

Groupon

GRPN:NasdaqGS

Analyst: Skyler Scavone

Sector: Technology

BUY

Price Target: \$10.17

Key Statistics as of 4/2/2015

Market Price:	\$7.02
Industry:	Internet Information Providers
Market Cap:	\$4.770 B
52-Week Range:	\$5.18-8.43
Beta:	1.29

Thesis Points:

- TicketMonster sale creating value which could lead to a buyback or special dividend
- Strong market prospects and shift from push to pull strategy leading to revenue and margin growth
- Superior growth in comparison to peers suggesting undervaluation

Company Description:

Groupon, Inc. operates online local commerce marketplaces that connect vendors to consumers by offering goods and services at a discount around the globe. It also, in some cases, offers deals in which it acts as the merchant on record. The company offers deals in vast varies including food and drink, events and activities, beauty and spa, health and fitness, home and garden, and automotive; product lines containing electronics, sporting goods, jewelry, toys, household items, and apparel mustn't be forgotten; feature items available include hotels, airfare, and package deals; and tools, such as payments and credit card payment processing service, as well as point-of-sale solutions to merchants. Deals are sold through mobile applications and mobile browsers that enable consumers to browse, purchase, manage, and redeems deals on their mobile devices; Websites; emails that are scoped by location, purchase history, and personal preferences; and search engines among others. In 2008, the company changed its name from ThePoint.com, Inc. to Groupon, Inc. and is headquartered in Chicago, Illinois.



Thesis

Groupon, Inc is a leading company in the discount market place that has shown rapid growth since its inception, despite a lack of shareholder returns (fallen over 60% since IPO). With the tricky nature of its business profits have eluded Groupon in the first few years, but strong diversification categorically and geographically with top line growth has the company projecting its first year of profits. With the shift to a more reliable, long term strategy of “pulling” customers Groupon has seen some headwind resulting in the market capitalization to deteriorate over 30% in the past year. With the bright prospects of the TicketMaster acquisition, the complete fruition of the “pull” strategy, and improving financials in comparison to peers, GRPN is a BUY at \$7.02 with a price target of \$10.17 (+44%).

Management Team

Upon quickly perusing the Groupon team it becomes apparent how the firm has sustained such growth in recent years. Much of the well qualified management team has migrated from internet giants such as Google and Amazon, a feat that should instill confidence in potential Groupon investors. An overview:

Eric Lefkofsky (CEO, co-founder): also a co-founder of EchoHoldings (\$ECHO 620M), InnerWorkings Inc. (\$INWK, 360M). Lawyer, author, adjunct professor at Booth. Net worth \$1.5B net worth, turned down Google buyout: committed

Rich Williams (President): Overseen some of the largest online marketing programs in the world, including analytics and technology. Immediately prior to Groupon, he ran Worldwide Marketing and Advertising at Amazon. Prior to that he spent 7 years developing marketing programs and technologies at Experian

Jason Harinstein (SVP of Corporate Development): Prior to Groupon worked in Corporate Development at Google, led the DoubleClick acquisition (\$3.1B), MBA from Booth.

Jason Child (CFO): held a number of senior positions at Amazon.com including CFO and VP of Finance, International. C.P.A.

