Pluralsight, Inc. (PS)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

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<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>35 - 7</td>
<td>Suitability:</td>
<td>Higher Risk</td>
<td>Q1</td>
<td>(0.07)A</td>
<td>(0.09)A</td>
<td></td>
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<tr>
<td>Market Cap (mil):</td>
<td>2,597</td>
<td>L-Term Rev. Gr Rate Est:</td>
<td>22</td>
<td>Q2</td>
<td>(0.06)A</td>
<td>(0.12)E</td>
<td></td>
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<tr>
<td>Shares Out (mil):</td>
<td>136.2</td>
<td>L-Term EPS Gr Rate Est:</td>
<td>30%</td>
<td>Q3</td>
<td>(0.08)A</td>
<td>(0.10)E</td>
<td></td>
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<tr>
<td>Float (mil):</td>
<td>87.8</td>
<td>Debt/Cap:</td>
<td>NA</td>
<td>Q4</td>
<td>(0.09)A</td>
<td>(0.06)E</td>
<td></td>
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<tr>
<td>Avg. Daily Vol (mil):</td>
<td>1.94</td>
<td>ROE:</td>
<td>74.3%</td>
<td>Total</td>
<td>(0.30)A</td>
<td>(0.38)E</td>
<td>(0.32)E</td>
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<tr>
<td>Dividend ($) :</td>
<td>0.00</td>
<td>Insider Ownership</td>
<td>17.8%</td>
<td>FY P/E</td>
<td>NM</td>
<td>NM</td>
<td>NM</td>
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<tr>
<td>Yield (%):</td>
<td>0.0</td>
<td></td>
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Headquartered IPO/Founded | Dec 2019A 2020E 2021E |
Farmington, Utah 2018/2004 | Revenue (Mil) | 316.9 | 376.9 | 448.5 |
Management | % Growth | 36.6% | 18.9% | 19.0% |
Co-founder/Chairman/CEO Aaron Skonnard |
Chief Financial Officer James Budge |
Chief Experience Officer Nate Walkingshaw |
Investor Relations Mark McReynolds |

Company Description

Pluralsight is a digital learning platform for technology skills, providing skills assessment, development, and management to businesses (B2B channel represents 88% of LTM billings) and individuals. It provides access to over 7,000 courses from an expert practitioner network of 1,500+ authors. It also provides skill/role assessment for technology skills, interactive courses and projects, and business analytics. It has a customer base of ~18,000 businesses (incl. ~70% of the Fortune 500), and more than 980,000 B2B customers exiting 2019 (implying ~55 seats per logo). Pluralsight was founded in 2004 and is headquartered in Farmington, Utah.

Revenue Profile

Pluralsight offers access to its platform for business users with annual seat-based subscriptions, while subscriptions through its DTC channel are billed monthly or annually. While average billings per B2B user has been increasing, it remains below listed price with the average user generating ~$335 in annual billings exiting 2019. The company employs a “land and expand” strategy among B2B users, looking to add new logos to its customer base and then expand penetration (currently averaging ~7% penetration, up to 15-20% penetration for strategic customers).

Pluralsight’s billings growth was strong for two years (B2B billings 48-62% between 2Q17 and 1Q19), but has decelerated due to sales execution, and now COVID-19 response implications.

Source: Company documents
**Competition**

Pluralsight faces a range of competition from companies providing learning solutions via both in-person and e-learning modalities, as well as free and pay for service solutions; however, we believe that the company's large and growing potential enterprise market is either largely unraveled, or poorly served by current legacy tech skills training solutions. Current competition includes: instructor-led training (sizable portion of current market revenue); e-learning services such as LinkedIn Learning (f/k/a Lynda), Udemy, and Udacity; coding bootcamps; legacy e-learning solutions (e.g., Skillsoft and Cornerstone OnDemand); free digital content providers such as YouTube; and technology offerings from educational institutions (both degree and non-degree), increasingly in conjunction with outsourced tech and services partners like 2U's GetSmarter, Coursera, Trilogy Education, EdX, etc.

