Angie's List, Inc. (ANGI) Memo

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Company Description

Angie's List, Inc. (ANGI) operates a website where members can research, hire, rate and review local service providers. To generate revenue, the company requires that members pay a monthly or yearly fee which varies depending on Angie's saturation in a particular locale. Additionally, the company sells advertisements to service providers. The company has recently rolled out an e-commerce service in which service providers and members can transact directly on the website; however, service providers are required to pay a 9.5% processing fee. The company currently has about 2.5 million members in 253 local markets in the United States. The typical member is between the ages of 35 and 64, is married, is college educated and has an annual income of at least $100,000. In its 18 year existence, ANGI has never been profitable.

Thesis / Key Points

- **Flawed business model creates zero economic moat.** Angie's business model revolves around requiring users to pay to see user-generated reviews. **There is no barrier to entry in this industry.** The only possible way to generate a moat is to create a network effect, but ANGI only has 2.5 million members, compared to Yelp's 100 million. Angie claims that prohibiting anonymous reviews encourages accountability and gives it a competitive advantage, but there is absolutely no reason that a free service couldn't do this as well.
- **Even if TAM increases, fierce competition will drive down profitability.** Angie specializes in providing consumers with reviews for "high cost of failure" services, like homecare and automobile services. Competitors are quickly moving into this space and eroding Angie's market share. Yelp, which has traditionally specialized in restaurant reviews, now offers reviews for services as well. Service Magic specializes in service reviews and was created to directly compete with Angie's List. Google Maps has a huge following and offers a similar review system. **Numerous free services do exactly what Angie's List does.** Competition will severely limit Angie's ability to charge for membership.
- **Disproportionately high marketing efforts cause the company to lose money on every added member.** Although the company touts its rising revenue figures, the cost of this revenue, mainly in terms of marketing costs, have been rising at a higher rate. In Q4 2013, marketing costs increased 30% as the company competed with other firms in the industry for market share. In Q4 2013, marketing cost per paid membership acquisition was $52, even though the price of membership ranges from $24 to $39. Due to historically disproportionately high marketing costs, **additional incremental revenue is associated with a net negative marginal return for the company** (See figure 1). Angie justifies this marketing expenditure by arguing that this one-time marketing cost generates a consistent revenue stream from renewing members, but due to high customer attrition rates, ANGI has to continually attract new members (See Figure 2).
- **Massive Insider Selling.** Company insiders always disliked this stock, and have unloaded it precipitously since its IPO in November of 2011. **In fact, at its IPO, insiders sold over 4 million shares, representing 50.1% of the total shared sold in the offering.** Even after the IPO, insiders have continued to sell shares; in 2013 alone, there were 910,000 shares sold by insiders and 0 shares bought by insiders (See Figures 3 and 4). This should raise a major red flag, as insiders typically know more about the company than investors do.
- **Inept management team faces "pump-and-dump" class action lawsuit**. A federal class action lawsuit accuses Angie's List executives of selling their own stock for more than $13 million after inflating the share price through false and misleading statements about the company. Specifically, management is accused of failing to disclose that a) Angie's List was increasingly relying on providing free memberships in order to artificially boost its subscriber figures; and b) contrary to Angie's List's repeated class period statements that Angie's List did not permit service providers to buy ratings on its website ('You can't pay to be on Angie's List'), the company was consistently deriving more than half of its revenues from the service provider side of its business - where it relied heavily on collecting fees for listing paid service providers more prominently. This class action suit may prove costly for the company if the plaintiffs win.

