


## KIT Digital, Inc. (KITD): Short

<b>Name:</b> Sean Xiaoyi Yu	<b>College/School:</b> CLAS	<b>Year:</b> 1st
-----------------------------	-----------------------------	------------------

<p><b><u>Important Company Financial Data</u></b></p> <p>Share Price: 7.5          Market Cap: 331.33M          52-week Range: 5.93 – 12.73          EPS: -0.66          Beta: 1.84          Short Interest Ratio: 8.2          Debt/Equity: 5.96          ROE%: -9.05</p>	<div style="text-align: center;">  </div> <p><b><u>Company Description</u></b></p> <p>KITD is a global provider of end-to-end video management software and services. The company is headquartered in Prague, and maintains principal offices in 23 other regions. The KIT Platform, the cloud-based video asset management system, enables over 2,300 media &amp; entertainment, network operator and non-media enterprise clients to produce, manage and deliver socially enabled video experiences to audiences wherever they are.</p>
--	--

<p><b><u>Thesis / Key Points</u></b></p> <ul style="list-style-type: none"> <li>➤ <b>Loss of clients because of weakness of their software and emerging competitors in the video managing market.</b> <ul style="list-style-type: none"> <li>The video managing platform (cloud video and cosmic video) is the main product of KITD, which contributes about 70% of company's revenue; so even a slight failure in this market will bring huge impact to the company.                     <ul style="list-style-type: none"> <li>• Terrible user experience:                             <ul style="list-style-type: none"> <li>- For the cosmic version, no access can be found; that may make sense since cosmic is version for big firms.</li> <li>- But for the cloud version, there is not even a link in company's main page; the reason for that is KITD actually got this whole service from kewego, a company it acquired, and all the video services are still host in the website of kewego.</li> <li>- The operating experience of KITD'S platform is also frustrating, which directly led to loss of clients(refer my VAR of Symantec)                                     <ul style="list-style-type: none"> <li>• Fail to marketing its services:   <ul style="list-style-type: none"> <li>- One of its competitors, Oculu, provides the same video managing service, but with many tutorial videos that introduce the strengths of Oculu on its weblite. Another competitor, Salesforce.com, also has similar virtual experience. But KITD has no tutorial video, only an inessential introduction, which gives the potential clients no idea about what KITD do and why choose it.</li> <li>- Both Oculu and Salesforce have free trials and clear pricing listed on their website, but KITD has neither.   <ul style="list-style-type: none"> <li>• Wrong mission for their video managing platform:   <ul style="list-style-type: none"> <li>- In KITD's mission statement, it says to "monetize clients' premium content assets" and it uses the user subscription to realize that goal. But all their clients are enterprises and they just need to get their voices out there instead of get money from videos.</li> <li>- Part of LITD's service is video production, which is unnecessary for their enterprise clients.</li> <li>- These two happen because they fail to incorporate services they acquired, which will incur much cost because of inefficiency.   <ul style="list-style-type: none"> <li>• High Price caused the loss of many big clients:   <ul style="list-style-type: none"> <li>- The price range from I got from VAR is \$1k to \$10k per month, but Oculu's price is \$245 and Salesforce is \$450 per month.</li> <li>- In the Q4 statement, KITD says it get 25 net clients in the forth quarter, it did not mention KITD also lost 35 clients out of about 2000-client base. "To loss one client means a lot more than getting a new one".</li> </ul> </li> </ul> </li> </ul> </li> </ul> </li> </ul> </li> </ul> </li> </ul> </li> </ul> </li> <li>➤ <b>The continuous acquisition strategies cloak the unsustainable business model.</b> <ul style="list-style-type: none"> <li>• KITD acquired 22 companies since 2007, so its assets and revenue jumped up very quickly, but the net income holds still, which implies KITD is unable to manage the cost derived form the acquisition. (Exhibit 2)</li> <li>• KITD also have a hard time to incorporate the service and technology it gets from other companies into its own service system; although their CEO believes they can do it smoothly.</li> <li>- On KITD's website, there are more than 40 services just listed there only with very basic classification. KITD got those services and technologies from the companies they acquired, but it did not incorporate that into its own service, it did not do any technology optimization, which is very important for Internet service companies.</li> <li>- KITD is unable to keep the companies they acquired profitable: I did research about those 14 companies separately, of the 14 recently acquired companies, only 3 of them showed positive results after the acquisition. (Exhibit 4)</li> <li>- 80% of the company's revenue is generated from the technology and products in the acquired companies; where is innovation?                     <ul style="list-style-type: none"> <li>• Mysterious R&amp;D: because of different accounting system, KITD never report its R&amp;D expense. According to my VAR, the R&amp;D/Revenue is about 7%, which is lower than the industry average 14.3%. ( refer to my VAR with Alex Blum)</li> <li>• Rely too much on equity: the D/E ration is 5.96, much lower than the industry average 38.75, which imply that KITD is reluctant to invest for R&amp;D; this fact add to its lack of innovation and unsustainable business model.</li> <li>• 100% non- recurring: COO of KITD believes 70% of revenue are recurring but all of them can be non-recurring (Exhibit5)</li> </ul> </li> </ul> </li> <li>➤ <b>The successive fraud and credit crisis make the investors loss confidence, which will stop the price from recovering.</b> <ul style="list-style-type: none"> <li>• Difference of amount of cash in Q4 and 10-K. (Exhibit 6)</li> <li>- In the Q4 statement, the cash and cash equivalents in the balance sheet is \$47.764 million, but after 15 days, this number become \$45.660 million and nobody had explained where did the \$2.1 million cash went.</li> <li>- In my VAR, although her official response is "I do not know anything about that" but she tried to convince me that this is just an error when transformed the number in to GAAP. Nevertheless, cash is the defined the same under any accounting system.</li> <li>- When asked the biggest worry about KITD, the former CEO Kaleil referred to the distraction of being a public company; the CEO</li> </ul> </li> </ul> </li></ul>
---

