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BJORKLUND FUND

October, 07, 2017

Grubhub Inc.: GRUB

Ryan Rosmarin

Sector: Information Technology
Industry: Online Takeout Ordering/Delivery
Current Price: $53.67
Target Price: $61.34

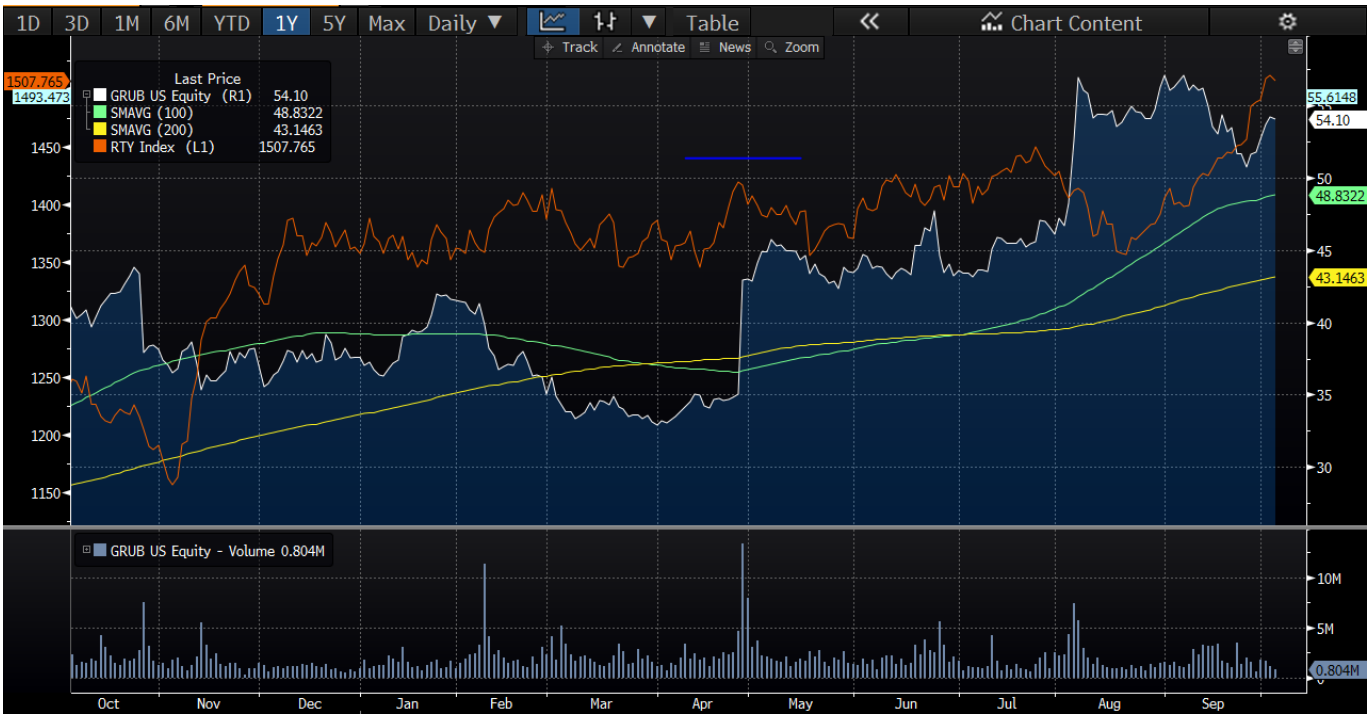
Company Description: Grubhub Inc. is the leading online/mobile platform for restaurant takeout ordering and delivery in the United States, serving across 1,200 cities for over 55,000 restaurants. Dedicated to improving the takeout experience for both diners and restaurants, Grubhub delivers a fast and easy ordering process for all parties involved. By providing customers with a direct-line of communication into the kitchen, Grubhub eliminates the inefficiencies and frustrations of the takeout ordering process. Grubhub operates under one business segment and owns Seamless, AllMenus, and MenuPages in their brand portfolio.

BUY

Current Price:	$53.67
Target Price:	$61.34
Market Cap:	4.64B
Beta:	1.05
52 Week Range:	$32.43-$57.61
Average Volume:	1.67M
D/E Ratio:	0.00
EBITDA Margin:	23.09%
ROE:	6.10%
ROIC:	7.75%
12M Total Return:	27.28%

Catalysts:

- **Short-Term** (within the year): Quarterly earnings report est. release on October 25, 2017. Strategic Partnerships with Yelp and Groupon.
- **Mid-Term** (1-2 years): Forecasted growth outlook within the Information Technology sector and economic optimism under Trump administration.
- **Long-Term** (3+years): Continual growth of the $80bn+ U.S. online takeout/delivery market as the population increasingly becomes more reliant on technology.