Misperceptions

- **Management's claim that the company is "consumer-driven" misleads investors.** The first line of ANGI's 2013 10K is, "Angie's List operates a *consumer-driven service* for members to research, hire, rate and review local professionals…" However, ANGI is not "consumer driven"; in 2013, 73% of ANGI's revenue came from service providers, while only 23% of revenue came from members. Moreover, the proportion of sales from service providers relative to members has been increasing significantly in recent years (See Figure 5). As this proportion grows, ANGI will feel greater pressure to cater to service providers at the expense of members. For example, ANGI already allows service providers to pay a fee to have their service listed higher on the page (see screenshot 3). These tactics will continue in the future, and ANGI will lose any competitive advantage it has left as its offering becomes biased.
- **Positive operating cash flow is NOT the result of operational efficiency, but rather due to high levels of deferred revenue and accrued liabilities.** The company reported an 8.9 M operating cash flow in 2013, compared to an operating cash flow of -33.4 M in 2012. All of this positive operating cash flow (and more) is from deferred revenue and accrued liabilities. The company reported deferred membership revenue of 8.5 M, deferred advertising revenue of 16.6 M, and accrued liabilities of 7.7 M. The

year end operating cash flows will undoubtedly be negative as deferred revenue slows (due to a slowdown in revenue from greater competition) and ANGI is forced to repay significant liabilities.

- **Although growing quickly at the moment, the e-commerce segment will NOT enjoy significant market penetration.** At 72% yoy growth in 2013, management expects ANGI's e-commerce segment (see company description above) to be a major revenue driver in the future. Investing articles have made comparisons that Angie's List will be to services what Paypal or Amazon is to commodities. However, this is an unfair comparison. Services are different than commodities because the service provider and the customer actually interact. For example, when I pay for plumbing, the guy comes to my house. There is absolutely no way that a majority of service providers will pay a 9.5% processing fee to Angie's List to transact online, when they can easily transact when they meet the customer. Therefore, I predict this initial growth to curve off asymptotically in the future.
- **Retention rates by management are overinflated due to asymmetric accounting practices.** There are two reasons for this. First, although every other metric that the company uses includes monthly membership, the retention rate statistic does not include monthly membership. This overinflates this statistic because monthly members are much more likely to not renew. Additionally, numerous testimonials indicate that the company engages in automatic renewals without consumer consent. Even when the consumer finds out about this and subsequently cancels, the company does not change its renewal statistic. As a result, the company's reported renewal rates of about 71% should actually be much lower. Consequently, the rate of customer attrition indicated in figure 2 may actually be much higher, forcing the company to spend even more on marketing to replace non-renewing members.
- **Sell-side analysts covering ANGI have an incentive to rate the stock more favorably than it should be.** ANGI does not generate sufficient cash from its operating activities, so the only way that it can finance its investments is through financing activities. When it creates new stock, it needs an underwriting bank. This bank generates fees as a percentage of the amount of money it raises, which, given a certain level of shares offered, is dependent on the price of the shares. Banks that believe ANGI will choose them as the underwriter therefore have an incentive to cause ANGI's share price to increase by issuing BUY or OUTPERFORM ratings. According to Street Insider, the average sell-side price target $23.06 and the average rating is a BUY. Moreover, firms that have underwritten ANGI's stock in the past (and have a greater chance of repeat business) tend to give ANGI a higher rating (See Figure 6).

VAR (see Appendix B for additional VAR)

For my VAR, I purchased a monthly subscription to Angie's List. My observations:

Subscription is only for one locale: the first thing that I noticed was that since I registered using my home address, I did not have access to service reviews in Charlottesville. To see these reviews, I would need to purchase an additional subscription. This was frustrating.

Technical Difficulties: The second time that I tried to login to Angie's List, I was unable to access any content and instead was rerouted to a blank screen. I checked to make sure that this was not a problem with my browser or the wifi. I filed an inquiry on the "contact us" page and have yet to hear back.

Some "B" rated companies are listed higher than "A" listed companies: This may confirm the allegation that service providers can pay ANGI to have their rating listed higher on the page.

More ratings per service provider: Each individual service provider had a significantly greater number of reviews on Angie's list than on competitor websites like Yelp. However, after some threshold, it is unclear what the marginal benefit of an additional rating is on accuracy. For example, there may be only a marginal difference in accuracy for a service provider with 45 vs. 345 reviews.

