



POLLEIT & RIECHERT
Investment Management



- A case study in disruptive innovation -



Presentation on the Widemoat Investing Summit 2015

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Idea summary

Cimpress (formerly known as Vistaprint) is a disruptive innovator, specialising in print on demand and mass customisation. It has a durable scale advantage, will compound for a long period in a large market and it is cheap.

Name	Cimpress (CMPR)
Stock price on 3.7.2015	\$82.01
Mcap	\$2,669 Mio.
+net Debt	\$359 Mio.
+ min. interest	\$14 Mio.
=TEV	\$3,041 Mio.
P/E (LTM)	28x
TEV/EBIT (LTM)	23x
But: P/Owner's Earnings estimate (2015)	14x

CEO Robert Keane owns 5.5%; several value investors are invested: Prescott Investors (14%), Brave Warrior (7.7%), Arlington (3.5%) ... and P&R (...%).



Stock chart

Focus on long-term results and willingness to suffer short-term.

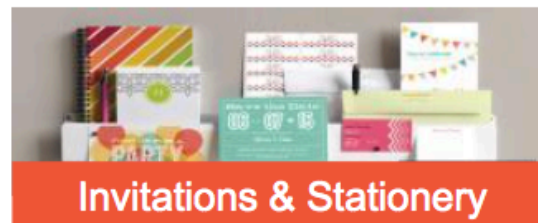
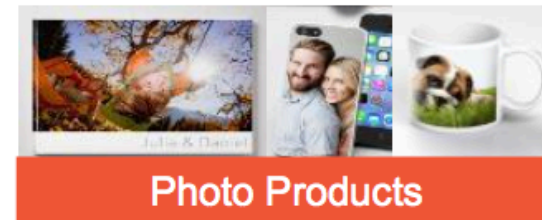


Business Model



How do they make money?

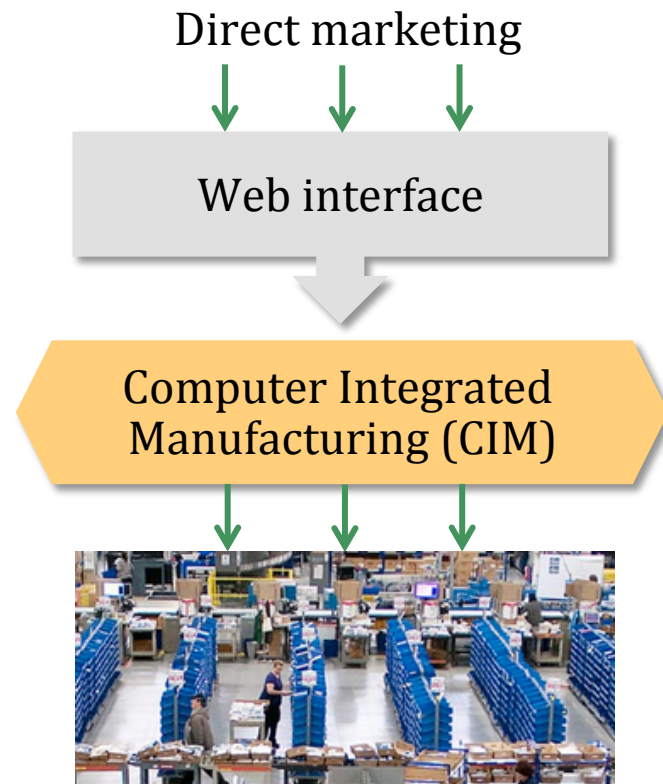
Cimpress produces individual personalised marketing products for small and micro businesses, graphic professionals and home & family.





How do they make money?

Cimpres produces small, individual orders with the reliability, quality and affordability of mass production



Acquisition of customer

Customer orders & designs individual products online

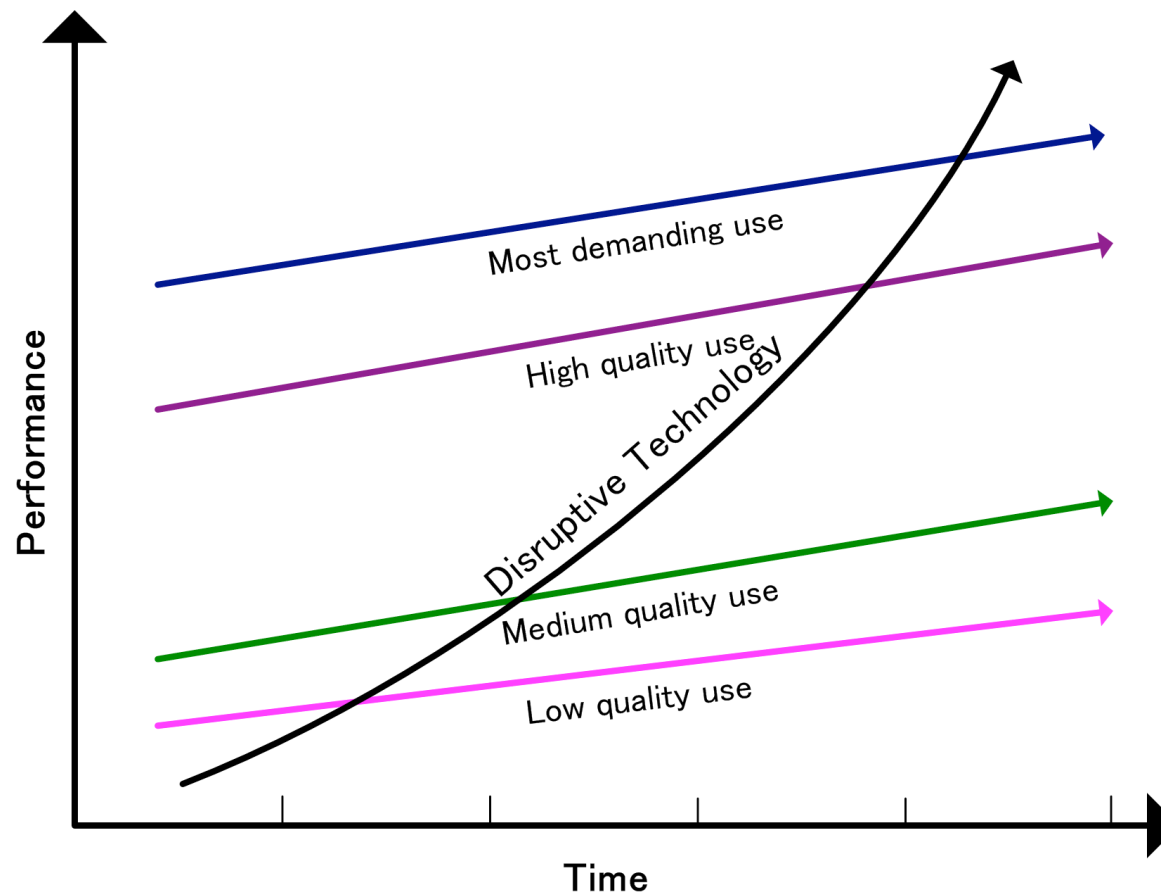
CIM system allocates and aggregates order to most efficient production unit

