

April 7th, 2017

HubSpot, Inc.: HUBS (NYSE)

Alec Odnoha

Sector: Information Technology

Industry: Application Software

Current Price: \$59.60

Target Price: \$68.56

HubSpot, Inc. is an application software provider that offers cloud-based marketing and sales software platforms that enable businesses to offer an inbound marketing and sales experience. Inbound marketing and sales attracts and engages customers by being more personalized and less interruptive than traditional marketing and sales tactics. The software platform developed by the company offers all-in-one integrated applications to aid businesses in driving traffic and exposure with customers, with an end goal of promotion of the business by the customer. These applications include social media, search engine optimization, marketing automation, and CRM to name a few. The company is headquartered in Cambridge, MA, and was founded in 2005 by two MIT graduate students, with the intent of changing the way the marketing and sales process is conducted by businesses.

BUY

Current Price: \$59.60

Target Price: \$68.56

Market Cap: 2.1B

52 Week Range: \$39.01 - \$66.10

Average Volume: 404,872

D/E Ratio: 0.9%

Ke: 19.01%

Gross Margin: 77.17%

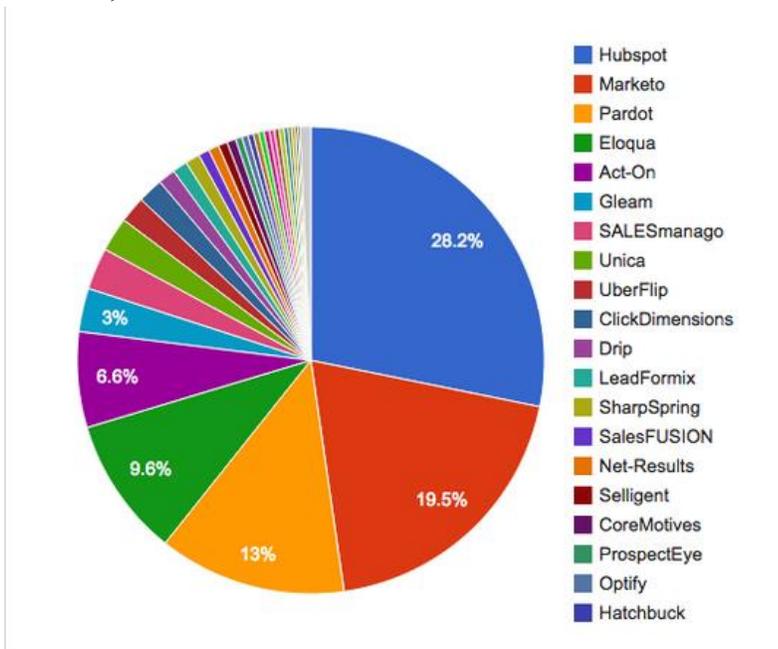
Catalysts:

- Short Term (within the year): International expansion, customer retention, increased investments into company, Q4 Earnings call
- Mid Term(1-2 years): Grow U.S. customer base, continual platform innovation
- Long Term(3+): Increasing market share, reduction in sales and marketing expenses



Thesis: Traditional sales and marketing techniques are becoming obsolete; more and more people are losing interest in classic sales and service models, such as cold calls or unsolicited emails. Marketing automation is becoming much more prevalent in the modernized world of Business-to-Business communication. To simplify, marketing automation eliminates time-wasting procedures, such as measurement and managing of data, and in turn streamlines sales and marketing organizations using an automated solution. HubSpot, Inc. has emerged as an industry leader in the marketing automation industry, and offers products that allow for businesses to optimize their sales and marketing needs to attract newer customers. Furthermore, the platform provided by the company offers personalization and scalability, which enables the “inbound” experience that HubSpot strives to provide for all of its customers. HubSpot has adapted a rapid-growth policy, investing considerably into the company to fund growth by research and development, customer base retention, and domestic/international expansion. In doing so, the company has seen incredulous revenue growth over the last few years. Plans are in place to continue stimulating that growth. Also, the company relies on subscription-based revenue per customer as its primary source, and has historically maintained a high customer retention rate at a level in the mid-to-high 90’s. HubSpot’s scalability and versatility allow for exposure in multiple industries, and as the company grows rapidly, that vision can easily come to fruition. Coupled with rapid growth and considerable funding back into the business, the company maintains a low level of debt as well. These factors are indicative of their capability to continue strong growth and creation of value moving forward.