How It Plays Out

- The "pump-and-dump" lawsuit will be more successful than investors believe, and ANGI will forced to pay greater damages than expected. This will prompt investors to start looking into the company and selling shares.
- More articles will be written about how Angie's List is biased and caters to service provider interests.
- The company's earnings, which will be released on April 23, will be lower than expected as greater competition erodes profits. **However, even if the stock spikes on earnings, this will be an even better entry point for MII.** Most of my catalysts and misperceptions are more long-term (given that MII's target time horizon is about 12-18 months).

Risks / What Signs Would Indicate We Are Wrong?

- ANGI generates positive operating cash flow even after accounting for deferred revenue and accrued liabilities.
- The "pump-and-dump" lawsuit is unsuccessful, and ANGI is not required to pay significant damages.
- The e-commerce segment continues to grow at a significant rate as service providers quickly adopt this transaction method.
- ANGI's renewal rates increase significantly.

Signposts / Follow-Up	**Important Company Financial Data**
➢ EPS releases, including the one on April 23	Market Cap: 722.56 M
➢ Operating cash flow	52-week range: 11.61-28.32
➢ E-commerce growth	Total paid memberships: 2,484,059
➢ Renewal rates	Average membership renewal rate: 75%
➢ Proceedings of the class-action lawsuit	Q4 e-commerce revenue growth: 72%

