

# Textura Corporation

## Believe Selloff Is Unwarranted and Provides a Buying Opportunity

### Summary

On Thursday, December 26, a short report was issued on Textura making various claims of fraud and collusion against the company. We believe that these claims are misleading and self-serving and believe that the 17% selloff is unwarranted and presents a very attractive entry point for investors.

While we believe that there is nothing fraudulent about Textura's operations and financials, we caution investors that authors of these reports typically issue multiple short reports on the same company and we expect them to do the same on Textura, possibly causing further volatility in the stock. In the following note, we address the major claims of the report and why we believe they are inaccurate.

**SEC Commentary and Retention Rates.** The report accuses Textura of lying to the SEC on its first S-1 about its revenue growth and subscriber churn rates. There is no proof that Textura lied, only that two statements, one related to retention rates and one related to global expansion, were removed in a revised S-1. We note that companies typically go through multiple revisions of their S-1s before filing the final prospectus, and it is not uncommon for companies to remove statements.

The report further accuses Textura of refusing to disclose data supporting retention rates. It is difficult for Textura to give subscriber retention rates since its CPM business is transaction based (on projects) with projects rolling on and off constantly; CPM is not a term-based subscription contract, as is typical with SaaS companies. Textura derives its CPM revenue based on the amount of construction value processed through the system and not on the number of subscribers. Further, subcontractors do not choose whether to use CPM; the decision is made by the general contractor or the owner/developer, so trying to track subcontractor "subscriber retention" is not really relevant. The more relevant metric is the general contractor retention rate, and we believe that Textura has rarely lost a client in its CPM business and **specifically, general contractor retention rates are close to 100%**. But in reality it is the number and size of projects that are on the system that is critical to revenue growth, making it difficult to actually provide a retention rate. Thus, we believe that Textura's choice to remove the statement related to retention rates makes sense.

**Metrics.** The report claims that Textura tries to confuse investors by giving them exaggerated metrics, such as construction value added. This metric is the estimated total construction value of projects added to the CPM system in a given period. Since CPM revenue is billed as a percentage of the construction value invoiced through the system, this metric is directly related to the future revenue that Textura should recognize and should give investors an idea how much revenue Textura will recognize over the next 12-16 months from the business booked in the quarter. In fact, we use a waterfall model based on construction value added to forecast Textura's revenue.

*Textura is the leading SaaS provider for the commercial construction industry. Its suite of solutions help general contractors and subcontractors with invoicing, lien waivers, project management, soliciting bids, creating estimates, qualifying potential partners, and LEED management.*

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December 27, 2013

Stock Rating: **Outperform**  
Company Profile: **Aggressive Growth**

Symbol: TXTR (NYSE)  
Price: \$31.30 (52-Wk.: \$20-\$47)  
Market Value (mil.): \$771  
Fiscal Year End: September  
Long-Term EPS Growth Rate: 50%  
Dividend/Yield: None

	2013A	2014E	2015E
<b>Estimates</b>			
EPS Q1	\$-0.56	\$-0.22	\$-0.05
Q2	\$-0.45	\$-0.19	\$-0.01
Q3	\$-0.75	\$-0.17	\$0.03
Q4	\$-0.23	\$-0.11	\$0.05
FY	\$-1.47	\$-0.68	\$0.02
CY			
Sales (mil.)	36	59	88
<b>Valuation</b>			
FY P/E	NM	NM	1,565.0x
CY P/E		NA	NA

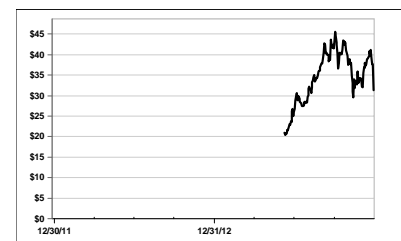
### Trading Data (FactSet)

Shares Outstanding (mil.)	23
Float (mil.)	17
Average Daily Volume	317,063

### Financial Data (FactSet)

Long-Term Debt/Total Capital (MRQ)	0.1
Book Value Per Share (MRQ)	5.7
Enterprise Value (mil.)	306.8
EBITDA (TTM)	-26.3
Enterprise Value/EBITDA (TTM)	-11.7x
Return on Equity (TTM)	-44.1

### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

The report's analogy of a pen manufacturer using the value of contracts signed with pens as a proxy for growth rate, while amusing, is absolutely incorrect. If the pen manufacturer charged a percentage based on contract value (as Textura does), then maybe the analogy might make more sense.

**Fraud Claims.** The report alleges that the Textura CEO Patrick J. Allin was involved in a pump-and-dump scheme related to the over-the-counter stock Combined Professional Services (CPFS) because he was CEO of CPFS between October 2002 and January 2004. Below we provide a clear timeline of events related to this situation, rather than use the report's conjecture and misleading assumptions to insinuate fraud.

Patron Systems was founded in April 2002 to provide comprehensive end-to-end enterprise IT security solutions and Mr. Allin was the CEO of Patron Systems.

Combined Professional Services (CPFS) was an entirely separate company, based in Florida, to create a merger-and-acquisition vehicle for rolling up financial services companies. The CEO, Marc Baker, resigned in July 2002 and on July 18, 2002, Jeff Spanier was elected sole director and president. Mr. Spanier had worked as recruiter of brokers at Florida Discount Brokerage, which was engaged in "pump" and "dump" activities in two stocks: CPFS and BSDS.

