December 11, 2018

Chegg, Inc: (CHGG)

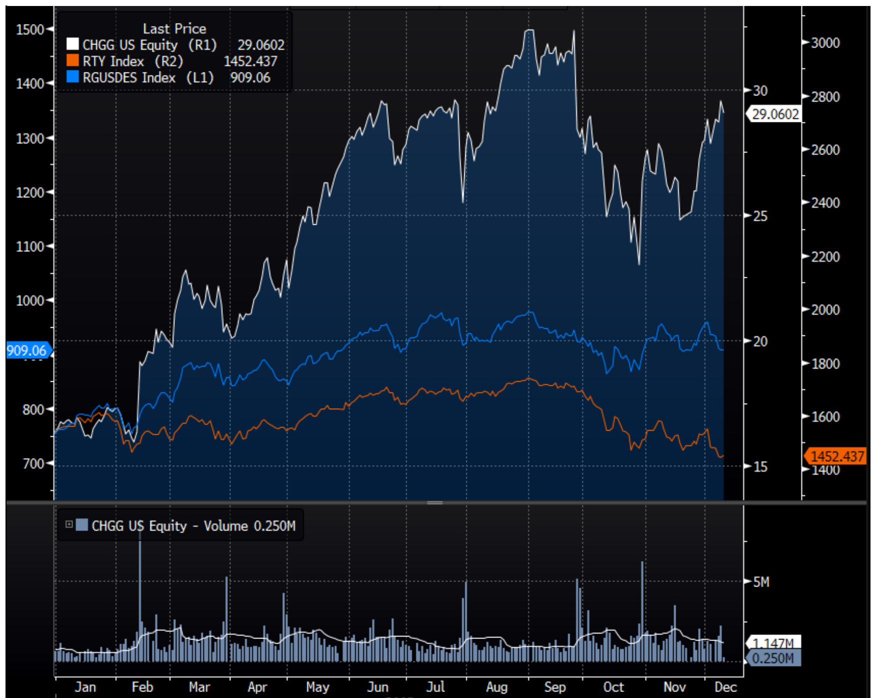
Samantha St.Germain

Sector: Consumer Discretionary
Industry: Educational Services
Current Price: $29.04
Target Price: $32.56

Company Description: Chegg (CHGG) provides students with textbook answers, study help, required materials, and more services in the areas of STEM, Writing, and more. Their direct-to-student platform operates on a subscription basis.

BUY @ $27.13

Current Price:	$29.04
Target Price:	$32.23
Market Cap:	3.3B
ROIC/WACC	21.5%
ROIC/WACC (w/o Goodwill)	32.9%
EBITDA Margin	24.77%
COR/Revenue	25.6%
Subscription Growth	45%
Unique Content Views	110M



Thesis:

Chegg (CHGG) offers a valuable service to students: providing textbook answers and study help on a subscription basis. Not only has CHGG been increasing their value to students in the past years, but to investors as well. By focusing on their digital offerings, CHGG has been able to take advantage of higher margins and economies of scale.

Catalysts:

Forward looking projections that call for positive/negative outlook that will strengthen your thesis. Example:

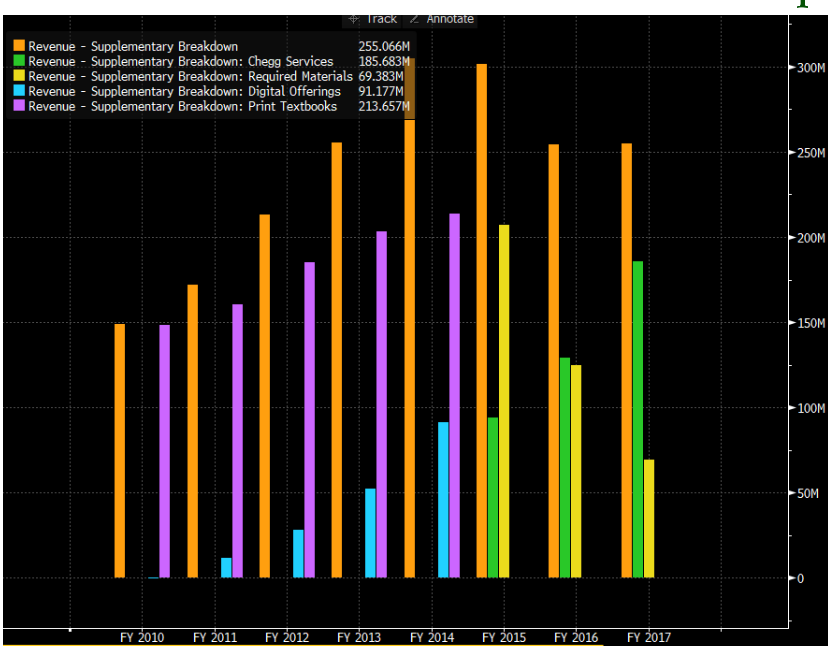
- Product Mix Shifting to favor high margin products
- Large college population with strong brand recognition
- Untapped high school market with potential to be accessed through CheggMath and CheggWriting
- Economies of Scale and brand recognition decrease customer acquisition costs while increasing cross selling potential

Earnings Performance:

CHGG had a strong Q3FY18, leading them to increase their forecast for the year. CHGG reported a 19% increase in total net revenues as compared to FY17, clocking in at $74.2 million. This beat estimations by $5.11 million. Q3 is their busiest quarter as it is their back to school season, where high school and college students are starting a new year. CHGG reported a net loss of $13.7 million, a greater loss than the $11.5 million loss in Q3FY17. Non-GAAP net income was $8.7 million for Q3FY18 compared to $1.5 million in Q3FY17. Service revenues grew 37% year over year, earning 54.2 million for Q3 and accounting for 73% of revenue. Product mix will be discussed in more detail in subsequent analysis.

Content views for Chegg Study increased 51% year over year to 110 million views in Q3. In Q3 Chegg had 1.7 million subscribers, a 45% year over year increase.

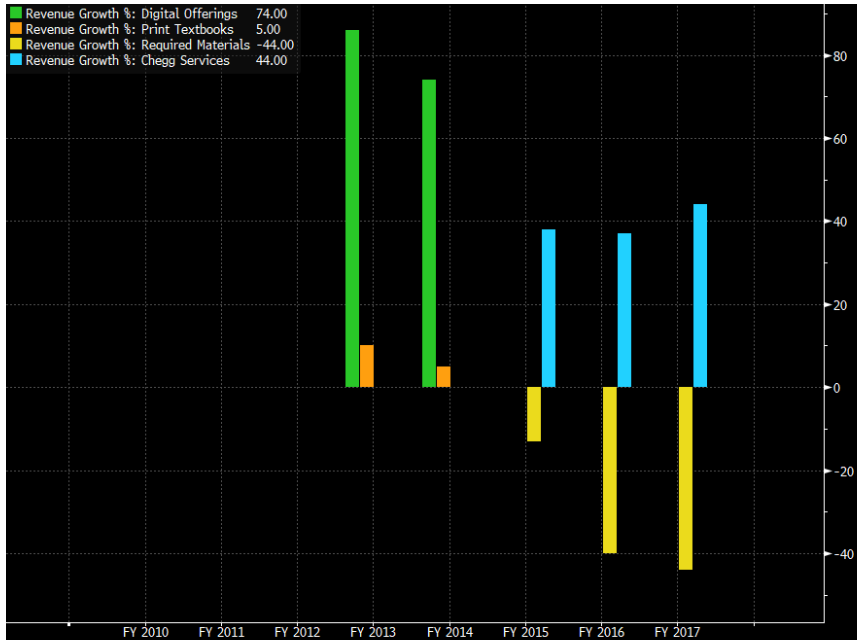
Product Mix of the Past: Textbooks and Required Materials



CHGG traditionally has been know for it's textbook services for college students. In 2010, Print Textbooks accounted for 99.8% of CHGG's revenue. At that time, revenue was broken down to Print Textbooks and Digital Offerings. In 2014, Digital Offerings made up 29.9% of CHGG's revenue, dropping Print Textbooks to 70.1% of revenue. While Print Textbooks were losing revenue share within the firm, they were still growing, having grown 5% in 2014.