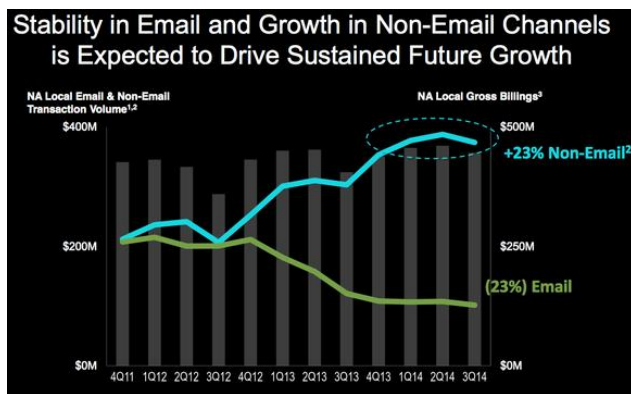
TicketMonster Prospects

On January 2, 2014, Groupon acquired LivingSocial Korea, Inc. a Korean corporation and holding company of Ticket Monster Inc., for total consideration of \$259.4 million, consisting of \$96.5 million cash and 13,825,283 shares of Class A common stock with an acquisition date fair value of \$162.9 million. CEO Lefkofsky suggested in October that the company was considering selling a stake in Ticket Monster. For Ticket Monster, South Korea’s second-largest mobile commerce company to Coupang, a stake sale would give it a much-needed infusion of cash to scale up its operations and marketing in efforts to better compete. Rapidly growing [TicketMonster is supposedly being valued at \\$1B](#), certainly not reflected in the current price of Groupon which is lower than when these talks began at the end of the 2014 calendar year. It should be noted that Coupang secured \$300 million of fresh capital late last year from investors, including asset manager BlackRock Inc. in a deal that valued Coupang, at about \$2 billion. However, Coupang is only the slightly bigger company, [recording \\$1.8 billion in gross merchandise value in 2014, compared with Ticket Monster’s \\$1.6 billion](#) over the same period. A positive for Groupon who only spent \$260m in the purchase.

Let’s take a look at the prospects of TicketMonster without the stake sell scenario. The ecommerce market in South Korea is one of great promise. The country is the most connected in the world with nearly 80% of the country’s 49m population online, and more than 75% of all people having smart phones with 98% of 18-24 year olds. Overall “mobile penetration rate” is greater than 100%, implying more than one connection per person. South Koreans have the fastest Internet speed in the world, with an average connection rate of 13.3mbps, making ecommerce sales here easier and faster than ever. Each of these factors contributes to the rapid recent growth of TicketMonster from 0 revenues to \$24m in the past 4 years and a break-even performance last year according to adjusted EBITDA (excluding SBCs and depreciation). Regardless of if the buyout happens, TicketMonster is still a strong component for the Groupon arsenal and is not reflected in a share price that is lower than before the acquisition.

Change to “pull” strategy

Upon inception Groupon relied on a strategy known as “push” marketing where sales are generated through massive amounts of emails sent to potential customers. While this worked well initially, email transactions began to drop. With email being 48% of all transactions in 4Q11, this lessening of the push strategy effectiveness (some decay can be attributed to GRPN’s shifting of strategy) called for a change. This shift in NA local transactions can be seen here:



The new “pull” strategy shows an evolution from primarily an email-based push model with a limited number of deals offered at any given time, to more extensive online pull marketplaces. This enables consumers to come across deals via a search engine, then search for deals and explore the Groupon marketplace.

More specifically, from 3Q13 to 3Q14 the % of NA transactions “related to search” rose from 9% to 24%, while the % of NA traffic that searched rose from 6% to 10% of this period. This means that this method is sticking; people are stumbling upon Groupon offerings through searches, and are more actively searching once they are in the marketplace. This has led to a shift from 52% non-email transactions in 4Q11 to 78% in 3Q14. Less than 10% of TicketMonster sales are via e-mail, indicating that this acquisition will not slow the shift to non-email transactions. Also contributing to the establishment of this Groupon marketplace is “Pages”. This recently launched platform is used to publish ratings and helpful tips from customers to highlight the unique aspects of local merchants, including merchants that have not yet offered deal. It also allows customers to submit requests for a deal from a specific business allowing the merchant to see the demand for such a deal instantaneously. In the 4Q earnings call Lefkofsky said:

“We’ve now released about 800,000 pages to be indexed

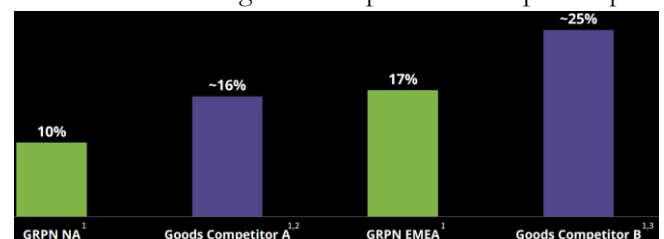
on Google. That’s up from 500,000 a quarter ago. We have about 800,000 people that have now [requested] a deal or [followed] a merchant. That’s doubled in the past quarter from 400,000. We’ve collected nearly an additional 5 million tips and reviews and ratings. We were at 20 million. We’re now at nearly 25 million ... we’ve got millions of visitors coming to these pages ... they are absolutely performing as we would have hoped.” Pages is a young initiative that will help boost sales, customer retention, and merchants available.