Industry Outlook: Marketing automation software makes a complex marketing campaign incredibly simple and successful. Software helps a marketing department market efficiently, over a number of online channels, and the automation facet of the software takes care of the repetition. Demand for digital marketing



is increasing, and more B2B companies are adopting the technological capability. Today, there are nearly 11 times more companies with marketing automation than there were in 2011. The main benefits of the automation capabilities are considered to be time-saving, increased customer engagement, and increased up-selling opportunity. HubSpot’s platform aim to fill those beneficial criteria, and the company considers upselling a primary pillar in their growth strategy. The automation industry as a whole is projected to increase at a CAGR of 9.26% between the 2016 and 2022. Furthermore, the industry is anticipated to generate up to \$6.58 billion in revenue by 2022. HubSpot already has

established themselves as a frontrunner in the industry, attaining roughly 28% of the market share, as displayed in the graph. A dominant market share for the company is a large competitive advantage for them, and the projected growth of the industry itself as a whole, coupled with current plans in place for expansion, will surely expand HubSpot’s market share and create more value for shareholders.

Products and Services: HubSpot has two segments, namely subscription-based revenue, and professional services. HubSpot offers three forms of software, being HubSpot Marketing, Sales, and CRM, respectively. HubSpot Marketing software is an all-in-one marketing toolset that has features such as advanced segmentation, personalization, and search engine optimization to name a few. This software enables businesses to simplify marketing initiatives, and aims to provide an “inbound” marketing experience, which essentially is to attract, engage, and delight customers, straying from the traditional marketing and sales tactics that tend to be interruptive and of little interest. HubSpot Sales enhances the productivity and effectiveness of sales representatives, and delivers a personalized experience to the customer. Personalization is emphasized in HubSpot’s platform, in order to be able to appeal to a larger number of customers. Some features under HubSpot sales includes sequencing, CRM tracking, and contact insights. HubSpot CRM is geared to aid business in tracking interactions with contacts and other companies, and also aids in managing and reporting sales activities. Global spending on CRM applications is projected to reach \$31.7 billion by 2018, as demand is on the rise. HubSpot’s three types of subscription-based software, as stated before, made up 94% of the company’s total revenue for FY 2016, with the other 6% being attributed to professional services. These include on-boarding and training services designed to help customers with their ability to attract and engage customers using the HubSpot platform. HubSpot also offers a “growth stack”, which is an all-in-one marketing and sales platform. Essentially this is a combination of all three types of software, which are aimed to give business what they need to create their own value by attracting newer customers. The pricing model for the company varies, as there are multiple levels of functionality within the software. The greater premium paid by the customer is what enables the different levels of functionality, offered at basic, pro, or enterprise. However, this variability is only for marketing software. Sales software is available in pro, or for free, and CRM is free for users entirely.



Growth Stack Visual

Revenue Generation: HubSpot is a company that generates revenue predominantly through subscription-based revenues. Businesses pay a premium to utilize HubSpot’s platform to create value for themselves, in attracting customers and engaging them in the “inbound” marketing experience. HubSpot saw incredible revenue growth in Q4 of 2016, totaling \$76.4 million, which is up 44% from Q4 of 2015. This 44% increase can be attributed to a strong increase in both segments reported, a 46% increase in subscription revenue, and a 15% services revenue growth. Full year revenue was up 49% from 2015, totaling \$271 million, and this in