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APPENDIX A

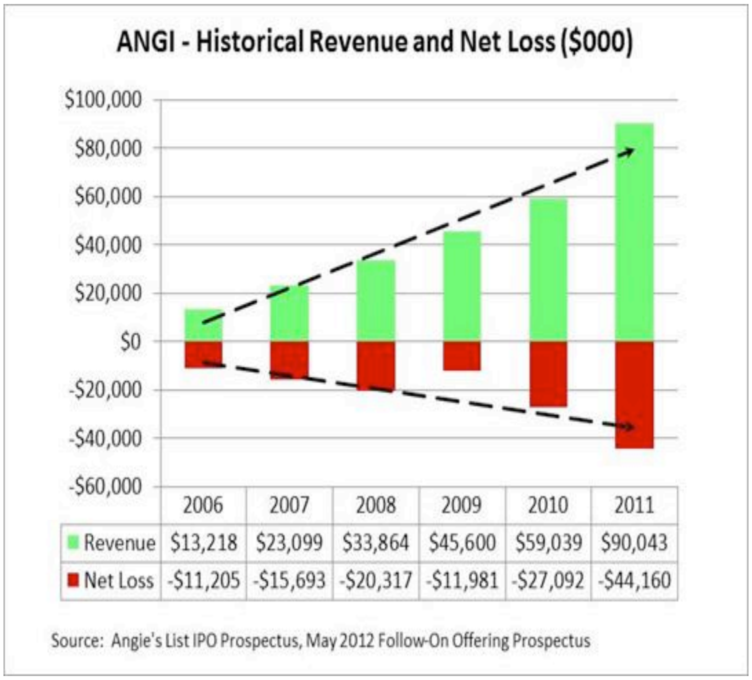


Figure 1

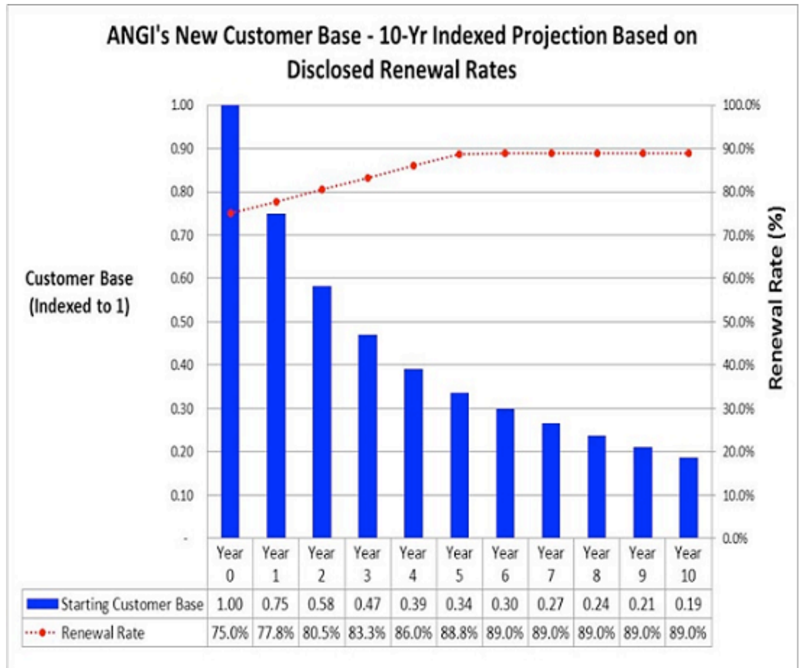


Figure 2
Note: projection assumes preference for renewal increases linearly over time

