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3-SIGMA VALUE

Q3 2016 in Review

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3-SIGMA VALUE

Q3 2016 in Review

For the quarter ended September 30, 2016, 3-Sigma Value, LP (the "Partnership") had an estimated loss of 0.4% (net of management fees and expenses) with average gross exposure of 97.3% and net exposure of *negative* 16.1%.

3-Sigma Value, LP

PERFORMANCE AND EXPOSURE STATISTICS[1]

	Monthly Performance		Average Fund Exposure			
	Gross[2]	Net[3]	Long	Short	Gross	Net
2011	37.4%	29.9%	78.6%	89.4%	168.1%	-10.8%
2012	32.3%	25.8%	64.8%	79.0%	143.8%	-14.1%
2013	-12.8%	-12.8%	46.7%	72.4%	119.1%	-25.7%
2014	18.1%	14.4%	7.4%	54.9%	62.3%	-47.4%
2015	12.8%	10.2%	22.9%	41.6%	64.5%	-18.7%
January	3.9%	3.1%	39.5%	54.2%	93.7%	-14.7%
February	-2.8%	-2.2%	36.2%	42.8%	79.0%	-6.6%
March	2.0%	1.6%	32.0%	40.8%	72.8%	-8.8%
April	-1.2%	-1.0%	35.0%	54.2%	89.2%	-19.2%
May	0.1%	0.1%	38.2%	60.5%	98.7%	-22.3%
June	-1.4%	-1.1%	37.7%	55.5%	93.2%	-17.8%
July	-1.4%	-1.4%	40.4%	55.1%	95.5%	-14.7%
August	0.5%	0.5%	41.4%	55.9%	97.3%	-14.4%
September	0.5%	0.5%	40.0%	59.1%	99.1%	-19.2%
2016 YTD	0.0%	0.0%	37.8%	53.1%	90.9%	-15.3%
Cumulative [4]	110.8%	79.7%				
Annualized [4]	13.8%	10.7%				

1 All performance statistics listed herein have been audited by an independent third party auditor with the exception of the statistics for any period after December 31, 2015, which are unaudited estimates confirmed by an independent third party administrator.
2 Net of management fee and expenses.
3 Net of incentive fee.
4 Since January 2011.

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The Partnership's portfolio, both long and short, focuses its investment efforts in three industries – Technology, Media & Telecom ("TMT"), Natural Resources, and Financials. In total, 3-Sigma Value, LP is invested long in 17 companies, and short 27 companies. Our investment approach is global in scope, yet, at this time, North American equities constitute the vast majority of our gross exposure. We are market-cap agnostic.

At September 30, 2016, the 3-Sigma Value portfolio had gross long exposure of 40.7% and gross short exposure of 63.8%, for net investment exposure of *negative* 23.1%. As value investors frequently targeting companies facing rapidly changing operating performance and/or market perceptions, we remain cognizant that portfolio correlation to the market can change on a dime and thus the continuity between the past and future is tenuous at best. Notwithstanding this caveat, we generally seek overall market agnosticism in the construction of the portfolio as reflected in a target range of net exposure between *negative* 25% and *positive* 25%.

Balance Sheet (% Of Equity) - 9/30/16				
	Long	Short	Gross	Net
By Industry				
Technology	13.5%	-39.7%	53.2%	-26.2%
Natural Resources	11.8%	-11.0%	22.9%	0.8%
Financials	15.4%	-13.0%	28.3%	2.4%
Total	40.7%	-63.8%	104.4%	-23.1%
By Geography				
North America	32.7%	-56.7%	89.5%	-24.0%
South America	3.0%	0.0%	3.0%	3.0%
EMEA	4.9%	-2.5%	7.4%	2.4%
Asia	0.0%	-4.5%	4.5%	-4.5%
Total	40.7%	-63.8%	104.4%	-23.1%
By Market Capitalization				
Greater than $1B	31.4%	-28.0%	59.4%	3.4%
$500M - $1B	1.1%	-12.5%	13.6%	-11.4%
Less than $500M	8.2%	-23.3%	31.5%	-15.1%
Total	40.7%	-63.8%	104.4%	-23.1%
# of Positions				
# of Long Positions	17			
# of Short Positions	27			
Total # of Positions	44			