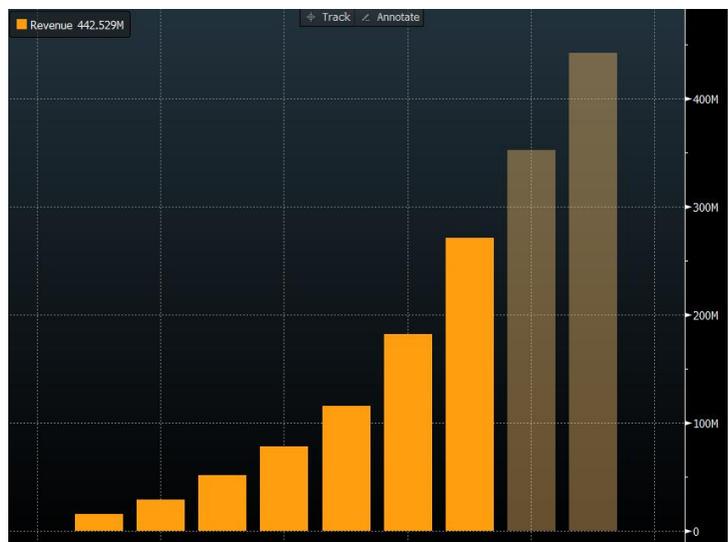


Exhibit 1: Bloomberg

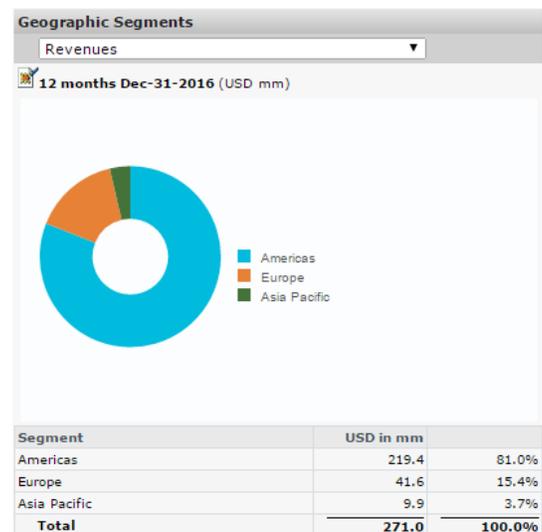
itself is a reduction from the prior year’s revenue growth of 57% from 2014. In 2016, subscriptions accounted for approximately 94% of company revenue, with the other 6% being attributed to services. Historically, the company has maintained a high-level of revenue growth YoY, with a 5-year CAGR of 56.8%. As revenue has spiked, the company has also seen growth in EBITDA and Operating income as a result.

| 12 Months Ending | 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 |
|--|------------|------------|------------|------------|------------|------------|
| 1 Year Growth | | | | | | |
|  Revenue | 85.57 | 80.73 | 50.44 | 49.26 | 57.02 | 48.93 |
|  EBITDA | – | 28.95 | -86.07 | -44.05 | 8.77 | 14.43 |
|  Operating Income | -94.33 | 23.24 | -82.76 | -41.92 | 4.39 | 3.90 |

Source: Bloomberg

With the majority of revenue being subscription-based, the company needs to ensure that a high-level of customer retention is maintained. This is one of the pillars in the company’s growth strategy, in that the expansion of customer use of the “all-in-one” platform needs to be a key focus. Already keeping high-levels of retention is a competitive advantage for the company, because, being multi-national, it enables HubSpot to retain a large portion of market share. The company also emphasized that to drive revenue growth, more focus needs to be given to selling to other parts of organizations (straying away from sales and marketing), cross-selling marketing and sales products, and upselling additional features and offerings. One of the primary goals for the company is to unify the sales and marketing businesses, aligned under one uniform HubSpot brand. In doing so, this allows for a greater likelihood of cross-selling. Additionally, the company generates revenue from “add-ons” that were developed and launched in Q4 of 2015. These add-ons expand the features of a platform that a given user is subscribed to, and can be purchased directly. HubSpot is able to generate revenue in a multitude of ways as a result of their product, and is sure to continue that trend as a result of their commitment to heavy investment back into the company to expand. Exhibit 1 above displays the steep annual increases in revenue, and forecasts run consistent with the company’s strategy to continue to drive growth.