In 2015, CHGG renamed the categories to reflect the changing nature of their business. Print Textbooks are now referred to as Required Materials, which saw a 13% decrease that same year. In 2014, CHGG partnered with Ingram to fulfill all of Chegg's print textbook sales and rentals. This has allowed CHGG to focus less on the physical aspect of the textbook business and more on their digital services, such as ebooks and study help for students. It also allows CHGG to offset some of their risk onto Ingram by not having to hold inventory or have any of the risk trying to forecast which textbooks will be in demand for the upcoming semester. The Required Materials portion of CHGG's business is now less of a revenue driver and more of an introduction of what Chegg offer's to students. Books are shipped to distinct, recognizable orange boxes that promotes brand recognition, which will be discussed later.

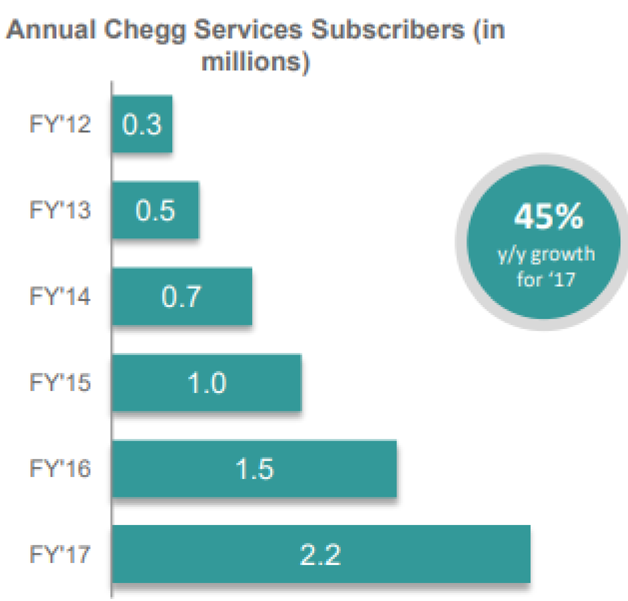
New Product Mix: Digital Offerings and



Digital Offerings, which have seen strong growth since 2010, are now classified as Chegg Services. This is a direct reflection of CHGG's shift from a textbook provider to a digital student support business. Chegg Services include study materials, textbook solutions, tutoring, test prep, internship and career postings, citation and writing help, and more. The Chegg Study and Chegg Writing services have been instrumental in the 44% growth in Chegg Service revenue in 2017. In Q3FY18, Chegg Service revenue grew 41% yoy.

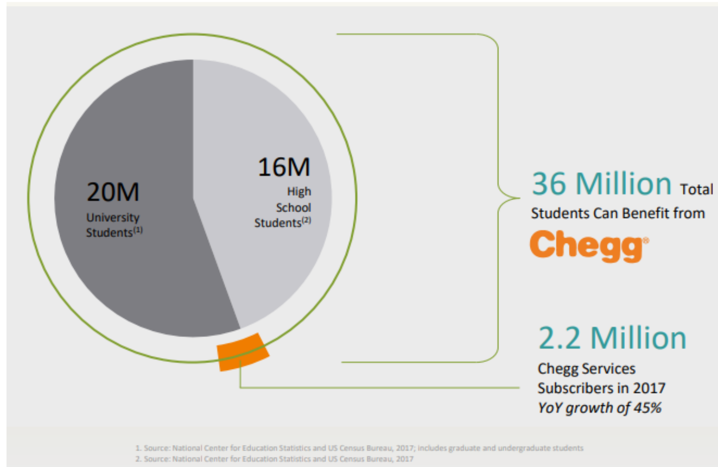
Chegg Study is CHGG's main service provided to students, with it's catalogue of textbook questions and answers growing 41% yoy. This growth in content will help CHGG reach new students. Q3 saw 110 million content views, up 51% yoy, reflecting a strong return on investment for Chegg Study. CHGG is also working on new products and services to help students and increase their use of Chegg. For example, Chegg is planning to add a chat feature to their tutoring platform, which will give students more flexibility on when they access tutoring and will be able to access Chegg for that purpose more often, driving site visits.

