volatile throughout the summer. IQ had substantial price swings usually without news or events pertaining to the company. IT has also been one of the most volatile sectors in the market this year. As the market continues to receive more information from management and the stock matures, volatility should subside in the coming months.
- **Unproven Management.** Majority of the company's BOD held executive positions at BIDU prior to their IPO. BIDU has a checkered past, mainly with censorship allegations of their main search engine. If IQ does not deviate from their parent company's tendencies, it could negatively impact investor outlook.

Management

Yu Gong is the founder and current CEO of IQ. He has been the head of five other companies and held multiple executive roles within BIDU. Xiao Dong Wang has been the CFO of IQ for 5 years. Prior to that he was CFO of BIDU. Over the summer the company brought on 2 new independent board members, Jane Jie Sun, CPA and Han Hui Sun, CPA. Jane is still the CEO of Ctrip.com and Han is the current Chief Financial and Principal Accounting Officer at Beijing Qunar Software Technology Co.



Peer Valuation

Name	Ticker	Market Cap (USD Mil)	P/S LTM	P/E	EV/EBITDA	LTM P/B*
iQIYI, Inc. Sponsored ADR Class A	IQ	19,221	7.07	--	14.03	6.48
Netflix, Inc.	NFLX	151,836	12.74	262.70	21.58	23.23
Spotify Technology SA	SPOT	31,965	5.65	--	--	27.06
Bilibili, Inc. Sponsored ADR Class Z	BILI	3,335	7.38	--	--	4.34
Roku, Inc. Class A	ROKU	6,920	8.55	--	5,389.89	33.72
Amazon.com, Inc.	AMZN	952,105	4.08	214.30	41.57	20.43
Peer Averages		229,232	7.68	238.50	1,817.68	21.75

Source: Factset

Peer Fundamentals

Name	Ticker	Revenues (USD)	ROE	ROA	Debt/Equity	Est 5 yr NI growth
iQIYI, Inc. Sponsored ADR Class A	IQ	3,219	-15.68	-18.88	0.04	--
Netflix, Inc.	NFLX	13,879	0.18	3.43	182.27	44%
Spotify Technology SA	SPOT	5,334	-85.33	-46.86	0.00	--
Bilibili, Inc. Sponsored ADR Class Z	BILI	520	-0.10	-6.43	0.00	--
Roku, Inc. Class A	ROKU	606	-0.74	-23.05	0.00	--
Amazon.com, Inc.	AMZN	208,125	0.13	2.79	159.32	74%
Peer Averages		45,693	-0.13	-14.02	68.32	59%

Source: Factset