## KIT Digital, Inc. (KITD): Short

of KITD even felt “we cannot pick and choose what operational information we expose to the market”. That is possibly the real reason behind this fraud.

- SEC subpoenas for both the former CEO Kaleil and KITD about insider trading.
- SEC issued two simultaneous subpoenas on February 24<sup>th</sup>, 2012.
- Kaleil bought KITD’s stock for the last time at August 2010 and sell 31% of his stock on November 2011. (Exhibit 8)
- This information should be released immediately with 8-K, but it was not shown until the 10-K in March 30<sup>th</sup>.
  - Default of a debt covenant on all of the secured notes payable.
- Fail to maintain at least 75% of the dollar value of worldwide cash with one or more banks in the United States.
- Received a waiver from the lender for the period through March 31, 2012.
- KITD did not give explanation for that; it just discussed with the lender to ensure that it is in compliance with this debt covenant in the future. Investor did not see active role of KITD when it met with credit crisis.
  - Lack of accounting and financial personnel: KITD explained all financial problems with the “Lack of financial personnel who understand US GAAP”. The General Counsel of KITD, Lou Schwartz, always complains about this lack. But first, for a public traded company in US, it doesn’t make sense that they cannot deal with the basic financial statement; and second, KITD seems never want to solve this problem, because in 65 positions they recruit right now, 41 are in North America and only 4 are business stuff.
- **Significant change in management team recently and the wish they want to sell KITD implies they loss confidence.**
  - Kaleil, the CEO of KITD, quitted for the CEO position and stayed for the chairman position in March. 23th, and the CPO, CFO, CTO, and another independent director quitted for their positions.
  - Kaleil and Santo Politi, the independent director, quitted because of differences of opinion about company's possible sale. Founder of KITD in 2007, Kaleil led the company to a highpoint with his vision; without him, the future in unclear.
  - All the other three directors are in the founding team of KITD, and they shared the some vision as Kaleil.
  - Kaleil Isaza Tuzman resigned his chairman position on April 16<sup>th</sup>, less than a month after his resignation of CEO.
  - Another reason of resignation is company’s unreasonable rely on equity—the D/E ratio is 5.96 compared with salesforce’s 35.10. And as the biggest shareholder, Kaleil paid much for company’s loss since the ROE is -9.05%, compared with the industry average 7.30%.