International Expansion: Executive management believes that one of the primary drivers for continued company growth is international expansion. Currently, the United States is the primary source of revenue for the company, but there is some influence in Europe and Asia. 31% of marketing customers are located outside of the United States, and as displayed in the visual to the right, those international customers are responsible for approximately 19.1% of revenue generated for the year. International revenue performance was strong, increase 67% YoY and totalling 29% of Q4 revenue. Already, the company has offices in Dublin, Sydney, Singapore, and Tokyo, and are currently pursuing plans to open a fifth international office in Berlin later this year. Management hopes to stimulate international exposure and growth through continued investments in local sales, marketing, and professional capabilities. As of year end 2016, HubSpot is reported to have 23,226 customers in their base spread out over 90 countries worldwide. Also, the company reports relations with 3,500 agency partners worldwide, Facebook and LinkedIn to name a few. Global exposure, partnerships with globally recognized brands, and the continued



Source: Capital IQ

heavy investments into store developments will likely increase the company's brand awareness, which in turn could attract a greater number of customers to their expanding client base, driving more revenue growth.

Financial Standing: As talked about in the above section, revenue growth for the company has been outstanding. However, there are a number of other factors that are important to consider. HubSpot reported incredible gross margins for 2016, at 77.2% for the full year. Historically, HubSpot has maintained a gross margin of over 60% for the last five years, and that trend has been on the rise since 2013. Marginal growth, despite negative values, has been positive over the last few years, as indicated in Exhibit 2. Understandably so,

| HUBS Marginal Snapshot | | | | |
|------------------------|---------|---------|---------|---------|
| | FY 2013 | FY 2014 | FY 2015 | FY 2016 |
| Gross Margin | 62.59 | 69.73 | 73.66 | 77.17 |
| EBITDA Margin | -38.36 | -37.02 | -21.51 | -12.36 |
| Operating Margin | -44.12 | -41.95 | -25.54 | -16.48 |
| Net Income Margin | -44.15 | -41.62 | -25.31 | -16.81 |

Exhibit 2

negative margins may be a red flag for someone looking to invest, but in the case of HubSpot, it is a part of their business strategy long-term. Historically, gross margins have been kept at a high level; this means that for every dollar of revenue generated (in 2016, let's say), HubSpot retains roughly 77 cents from each dollar, with the remainder being spent on

cost of goods sold. The company does not pay dividends and highly re-invests back into itself, as part of their rapid-growth strategy that was referred to in the above sections. The reasons for the negative margins are in part due to the continual investments made to expand HubSpot's customer base. In doing so, revenues are expected to grow more rapidly than an increase in sales and marketing, R&D, and G&A expenses. The company is aware that they will incur a growth in cost over time, which is expected due to company growth. However, in doing so, expenses are slated to decrease as a percentage of revenue over time. The company is also taking initiatives to reduce any costs possible whilst maintaining revenue growth. In Q4, CAPEX was totaled at \$4 million, down from \$7.4 million the previous year. The company expects CAPEX to increase as a result of expansion plans (store build-ups, Berlin opening), but this is only expected to hold for the first half of 2017. The company maintains a small level of debt; D/E for year end 2016 totaled 0.9. HubSpot did have a \$35 million line of credit at their disposal last year, and as of year-end, there was no outstanding balance. The debt incurred by the company were letters of credit totaling \$4.4 million dollars, indebted to landlords for office space. HubSpot maintains a healthy cash position, with \$59.7 million in cash at year-end 2016. Moving forward in 2017, the company anticipate losses in operating income and net income per share, but again this is due to their heavy investment strategy to grow the company. Marginally, headwinds are expected as a result of new hires, payroll resets, and compensation adjustments, but the company still expects marginal expansion for FY 2017. In comparison with others in the industry, HubSpot stands out as best-in-class for 1 year gross margin percentage, and is in the upper echelon for sales growth as well. The negative margins are expected to become positive down the line, so those negative values in comparison to others should not be alarming to investors.