**Quick Summary**

Outperform rating. Bookings are being negatively impacted in the short-term, which we do not view as surprising, but were positively surprised by increased usage during shelter-in-place period and aggressive expense management. We continue to believe Pluralsight is extremely well positioned to capture a massive, growing, and underserved market opportunity with an effective and high-value solution. The inherent economics of its model at scale are attractive, and in our view defensible, employing cost-effective content development, benefits from scale and network effects, brand with potential assessment/credentialing signaling value, and increasingly embedded across an attractive (yet significantly underpenetrated) client base.

$22 price target reflects 7.4x EV/21E revenue. We utilize a broad comp group of SMID-cap fast-growth SaaS stocks for valuation purposes. Our comp group is currently trading at a mean/median EV/21E revenue multiple of 12.8x (with very wide 2.6x-29.3x range). We assume a roughly lower-quartile revenue multiple for PS, which we believe is justified given its slower billings growth, recent history of billings volatility and current adj. EPS losses. However, we continue to believe PS’ long-term organic growth potential is significant, and believe material multiple expansion is possible (assuming comp multiples remain similar) if billings growth reaccelerates further intermediate term, and it starts to make meaningful margin progress towards the company's intermediate-term targets (~20-25% adj. EBIT margin target with attractive negative working capital characteristics).

**Investment Thesis**

Pluralsight is the leading technology skills learning platform with an effective solution and a business model that benefits from scale and network effects. Pluralsight’s platform provides access to over 7,000 courses from an expert practitioner network of 1,500+ authors, and it has a customer base of ~18,000 businesses (incl. ~70% of the Fortune 500). We believe that Pluralsight’s solutions work well and are attractively priced, which we believe provides barriers to entry to potential competitors/alternatives. It appears well positioned to sustain its advantage in terms of curated premium content given its cost-effective content development, and given that it is embedded at a client base that represents a very attractive audience for authors and technology companies. In addition to a competitive advantage in its curated premium content library, Pluralsight has also been adding features/functionality (interactive courses and projects, business analytics, etc.) that should enhance its value proposition and competitive differentiation, and could position Pluralsight as a full lifecycle talent management solution for the enterprise technology function.

Potential addressable market appears massive and likely will continue to grow. Given the (increasing) importance of technology and tech skills to virtually all businesses, and the rate of change of technology skills (obsolete fairly quickly), we believe the addressable market is massive, and Pluralsight’s solution can be effective for businesses of virtually any size, in any industry and geography. Yet, despite the potential broad applicability and despite being a market leader in a scale and network effect business with an effective and high-value solution, Pluralsight currently serves only a small fraction of the addressable market. There are ~102mn estimated members of technology teams (PS had 980k paid users at 2019 year-end), and Pluralsight has ~18k enterprise clients (Gartner estimates 138k enterprises spend ~$10mn+ on technology annually, and Pluralsight can effectively serve business users well below that spend threshold as well). Notably, the market is currently largely unvended by competitive digital learning platforms, and rather is primarily served by less-effective and/or less scalable instructor-led training providers. Further, potential digital platform alternatives to Pluralsight appear to lack the depth and breadth of tech skills content that Pluralsight offers, and/or have not proven an ability to scale a B2B platform.

Strong market position, and a proven track record of rapidly growing enterprise client count, and significantly upselling existing clients (and both drivers still have substantial runway). Pluralsight client count has grown every quarter since at least Q1-17. Notably, the average initial size of new B2B billing relationships is also growing (despite the fact that F500 logo penetration is already ~70%). Further, it has an attractive foothold in the B2B market and has a strong track record of increasing billings at existing clients (through a combination of increasing seat penetration and upselling to higher-priced SKUs). B2B net revenue retention is running 120%+, and top 25 customer billings are 23x initial purchase amount. B2B accounts with >$100k in annual billings have also grown from 78 at the end of 2016 to ~400 exiting 2019.

