3-SIGMA VALUE

Polishing Turd

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On June 25, 2012, Microsoft (MSFT) announced the acquisition of Yammer for $1.2 billion cash. The valuation is irrelevant from a comparable company standpoint as Yammer only generated $15-$20 million of revenue in 2011 according to reports. And by all accounts Yammer is not a category killer on the cusp of dramatic adoption. Therefore, the valuation paid by Microsoft is strategic, not financial. It fills a widening gap that Microsoft was struggling to fill as its SharePoint application for creating private websites for intra-company projects was losing clients to the new collaboration platforms that integrate social and mobile in addition to web sites.

Collaboration software for enterprises has attracted big technology vendors such as Cisco Systems (CSCO), which has a similar offering to Yammer called WebEx Social, and International Business Machine (IBM) with a rival product called Connections. In addition, Yammer competes against Asana (founded by Dustin Moskovitz), Salesforce.com Chatter (CRM), and VMWare/SocialCast (VMW).

On December 13, 2011, **Jive Software (JIVE)** went public at $12.00 per share, and closed its first day of trading at $15.05. Jive, founded in 2001 by a dot com redux management team led by CEO Tony Zingale is changing the world. The pitch, which is valid, is that collaboration increases productivity, produces fewer emails, decreases support calls, and overall lowers cost. The problem is that workplace collaboration software is already the most popular and commoditized SaaS application (by function) with low complexity and low IP value. According to IDC data, $3.5 billion was spent (in 2010) on subscription-based collaboration software, followed by content ($1.8B), CRM ($1.6B), Engineering ($1.2B), ERM ($1.1B), Operations / Manufacturing ($0.7B), and Supply Chain Management ($0.4B).

Competition in collaboration software (re-named social business) is free/freemium and fierce. Salesforce.com's Chatter is offered for free, at the entry level. Yammer is freemium and sold via integration partnerships with channels including **Netsuite (N)** and Microsoft Dynamics. IBM – enterprise collaboration products include Lotus Quikr and Lotus Live, and IBM Connections products, EMC/Documentum – eRoom, CenterStage, and **TIBCO (TIBX)** – enterprise social collaboration tool called Tibbr launched Jan 2011, give it away to customers at no incremental

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cost. Telligent ($32M in 2010), Socialtext ($26M), and Lithium ($22M) are independent social vendors that have also achieved similar critical mass (Jive was only $38M in 2010).

In May 2012, Jive formally launched Try Jive, a fully-loaded edition of Jive's platform that prospective clients can trial for free for 30 days. This is the first step of a 2-step transition to the pitiable freemium model which is always more free than premium.

Clients access the platform via cloud, hosted or on-premise deployments. Hosted services are outsourced to SunGuard Availability Services (SunGuard). Jive is in the process of transitioning a portion of its hosting services to a Jive managed hosting facility, but has no plans to transition entirely. As a result of the outsourcing of a large portion of its cost of goods sold (COGS), Jive reports lower gross margins than its SaaS peers, in fact, Jive is near the low end of the software universe ~60%. In contrast, **Check Point Technologies (CHKP)** reports 60% operating margins.

In addition to the lack of a proprietary back-end and reliance on 3rd-party providers, Jive's product architecture is not based on a single base of code; it is not multi-tenant software that is shared by its customer base enabling operating leverage. Instead, Jive's customer base uses several different versions of the technology, including Jive Express, v3, v4, and v5 of the core product, and now Try Jive. Supporting multiple versions of code adds complexity and cost. Excluding the 100 or so clients on Jive Express rolling off throughout the remainder of 2012, the majority of Jive clients are still using v4 and face an uncertain upgrade decision – allow Jive to retrofit legacy on-premise deployments or use new, multi-tenant architecture designed for the cloud – e.g. Yammer, Salesforce.com (CRM).

As of December 31, 2011, Jive had 667 Engage Platform customers with over 20 million users within these customers and their communities. The top 10 customers by annual contract value include ACE Group, H-P, SAP, T-Mobile, and UBS. Top line growth is tied to sales execution, and therefore the Company is doubling the size of its sales force by the end of 2012 versus 2010.

Following is a summary of the significant assumptions underlying 3-Sigma Value’s scenario analysis:

1. **Billings** (new customers, net of churn + upsell of customers above the amount of renewal) is a leading indicator of growth, while revenue is a lagging indicator. In the first quarter of 2012, upsell was strong within Jive’s customer base (65% of billings are attributable to upsell

according to management, up from 62% in Q4 2011), but this data is misleading because expansion in upsell as a % is the natural result of deceleration in new customer growth. Management says attracting new enterprise customers is difficult, and growth is dependent on the upsell - they say upsell within the customer base is 6x the initial purchase, on average, driving an incremental share of new billings. In fact, Q1 2012 was horrible with respect to revenue from new subscriptions, declining from $6.8 million to $4.7 million (down 32%).