*Automation + mass customisation
>>> **economies of scale***



The theory: Disruptive Innovation

Clay Christensen (Innovator's Dilemma) describes a process by which a product or service takes root initially in simple applications at the bottom of a market and then relentlessly moves up market, eventually displacing established competitors.





Test questions: Disruptive Innovation

1. Is the DISRUPTOR offering simpler, cheaper, more reliable, more comfortable – but not necessarily more sophisticated products?



2. Is the DISRUPTOR targeting a new (or price sensitive) group of customers?



3. Does the DISRUPTOR have a different business model that allows for attractive returns and low prices?



4. Are incumbents able to flee upmarket?



5. Is the DISRUPTOR creating new barriers to entry?





Evolution of Cimpres

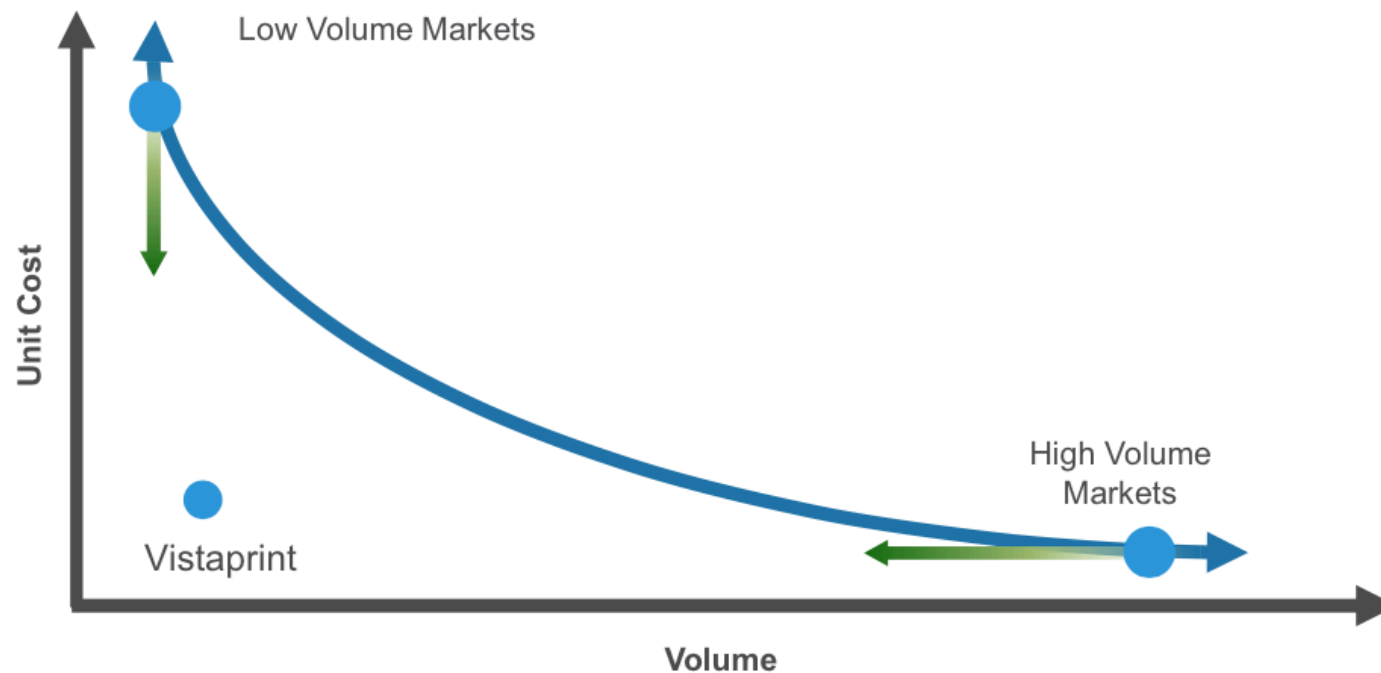
Phase 1: cheap, low quality – transaction focus