### Misperception

- KITD has a strong balance sheet and revenue. From my VAR, about half of the revenue growth is because of accretive acquisition, we do not know if the acquisition account for more growth, but that makes the revenue less attractive.
- KITD has such a global presence, which makes it less risky. KITD expand by acquisition, but those acquisitions are always small scale. For example, KITD acquired a two-people firm in Sofia and claimed it expands into Bulgaria. And as stated before, KITD is not good at keep acquired company profitable, so that small firm in Sofia nearly “disappear” now, which has no market impact at Bulgaria at all, so global presence did not mean global market impact.
- The P/B ratio is only 0.92, which is attractive. But the reason is after the frequent acquisitions, the asset jump to a very high level, but the development capacity of the company cannot keep up with it. And as stated before, KITD had a hard time incorporate those new technologies in acquired companies into its own service and generate value, so there are a lot of “dead asset” which imply that the asset value is extremely overvalued. So the low P/B ratio is not that attractive.
- Probable acquisition of IBM will drag the stock price up. See Exhibit 8.

### How It Plays Out

- The bad user experience and high price keep pushing KITD’s clients to its competitors, which further crowd out its market share.
- The transition of management team will stop the continuous acquisitions, which will wipe out at least half of the revenue and continually grind down the already miserable margin and drag the stock price down.
- Kaleil will continue to quietly sell his shares in KITD, which remove the only “pillar” that keeps the price in an acceptable level.
- Lenders will either reduce their borrowing or increase the interest rate after the default, which will put more pressure on equity.
- Investors will lose confidence about KITD and stock price crash.
- The transition of new management team coupled with resistance of acquisition requires a rough adjusting period before positive outcomes, if any, may appear.

### Risks / What Signs Would Indicate We Are Wrong?

- If IBM announces acquisition of KITD, price will soar.
- If the new management team stops the strategy of constantly acquisition and start to focus on self-development, the unsustainable model can be corrected, and KITD can attract more clients, but it takes time.
- KITD has a lot of technologies and intangible assets now, if it can restructure those assets, KITD will be profitable.
- If KITD can lower the price for low-end small firms, it can attract more clients, which means much more “organic” growth.
- If the D/E ratio increases, KITD won’t much rely on equity and start to growth healthily.

### Signposts / Follow-Up

- Acquisition information of KITD
- The vision of the new management team
- The price change for their video managing platform
- Change in short interest
- Kaleil’s continuous action about sell shares
- The result of SEC investigation

## KIT Digital, Inc. (KITD): Short

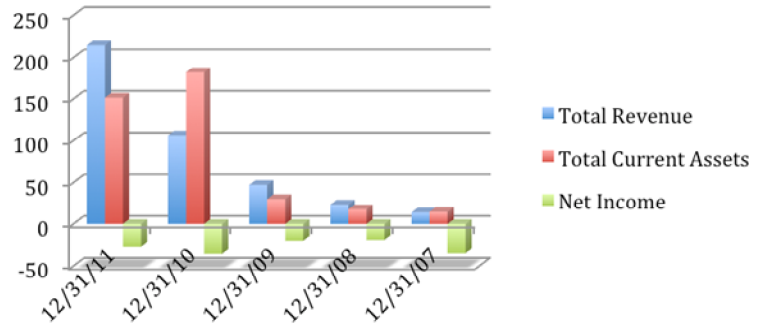
(Page of Exhibit/s)