Coupled with the shift to a pull strategy was a refocus on the local segment which grew less than 2% in FY13 but was up 14% in 4Q14. However, there is still much room to grow in this high margin segment:



Comparing this past 4Q YoY, the local segment’s share of gross billings fell from 52% to 43%, with goods rising from 37% to 46%, and travel remaining at 11%. Over FY14, local had a gross margin of 31.43%, compared to 10.19% from goods, and 14.9% from travel. One might wonder why a company would shift product share from the higher margin segment, the answer is to grow.

Groupon started out as local deals, but once they put 6 products in an email and had over 30k units sold in 3 days the choice to add a goods segment was made. Rapidly growing this segment caused growth in the local segment to stagnate temporarily, but it has reignited in 4Q. Also contributing to future margins is an improving margin in the goods segments thanks to an increase in scale and other factors; the average gross margin in the past 5 quarters for NA goods was 8.4%, with 4Q yielding a 10% so margin improvements are being seen. However, there is also still room to go as Groupon catches up to its peers:



Management has said the biggest factors for the good's margin have not yet been fully implemented including more scale, products per box, as well as drop-shipping.

The above graphic also brings about another curious question with superior margins but less segmental share in the EMEA region. In the past 5 quarters the EMEA segment has yielded an average operating margin of 5.6% compared to 2.2% in North America. As of 4Q14 NA YoY revenue grew 24% compared to EMEA's 8%. However, this trend is changing with an abysmal first 3 quarters in ESEA, QoQ revenue growth in the last quarter was 18%. Management has said it thinks the region's local business (highest margin) is lagging about a year behind which calls for billings to pick up at the end of this year. Mobile growth will also be a tailwind for margins going forward. In 4Q11 15% of orders were via mobile devices compared to 63% in 3Q14. On average, mobile customers [generate over \\$70 additional annual gross billings](#), indicating a free source of margin growth. Despite the vast number of changes and advances in the past year, gross margins in the next 2 years expected to drop .9 bps and .3, respectively. This with expected sales growth this year of 10.9% much lower than the 24% growth seen last year. It seems these are a bit understated with the market expecting massive drops in revenue growth after the inception of the goods segment this year, however as previously explained positive outlooks in other segments should offset some of this expected large drop in revenue growth.

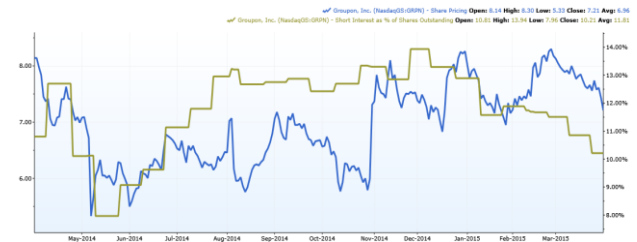
Strong comparative performance

In the past year Groupon has outperformed its much larger peers in Ebay and Amazon, but the market has not reflected this. The company's annual revenue growth in the last quarter came in at 25%, compared to 18% growth at Amazon and just 9% at eBay. In terms of core, billings growth GRPN also outperformed at a 36% increase compared to 27% and 21% for Amazon and Ebay respectively. Groupon's overall operating margin matches Amazon at 2% at a much younger stage and a market capitalization that is 3% of AMZN's. Groupon also showed impressive operating cash flow improvements specifically in the last earnings report with a 160% increase compared to 33% and 7% for Amazon and Ebay. Since April 1 2014, Groupon shares have fallen 13% and Amazon has appreciated 9%, with Ebay at the same levels. Institutional investors, however, are noticing this

attractive price (3/23/14-4/1/15):

51) Institutional	03/23	04/01	Change
11) % of Shares Held	71.92	85.16	+13.24

Additionally, bears are also realizing the positive horizon for Groupon:



One can notice the falling % of shares hold short compared to the latter stages of 2014.

Another thing to think about is Google's offer of \$6B which Groupon turned down in 2010. With not exactly the ideal performance since then leading to a ~30% fall in 2014, coupled with GRPN's strong cash position, it would not be out of the question for Google to reconsider such an acquisition which could be done for nearly the same price offered in 2010. Additionally, Google has recently started Google Offerings which directly competes with Groupon and could be streamlined with such an acquisition.