Evolution of Cimpres

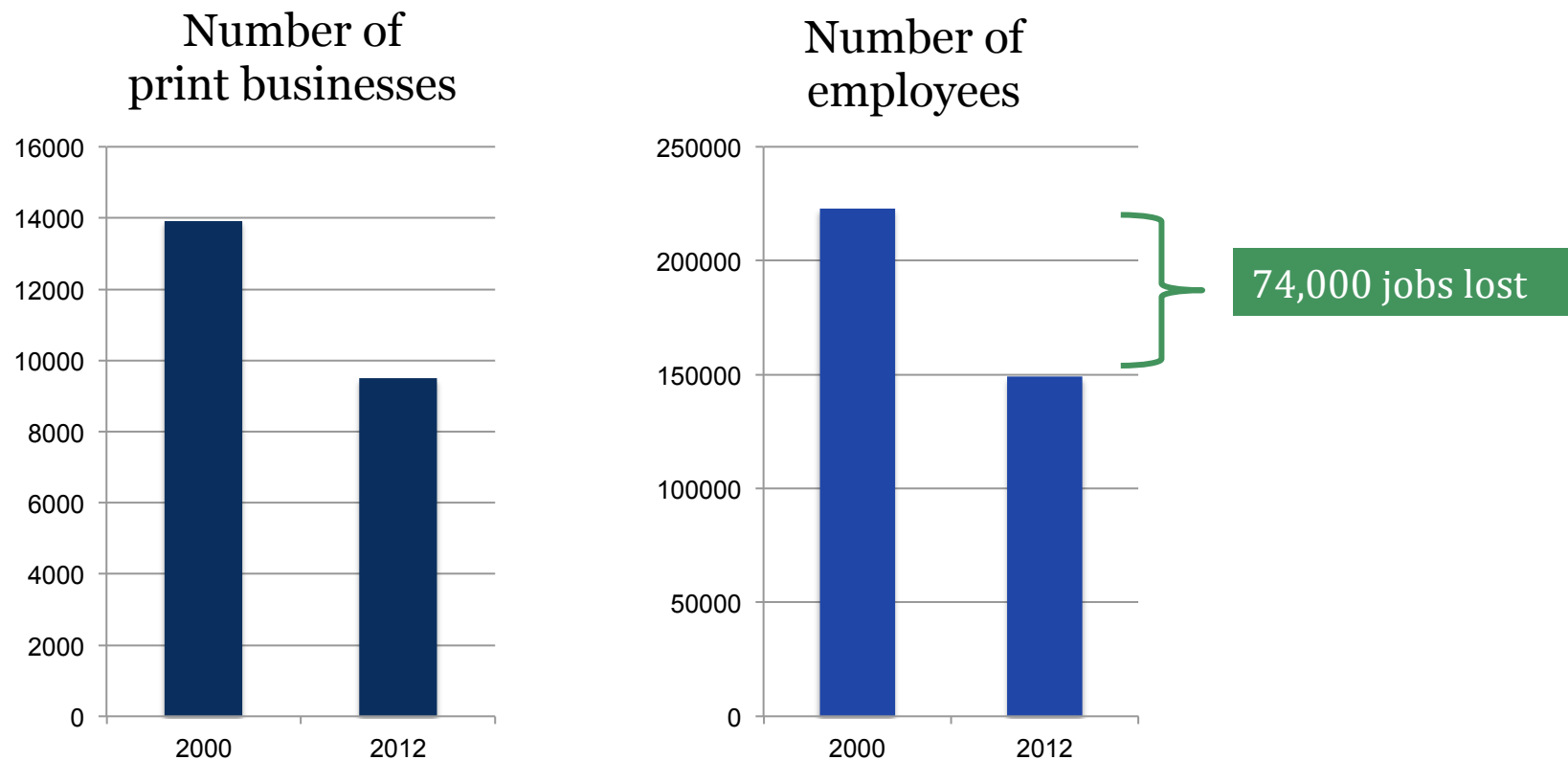
Phase 2: Mass customisation – large scale in small quantities – quality is improving, focus on lifetime customer value





"The death of print businesses"

Incumbents lose unless they specialise. One third of all printing businesses disappeared since 2000 in Germany.