**Exhibit 1: The Stock Chart of KITD**



**Exhibit 2: Continuous Acquisitions' Influence**

**Trend of Revenue, Assets and Net Income**



Continuous Acquisitions keep revenue and assets high but not the net

income

**Exhibit 2: Compare three video services**

	Kit Digital	Oculu	Salesforce
Cloud-based video hosting	✓	✓	✓
Ad-free video hosting	✓	✓	✗
Dedicated bandwidth for faster playback	✓	✓	✓
Human customer support	✗	✓	✗
Human computer interaction	✓	✗	✓
SEO value on you won website	✓	✓	✓
Editing, production service	✓	✓	✗
Downloadable, detailed statistics	✓	✓	✓
Mobile video support	✓	✓	✓
Social media link	✓	✗	✓
Security guarantee	✓	✗	✓
Promotion ways other than video	✗	✗	✓
Private cloud based video managing service	✓	✗	✗

Their services are pretty similar; each of them also specializes in some specific fields. So Oculu and Salesforce are very strong competitors to KITD.

**Exhibit 3: Companies' situation after being by KITD**

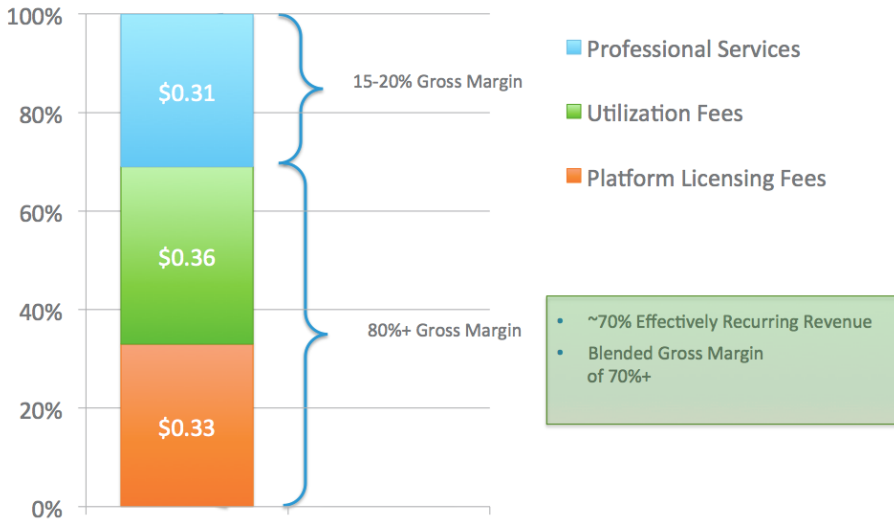
Company Name	Date	Purchase Price	Shares	Situation right now
Multicast	3/16/2010	\$17,668	1,312,034	N/A
Benchmark	5/14/2010	\$15,762	353,774	Revenue increase 5.4%
Brickbox	9/21/2010	\$16,709	604,738	Company out of market
Accela	9/8/2010	\$5,309	332,764	"Suffering from loss"
Megahertz	9/8/2010	\$3,251	N/A	N/A
Kyte	1/21/2011	\$5,765	189,348	"Revenue decline"
Kewego	1/26/2011	\$27,306	1,411,704	612,000-euro revenue in 2011, 500,000 in 2009. 22% growth.
Kickapps	1/28/2011	\$32,046	2,990,551	"Unable to keep revenue"
WWB	2/21/2011	\$2,163	23,514	"Lost many clients"
IOKO	5/2/2011	\$87,000	1,509,804	Out of market
Polymedia	5/17/2011	\$37,324	1,178,381	Became part of KITD and lost many employees and clients
Peeset	6/9/2011	\$1,499	10,611	Out of market
DMP	10/3/2011	\$3,070	42,500	"Great support from KIT Digital"
Sezmi	12/30/2011	\$27,001	N/A	Not yet available

I did research about 13 companies that KITD acquired in the past two years. Only 3 out of 14 showed positive progresses after acquisition, which shows that KITD cannot incorporate the acquired companies well.