Valuation

Generally speaking, Groupon's management provides conservative sales estimates beating the last 6 of 8 times. The valuation attached assumes a conservative year over year growth rate in sales of 11% for FY2015 (guidance 11%) much lower than the 2014 rate of 24%. An 11% is growth chosen for FY2016 (guidance 13%), and 10% for FY2017. It assumes a long term growth rate of 5%, much lower than the historical peer growth. It assumes that total operating costs will be 87% of the revenues in FY2015, will drop to 86% FY2016 to reach a long term of 85%. Even if Goods' portion of sales are increasing and margins there are lower, scale and increases in the high margin travel segment Travel as well as drop-ships can offset this. Furthermore, conservative multiples (Justified TEV/Revenue, EBITDA, EBIT, UFCF) with respect to peers were chosen.

CENTER FOR GLOBAL FINANCIAL STUDIES										
Groupon, Inc.		GRPN	Analyst Skyler Scavone	Current Price \$7.02	Intrinsic Value \$8.80	Target Value \$10.17	Divident Yield 0%	Target Return 44.91%	BULLISH	
General Info		Peers	Market Cap.	Management						
Sector	Consumer Discretionary	Coupons.com Incorporated	\$971.10	Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014		
Industry	Internet and Catalog Retail	Expedia Inc	\$11,928.15	Lefkofsky, Eric	Co-Founder, Chief Executive Of	\$ 200,000.00	\$ 7,109,996.00	\$ -		
Last Guidance	Feb-12-2015	RetailMeNot, Inc.	\$985.52	Keywell, Bradley	Co-Founder, Independent Direc	\$ 210,000.00	\$ 210,000.00	\$ -		
Next earnings date	NM	eBay Inc	\$69,945.71	Child, Jason	Chief Financial Officer	\$ 729,175.00	\$ 5,322,107.00	\$ -		
Market Data		Yelp, Inc	\$3,526.77	Srinivasan, Kalyanaraman	Chief Operating Officer	\$ 8,344,913.00	\$ 6,139,492.00	\$ -		
Enterprise value	\$3,837.83	zulily, Inc	\$1,623.63	Schellhase, David	Strategic Advisor	\$ 2,596,227.00	\$ 3,768,435.00	\$ -		
Market Capitalization	\$933.35	TripAdvisor Inc	\$11,887.21	Stevens, Brian	Chief Accounting Officer	\$ -	\$ -	\$ -		
Daily volume	0.86	Amazon.com Inc	\$172,797.29	Historical Performance						
Shares outstanding	675.36	Liberty TripAdvisor Holdings, Inc.	\$2,372.80	GRPN						
Diluted shares outstanding	674.83	Orbitz Worldwide, Inc	\$1,302.52	Growth	692.3%	Peers	20.6%	Industry	6.4%	
% shares held by institutions	77.02%	Current Capital Structure			Retention Ratio	0.0%	166.0%	43.4%	All U.S. firms	61.6%
% shares held by insiders	23.39%	Total debt/market cap	1.00%	ROIC		10.5%	15.7%	11.8%		
Short interest	10.21%	Cost of Borrowing	3.81%	EBITDA Margin	0.0%	14.6%	10.4%	13.7%		
Days to cover short interest	6.02	Interest Coverage	-1496.47%	Revenues/Invested capital	3062.6%	158.5%	410.7%	202.3%		
52 week high	\$8.43	Altman Z	2.95	Excess Cash/Revenue	#DIV/0!	16.5%	16.4%	18.5%		
52-week low	\$5.18	Debt Rating	AAA	Unlevered Beta	0.70	1.93	1.30	0.95		