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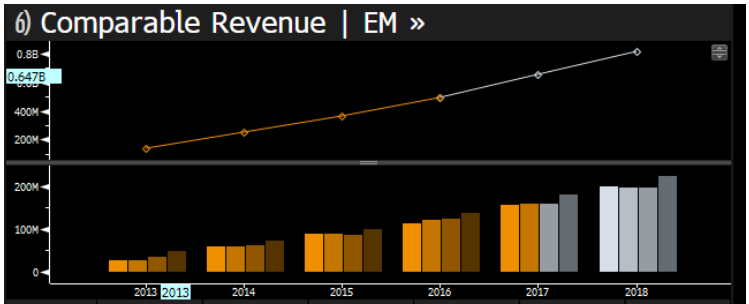
Thesis:

Grubhub Inc. is the leading force in the United States online takeout/delivery market and will continue to drive growth within the $80bn+ online takeout industry. In addition to holding a portfolio of strong subsidiaries, Grubhub has recently partnered with both Yelp and Groupon, expanding their customer base and potential for increasing revenues. Grubhub consistently beats earnings estimates and continues to grow organically as Active Diners and Daily Average Grubs (DAGs) have increased 25% and 16% respectively year-over-year. Grubhub's continued success and ability to attract restaurants and diners through marketing, expansion, and innovation will create internal value and appreciate the company's stock price.

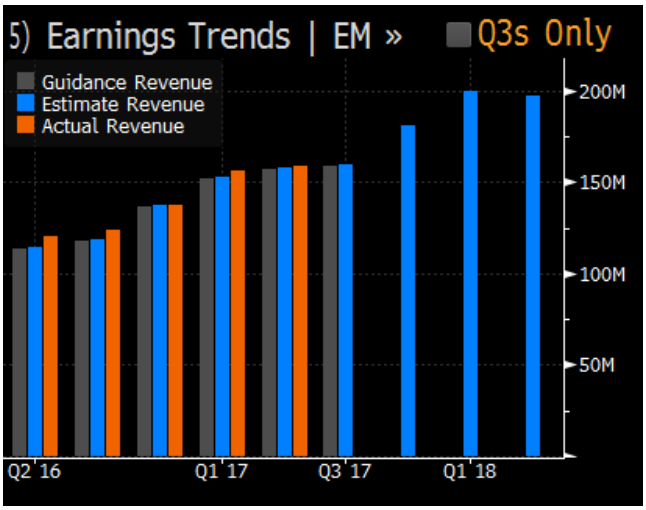


(USD)	2013	2014	2015	2016	2017	2018
FY	137.1M	253.9M	361.8M	493.3M	656.0M	816.8M
Q1	25.8M	58.6M	88.2M	112.2M	156.1M	199.9M
Q2	26.9M	60.0M	88.0M	120.2M	158.8M	197.0M
Q3	35.5M	61.9M	85.7M	123.5M	159.4M	195.5M
Q4	49.0M	73.3M	100.0M	137.5M	180.9M	222.8M

Business Overview:

Grubhub Inc. provides an online/mobile platform for diners to place orders for pick-up and delivery with their favorite restaurants in over 1,200 cities across the United States. They are the largest provider of online takeout ordering in the United States, as they own several other major platforms within the industry and continue to expand. Grubhub's services consist of a two-sided platform benefiting both restaurants and customers with takeout ordering. Grubhub allows restaurants to focus more on meal preparation and quality, and less on receiving actual orders. In addition, Grubhub advertises for restaurants, reducing the inefficiencies of menu and ad distribution which significantly saves costs and time. Grubhub provides a low-risk, high-return business opportunity for restaurants as they only collect payment on orders they generate. Revenues are primarily generated as orders are placed on the Grubhub platform and are collected for delivery services as well. Restaurants typically pay a percentage of the transaction based on the commission for the level of service they choose on the platform. When restaurants pay commissions above the base rate, they receive additional exposure and advertisement on Grubhub. Grubhub collects the total payment and remits net proceeds less commission back to the restaurant on at least a monthly basis. Consistency and convenience creates value for diners as orders are prepared correctly with the elimination of phone calls and paper menus. The Grubhub and Seamless network allows diners access through iPhones, Androids, iPads, Apple Watches, and Apple TV. Diners can enter their delivery address or use geo-location which presents local restaurants providing takeout. Customers can refine searches by restaurant, cuisine type, rating, etc. and can select options or provide specific instructions on a dish-by-dish basis. In addition to the traditional ordering system, Grubhub also provides an express, pre-order, and pickup features, diversifying their brand even more from its competition. The express service saves the history of previous orders, allowing diners to conveniently choose meals for future orders. Pre-order allows diners to place orders up to five days in advance and pickup eliminates delivery and service fees, saving money for the customer. Grubhub's success is heavily reliant on Gross Food Sales (GFS), technological innovation and the ability to grow its restaurant/customer base in multiple markets across the United States.