The focus on moving towards a more digital focused company has two benefits. First, it differentiates itself from competitors. Amazon is another main player in the textbook rental business. As Amazon's business has grown, it has become a major source of competition for Chegg. Chegg has been able to differentiate itself by moving into a different, yet related, business. CHGG has seen their required material segment decrease substantially, only representing 27.2% of their business in 2017.



The other major area of value created by this shift is in margin. Digital products offer a much higher margin than physical products. EBITDA margin has improved from 6.7% in 2014 to 8% for the LTM ending September 30, 2018. Net income margin has increased from -40.3% in 2017 to -1.8% for the LTM ending September 30, 2018. Net income margin is projected to be 19.6% in 2018.

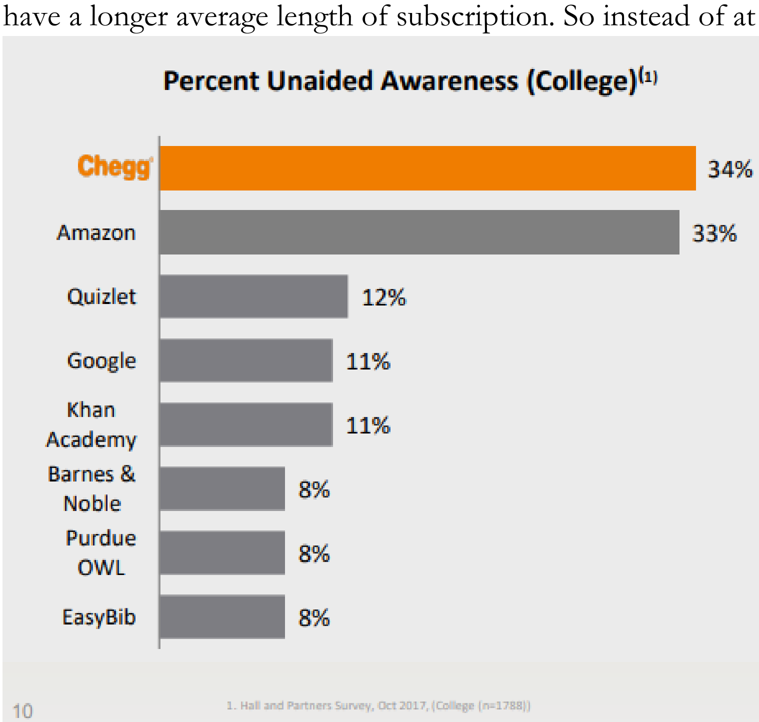
Large Market and Untapped Potential:



Education accounts for 7% of the United States's Gross Domestic Product. There are 20 million college students in the United States alone. Chegg had 2.2 million subscribers in 2017. Now add 16 million high school students to that equation. That means there are 36 million individuals in high school or higher, and Chegg subscribers account for 6.11% of all students who can benefit from their services. Some of Chegg's products can also reach younger audiences, such as their writing and citation services, which can help students as young as middle school. Chegg is also planning on expanding into international markets in the future.

Beyond subscribers, the Chegg platform has approximately 11 million unique visitors every month. This accounts for 30.6% of the education market for high school and above in the United States. Each of these visitors has an opportunity to interact with the platform, understand the benefits, and get the word out to other students or to become subscribers themselves. As discussed earlier, the textbooks are shipped in bright, distinct boxes, which immediately catch the eye. This brand recognition is invaluable. Look in any college post office at the beginning of the semester and its likely you'll see at least one of those boxes waiting for pickup. Brand recognition is crucial and CHGG can leverage it as it taps into new and existing markets.

CHGG is also hoping that its new AI driven math service will help them expand influence in the high school market. Introducing students to the brand early is important. Chegg is not a service consumers will stay subscribed to in perpetuity like Spotify or Netflix, Chegg's usefulness is limited to however long the student is in school. By reaching students earlier, not only will they have a first mover advantage but will also have a longer average length of subscription. So instead of at most a possible life of the subscription being 4 years, a Chegg subscriber could possibly be subscribed for as many as 8 or more years.