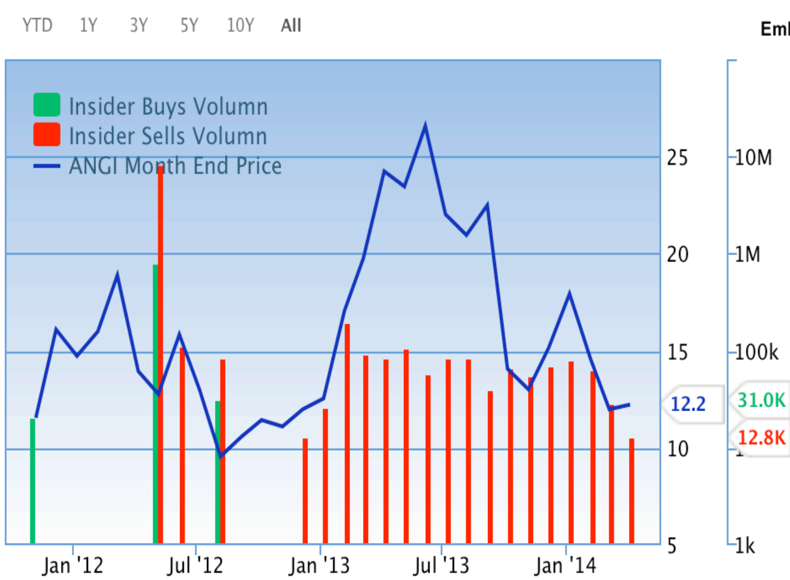


Figure 3

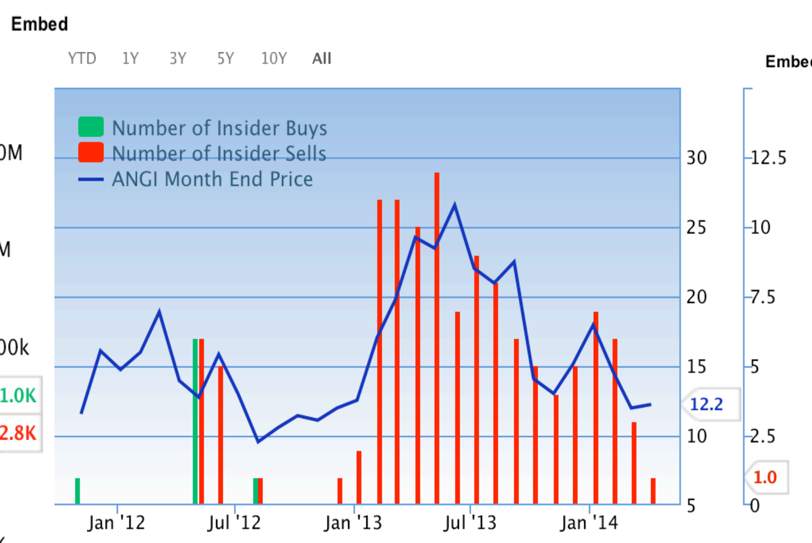


Figure 4

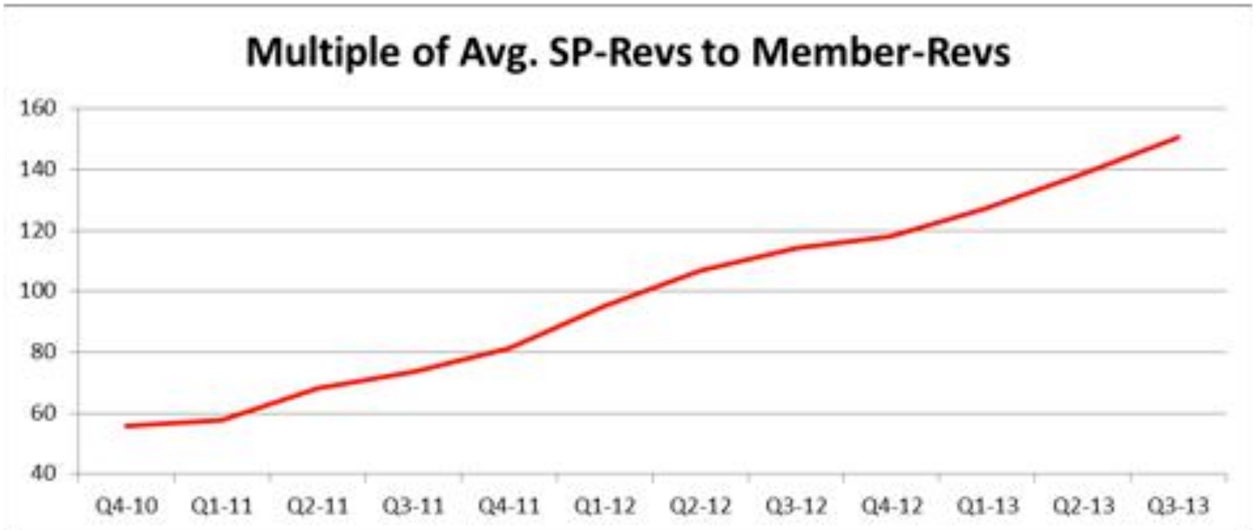


Figure 5

Underwriters

	Rating	Price Target
BofA - Merill Lynch	Buy	$ 18.00
Janney Montgomery Scott	Buy	$ 19.00
Oppenheimer	Perform	$ 17.00
RBC Capital Markets	Buy	$ 17.00
Stifel Nicolaus Weisel	Buy	$ 21.00
Think Equity	Buy	$ 22.00
Average Target Price		**$ 19.00**

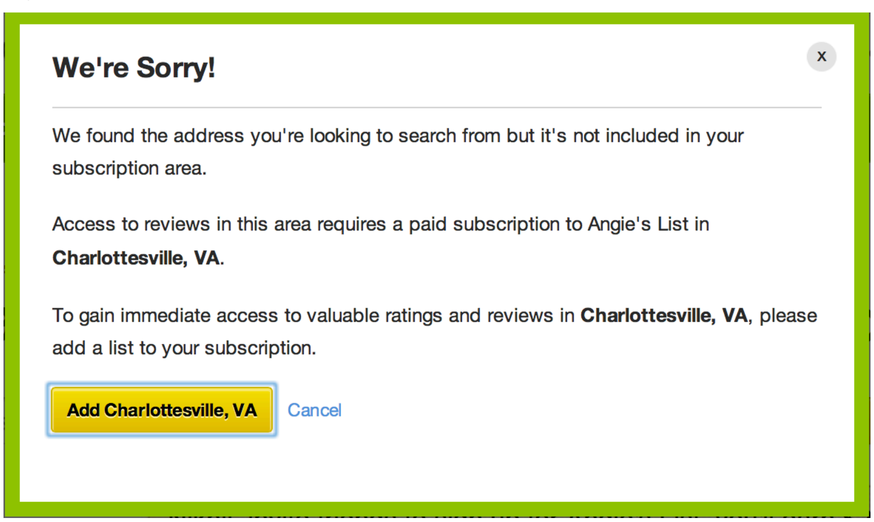
Non-Underwriters

	Rating	Price Target
B Riley & Co.	Sell	$ 10.00
Cannacord Genuity	Buy	$ 20.00
Wells Fargo	Market Perform	$ 16.00
Average Target Price		**$ 15.33**

Figure 6

Note: Since I would have to pay to see current data, this data is from about 2 years ago when the stock was trading at about $14.71. However, ANGI currently has an average rating of BUY and this dichotomy should still be true. Perhaps we could use the Bloomberg terminal to verify this.