## KIT Digital, Inc. (KITD): Short

(Page of Exhibit/s)

### Exhibit 5: KITD's interpretation of 70% recurring revenue



100% Non- recurring revenue: COO of KITD believe 70% of the revenue are recurring because they are utilization fees and platform licensing fees, and people have to pay it constantly as long as they use KITD's platform service. The rest 30% revenue is from solution services, which is one-time revenue. But the fact is since the contract period for KITD's video managing platform is only 2 weeks, so if KITD's services are not good and attractive enough, clients will just stop using it after two weeks, so none of KITD's revenue is recurring independent of the quality of services.

### Exhibit 6: Difference of cash between Q4 and 10-K

KIT DIGITAL, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Amounts in Thousands, Except Share Data)

#### Q4 Statement

	December 31, 2011	December 31, 2010
<b>Assets:</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 47,764	\$ 141,233
Restricted cash	238	2,000
Investment	1,915	1,050
Accounts receivable, net	73,970	29,349
Unbilled revenue	13,899	537
Inventory, net	1,338	301
Loan receivable, current portion	2,756	2,486
Other current assets	11,350	5,104
<b>Total current assets</b>	<b>153,230</b>	<b>182,060</b>

#### Consolidated Balance Sheet Data (at end of period):

Cash and cash equivalents	\$ 45,660
Working capital (deficiency)	66,578
<b>Total assets</b>	<b>501,737</b>
<b>Total liabilities</b>	<b>148,067</b>
<b>Total stockholders' equity</b>	<b>353,670</b>

#### 10-K Statement

### Exhibit 7: Insider Trade

Trades in last 3 months: 0  
Trades in last 12 months: 1

Click on the column header links to resort ascending (^) or descending (v).

Insider	Relation	Last Date	Transaction Type	OwnerType	Shares Traded	Last Price	Shares Held
<a href="#">ISAZA TUZMAN KALEIL</a>	Officer	11/18/2011	Sell	indirect	677,000	10.4600	2,171,290
<a href="#">ISAZA TUZMAN KALEIL</a>	Officer	08/26/2010	Buy	indirect	10,000	8.0500	2,848,290
<a href="#">KROJER LARS</a>	Director	06/30/2010	Buy	direct	5,000	8.9000	6,143
<a href="#">ISAZA TUZMAN KALEIL</a>	Officer	06/29/2010	Buy	indirect	12,500	8.6900	2,838,290
<a href="#">ISAZA TUZMAN KALEIL</a>	Officer	06/09/2010	Buy	indirect	54,645	9.1500	2,825,790
<a href="#">ISAZA TUZMAN KALEIL</a>	Officer	04/27/2010	Buy	indirect	100,000	13.0000	2,771,145
<a href="#">ABACUS TRUSTEES (GIBRALTAR) LTD</a>	Other	04/22/2010	Buy	indirect	230,769	13.0000	1,998,880
<a href="#">ZIVAR INVESTMENTS LTD</a>	Other	04/22/2010	Buy	direct	230,769	13.0000	1,998,880

Kaleil did his last buy on 8/26/2010 and did not buy any more shares until sold 31% of his share on 11/18/2011. This action showed his uncertainty and unconfidence about company's performance

## KIT Digital, Inc. (KITD): Short

(Page of Exhibit/s)