There was clearly wrongdoing at Florida Discount Brokerage (and a number of its representatives have been censured by FINRA) and all of the complaints by FINRA are for activities before September 2002. At the end of August 2002, FINRA and the SEC started to investigate Florida Discount Brokerage and commensurate with this action, the stock of CPFS dropped 80%.

On September 27, 2002, Patron merged with CPFS. We suspect this occurred because Patron has been unsuccessful in raising private money and was looking for a vehicle in the public markets to raise equity capital. Mr. Allin became involved with CPFS at this time and he replaced Mr. Spanier as director and CEO.

On October 23, 2002, CPFS re-domesticated from Nevada to Delaware and was renamed Patron Systems, Inc. (the ticker changed to PTRN).

At this point, the Patron Systems team began to look at possible acquisitions and started raising funds. The company also added some significant members to the board including:

- Richard Beggs, who was at the time director, executive vice president, and chief administrative officer of Daiwa Securities America. Prior to Daiwa, Mr. Beggs was the managing director and chief operating officer of Kemper Clearing Corporation and has held several positions at Security Pacific Bank/Bank of America, including president and CEO of the Treasury Management Corporation, president and COO of Security Pacific Securities Inc., and managing director of the Global Securities Services Group.
- Warren Luke, who at the time was chairman and CEO of Hawaii National Bank and its parent, Hawaii National Bancshares, Inc. He formerly served three three-year terms as director of the Federal Reserve San Francisco, including a term as chair of its audit committee.
- Robert Yaw (a founding principal of Patron) had served as a director of several private companies, including principal equity partnerships with Prudential Insurance Company and New York Life Insurance Company. He founded Salomon Brother Global Telecommunications Group.

Over the course of a year, during which the stock (PTRN) continued to decline, the company announced several potential mergers, partnerships, and acquisitions (including Entelagent Software, Trustwave, and Telesecure) and the entry to a potential term sheet with investors. The funding did not come together and Mr. Allin resigned effective January 21, 2004. We do not believe that Mr. Allin knew of the history of the CPFS before the merger with Patron.

**Internal Controls.** Most emerging growth companies that we are aware of have material weakness in financial controls before their IPO. Becoming compliant with these requirements is part of the increased expense associated with becoming a public company, since small, formerly private companies need to hire additional accounting staff to fulfill these requirements.

**Solvency.** Given the company's cash balance and cash burn before its IPO, Textura needed to attain additional funding. However, this is not out of the ordinary with companies of this size and growth rate. Textura is not the only SaaS company that is burning cash and needs to eventually become cash flow positive to be sustainable. We believe that Textura has sufficient

cash on hand and should begin to see leverage in its cash flow over the next year, possibly realizing positive cash from operations in the fourth quarter of fiscal 2014.

**Head of Business Development.** The report cites concerns that the head of business development has no experience in the software business, as he was formally a sell-side analyst. We have seen numerous sell-side analysts and investment bankers move to the corporate world and have success, and do not see why this is a concern. Some examples are Sarah Friar (former Goldman Sachs [GS \$176.45] software analyst, now CFO of Square) and Charles Phillips (former Morgan Stanley [MS \$31.10] software analyst who became the president of Oracle [ORCL \$37.69; Market Perform] and now serves as CEO of Infor).

### Rating and Valuation

Textura provides investors with the opportunity to invest in the movement to software as a service and the commercial construction industry. The stock trades at an enterprise value of 10.3 times our calendar 2014 revenue estimate. Although this is above the comparable network group (which comprises vertically focused companies that have built a network), we believe that Textura deserves to trade at a premium given its much higher revenue growth rate (62% in calendar 2014 versus the group median of 20%)—we believe that Textura’s growth will continue to outpace the group for the next five-plus years because of the company’s competitive advantages and growth opportunities.

Calendar 2013	EV/Revenue
<b>Textura</b>	<b>16.6x</b>
<i>Network group median</i>	9.4x
<i>Fast growth SaaS median</i>	16.6x
<i>SaaS group median</i>	7.3x

Calendar 2014	EV/Revenue
<b>Textura</b>	<b>10.3x</b>
<i>Network group median</i>	7.9x
<i>Fast growth SaaS median</i>	11.2x
<i>SaaS group median</i>	6.0x



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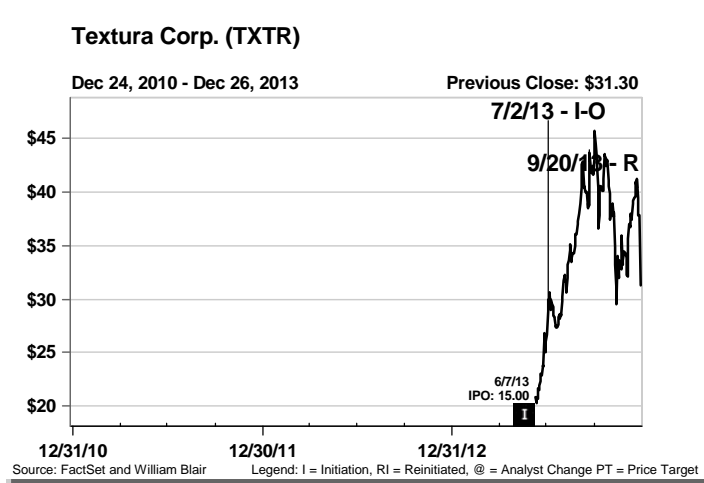
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DOW JONES: 16,479.88

S&P 500: 1,842.02

NASDAQ: 4,167.18



**Current Rating Distribution (as of 11/30/13)**

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	61	Outperform (Buy)	11
Market Perform (Hold)	35	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

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