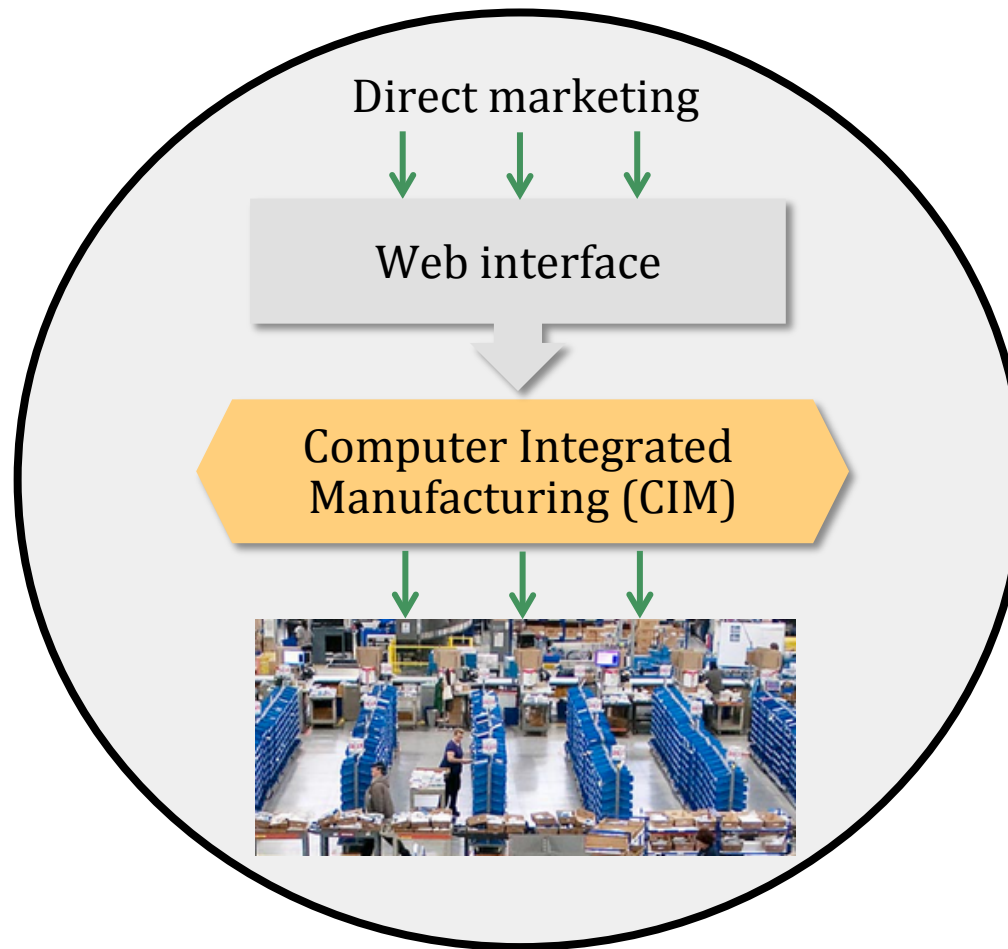
The future for Cimpres

From integration to modularity



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Closed system



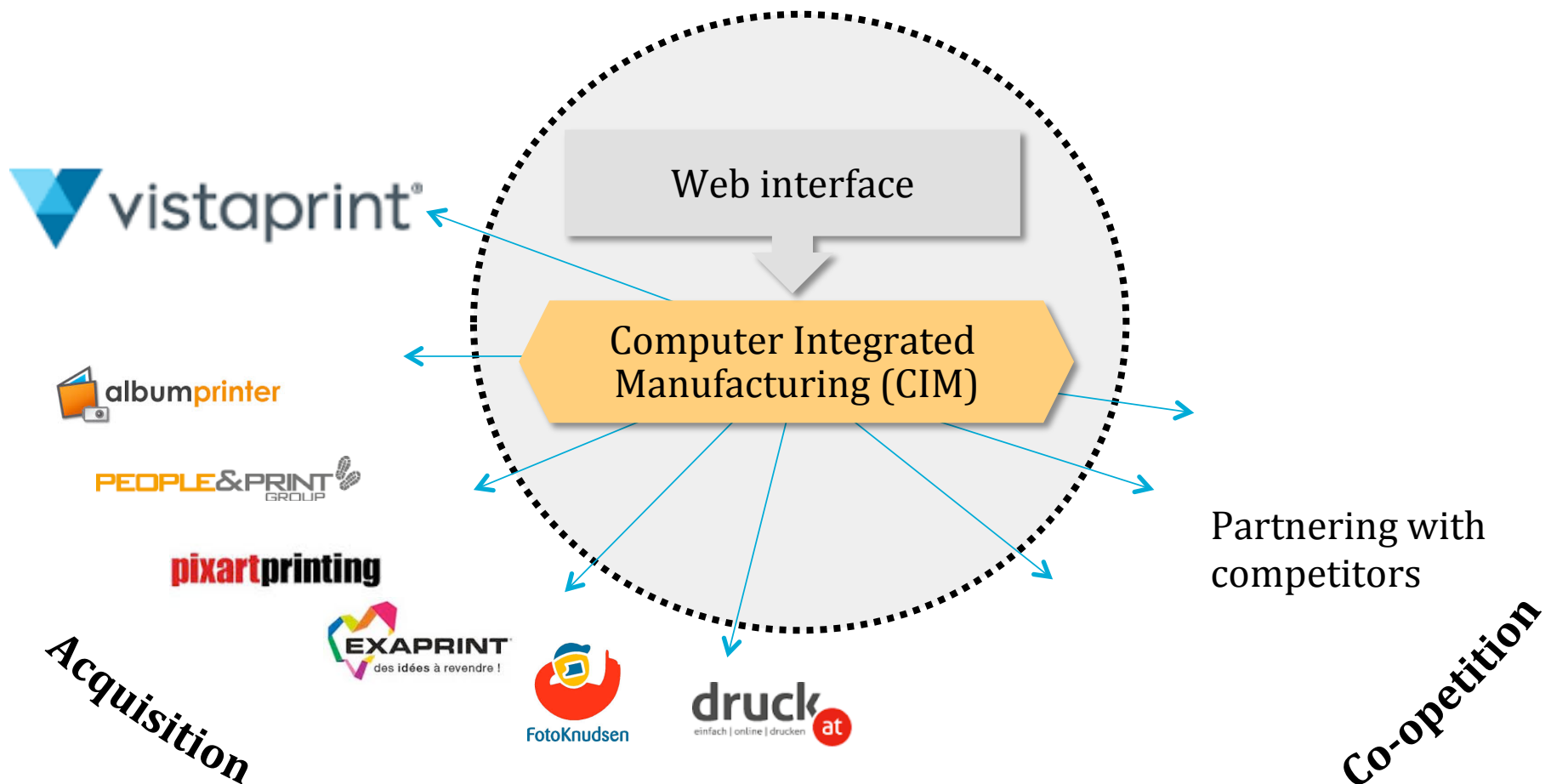
The future for Cimpres

From integration to modularity



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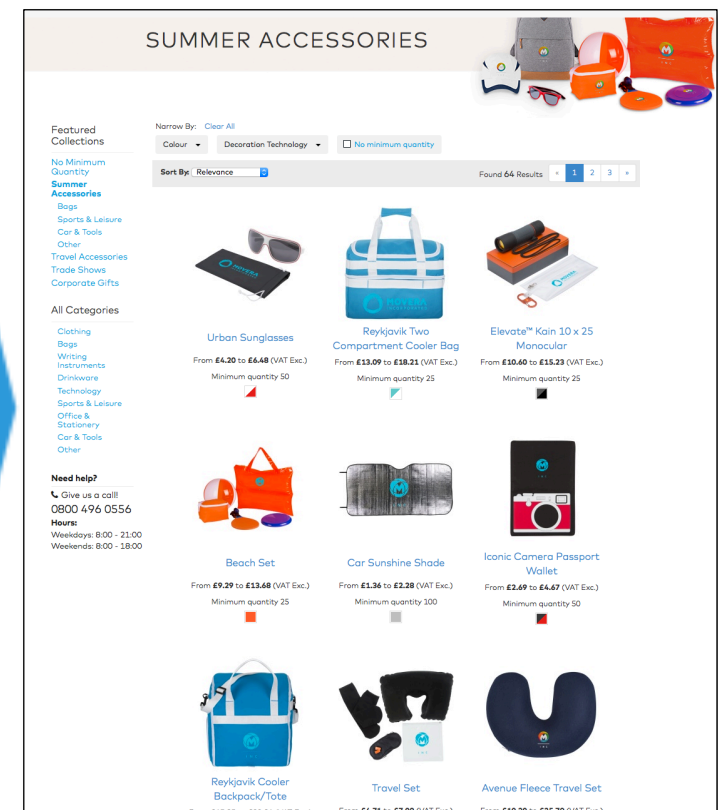
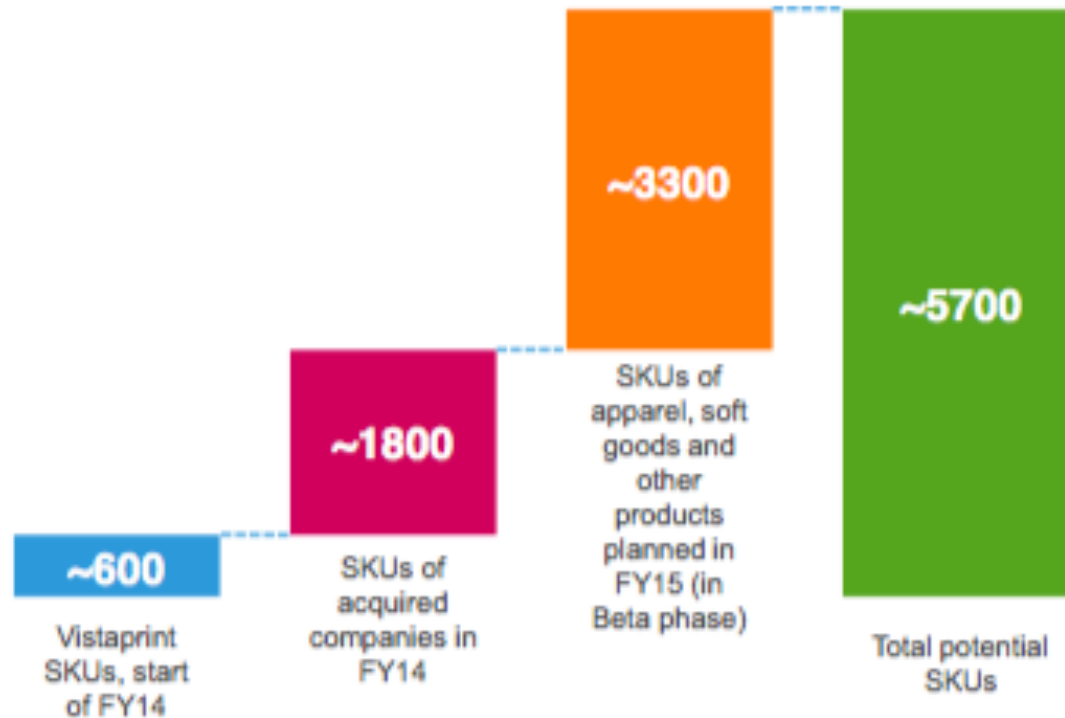
Open/modular system





Cimpress just expanded their product range

Long tail of new products... all with a minimum order size of one.