| Name (BICS Best Fit) | Sales 1 Yr | Gross Margin | Gross Margin 3 Yr | Operating Margin | Operating Margin 3 Yr | EBITDA Margin | EBITDA Margin 3 Yr | EPS Before XO 1 Yr | Return on Equity 3 Yr Average | Return on Capital 3 Yr |
|------------------------------|---------------|-----------------|-------------------------|---------------------|-----------------------------|------------------|--------------------------|--------------------------|-------------------------------------|------------------------------|
| Median | 25.87% | 65.41% | 64.27% | -4.04% | -8.76% | 8.30% | -1.22% | 23.39% | 1.39% | -14.17% |
| 100) HUBSPOT INC | 48.93% | 77.17% | 73.52% | -16.48% | -27.99% | -12.36% | -23.63% | 7.19% | -- | -52.46% |
| 101) COUPA SOFTWARE INC | 59.87% | 65.41% | 63.48% | -26.37% | -38.94% | -- | -35.80% | 80.82% | -- | -- |
| 102) FIVE9 INC | 25.78% | 58.71% | 53.17% | -4.04% | -18.30% | 1.14% | -12.57% | 55.77% | -- | -33.15% |
| 103) EVERBRIDGE INC | 30.87% | 69.07% | -- | -13.99% | -- | -- | -- | 22.73% | -- | -- |
| 104) ACTIVISION BLIZZARD INC | 41.68% | 63.77% | 65.06% | 22.19% | 25.83% | 39.17% | 37.78% | 7.44% | 11.91% | 9.05% |
| 105) QUALITY SYSTEMS INC | 0.46% | 54.19% | 54.56% | 10.02% | 10.17% | 17.16% | 16.33% | -80.00% | 11.66% | -- |
| 106) SALESFORCE.COM INC | 25.87% | 73.38% | 74.86% | 0.77% | -0.26% | 8.30% | 7.66% | -- | -3.70% | -3.27% |

Source: Bloomberg

Free Cash Flow for FY 2016 totaled \$3.6 million, and that number is forecasted to rise. Negative FCF will occur in Q2 and Q3 as a result of vendor payments and the company's INBOUND marketing event, but a positive FCF in Q4 is slated due to reductions in CAPEX. The initiatives set in place are set to continually spike revenue growth at a higher rate than expenses are projected, which will create value to the company as it expands. The small amount of debt, strong gross margins, and healthy cash position allow for the company to continue funding any expenditures or acquisitions they seek moving forward.

Conclusion:

In summation, HubSpot can be viewed as an investment with considerable upside. Their high retention rates, global partnerships, leading market share, and development of newer products and platforms are key in realizing the company's competitive position. The marketing automation industry is becoming more and more prevalent between businesses, and HubSpot has the technological capability, global presence, and financial allowance to continually pursue the rapid-growth strategy they have been following. Increases in revenue and long-term positive margins will allow for the company to create value within itself and generate higher return for their shareholders. A 1-year target price of \$68.56 is surely attainable with the commitment to the initiatives that the company has set in place.

HubSpot, Inc. (HUBS)

CENTER FOR GLOBAL FINANCIAL STUDIES

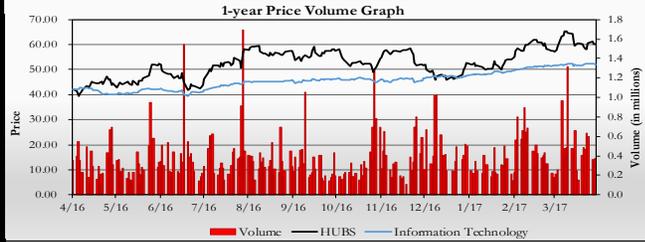
BULLISH

Analysis by Alec Odnoha
4/8/2017

Current Price: **\$59.60**
Divident Yield: **0.1%**

Intrinsic Value: **\$107.01**
Target Price: **\$133.66**

Target 1 year Return: **124.38%**
Probability of Price Increase: **100%**

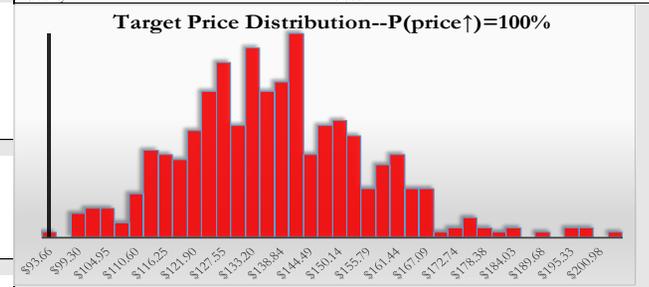


| Description | |
|--|------------------------|
| HubSpot, Inc. provides a cloud-based marketing and sales software platform for businesses in the Americas, Europe, and the Asia Pacific. | |
| General Information | |
| Sector | Information Technology |
| Industry | Software |
| Last Guidance | November 3, 2015 |
| Next earnings date | NM |
| Estimated Country Risk Premium | 6.65% |
| Effective Tax rate | 36% |
| Effective Operating Tax rate | 36% |