> Billings is determined by (1a) new customers, gross; (1b) new billings per new customer; (1c) upsell rate; (1d) churn – high at nearly 20% per annum is a red flag

Billings deceleration is a certainty, undermining the consensus view that Jive is a growth stock. Jive is not Facebook with 900+ million individual customers. It has 667 enterprise customers at the end of 2011, up only 13% from the 590 customers reported at the end of 2010. Collaboration is an intensely competitive market, one that will restrict the ability of Jive to become a dominant vendor like Facebook. Instead, Jive will be a niche provider that is roughly breakeven on an operating basis. The best case scenario for Jive is obviously a take-out.

2. **Retention** (renewal billings as a % of total billings) – moving up from 35-36% in Q2/Q3 2011 to 42% in Q4, and 46% in Q1 2012. Management expects the percentage to rise as new billings growth decelerates. This assumption is tied to upsell rate.

3. **Professional Services Attach Rate** – the mix of subscriptions versus services impacts margin as services is a zero margin business.

4. **Gross Margins** – subscription gross margin of ~70% is low by software standards, suggesting a lack of IP in the products being sold. Services is a zero margin business, and has been in negative territory for the past two years (-17% in 2010, -5% in 2011).

5. **Operating Expenses** - Management is doubling the sales force (S&M) off a Q1 2011 base of $8.5 million by the end of Q4 2012 (Q1 2013 S&M = $17 million). Increased spending in R&D and G&A is expected as well.

6. **No taxes** because no profits

7. **WACC & Terminal Value Multiple** – WACC is elevated at 16% due to a high 2.25 beta. Multiple is based on comparable M&A transactions.

Valuation multiples paid in M&A are all over the place, largely based on the quality of the IP and strategic rationale for the acquisition.

At the high end, on June 4, 2012, **Salesforce.com (CRM)** announced the $689 million acquisition of Buddy Media (14x $50 million run rate revenue), a company that helps more than 1,000 marketers including Ford Motor and L'Oreal, to manage their presence on Facebook and other social networking sites. This comes two weeks after Oracle acquired Vitrue, an Atlanta-based social marketing platform for $310 million ($10-$25 million of revenue). Vitrue clients include MCD, YHOO, AXP, and LUV. Consolidation will leave the weakest players to fend for themselves.

At the low end are take-outs of commoditized / low tech SaaS vendors including iContact, an email-marketer that was acquired by **Vocus (VOCS)** for 3.5x revenue (on 2/28/12), and Convio, an internet marketer tailored for non-profit organizations that was acquired by **Blackbaud (BLKB)** for 3.4x (on 1/17/12).

In an Upside Case operating scenario in which Jive is acquired, we believe the multiple will depend on the timing, strategic value, and wherewithal of the acquirer. This results in a broad range of valuations between 3.4x and 10x billings (consolidation around 5x).

Our Base Case operating scenario is not dependent on M&A, and therefore the valuation is more directly related to the underlying fundamentals. Although Jive generates no EPS, EBIT or EBITDA, it does generate positive free cash flow in our Base Case scenarios. That is because deferred revenue is not reflected in the income statement and therefore revenues are less meaningful when valuing a subscription-based software company. Billings is more significant because it more accurately captures the current state of the business and its momentum. In addition, we incorporate a free cash flow model into our valuation work.

	Upside	Base	Downside	Avg Billings
Probability (%)	20%	60%	20%	
Billings - 2012E	144.1	120.7	98.8	
Billings - 2013E	153.9	132.1	109.9	132.0
Multiple of Billings *	5.0x	3.4x	2.0x	3.4x
Enterprise Value (EV)	769.7	449.2	219.8	448.9
Plus: Net Cash	165.7	165.7	165.7	165.7
Market Cap	935.4	614.9	385.5	614.6
Fully-diluted Shares Out	77.9	77.9	77.9	77.9
Target Price	12.02	7.90	4.95	7.89
% Upside (Downside) =	*-29.5%*	*-53.7%*	*-71.0%*	*-53.7%*
Weighted-average Billings-based Target Price	8.13			
Free Cash Flow - 2013	13.4	-5.6	-24.3	-5.5
% Yield (comps)	*5.0%*	*0.0%*	*0.0%*	*0.0%*
Enterprise Value (EV)	268.0	0.0	0.0	0.0
Target Price	5.57	2.13	2.13	2.13
% Upside (Downside) =	*-67.3%*	*-87.5%*	*-87.5%*	*-87.5%*
Weighted-average FCF-based Target Price	2.82			
Average of Billings- and FCF-based Valuation Meth	5.47			
	-67.9%			

* 5x upside take-out, 3.4x for zero profit software take-out, 2x for junk

Conclusion: Jive is jive. Jive is still jive. And jive will always be jive. According to the dictionary, jive means glib, deceptive, or foolish talk. It can also mean deceitful or worthless, as well as it refers to a lively style of dance popular especially in the 1940s and 1950s. In the case of Jive Software, it is collaboration masking as social, the old pretending to be new. Jive is not Facebook, although it was priced in the immediate lead up to The Social Network's epic IPO. Instead, it is a standalone copy of Salesforce.com Chatter, competing against Microsoft Sharepoint/Yammer, IBM, Oracle and the other incumbent enterprise software vendors. Jive is an old idea regurgitated as new. Jive is a turd, what we refer to here at 3-Sigma Value as *a polished turd*.