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Net exposure is roughly flat in two of the three industries that we invest in – Natural Resources/Industrials (+0.8% net) and Financials (+2.4% net). In our third industry – Technology, Media and Telecommunications (TMT) – we continue to find significantly more attractive short candidates than long and as a result continue to maintain material short exposure. The 39.7% gross short invested in TMT is comprised of 13 companies ranging in allocation from 1.6% to 4.5% of AUM. Every one of them has a great story, some of which are available in the research section at www.3sigmavalue.com, including the idea we shared in our second quarter 2016 letter – **Atlassian (TEAM)**, a polished turd at the peak of its hype cycle executing on a fundamentally flawed business model. While we love sharing these short stories, we equally love the three TMT longs in the portfolio (at 9/30/16) – two of which were spin-offs in 2015, the third is featured here.

A confluence of powerful secular trends are revolutionizing the advertising business – (1) the continuing digitalization of advertising, (2) the coordination of advertising across channels/devices, (3) the secular shift to real-time bidding (RTB) and programmatic buying of advertising, (4) the increase in one-to-one, personalized advertising, and (5) performance-based advertising (cost per click (CPC)). **Criteo SA (CRTO)**, based in Paris France, sells a digital ad re-targeting technology that works with retailers to serve personalized online/mobile display advertisements to consumers that have previously visited the advertiser's website/mobile application. Rather than charge clients on a traditional cost per thousand impressions (CPM) basis for ads delivered, i.e. $10 CPM, Criteo charges on a click-through basis and measures performance on the basis of post-click sales[1].

Since Criteo only gets paid when a user engages with an advertisement (clicking on it), the result is a pay for performance model that is more effective (higher ROIC) than the traditional pay for delivery model. Moreover, whereas CPM pricing requires clients to set a budget, the click-through model enables uncapped spending that is effectively constrained only be Criteo’s ability to find enough relevant opportunities for clients to achieve their specific return objectives. In 2015, 78% of Criteo’s revenues were derived from clients with uncapped budgets.

On May 31, 2016, Marketo (MKTO), a marketing automation software company comparable to Criteo (CRTO) was taken out by private equity firm Vista Equity Partners for $1.7 billion

[1] A post-click sale is defined as a purchase made by a user within a certain period of time following the user clicking on an advertisement that Criteo delivered for that client. This period of time varies by client, but is a maximum of 30 days. Post-click sales is a superior way to measure effectiveness.

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enterprise value, equal to 5.3x CY16 revenue. Unlike Criteo, which is profitable (15% operating margin and rising), Marketo generates negative EBITDA.

The Marketo take-out is the latest in a long line of digital advertising M&A that dates back to the great Internet advertising consolidation of 2007 when Google acquired DoubleClick, Yahoo acquired Right Media, Microsoft acquired aQuantive, and WPP acquired 24/7 Real Media. More recently, Oracle acquired Eloqua for 8.6x NTM revenue, and Alliance Data Systems (ADS) acquired Conversant f.k.a. ValueClick for 3.4x NTM revenue.

Between Eloqua and Conversant, the range of valuation is wide, from 3.4x (10x EBITDA) to 8.6x revenue (NM EBITDA)[2]. The discriminating factor is not timing nor perception; it is the quality of the underlying business, quantified as follows:

(1) Gross Margin (GM) – shows how much technology content is in each sale. A lower gross margin means the vendor is paying someone else, generally in the form of a license or royalty. The most efficient technology companies that develop all of their IP in-house report gross margins above 90%. On the other end of the spectrum, vendors that license or pay royalties on technology developed elsewhere report gross margins closer to 60%. Criteo's gross margin hovers around 88%.