Quarter 2 Earnings Performance:



In Q2 2017, Grubhub reported revenue of $158.8mn showing a 32% year-over-year increase from $120.2mn in Q2 2016. Net income for the quarter increased 15% year-over-year to $15mn and adjusted EBITDA increased 12% to $42.2mn. EPS in Q2 was $0.26 and Gross Food Sales increase 20% to $880mn. This increase in Sales was driven by an increase in Grubhub delivered orders and restaurants paying higher rates for greater exposure on the Grubhub platform. Grubhub continued to grow organically as it increased its Active Diners by 25% to 9.18mn from 7.35mn in Q2 2016. Daily Average Grubs (DAGs) also increased 16% in Q2 to 313,900. Orders per diner decreased 7.5% in Q2 due to growth in tier 2 and 3 cities, which generally carry lower order frequency. The tier 2 and 3 restaurant network grew over 40% and average order sizes grew roughly 3.7%. Q2 chain restaurant signings included Qdoba, Del Taco, Moe's, Jack in the Box, Wawa, BJ's and several others. In addition to its organic growth, Grubhub announced a deal in June to acquire the online platform Foodler, headquartered in Boston, MA. This acquisition will help Grubhub expand more into the New England markets as it has a very loyal customer base.

Growth Strategy & Risks:

Grubhub intends to grow their "two-sided" network by adding independent and chain restaurants in existing and new geographic markets by providing them the opportunity to generate more orders and deliveries. As the number of Active Diners continue to increase, Grubhub plans to increase marketing and technology expenditures to remain the top competitor in the online takeout industry. Marketing expenditures are being used mainly for television and social media advertisements with Facebook, YouTube, etc. Grubhub will continually invest in its mobile products and websites to deliver new products and better leverage the amount of order data that the company collects. Grubhub has invested in technology integrations with companies such as Oracle, NCR, and Breadcrumb and Toast, as well as internally to improve their platform and maintain their competitive advantage in the market. Strategic Acquisitions will remain a part of Grubhub's growth strategy as well to decrease competition and increase its market share. Current Grubhub subsidiaries include Seamless, MeunPages, AllMenus, OrderUp, Restaurants on the Run, DiningIn, Delivered Dish, and LAbite with the expected addition of Eat24 and Foodler in Q3 2017. Revenue is forecasted to increase to 656.0mn and 816.8mn in 2017 and 2018, respectively.

The largest risk and competition to Grubhub are diners who choose to order takeout the traditional way, instead of using online/mobile platforms. The largest hurdle in attracting new diners is the initial order away from the traditional process. This risk is likely to diminish as societal trends continually show an increased reliance on technology in the daily lives of the average consumer. Successful integration of newly acquired platforms to the Grubhub network and seasonal trends are challenges as well. In metropolitan markets, Grubhub experiences relative increases in diner activity from September to April, and a relative decrease during the summer months. Grubhub also benefits when colleges and universities are in session, and when weather is inclement. Lastly, Grubhub bears the risks of low barriers to entry into the online takeout market.

Industry Analysis:

The overall forecast for the Information Technology sector on the Russell 2000 index continues to look promising as it has outperformed the RTY Index by 6.23% YTD and has beaten it by 45.09% over the last five years. The Russell 2000 IT segment has returned 18.75% YTD as R&D continues to pour into technological innovation, driving growth for the industry as a whole. High levels of product elasticity and substitutes spur competition within the index putting upward pressure on the profit margins of companies who can successfully adapt. Grubhub is performing near the top of the IT sector with high profitability margins. Compared to its' industry peers, Grubhub has high EBITDA, Operating and Net Profit Margins of 23.09%, 16.24%, and 10.54% respectively. These margins are well above the industry average, making Grubhub a significant force in the market. In a more narrowed aspect, the online payment sub-segment is currently estimated at volume of $28tn and is forecasted to almost double by 2026. Online payments are generating $84bn in fees and have a projected 10 year CAGR of 9.2% to $202bn by 2026. The sub-segment includes 10 different market, one of which is food ordering/delivery. The online food ordering/delivery market remains competitive and is expected to grow at a 12.8% CAGR over the next 10 years. This is a positive growth environment for Grubhub who will continue to be the leading provider in industry. Another driver of the industry is the economic optimism under the Trump Administration. Markets continue to act bullish despite geopolitical concerns and a projected increasing rate environment. Trump's pro-growth strategy, tax-cuts, and deregulation should have a positive influence on e-commerce, as companies will have an easier time gaining access to new markets and expanding their business. This should directly impact Grubhub as they are currently awaiting the regulatory process of acquiring Yelp's Eat24 business into the Grubhub platform.

	Name (BICS Best Fit)	Sales Growth (%)	EBITDA Growth (%)	EBITDA Margin	Operating Income Margin	Net Profit	Net Income Growth (%)
	Median	19.80%	34.31%	19.06%	9.78%	3.98%	45.46%
100)	GRUBHUB INC	37.75%	34.74%	23.09%	16.24%	10.54%	43.61%
101)	BOINGO WIRELESS INC	19.80%	99.32%	23.23%	-11.40%	-12.75%	11.32%
102)	SHUTTERFLY INC	4.39%	9.02%	14.16%	4.64%	1.70%	-21.76%
103)	ZILLOW GROUP INC - A	30.29%	716.67%	10.80%	-0.12%	-1.76%	80.70%
104)	TRUECAR INC	16.09%	96.38%	-0.41%	-7.98%	-9.00%	47.32%
105)	TRIPADVISOR INC	4.50%	10.34%	16.70%	9.78%	6.30%	-26.95%
106)	MATCH GROUP INC	13.43%	32.76%	30.48%	27.16%	16.20%	70.13%
107)	WEB.COM GROUP INC	23.36%	34.31%	21.77%	11.68%	3.98%	73.20%
108)	GODADDY INC - CLASS A	16.17%	25.05%	12.35%	3.92%	2.43%	--
109)	BANKRATE INC	23.83%	-10.17%	19.06%	10.05%	4.66%	50.69%

Partnerships and Acquisitions:

In August 2017, Grubhub announced a long-term partnership with Yelp consisting of two primary components, causing a jump in its stock price and trade volumes in early August. Grubhub will become the preferred partner for online takeout ordering from restaurants on Yelp's platform, and will directly purchase

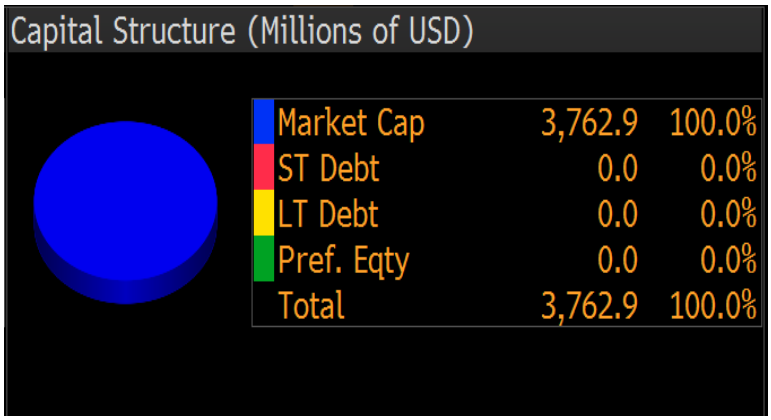
Yelp's Eat24 business for $287.5mn in cash. This acquisition is projected to be completed in Q3 2017 and is forecasted to drive millions of new orders a year for Grubhub. Yelp has significantly grown its network of restaurants since pushing into online food takeout market, creating a valuable opportunity for Grubhub to expand its own platform and attract new diners, thus increasing DAGs as well. Diners will benefit from this partnership too, as there will be a higher selection of low-cost dining options on the Grubhub platform. New restaurants on the platform will see an increase in new customers as well, due to increased advertising through Grubhub's network, creating a win-win scenario for all parties involved. If the regulations with the acquisition go through, Grubhub will gain an additional 15,000 restaurants in major cities such as Los Angeles and San Francisco. This will be a key driver in DAGs as historical data shows restaurant density increases Active Diners.