### Exhibit 8: IBM's possible acquisition of MITD

- Background:
  - The first implication of acquisition came from February 27 when the company issued preliminary full year results and updated guidance. In that press release, former CEO and Chairman Isaza Tuzman, who is the people favored acquisition, said, "We have from time to time received expressions of interest concerning significant investment in, and possible purchase of, our company. Due to recent inquiries and conversations, in January our board established a strategic transaction committee of independent directors to allow for responsible and efficient review of such opportunities as they arise."
  - The reason why IBM came to sight is because KITD just partnered IBM and launch a new mobile eCommerce video solution at the myNAB Show in Las Vegas, so many analysts thought IBM is going to acquire KITD.
- But I want to bring three reasons that this acquisition will not happen soon:
  - Kaleil, who is the people favored acquisition had left KITD completely and nobody know which direction the new management team is going, but there is a clear clue that the new executive people do not agree on Kaleil and Politi's idea about actively seeking acquisition opportunities. So there is a huge probability that the new management team will be resistant to the acquisition.
  - The stock price actually went down when the news about acquisition was released instead of going up, probably because investors treated the fact that KITD started to seek for buyers as an implication that KITD really has a problem inside that it needs help. That's good sign for us to short for KITD because we do not need to worry about the increase of stock price as a result of people's positive expectation about acquisition before the transaction really happen.
  - In my VAR, Dr. Andre told me that he had been doing research about all kind of Internet cloud-related services for years, and he believes that the mobile eCommerce video solution that MITD and IBM launched together "has not big difference in the functions description and source code as KITD's mobile video managing platform". This fact implies that for this partnership, IBM found KITD not because IBM was interested in KITD's technology and want to seek acquisition possibility but because IBM and KITD just want to do marketing and let their name out in each other's industry.



### Exhibit 9: VAR Research Reference Chart

Category	Names/Positions	Takeaways
KITD	Murray Arenson VP, Investor Relations & Corporate Development	<ul style="list-style-type: none"> <li>• KITD do not want people to compare their price with other low level video service companies, that's why it do not post price online. The price range from 1k to 100k per month. 1K to 10K for the cloud edition (for small enterprises) and 20K to 100K for the cosmic edition (for big firms).</li> <li>• KITD has a very sustainable business model and more than 70% of revenue is recurring.</li> <li>• About 53 percentage of KITD's revenue growth is due to accretive acquisition.</li> <li>• IBM has not shown any interest in KITD's technology and business scale.</li> </ul>
KITD	Alex Blum Chief Operating Officer	<ul style="list-style-type: none"> <li>• The R&amp;D group did a lot of technical improvement and change to Kewego's product and made our cloud video platform totally new. He denied the fact that about 80 of company's revenue is accounted for Kewego's products.</li> <li>• KITD's R&amp;D expense is about 7%, and company is thinking about report the R&amp;D expense start from the FY 2012.</li> <li>• KITD's vision is not about use small invention to please low-end clients; KITD want to be professional and meet with the need of big firms clients and cultivate their loyalty.</li> </ul>
KITD	Kate Executive Assistant of Lou Schwartz, head of America, General Counsel	<ul style="list-style-type: none"> <li>• She do not know anything about the difference of cash in Q4 and 10-K, but that's may because of the difference between two accounting system.</li> <li>• Mr. Schwartz always complains about lack of accounting personnel who are familiar with both accounting system and how to transform between those two.</li> </ul>
Competitor	Jim Steele Chief Customer Officer	<ul style="list-style-type: none"> <li>• KITD used to be the leader in this video service market but not any more.</li> <li>• Salesforce.com provides the similar service as KITD does but with more personalized solutions. Salesforce.com is not only a platform as KITD; it's more like a social media to enable clients to take advantage of the technology to promote everywhere.</li> <li>• Salesforce successfully attracted many clients of KITD, Symantec for example.</li> </ul>