(2) Cumulative R&D / R&D as a % of Revenue + Cumulative Capex / Capex as a % of Revenue – signals the value of the underlying intellectual property (IP). While plenty of companies waste money developing technologies that don't work or aren't wanted, if a company doesn't spend any money at all on research and development (R&D) then how can it purport to be a technology company? Criteo will spend around $126 million on R&D in 2016, equal to ~17% of revenue, and ~$56 million on capital expenditures (PP&E + capitalized software), down from $76 million spent on capex in 2015. Management's guidance for capex is 5% of revenues. Combined technology expenditures in excess of 20% of revenue is robust.

(3) Operating Margin (OM) – shows how efficiently a company is managed. Technology is scalable and the cost of technology deflationary due to innovation and Moore's Law. R&D

[2] Similar to the wide range of valuations earned in M&A transactions, valuations of publicly-traded digital advertising companies diverge on the basis of the quality of the underlying business and technology. Publicly-traded comparable companies include: HubSpot (HUBS), The Rubicon Project (RUBI) TubeModul (TUBE), Marin Software (MRIN), RocketFuel (FUEL), and The Trade Desk (TTD).

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expenses tend to be relatively consistent over time while operating leverage is earned in sales and marketing (S&M), and general and administrative (G&A) to a lesser extent. Criteo's operating margin in 2016 should exceed 15%.

(4) Ultimately, cash is what matters, not earnings. 2016E EBITDA ~$177 million (10.4x EBITDA) translates into free cash flow of approx. $95 million. In our Base Case Operating Scenario 1, we assume Criteo adds approximately 3,000 net clients per year, consistent with recent history. In this scenario, EBITDA grows to $338 million (5.4x EBITDA) in 2018 with FCF in excess of $258 million.

In a Downside Case Operating Scenario, in which Criteo adds zero net clients per year, revenue stagnates ~$770 million, with EBITDA ~$200 million and FCF ~$150 million. As we illustrate later in this analysis, we believe the current stock price ($33.57) reflects this downside and underestimates the ability of Criteo to continue adding new middle-market clients.

CRTO Capitalization (in US$) as of 6/30/16				
10/30/13 IPO Price				$31.00
Share Price at end of first day of trading				$35.39
Share Price as of 10/11/16				$33.57
x Shares Out.				65.6
= Market Capitalization				$2,203.0
- Cash & S-T Investments				$377.4
+ Total Debt				$8.9
= Enterprise Value (EV)				$1,834.5
	Base Case Operating Scenario 1			
	2015	2016E	2017E	2018E
Revenue, ex. TAC	$534.0	$730.7	$925.9	$1,110.4
EV / Revenue	3.4x	2.5x	2.0x	1.7x
EBITDA	$123.4	$177.1	$242.3	$337.8
EV / EBITDA	14.9x	10.4x	7.6x	5.4x
EPS	$0.94	$1.21	$1.81	$2.71
P/E, cash adjusted	29.6x	23.1x	15.5x	10.3x

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Financial Analysis

We identify the significant assumptions (factors) underlying our analysis of Criteo (CRTO):

1. Net Additions (Gross Additions less Cancellations) – we use rolling LTM client additions and cancellations in the Base Case Operating Scenarios and establish a range plus/minus 10% for the upside/downside scenarios in 2016. We assume zero net client additions beyond 2016 in the downside cases.

2. Revenue per Average Client – we use a range around 0%, despite historical growth in excess of 20%. 85% of new client growth is from the middle-market, which offsets organic same-store revenue growth.

3. Traffic Acquisition Cost (TAC) and other Cost of Revenue (mainly hosting and data) – we use rolling LTM across all scenarios as there is limited deviation. When we use the metric *revenue* in the context of digital advertising, we are referring to *revenue ex. TAC*.

4. Operating Expenses:
    a. S&M as a % of Revenue – we use rolling LTM, reflecting little-to-no operating leverage in spite of management insistence otherwise
    b. R&D – no leverage in R&D according to management
    c. G&A – we use LQA, reflecting flattish G&A.