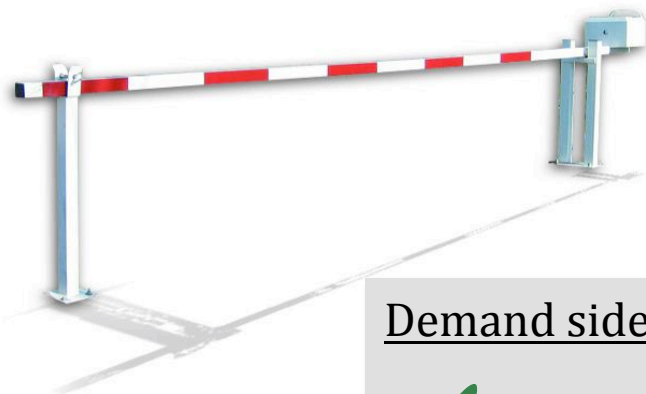


Elements of a Great Business



Does the business have barriers-to-entry?

We use the “Greenwaldian” methodology of competitive advantage analysis.



Barriers-to-entry checklist

Demand side/Consumer

- ✓ Search costs
- ✓ Habit
- ✓ Switch cost

Supply side / producer

- ✓ Protected technology
- ✓ Learning curve
- Location / Access to resources
- ✓ Economies of scale
- Network Effect



Does the business have barriers-to-entry?