Economies of Scale:

CHGG has an already large and growing database of study materials for students across multiple areas of study. This means that students are more likely to find the content they are looking for on Chegg's platform - and more likely to use it again. If students know there is one place that will have their answers instead of having to search multiple sites for what they are looking for, they will just go to where they know they can get their answers, which is Chegg. The variety of subjects is also important as college curriculum requires students to take a variety of classes in multiple subjects. The shear amount of reliable material increases brand loyalty.

A bonus of Chegg's market is the word-of-mouth opportunity that arises. High School and College are very focused on group work. When working on a group project, if one student has Chegg and uses it, it introduces other students to the platform. Even outside group work settings, students will often collaborate on homework and other assignments, increasing the number of opportunities students have to share the platform. And as CHGG starts targeting younger high school and middle school audiences, it increases the odds of an older sibling introducing younger siblings or parents it Chegg's platform. As the number of subscribers and users grows, CHGG has a greater opportunity of reaching new students without having to spend as many valuable marking dollars on customer acquisition. As mentioned earlier, CHGG subscriptions increased 45% year over year and content views increased 51%. The more students that actively use Chegg, the greater their word-of-mouth power will be.

While the Chegg platform has been growing, less has been spent on marketing in the past few years. Selling and marketing decreased from $64.1 million in 2016 to $51.2 million in 2017, a 20% decrease. The increasing revenues and subscibtions add substance to the fact that CHGG does not need to spend as much on customer acquisition because of their vast network of college students using word-of-mouth to introduce new students to Chegg. And as Chegg grows, they can take further advantages of these economies of scale.

Conclusion:

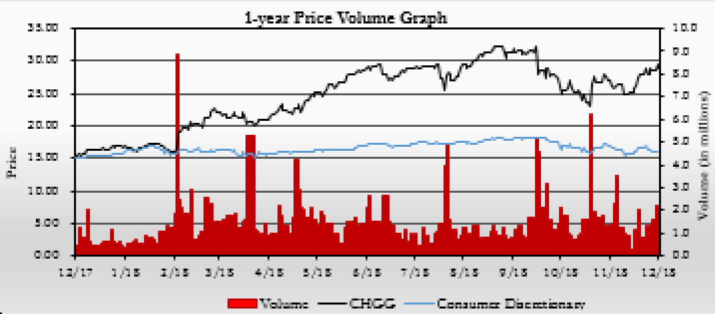
CHGG offers a valuable service to a large market. They have created a brand loyalty that no other study platform is able to boast. As they move away from their traditional business of physical textbooks and toward higher margin digital products, CHGG is able to create more value for shareholders. CHGG is growing at a rapid pace, and with their brand loyalty, word-of-mouth, especially in the college and high school setting, is invaluable. This will allow CHGG to continue its growth momentum as lower customer acquisition costs. For the foreseeable future, CHGG should continue to offer value to both college students and investors as it expands and grows.

Chegg, Inc. (CHGG)

CENTER FOR GLOBAL FINANCIAL STUDIES

NEUTRAL

Analysis by Sam St.Germain	Current Price:	$28.97	Intrinsic Value	$29.62	Target 1 year Return: 11.27%
12/11/2018	Divident Yield:	0.0%	Target Price	$32.23	Probability of Price Increase: 88%



Description

Chegg, Inc. operates direct-to-student learning platform that supports students on their journey from high school to college and into their career with tools designed to help them pass their test, pass their class, and save money on required materials.

General Information	
Sector	Consumer Discretionary
Industry	Diversified Consumer Services
Last Guidance	May 8, 2018
Next earnings date	February 11, 2019

Market Assumptions	
Estimated Equity Risk Premium	6.00%
Effective Tax rate	21%

Market Data	
Market Capitalization	$3,391.78
Daily volume (mil)	0.26
Shares outstanding (mil)	114.90
Diluted shares outstanding (mil)	111.73
% shares held by institutions	101%
% shares held by investments Managers	86%
% shares held by hedge funds	12%
% shares held by insiders	5.20%
Short interest	10.71%
Days to cover short interest	8.13
52 week high	$32.82
52-week low	$15.05
Volatility	43.13%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
9/30/2017	8.78%	-65.24%
12/31/2017	4.27%	-34.83%
3/31/2018	3.90%	-46.98%
6/30/2018	6.03%	-43.08%
9/30/2018	7.75%	-60.47%
Mean	**6.15%**	**-50.12%**
Standard error	1.0%	16.6%