5. Tax Rate – we use French income tax rates in connection with management's guidance of 30%

6. Stock Comp as a % of Revenue ex. TAC – we use rolling LTM, which is approximately 5% of revenues.

7. Capex (PP&E + Capitalized Software) – we use management's guidance of 5% of revenues.

8. WACC / Terminal Value Multiple – we use 10% WACC and CTRO's current multiple of 2016 EBITDA, which is 10.4x. Therefore, multiple expansion is not necessary for an investment in CRTO to be profitable.

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Criteo (CRTO) - Base Case Operating Scenario 1						
IN US$ UNLESS OTHERWISE INDICATED	2013	2014	2015	2016	2017	2018
Customer Metrics						
# of Active Clients, beginning of period	3,379	5,072	7,190	10,198	13,554	16,554
Net Additions	1,693	2,118	3,008	3,356	3,000	3,000
Active Clients, end of period	5,072	7,190	10,198	13,554	16,554	19,554
Active Clients, average	4,226	6,131	8,694	11,876	15,054	18,054
Gross Revenue per Avg Client	116.0	121.3	153.7	151.6	151.6	151.6
% Growth YoY		*4.6%*	*26.7%*	*-1.3%*	*0.0%*	*0.0%*
Gross Revenue	443,960	745,082	1,323,170	1,801,266	2,282,439	2,737,278
Change			578,088	478,096	481,173	454,839
% Change			*77.6%*	*36.1%*	*26.7%*	*19.9%*
Cost of Revenue:						
Traffic Acquisition Cost (TAC)	-264,952	-441,428	-789,153	-1,070,590	-1,356,578	-1,626,913
% of Revenue	*59.7%*	*59.2%*	*59.6%*	*59.4%*	*59.4%*	*59.4%*
Revenue ex. TAC	**179,008**	**303,654**	**534,017**	**730,676**	**925,861**	**1,110,365**
% Growth YoY		***69.6%***	***75.9%***	***36.8%***	***26.7%***	***19.9%***
Other Cost of Revenue	-21,956	-36,150	-62,200	-85,775	-108,688	-130,347
% of Revenue	*12.3%*	*11.9%*	*11.6%*	*11.7%*	*11.7%*	*11.7%*
Total Cost of Revenue	-286,908	-477,578	-851,353	-1,156,365	-1,465,266	-1,757,260
Gross Profit	**157,052**	**267,504**	**471,817**	**644,901**	**817,174**	**980,018**
% Margin	***87.7%***	***88.1%***	***88.4%***	***88.3%***	***88.3%***	***88.3%***
Operating Expenses:						
S&M	-82,816	-133,392	-229,530	-294,699	-373,422	-447,837
% of Revenue	*46.3%*	*43.9%*	*43.0%*	*40.3%*	*40.3%*	*40.3%*
R&D	-32,175	-45,292	-86,806	-126,253	-159,979	-163,979
% of Revenue	*18.0%*	*14.9%*	*16.3%*	*17.3%*	*17.3%*	*17.3%*
G&A	-31,387	-48,788	-79,145	-110,567	-114,440	-114,440
% of Revenue	*17.5%*	*16.1%*	*14.8%*	*15.1%*	*12.4%*	*10.3%*
Total Operating Expenses	-146,378	-227,472	-395,481	-531,519	-647,841	-726,256
% of Revenue	*81.8%*	*74.9%*	*74.1%*	*72.7%*	*70.0%*	*65.4%*
EBIT	**10,674**	**40,032**	**76,336**	**113,382**	**169,333**	**253,763**
% Margin	***6.0%***	***13.2%***	***14.3%***	***15.5%***	***18.3%***	***22.9%***
Other Income (Expense)	-6,868	8,586	-4,541	-1,411	0	0
Pre-tax Income	3,806	48,618	71,795	111,971	169,333	253,763
Tax Provision	-2,413	-13,252	-9,518	-32,707	-50,800	-76,129
Tax Rate	*63.4%*	*27.3%*	*13.3%*	*29.2%*	*30.0%*	*30.0%*
Net Income	1,393	35,366	62,277	79,264	118,533	177,634
FD Shares Outstanding	55,175	62,646	66,002	65,440	65,625	65,625
EPS	**0.03**	**0.52**	**0.94**	**1.21**	**1.81**	**2.71**
EBITDA	**22,869**	**65,178**	**123,421**	**177,065**	**242,274**	**337,808**
NOPAT	3,907	29,120	66,216	80,263	118,533	177,634
+ D&A	12,195	25,146	47,085	63,683	72,942	84,045
+ Stock Comp	6,876	14,778	23,989	34,671	43,933	52,688
as a % of Revenue ex. TAC	*3.8%*	*4.9%*	*4.5%*	*4.7%*	*4.7%*	*4.7%*
+ Decrease (Increase) in Working Capital	12,965	3,450	15,231	-27,437	0	0
- Capex (PP&E + Capitalized Software)	-21,913	-35,389	-75,617	-56,098	-46,293	-55,518
as a % of Revenue ex. TAC	*12.2%*	*11.7%*	*14.2%*	*7.7%*	*5.0%*	*5.0%*
Free Cash Flow	**14,030**	**37,105**	**76,904**	**95,082**	**189,115**	**258,849**