More than 90,000 orders shipped per average day. Focus on lean manufacturing leads to constant improvements in manufacturing efficiency. Knowledge is protected by more than 200 patents. Core barrier-to-entry are economies of scale.

Higher utilisation leads to higher ROIC:
Increasing volume flowing across equipment and facilities with 24 hours of daily production

Shipping: Better shipping rates and service through scale based relationships

Raw material: using scale advantage to drive down costs of material

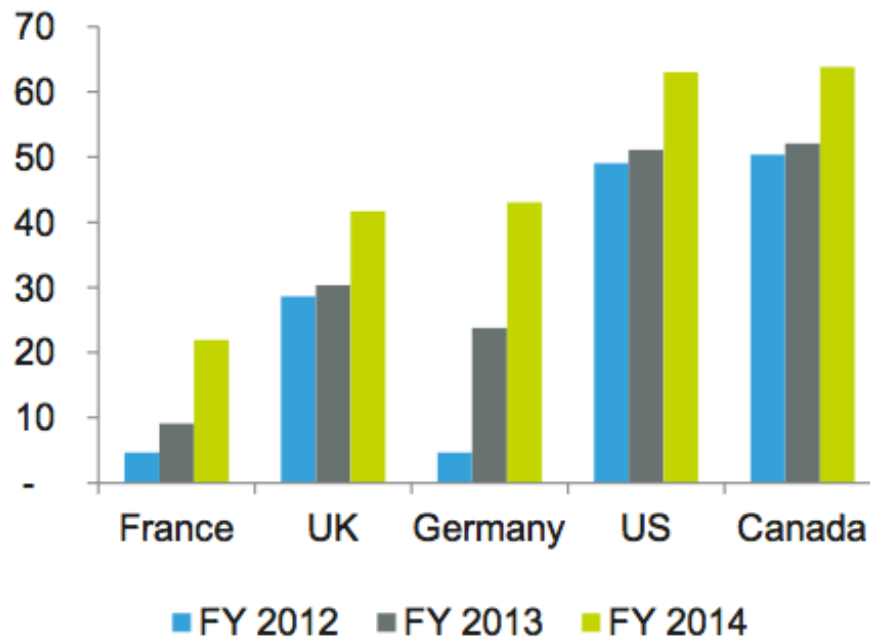
Direct labour: Lean production and automation increases labour efficiency

>>> Strong evidence: The moat is widening over time because of increasing investments in technology, manufacturing and brand.

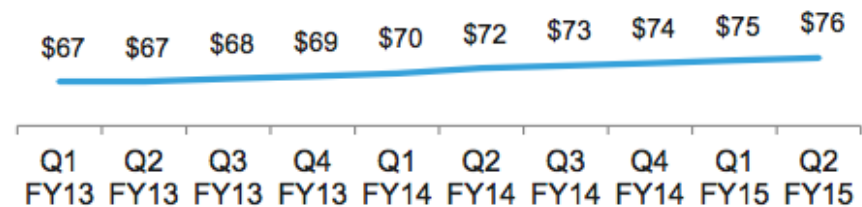


Value creation – customers

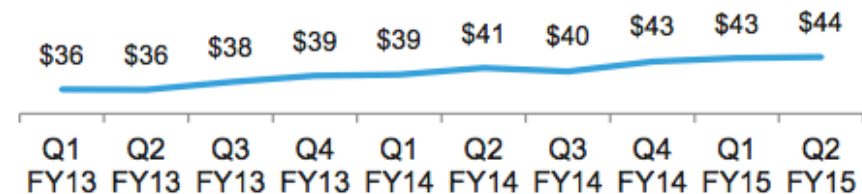
New Customer Net Promoter Score*



Average TTM Bookings Per Unique Customer (USD)



Average Order Value (USD)