APPENDIX B (Additional VAR)



Screenshot 1

Frustratingly, seeing reviews from other locales requires an additional subscription.

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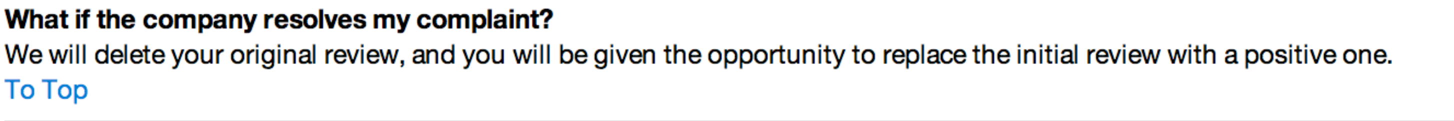
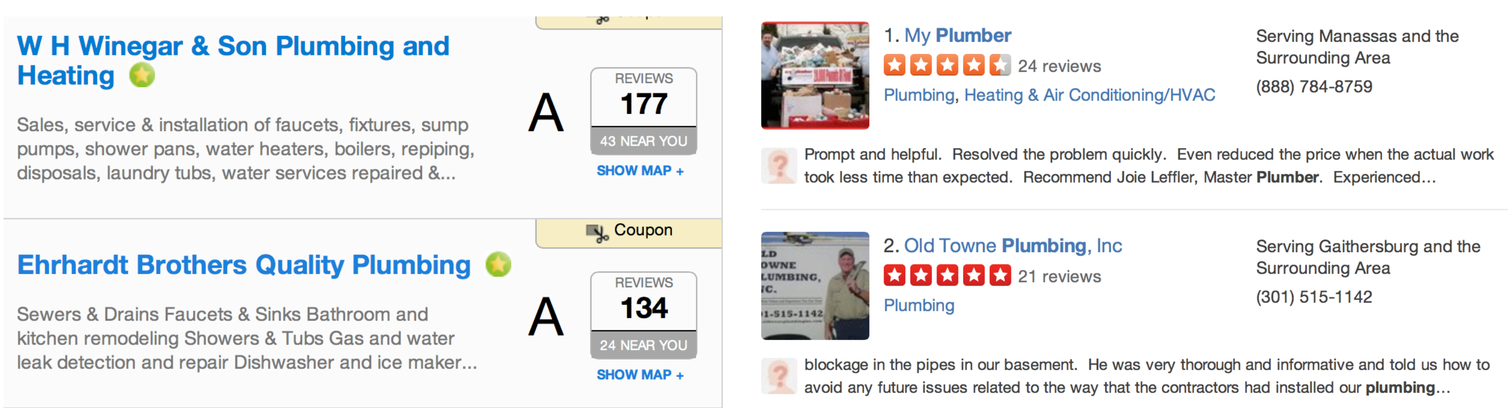


Screenshot 2

From the FAQ section. Angie's List deletes bad reviews after a service provider "addresses" the complaint. This means that service providers can just provide a refund to the disgruntled customer to avoid bad publicity, even if the service provided is still of poor quality.

Screenshot 3

Services that have lower ratings are sometimes listed higher than services that have higher ratings. This screenshot is from the first page, but there are multiple "A" rated companies on the second and subsequent pages. Consumers usually only look at page 1 to make a decision. One allegation in the class action lawsuit is that ANGI accepts payment from service providers in exchange for a higher location on the page.



Screenshot 4

The first two reviews when searching for "plumbing" using Angie's List (left) and Yelp (right). Angie's List has a significantly greater number of reviews, but the marginal return from these extra reviews may not be worth the cost of a paid subscription when Yelp offers the same service for free.