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Revenue growth slows to 20% in Base Case Operating Scenario 1 while operating margin climbs from 15% to 23%. Similarly, $1.21 of 2016 EPS grows to $2.71 in 2018. To value CRTO, we use discounted cash flow analysis (DCF), sanity checked with price-to-earnings (P/E).

CRTO Valuation Summary

	Live	Upside	Base 1	Base 2	Base 3	Downside	Weighted-Avg
Net Client Additions - 2018	3,000	3,300	3,000	2,000	1,000	0	
Revenue ex. TAC	1,110,365	1,223,481	1,110,365	1,018,113	925,861	771,510	
EBITDA	337,808	384,001	337,808	297,676	257,545	193,808	
Free Cash Flow	258,849	291,395	258,849	230,623	202,397	157,495	
PV of UFCF @ WACC	437,208	474,773	437,208	410,360	383,511	333,771	
Terminal Valuation @ Current Multiple	2,629,585	2,921,653	2,629,585	2,317,190	2,004,796	1,543,836	
Net Debt	-368,489	-368,489	-368,489	-368,489	-368,489	-368,489	
Equity Value	3,435,281	3,764,914	3,435,281	3,096,039	2,756,796	2,246,097	
per share	$52.35	$57.37	$52.35	$47.18	$42.01	$34.23	**$48.44**
% Upside (Downside)	55.9%	70.9%	55.9%	40.5%	25.1%	2.0%	**44.3%**
2018 EPS	2.71	3.18	2.71	2.29	1.88	1.22	
Current P/E Multiple, cash adjusted	23.1x	23.1x	23.1x	23.1x	23.1x	23.1x	
Target Price	$62.47	$73.41	$62.47	$52.89	$43.32	$28.20	**$55.49**
% Upside (Downside)	86.1%	118.7%	86.1%	57.6%	29.0%	-16.0%	**65.3%**
Average of DCF & P/E	$57.41	$65.39	$57.41	$50.04	$42.66	$31.21	**$51.96**
% Upside (Downside)	71.0%	94.8%	71.0%	49.1%	27.1%	-7.0%	**54.8%**
Implied Multiple of Revenue	3.7x	3.8x	3.7x	3.6x	3.4x	3.1x	

Downside Analysis (Quantifying the Risk)

The major risk facing CRTO is from ad blocking technology. CRTO maintains that ad blocking will have nothing more than a minimal impact on financial performance because CRTO's adds are highly re-targeted and high quality. Nevertheless, it is plausible that ad blocking more substantially disrupts CRTO than expected and growth arrests. With clients ramping through 2016, revenue will grow to over $700 million. Beyond 2016, if we assume zero net client additions and zero growth in revenue per client, then revenue will flat line at around $770 million. This produces flattish operating margin and EPS of $1.22 in 2018. Average of DCF & P/E = $31.21.

In conclusion, the market presupposes CRTO has fundamentally peaked. In contrast, we see the stock as an opportunity to earn 50% capital appreciation with asymmetrical reward versus risk. Downside is limited. CRTO is materially undervalued.

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