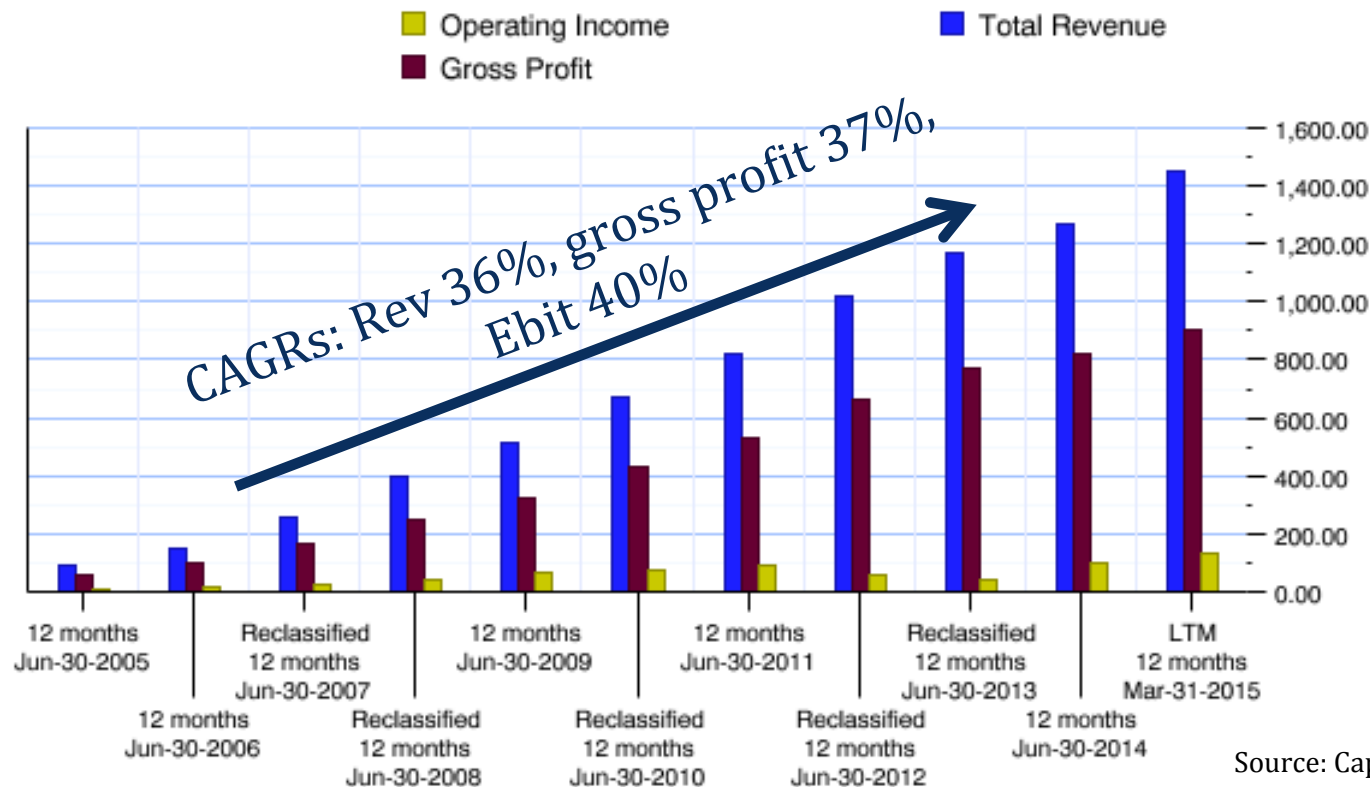
Source: Company presentation. Net Promoter Score® is based on asking customers a direct question: How likely is it that you would recommend Vistaprint to a friend or colleague (0-10 scale)? The score is calculated by subtracting the number of detractors (0-6 responses) from the number of promoters (9-10 responses). Net Promoter Score is a registered trademark of Fred Reichheld, Bain & Company, and Satmetrix. Average TTM Bookings Per Unique Customer and Order Value excludes bookings/customer and average order value from companies acquired in FY 2014 and FY 2015.

>>> Strong signs of improving customer satisfaction



Value creation – shareholders

Top and bottom line growth has been excellent over the last 10 years. Ebit growth dipped between 2011 and 2013 as a result of the strategy change.



>>> In the past Cimpres produced growing shareholder value



Is there a large market potential?

Main drivers are (1) transition from offline to online print and (2) market share growth within online.

60 million businesses with fewer than 10 employees in North America and Europe

\$30 billion marketing spend by micro businesses (NA + Europe)

More than 50% of marketing spending is still done offline

eCommerce print forecasted growth is 11% CAGR in NA

Geographic expansion Asia Pac, India, China, Japan

Circa 5% market share and growing

>>> Strong signs of large demand for the foreseeable future



Evidence for sales & marketing expertise

Evolution from transaction based marketing (e.g. very promotional Emails) to long-term relationship building (e.g. design help, improved webpage, simple pricing).



Example story: Real life rendering technology shows personal images in a real-life context. It is so good that it can cause irritations - as in this example of an embedded personal photo.



Evidence for sales & marketing expertise

New TV advertising campaign uses emotional marketing to build brand value. It is speaking to Daniel Kahnemann's "system one" (intuition), not "system two" (facts & figures).



Most recent TV
campaign.
It's brilliant and
very emotional.

"The Postcard" | 2015 Vistaprint Commercial | Full Length

>>> Strong signs of above average marketing competency

Source: Youtube. Daniel Kahnemann „Thinking fast and slow“



Culture & Management

We like companies with managers who have focus and a clear understanding of what the firm can be best in the world at. (Reference: "Good to Great", Jim Collins).

What is your focus?

*Mass customisation is
at the core of
everything we do*

Where do you aspire to be the best in the world?

*Computer-Integrated
Manufacturing (CIM)*

What are you passionate about?

*Empowering people to
make an impression*

What drives your economic engine?

*Large scale in small
quantities, resulting in
lower per-unit costs.*



Management – capital allocation

We found much evidence of good capital stewardship.

Examples:

- Founding CEO Robert Keane has a major equity stake and outstanding options
- Share repurchase if stock trades below their estimate of intrinsic value (Bought back 26% of share count since end of FY10 when stock traded down)
- Focus on long-term growth in intrinsic value per share
- Capital allocation discipline (compare organic investments, M&A, share repurchases)
- Long-term focus (thinking in decades, focus on adding value for customers, team members, society and long-term investors)
- Financial discipline (ROIC threshold; they have a DCF of advertising spent for every country. Stopped advertising spend in Germany after recognizing low ROIC)

>>> CEO thinks and acts like an owner. He is a great capital allocator.

Valuation



Unit economics estimate

Cimpress spends ~\$29 to acquire a new customer. Out of a cohort of 100 new costumers, ~30 return in the second year spending ~\$93. Thereafter the retention is sticky (~80%).

year	A	retention rate	B	A/100 x B	Net income/ cust (ex COCA)	Dfactor @10%	PV
	no. of customers		avrg. \$ amount per yr	spent per new customer			
1	100	100%	70	70.0	17.9	1.00	17.9
2	30	30%	93	27.9	7.1	0.91	6.5
3	24	80%	110	26.4	6.7	0.83	5.6
4	19	80%	130	25.0	6.4	0.75	4.8
5	15	80%	145	22.3	5.7	0.68	3.9
6	12	80%	150	18.4	4.7	0.62	2.9
7	10	80%	165	16.2	4.1	0.56	2.3
8	8	80%	165	13.0	3.3	0.51	1.7
9	6	80%	165	10.4	2.6	0.47	1.2
Sum:			230	59	47		

COCA of \$29
is paid back
after 3 years.