| Market Data | |
|---------------------------------------|------------|
| Market Capitalization | \$2,155.10 |
| Daily volume (mil) | 0.30 |
| Shares outstanding (mil) | 36.16 |
| Diluted shares outstanding (mil) | 35.20 |
| % shares held by institutions | 74% |
| % shares held by investments Managers | 83% |
| % shares held by hedge funds | 5% |
| % shares held by insiders | 7.08% |
| Short interest | 7.40% |
| Days to cover short interest | 6.63 |
| 52 week high | \$66.10 |
| 52-week low | \$39.01 |
| Levered Beta | 2.25 |
| Volatility | 0.00% |

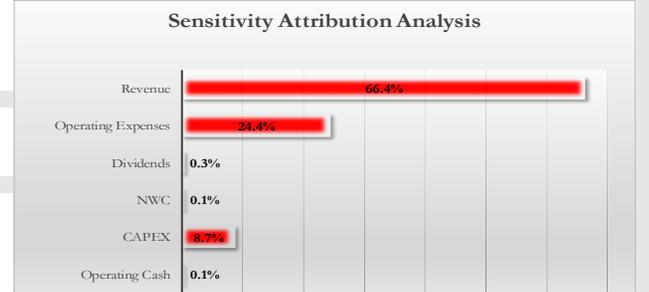
| Quarter ending | Revenue | EBITDA |
|----------------|---------|----------|
| 12/31/2015 | 4.79% | -488.08% |
| 3/31/2016 | 5.65% | -516.77% |
| 6/30/2016 | 4.79% | -552.10% |
| 9/30/2016 | 2.18% | -694.43% |
| 12/31/2016 | 1.94% | -413.50% |
| Mean | 3.87% | -532.98% |
| Standard error | 0.8% | 46.4% |

| Past Earning Surprises | | Peers | |
|------------------------|-------------------------------|----------------------------|------------------------------|
| Management | Position | Total compensations growth | Total return to shareholders |
| Halligan, Brian | Co-Founder, Chairman and Chi | 158.45% per annum over 2y | N/M |
| Sherman, J. | President and Chief Operatin | 104.64% per annum over 2y | N/M |
| Shah, Dharmesh | Co-Founder, Chief Technology | N/M | 0% per annum over 0y |
| Kinzer, John | Chief Financial Officer | 21.2% per annum over 2y | N/M |
| Kelleher, John | General Counsel and Secreatar | N/M | 0% per annum over 0y |
| Auger, Frank | Chief Information Officer | N/M | N/M |



| Management | | Position | |
|-----------------|-------------------------------|---------------------------|----------------------|
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| Auger, Frank | Chief Information Officer | N/M | N/M |

| Profitability | | HUBS (LTM) | | HUBS (5 years historical average) | | Industry (LTM) | |
|-----------------------------|-------|------------|--------|-----------------------------------|--------|----------------|--|
| ROIC | 14.4% | 0.03% | 0.03% | 9.78% | 12.9% | | |
| NOPAT Margin | 10% | 2.03% | 0.01 | 0.76 | 10.77% | | |
| Revenue/Invested Capital | 1.42 | 7.70% | 0.98% | 11.2% | 0.96 | | |
| ROE | 8.7% | 7.87 | 8.51% | 65% | 10.92% | | |
| Adjusted net margin | 9% | 10.77% | 10.71% | 10.92% | | | |
| Revenue/Adjusted Book Value | 0.98 | 7.87 | 10.71% | 10.92% | | | |