### KIT Digital, Inc. (KITD): Short

	Salesforce.com	<ul style="list-style-type: none"> <li>• Salesforce is working on a private cloud based marketing solution aimed for the big firms who need comprehensive solution for marketing. This product will threaten KITD's last advanced position in the private cloud video service.</li> </ul>
Former User	<p>Cecilia Daclan</p> <p>Consumer PR, Americas</p>	<ul style="list-style-type: none"> <li>• About KITD's product, there is no way people can figure out how to do it without CS knowledge or the help of technology people, and the source code part is the most stressful.</li> <li>• About Salesforce' solution, the software is really simple and I only need to click to upload files and they will do the rest for you.</li> <li>• KITD's cloud video platform is so expensive compared with Salesforce's service.</li> </ul>
Expert in online video service's technical part	<p>Paul Andre Post Doctoral Fellow</p> <p>Human Computer Interaction Institute&amp; Social Computing</p> <p>Carnegie Melon University</p>	<ul style="list-style-type: none"> <li>• KITD's user experience is really a mess; without clear guide, tutorial video, it fails to attract the potential customers.</li> <li>• KITD's cloud video service's operating platform is "developer-based", which means it still requires some knowledge in JAVA programming. It's not customer-based.</li> <li>• About the newly launched mobile eCommerce video solution, it is almost that same as the existing mobile version of cloud video platform in terms of the functions description and source code of the products. IBM is really good at algorithm optimizing and this was not shown in this new product, so he doubts if IBM really participates in the development of this product.</li> </ul>
Expert in online video service's financial part	<p>Ming Wei</p> <p>Senior Chief Operating Officer</p> <p>Youku.com</p>	<ul style="list-style-type: none"> <li>• For online video services provider, constantly acquisition is never a good choice to expand because clients pay for good and customer-based services, not the global expansion.</li> <li>• To loss one client means a lot more than getting a new one.</li> <li>• R&amp;D is the most important factor in order to survive in this market. Fail to make innovation to satisfy clients constantly changing need will kick the company out of market.</li> <li>• When we bought a technology from other company, we will never just put it there; we would spend a lot of effort in technology optimization and try to integrate that specific technology into our services and products. That's very important when after the acquisition of other companies because other people's technologies are good, but they will not generate values in your company.</li> </ul>
Analyst	<p>Steve Tang</p> <p>Analyst in Internet Division JP Morgan</p>	<ul style="list-style-type: none"> <li>• The credit crisis has server impact on KITD's reputation, which is the key factor that will keep the price decreasing until some excitements happen.</li> <li>• Loss of reputation will drag the price down no matter what service that company provides.</li> </ul>

**KIT Digital, Inc. (KITD): Short  
Ideas for the Club**

1. About Social Event about Stock:

I have heard many of my friends who just joined MII in this semester complain about they did not learn anything from the weekly presentations. I really understand their situation because I went through the same period when I first joined MII last semester. But after a semester's exploration, I find out the most useful and efficient way to understand how stock research works is to talk with the managers about stocks. I talked to Ryan about stocks and the market trends several time in a semester and every time I can learnt a lot from it. So if we can organize some social events to give members the chances to have deeply conversation about stocks with the managers, it will be really helpful for our member.

2. Mentor Program:

We have the mentor program for the people who want to pitch and it is only a one-time program. Why not we assign all the members to all the managers and associates, and then each manager or associate will have 7-8 mentees. Mentors can organize two or three get-together events for all the mentees to give them ideas about what is stock research like and get them prepared for their own pitches. We can make our member selection process more rigorous and therefore give the each member more personally attention and care.

3. Mini Pitch Competition:

Many of my friends think the whole research and pitch process need too much work and time and they do not want to try it. So we can hold Mini Pitch Competition for all the first year members. Basically we give them part the research and let them finish the rest by doing their own work. For example we can provide them with company's info and the financial data's research outcome and let them do some company's valuation by doing research about company's service and products, company's competitors and VAR. We can even leave the long or short choice for our members. The reward of the winner for this competition can be going with the managers to have dinner with John Griffin, which will be a huge incentive for the first year members.

4. MII Alumni:

Every year, we have many former or current MII managers or associates go to prestigious banks on the Street. These connections are very precious and we can use various ways to keep the connections. For example we can organize a MII Alumni Reception in a weekend to invite as much as possible former MII Alumni back to UVa and share their experiences with current MII members. This reception is also a good chance for MII members to networking.

We can also invite MII Alumni come back to UVa and do the presentation about their companys to MII members. Actually everybody can be benefit from this event. The members get chances to know their potential employers and network with people; MII Alumni can get more appreciation from their bosses; and MII can get more awareness in Wall Street, which will be crucial for our future development.