In a similar deal, Grubhub announced that they will be acquiring assets from Groupon's OrderUp business and will become their exclusive partner for online takeout ordering. Although smaller than the deal with Yelp, OrderUp is expected to boost Grubhub's exposure in Tier 2 and 3 markets that will likely complement their current footprint. Profits will be driven from increased ordering in State Colleges and markets such as Nashville, Baltimore, Indianapolis, and Cincinnati. The acquisition of Groupon's OrderUp platform has expanded Grubhub over an additional 27 markets and will drive over 6,000 DAGs in their respective markets

In addition, Grubhub has also announced the acquisition of Boston-based Foodler this past June and is expected to close out the deal in Q3 2017. Foodler brings a valuable customer-base as it was the first online food ordering platform in Boston and still has a loyal, frequent using customer base since its inception. Although the deal adds smaller volumes to Grubhub's network than the other contracts for Q3, it allows the unique opportunity to expand more in Boston and potentially the entire New England region.

Capital Structure & Expenditures:

Grubhub runs its operations with a WACC of 9.8% that consists of 100% equity. Although Grubhub's books state a D/E ratio of 0.0, Grubhub's 10k shows the usage of debt for leasing office facilities in its financial notes. In 2017, lease expenses were $5.3mn with a total of $41.8mn due by 2021. Beyond office facility leasing, Grubhub purchases all property, equipment, and software with cash and does not having any material long-term purchase obligations outstanding.



Recent expenditure within Grubhub's organization has focused on the improvement of marketing tactics and technology. Marketing and technology expenses in Q2 totaled $34.8mn and $14.1, respectively. This increase

of 37% and 33% shows Grubhub's commitment to improve its organization along with the growing online takeout industry. Depreciation expense and amortization increased 17% to $10.4mn year-over-year creating more tax savings and freed up cash.

Conclusion:

Growth forecasts within the Information Technology industry provide a positive outlook for Grubhub Inc., the leading provider in online food ordering. With the online food industry continually becoming more popular, Grubhub holds a strong position to attract new active diners due to their current market exposure and large network of popular restaurants. Continual organic growth combined with the partnerships of Yelp and Groupon will drive increases in GFS and DAGs, leading to value creation within the company. Earnings should come in higher for the remainder of the year and beginning of 2018 as seasonality effects benefit from the winter months. I think Grubhub will appreciate marginally through year-end with high growth potential in the coming 1-2 years.

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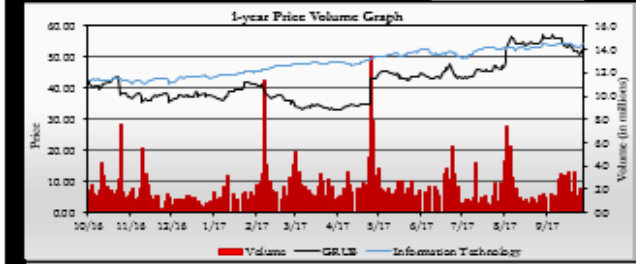
GrubHub Inc. (GRUB) — CENTER FOR GLOBAL FINANCIAL STUDIES — NEUTRAL

Analysis by RYAN ROSMARIN
10/5/2017

Current Price:	$53.67	Intrinsic Value	$54.68
Divident Yield:	0.0%	Target Price	$61.34

Target 1 year Return: 14.28%
Probability of Price Increase: 91



Description

GrubHub Inc., together with its subsidiaries, provides an online and mobile platform for restaurant pick-up and delivery orders in the United States.

General Information

Sector	Information Technology
Industry	Internet Software and Services
Last Guidance	November 3, 2015
Next earnings date	October 23, 2017
Estimated Country Risk Premium	5.69%
Effective Tax rate	20%
Effective Operating Tax rate	25%

Market Data

Market Capitalization	$4,636.70
Daily volume (mil)	1.67
Shares outstanding (mil)	86.39
Diluted shares outstanding (mil)	86.98
% shares held by institutions	84%
% shares held by investment Managers	80%
% shares held by hedge funds	39%
% shares held by insiders	0.67%
Short interest	22.32%
Days to cover short interest	10.61
52 week high	$57.61
52-week low	$32.43
Volatility	0.00%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
6/30/2016	4.05%	-6.43%
9/30/2016	2.03%	-15.72%
12/31/2016	-1.18%	-21.02%
3/31/2017	0.34%	-20.68%
6/30/2017	-1.06%	-28.82%
Mean	0.84%	-18.53%
Standard error	1.0%	3.7%