COCA IRR is
~41%

Note: This is a rough estimate based on company information (investor day 2012 slides) and conversation with the company. Cimpress does not disclose LTV calculations since the strategy change in 2012. Net income (ex COCA) is 25.5% according to FY 2014.



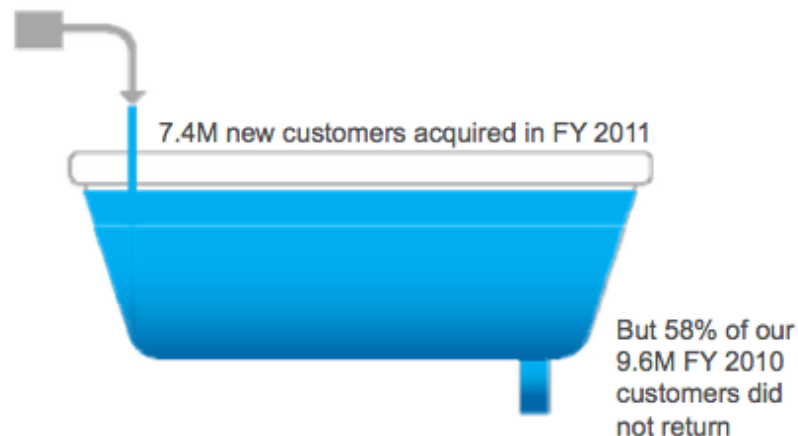
Improving customer retention

The strategy slowly starts to pay off.

Investor day presentation 2012:

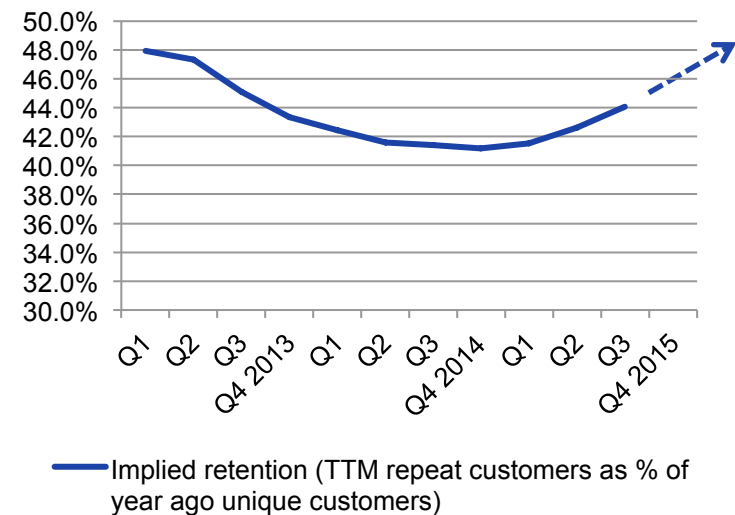
Customer Value Proposition & Churn Reduction

Improve customer loyalty, retention rates and LTV through focus on areas such as product quality, user experience and service



As of last quarter:

Retention Rate



Source: Company presentation and own calculations



Owner's Earnings estimate

Advertising costs are expensed when incurred. However, advertising expenses generate multi-year cash flows from recurring customers. To estimate Owner's Earnings (true economic earnings) we must include only those costs required to maintain the firm's earnings power. How much does Cimpres need to spend to replace customers they are losing?

(As of Q3 2015)	LTM	
Total advertising cost (\$mill)	272	18.7% of revenues
TTM repeat customers (mill)	7.4	
1 year ago TTM total unique customers (mill)	16.8	
To replace $(16.8 - 7.4) / 16.8$	56%	

Based on conversations with the company I believe it is likely that less than half of advertising costs are required to maintain their customer base. As an estimate I assume 50% of total advertising costs.

Maintenance advertising cost (\$mill)	136	9.3%	of revenues
Growth advertising cost (\$mill)	136	9.3%	of revenues

Note: By definition estimating Owner's Earnings requires some guessing. Despite the imprecision I consider the Owner's Earnings figure more relevant for valuation purposes than GAAP earnings.



Owner's Earnings estimate

The true economic earnings power is hidden behind the long-term investments in customer lifetime value.

Income statement	actual 2014	adjustment	OE 2014
Cost of revenue	35.5%		35.5%
Marketing & advertisg	34.6%	9.3%	25.3%
Technology & Development	13.9%		13.9%
G&A	9.2%		9.2%
Ebit	6.8%		16.1%

(Owner's Earnings-) Income statement	2015E	2016E
Revenues (2015: mid guidance; 2016: +15% growth)	1470	1691
Ebit (16.1%)	237	273
Interest Expense (419 mill @ 5.5%)	23	23
Tax Expense (fixed due to low tax arrgmt)	13	13
Owner's Earnings	201	237

Per share (diluted 34 mill outstdg.)	5.9	7.0
P/OE based on \$82.01	13.7	11.8

Our Owner's
earnings
estimate.



Conclusion

Cimpress has many elements of a great business. It has ROIC of more than 20% and it seems likely that the business will significantly grow shareholder value over time. The current price offers a sufficient margin of safety.

Risks are a loss of focus because of too many projects (M&A, India, Japan) and changes to the favorable low tax arrangement.



Robert Keane and Matthias Riechert
at the Online Print Symposium, Munic 2015

„I wouldn't worry about the stock price. If it goes down, we will buy back more.“

CEO Robert Keane

That's all. Thank you.



Matthias Riechert

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