5y Beta	1.10	Levered Beta	1.27	TEV/REV	2.0x	2.8x	2.5x	2.4x		
6-month volatility	47.69%	WACC (based on market value weights)	9.07%	TEV/EBITDA	48.0x	24.6x	16.0x	11.3x		
Past Earning Surprises		Revenue	EBITDA	Norm. EPS	TEV/EBITDA	69.0x	29.9x	20.2x	15.4x	
Last Quarter	1.8%	-5.2%	100.0%	TEV/UPCF	1016.5x	69.0x	23.8x	26.8x		
Last Quarter-1	1.1%	200.0%	200.0%	Non GAAP Adjustments						
Last Quarter -2	-1.4%	1.1%	0.0%	Operating Leases Capitalization	100%	Straightline		10 years		
Last Quarter -3	2.4%	13.8%		R&D Exp. Capitalization	100%	Straightline		10 years		
Last Quarter -4	6.9%	-5.7%	100.0%	Expl./Drilling Exp. Capitalization	0%	N/A		N/A		
Proforma Assumptions		Period			Rev. Growth	Adj. Op. Cost/Rev	Forecasted Profitability			
Operating Cash/Cash	0.0%	LTM	24%	89%	Revenue	NOPLAT	Invested capital	UFCF		
Unlevered Beta	1.20	LTM+1Y	11%	87%	\$3,191.69	\$74.07	\$233.20	\$333.72		
Rev/Invested Capital	190.0%	LTM+2Y	11%	86%	\$3,549.16	\$149.75	\$698.95	-\$56.36		
Continuing Period Revenue Growth	5.0%	LTM+3Y	10%	85%	\$3,932.47	\$212.81	\$710.39	\$201.36		
Long Term ROIC	12.4%	LTM+4Y	9%	85%	\$4,338.24	\$274.77	\$712.86	\$272.30		
Invested Capital Growth	Equals to Maintenance	LTM+5Y	8%	85%	\$4,706.99	\$334.12	\$718.35	\$328.63		
Justified TEV/REV	2.0x	LTM+6Y	7%	85%	\$5,078.84	\$366.25	\$713.30	\$371.30		
Justified TEV/EBITDA	13.0x	LTM+7Y	6%	85%	\$5,429.28	\$390.90	\$829.89	\$274.32		
Justified TEV/EBITDA	20.0x	LTM+8Y	5%	85%	\$5,749.61	\$415.93	\$829.24	\$416.57		
Justified TEV/UPCF	25.0x	LTM+9Y	5%	85%	\$6,065.84	\$440.02	\$817.62	\$451.65		
Valuation		ROIC	WACC	EVA	Enterprise Value	Total Debt	Other claims	Equity	Adjusted Price	
LTM	15.0%	9.1%	\$13.89	\$5,777.02	\$38.26	-\$624.90	\$6,363.66	\$9.76		
LTM+1Y	64.2%	9.2%	\$384.73	\$6,758.11	\$38.26	-\$555.08	\$7,274.93	\$10.92		
LTM+2Y	30.4%	9.3%	\$150.48	\$6,892.27	\$38.26	-\$749.67	\$7,603.68	\$11.51		
LTM+3Y	38.7%	9.4%	\$208.95	\$7,302.20	\$38.26	-\$1,018.50	\$8,282.44	\$12.53		
LTM+4Y	46.9%	9.5%	\$268.67	\$7,692.27	\$38.26	-\$1,351.53	\$9,005.54	\$13.58		
LTM+5Y	51.0%	9.5%	\$295.56	\$8,045.35	\$38.26	-\$1,664.83	\$9,671.92	\$14.59		
LTM+6Y	54.8%	9.7%	\$374.71	\$8,536.22	\$38.26	-\$1,813.41	\$10,311.37	\$15.48		
LTM+7Y	50.1%	9.7%	\$334.76	\$8,859.00	\$38.26	-\$2,088.84	\$10,909.57	\$16.41		
LTM+8Y	53.1%	9.9%	\$353.27	\$9,256.13	\$38.26	-\$2,389.40	\$11,607.26	\$17.45		
LTM+9Y	56.7%	9.9%	\$373.29	\$9,655.78	\$38.26	-\$2,711.08	\$12,328.60	\$18.25		
Monte Carlo Simulation Assumptions		Base	Stdev	Min	Max	Distribution	Monte Carlo Simulation Results			
Revenue Variation	0	10%	N/A	N/A	Normal	Mean est.	Intrinsic Value	1y-Target		
Op. Costs Variation	0	10%	N/A	N/A	Normal	σ(s)				
Market Risk Premium	6%	N/A	5%	7%	Triangular	3 σ(s) adjusted price	\$8.80	\$10.17		
Long term Growth	5%	N/A	3%	692%	Triangular	Current Price	\$7.02			
Terminal Value	0	0.1	N/A	N/A	Normal	Analysts' median est.		\$8.93		