Peers

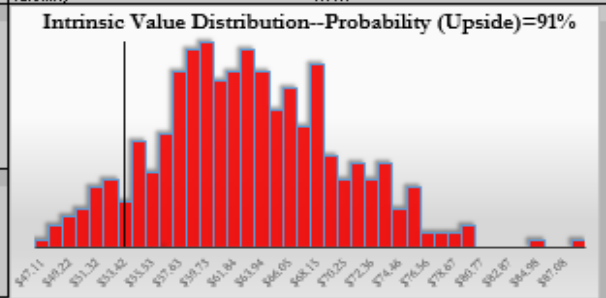
Yelp Inc.
Zillow Group, Inc.
Shutterstock, Inc.
LogMeIn, Inc.
Cars.com Inc.
Bankrate, Inc.
Pandora Media, Inc.
Shopify Inc.

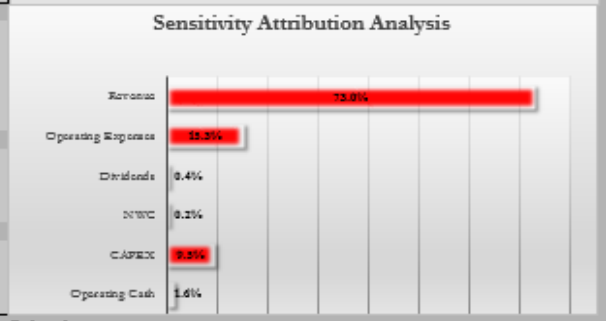
Management	Position	Total compensation grou	Total return to shareholders
Maloney, Matthew	Founder, Chief Executive Off	11.36% per annum over 3y	N/M
DeWitt, Adam	Chief Financial Officer and	-5.13% per annum over 3y	N/M
Chia, Stanley	Chief Operating Officer	-84.25% per annum over 1y	55.45% per annum over 1y
Drucker, Marga	Senior Vice President, Gener	22.57% per annum over 3y	N/M
Cappola, Barbara	Chief Marketing Officer	-87.2% per annum over 1y	55.45% per annum over 1y
Zaragoza, David	Director of Corporate Financ	N/M	N/M

Profitability	GRUB (LTM)	GRUB (5 years hirtorical av Peers' Median (LTM)
Return on Capital (GAAP)	14.1%	15.07%	81.18%
Operating Margin	16%	19.11%	3.82%
Revenue/Capital (GAAP)	0.89	0.79	21.23
ROE (GAAP)	6.1%	4.9%	6.0%
Net margin	10.3%	9.6%	10.4%
Revenue/Book Value (GAAP)	0.59	0.51	0.58

Invested Funds	GRUB (LTM)	GRUB (5 years hirtorical av Peers' Median (LTM)
Cash/Capital	36.3%	31.6%	55.2%
NWC/Capital	-4.4%	-9.6%	-29.5%
Operating Assets/Capital	25.6%	23.7%	39.1%
Goodwill/Capital	42.5%	54.5%	35.2%

Capital Structure	GRUB (LTM)	GRUB (5 years hirtorical av Peers' Median (LTM)
Total Debt/Market Capitalization	0.00	0.00	0.16
Cost of Existing Debt	4.0%	4.0%	5.0%
CGFS Rating (Fscore, Zscore, and default Probabili	BBB	BB	BB
WACC	9.2%	9.7%	10.2%





Porter's 5 Forces (scores are out of 100)

Valuation

Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	38%	23.1%	0.43
6/30/2018	18%	10.9%	0.46
6/30/2019	16%	14.0%	0.47
6/30/2020	15%	16.4%	0.48
6/30/2021	13%	18.4%	0.47
6/30/2022	12%	20.1%	0.46
6/30/2023	11%	30.9%	0.45
6/30/2024	9%	31.3%	0.41
6/30/2025	8%	31.7%	0.38
6/30/2026	6%	32.1%	0.35
6/30/2027	5%	32.4%	0.32
Continuing Period	4%	32.7%	0.29

Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	10.0%	9.2%	$53.87
6/30/2018	5.1%	9.2%	$59.87
6/30/2019	6.6%	9.2%	$66.48
6/30/2020	7.8%	9.2%	$73.56
6/30/2021	8.7%	9.2%	$81.11
6/30/2022	9.3%	9.2%	$89.12
6/30/2023	13.8%	9.2%	$97.59
6/30/2024	12.8%	9.3%	$106.49
6/30/2025	11.9%	9.3%	$116.79
6/30/2026	11.1%	9.3%	$126.45
6/30/2027	10.3%	9.3%	$136.44
Continuing Period	9.5%	9.3%	