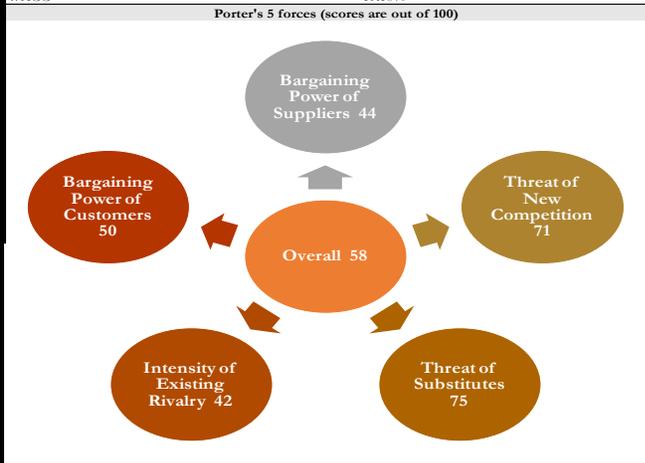
| Invested Funds | | HUBS (LTM) | | HUBS (5 years historical average) | | Industry (LTM) | |
|--|--------|------------|------|-----------------------------------|--|----------------|--|
| Total Cash/Total Capital | 30.6% | 45.0% | 54% | 54% | | | |
| Estimated Operating Cash/Total Capital | 16.0% | 23.6% | N/A | | | | |
| Non-cash working Capital/Total Capital | -17.3% | -21.3% | -29% | | | | |
| Invested Capital/Total Capital | 71.7% | 85.1% | 65% | | | | |

| Capital Structure | | HUBS (LTM) | | HUBS (5 years historical average) | | Industry (LTM) | |
|---------------------------------|--------|------------|--------|-----------------------------------|-------|----------------|--|
| Total Debt/Common Equity (LTM) | 0.01 | 0.00 | 0.13 | 3.01% | 3.01% | | |
| Cost of Existing Debt | 58.98% | 33.22% | 3.01% | 3.01% | | | |
| Estimated Cost of new Borrowing | 15.25% | 5.79% | 3.01% | | | | |
| CGFS Risk Rating | F | CCC | B | | | | |
| Unlevered Beta (LTM) | 2.24 | 1.00 | 1.10 | | | | |
| WACC | 19.10% | 10.71% | 10.92% | | | | |

| Porter's 5 forces (scores are out of 100) | |
|---|-----------|
| Bargaining Power of Suppliers | 44 |
| Bargaining Power of Customers | 50 |
| Intensity of Existing Rivalry | 42 |
| Threat of New Competition | 71 |
| Threat of Substitutes | 75 |
| Overall | 58 |

| Period | Revenue growth | Valuation | ROIC/WACC |
|-------------------|----------------|--------------|-----------|
| Base Year | 48.9% | NOPAT margin | |
| 12/31/2017 | 29.2% | 10.2% | 0.75 |
| 12/31/2018 | 21.5% | 17.0% | 1.18 |
| 12/31/2019 | 22.4% | 18.6% | 0.82 |
| 12/31/2020 | 32.0% | 20.6% | 0.80 |
| 12/31/2021 | 18.8% | 23.5% | 0.95 |
| 12/31/2022 | 16.4% | 22.9% | 0.84 |
| 12/31/2023 | 13.9% | 23.7% | 0.81 |
| 12/31/2024 | 11.4% | 24.4% | 0.78 |
| 12/31/2025 | 9.0% | 25.1% | 0.75 |
| 12/31/2026 | 6.5% | 25.8% | 0.73 |
| Continuing Period | 4.1% | 26.3% | 0.70 |
| | | 26.8% | 0.66 |

| Period | Invested Capital | Net Claims | Price per share |
|-------------------|------------------|------------|-----------------|
| Base Year | \$35.47 | \$14.90 | -\$4.07 |
| 12/31/2017 | \$64.40 | \$90.31 | -\$1.68 |
| 12/31/2018 | \$75.31 | \$86.00 | \$2.01 |
| 12/31/2019 | \$150.68 | \$34.16 | \$6.72 |
| 12/31/2020 | \$191.36 | -\$22.07 | \$13.11 |
| 12/31/2021 | \$268.08 | -\$79.17 | \$20.26 |
| 12/31/2022 | \$511.37 | -\$158.78 | \$28.50 |
| 12/31/2023 | \$710.31 | -\$252.23 | \$37.51 |
| 12/31/2024 | \$902.15 | -\$362.03 | \$47.28 |
| 12/31/2025 | \$1,181.17 | -\$487.58 | \$57.82 |
| 12/31/2026 | \$1,479.72 | -\$647.56 | \$68.92 |
| Continuing Period | | | |



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| Continuing Period | | | |