Market and Credit Scores
Recommendation (STARS) Value--0
Recommendation (STARS) Description--0
Quality Ranking Value--0
Quality Ranking Description--0
Short Score--2
Market Signal Probability of Default % (Non-Ratings)--0.56%
CreditModel Score (Non-Ratings)--b+

Industry and Segment Information

LTM Revenues by Geographic Segments	LTM Revenues by Business Segments
United States--100%	Online Retailers--100%
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Peers

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--	Barnes & Noble Education, Inc.
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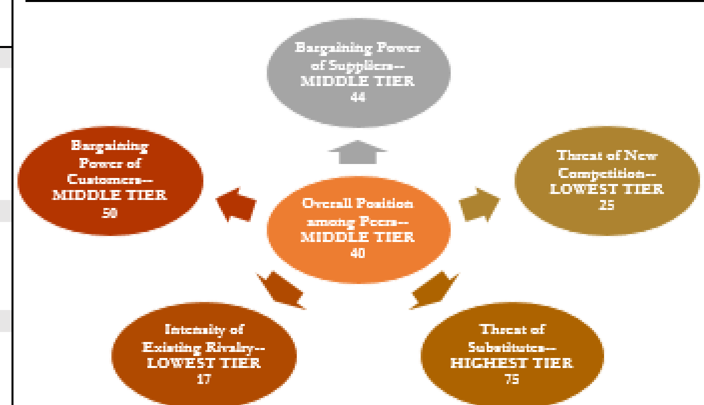
Cambium Learning Group, Inc.	--

Management	Position	Total Compensations Growth	Stock Price Growth During Tenure
Rosensweig, Daniel	Co-Chairman, CEO & President	19.49% per annum over 5y	
Brown, Andrew	Chief Financial Officer	42.93% per annum over 5y	
Lem, Esther	Chief Marketing Officer	8.58% per annum over 2y	55.72% per annum over 2y
Geiger, Charles	Chief Product Officer	27.4% per annum over 5y	
Schultz, Nathan	Chief Learning Officer	-100% per annum over 3y	14.89% per annum over 3y
Osier, Michael	Chief Outcomes Officer	-100% per annum over 3y	14.89% per annum over 3y

Profitability	CHGG (LTM)	CHGG Historical	Peers' Median (LTM)
Return on Capital (GAAP)	21.5%	-4.59%	23.90%
Operating Margin	25%	-7.13%	18.85%
Revenue/Capital (GAAP)	0.87	0.64	1.27
ROE (GAAP)		3.3%	135.6%
Net margin		2.1%	24.1%
Revenue/Book Value (GAAP)		1.85	5.62
Invested Funds	**CHGG (LTM)**	**CHGG Historical**	**Peers' Median (LTM)**
Cash/Capital	52.7%	37.0%	10.1%
NWC/Capital	-3.8%	-7.4%	-27.7%
Operating Assets/Capital	33.6%	50.2%	96.9%
Goodwill/Capital	17.4%	22.7%	20.7%
Capital Structure	**CHGG (LTM)**	**CHGG Historical**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.34	0.03	0.57
Cost of Debt	5.0%	5.0%	5.0%
CGFS Rating (F-score, Z-score, and default Probabilit	A		
WACC	10.2%	11.0%	11.5%

Porter's 5 forces (Scores are percentiles)



Valuation

Forecast Assumptions	Explicit Period (15 years)	Continuing Period
Revenue Growth CAGR	19%	3.0%
Average Operating Margin	21%	20%
Average Net Margin	26%	15%
Growth in Capital CAGR	15%	3%
Growth in Claims CAGR	0%	3%
Average Return on Capital	18%	8%
Average Return on Equity	18%	9%
Average Cost of Capital	10%	11%
Average Cost of Equity	11%	11%