Underlying financial model is attractive and Pluralsight's attractive market position is defensible. Pluralsight's revenue has attractive characteristics -- subscription revenue that is paid in advance that we expect to retain at high rates. Further, the company's attractive 80% gross margin target appears achievable given its cost-effective premium content model that benefits from scale and network effects. While the company is rightly currently aggressively investing in go-to-market capabilities, we believe its operating margin and FCF conversion should be highly attractive at scale as go-to-market investments are harvested. Pluralsight operated at adj. EBIT breakeven in 2016 before making the more aggressive go-to-market investments. We believe its 22% long-term operating margin target appears highly achievable with scale, as sales productivity ages along the tenure-productivity curve and as it leverages other expense categories. Finally, FCF characteristics are even more favorable with growth given PS’ working capital model (paid in advance with some expenses paid in arrears).
Pluralsight, Inc.
May 15, 2020

Risks & Caveats
Risk of competition from other digital learning or broader content platforms. Pluralsight faces a range of competition from companies providing learning solutions via both in-person and e-learning modalities, as well as free and pay for service solutions. Current competition includes: instructor-led training (sizable portion of current market revenue); e-learning services such as LinkedIn Learning (f/k/a Lynda), Udemy, and Udacity; coding bootcamps; legacy e-learning solutions (e.g., Skillsoft and Cornerstone OnDemand); free digital content providers such as YouTube; and technology offerings from educational institutions (both degreed and non-degded), increasingly in conjunction with outsourced tech and services partners like 2U's GetSmarter, Coursera, Trilogy Education, EdX, etc.).

Expected further dilution and "anti-dilutive" shares. Pluralsight's stock-based compensation is currently high as a percentage of revenue (~29% in 2019), but is excluded from the company's and consensus earnings methodology. The company has noted that it intends to limit annual sharecount dilution from stock compensation programs to 6%, which we consider high. Should it maintain similar annual dilution levels on a percentage basis intermediate- to long-term, we believe that it could have a detrimental impact on its stock performance, all else equal. Further, as discussed in PS's S-1, 10-Q, and other filings with the SEC, it currently has stock options and restricted stock units that would have been anti-dilutive given its net loss position in recent periods, and hence are excluded from its average diluted sharecount. Management does not currently provide an estimate of a "non-GAAP" diluted sharecount assuming profitability. We believe that some investors may not be fully aware of potential implications from the anti-dilutive shares, and the implication of the anti-dilutive shares on some valuation metrics. Using a recent share price, we estimate the company's average diluted share count would be approximately 8% higher than its basic share count if the company were profitable, and accounting for the anti-dilutive shares.

Author network management risks, including author recruitment, compensation, retention, and concentration. We view Pluralsight's author network as a differentiating feature of its model that enables the cost-effective production of high-quality content. Given the importance of the author network to generating the content that we view as the current key source of value on the Pluralsight platform, author recruitment, compensation, and retention are key. Further, a small group of authors have created the content that historically represented a sizable percentage of the viewing time on the Pluralsight platform, and hence the loss of one or more popular authors could materially impact user experience, and potentially business operations.

Valuation and potential volatility in thinly traded stock that we believe "trades on" a revenue/bookings multiple shorter term. Pluralsight is currently a loss-generating business, and trades at an elevated revenue multiple, similar to other fast-growth SaaS comparable companies. Given this dynamic, amplified by its limited public float, We expect shares to experience above-average volatility over the near-to-intermediate term.

Multi-class share structure and controlled company. Pluralsight has a multi-class structure for its common stock, including Class C shares with 10 votes per share, with Class C shares held in their entirety by Pluralsight's Co-Founder, Chairman, and CEO Aaron Skonnard, resulting in him (and related entities) controlling more than 50% of the outstanding voting power in shares. The company does not expect to rely on the controlled company exemption (per S-1 filing); however, if it were to utilize some or all of the exemptions the company would not be subject to certain Nasdaq corporate governance standards, including the requirement that a majority of its board of directors be independent, or that the company have corporate governance or compensation committees that are composed entirely of independent directors and subject to annual performance evaluations.

UP-C Corporate Structure. Pluralsight's recent IPO offering was conducted via a “UP-C” structure. The revised corporate structure provides the benefits of a gain deferral to existing shareholders, as well as a tax-basis step-up to the newly formed public company, with potential for additional allocable depreciation and amortization deductions. Following the corporate reorganization, Pluralsight, Inc. will hold an economic interest equivalent to the equity origination in Pluralsight Holdings, LLC, with the company's CEO and other "Continuing Members" retaining remaining ownership. In addition to the UP-C corporate structure, Pluralsight, Inc. also entered into a Tax Receivable Agreement, or TRA, with Pluralsight Holdings and its Continuing Members. Under the agreement, Pluralsight, Inc. retains 15% of certain tax savings available to it under the tax rules applicable to the UP-C structure, with the remaining 85% of such tax savings paid to the TRA Members. The TRA and Pluralsight's corporate structure in general appear to create additional risks, including in the event that any tax benefits from the structure are disallowed given that Pluralsight would generally not be reimbursed for any payments previously made under the TRA in the event that benefits are disallowed by the IRS. It is difficult for us to estimate the probability from an adverse outcome to PS shareholders as the result of Pluralsight's UP-C Corporate Structure and/or TRA.

Near-term operating losses and cash outflow. Given the company's early-stage growth profile, and recently increased investment in growth initiatives, PS currently operates at a loss and produces negative cash flow. The company expects to improve profitability near-term and generate positive free cash flow next year, excluding one-time investments; however, given the intermediate-term growth opportunity we do not expect material consolidated profitability for the next couple years.

Potential follow-on equity offerings. According to company's SEC filings, PS's insider ownership currently accounts for the majority of potential shares outstanding. Further, the company is currently generating free cash outflows, and may consider acquisitions in
the future. Hence, we believe follow-on equity offerings are likely. The currently elevated insider ownership also results in a currently limited average daily trading volume of PS shares.

**Currently, not required to comply with SOX404.** Pluralsight is not currently required to comply with Sarbanes-Oxley Section 404, potentially increasing internal controls risks and/or required additional expenses. Further, on June 13, 2019, the company determined that it had understated 2018 equity-based compensation expense and plans to restate its 2018 results in an amended 10-K. As a result, based on a preliminary assessment, it also determined that the cause of the restatement is determined to represent a material weakness in its internal controls.

**FX risks, including a revenue-expense mismatch.** All of its customer contracts are currently denominated in USD despite generating ~37% of 2019 revenue in geographies other than the United States (although it plans to increasingly denominate customer contracts in local currencies over time). Given its geographic breadth of operations, Pluralsight generates operating expenses outside of the U.S. that are often denominated in local currencies. Hence, a material USD weakness relative to a basket of currencies in which Pluralsight generates operating expenses could negatively impact its margins.
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- **Outperform (O)** - Expected to outperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.
- **Neutral (N)** - Expected to perform in line with the broader U.S. equity market over the next 12 months.
- **Underperform (U)** - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

Risk Ratings:

- **L - Lower Risk** – Higher-quality companies for investors seeking capital appreciation or income with an emphasis on safety. Company characteristics may include: stable earnings, conservative balance sheets, and an established history of revenue and earnings.
- **A - Average Risk** – Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings.
- **H - Higher Risk** – Higher-growth situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include: higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility.
- **S - Speculative Risk** – High growth situations appropriate only for investors willing to accept a high degree of volatility and risk. Company characteristics may include: unpredictable earnings, small capitalization, aggressive growth strategies, rapidly changing market dynamics, high leverage, extreme price volatility and unknown competitive challenges.

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