PAR: A Framework For $30

September 27th, 2017

PAR has been an excellent performer in 2017, up 80% YTD as of September 27th ($10.02). While we do not expect stocks to go straight up, we believe there is a reasonable path to $30 for the stock over the next couple years. This note breaks down how the stock could get to $30 over the next few years.

Summary

To simplify, we believe if you can answer these three questions you can determine PAR's stock path:

1) How many restaurants will Brink POS (cloud software) be in?
2) What will be the average monthly subscription fee per restaurant (e.g. ARPU)?
3) What EV/Sales multiple should Brink/PAR get off this restaurant base and ARPU?

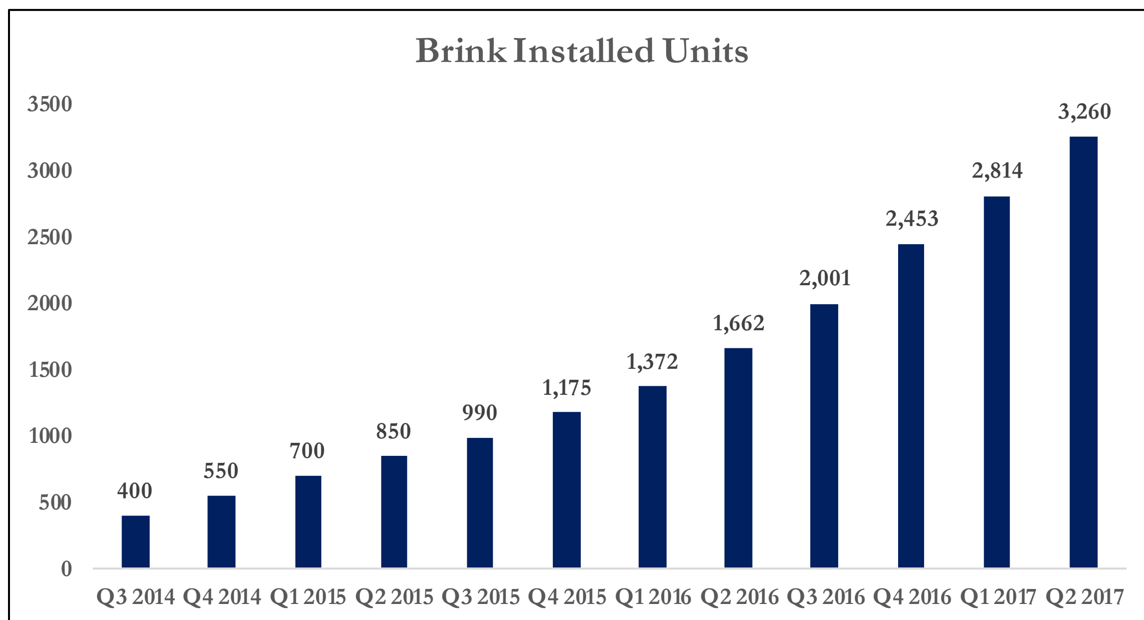
Getting these three things approximately right, and then using reasonably conservative assumptions on the rest of the businesses, can hone in on the underlying value of the stock, as we believe Brink is, by far, the largest value driver for the company.

Our long term $30+ price target for PAR is based on the thesis that Brink can be in ~26,000 restaurants by the end of 2020 and have an ARPU of around $170/restaurant/month, which would generate annual recurring software revenue of ~$54 million, hardware revenue of about $58 million, and hardware maintenance of $16 million. We believe this ~$128 million dollar Brink revenue stream would command a 3-4x multiple on its own ($24-$30) based on a SOTP and looking at competitors MICROS and Radiant before they were acquired. Taking the rest of the businesses (Government, SureCheck, Pixelpoint, and all of their legacy hardware/hardware maintenance revenues) could result in a $30 stock over the next few years.

#1 How Many Restaurants Will Brink POS Be In?

What do we know?

1) **Current:** At the end of Q2, Brink was live in 3260 restaurant sites, a ~96% jump from a year ago. Here is Brink's trajectory since the company was acquired:



2) **Medium Target**: Management has repeatedly targeted, by the end of 2017, being in 5000 stores, and by 2018 being in 10,000 stores. In other words, a continuation of the near 100% growth for another two years. We note they are a bit behind in 2017 so far, but believe Q3 and Q4 are stronger seasonally and we expect them to get near the 5,000 number, if not hit it.
3) **Long Term Target**: Management has set a target of 34,000 units by the end of 2020. Assuming they hit 10,000 by the end of 2018, this implies ~80% growth between 2018 and 2020.

4) **Medium Term Visibility**: we believe management has visibility here, certainly to the 10,000 target in 2018. For instance, they believe they can get reasonably close to 5,000 with very little contribution from the larger Tier 1 vendors they are starting to sign (see Tier 1 below). To boot, on the last call they noted their signed but not implemented backlog was at 2,000, with only a small piece coming from Tier 1s. Just getting these signed customers implemented puts them over 5,000 stores.
5) **Tier 1**/Long Term Visibility: we believe the following:
    a. They have completely signed and started deploying one 3,000 restaurant Tier 1 (Arby's we believe)
    b. They are finalizing terms with a second (Dairy Queen, we believe)
    c. They are close to finalizing terms with a third
    d. They are having conversations with "several more" Tier 1s
    e. They have the runaway best cloud product on the market and combined with their hardware know how are in great position to capture more Tier 1s.

Thus, we believe at minimum they should get 80% of the two Tier 1s we believe they have signed (Dairy Queen and Arby's), which would be an additional 6,300 units in the 2018/2019 timeframe.

Given that they are close on other Tier 1s, and they plan to launch their international offering in the 2018 period (along with table service restaurants), we believe the company can reasonably expect to do 8,000 Tier 1 units in the 2018-2019 frame, and it could be much higher.

Below is a table showing Quick Service Restaurant Tier 1s and their approximate number of North American Units, along with their current hardware relationship with the customer. We believe the hardware relationship is critical, as they have customers who have worked with PAR for many years

United State Restaurant TAM

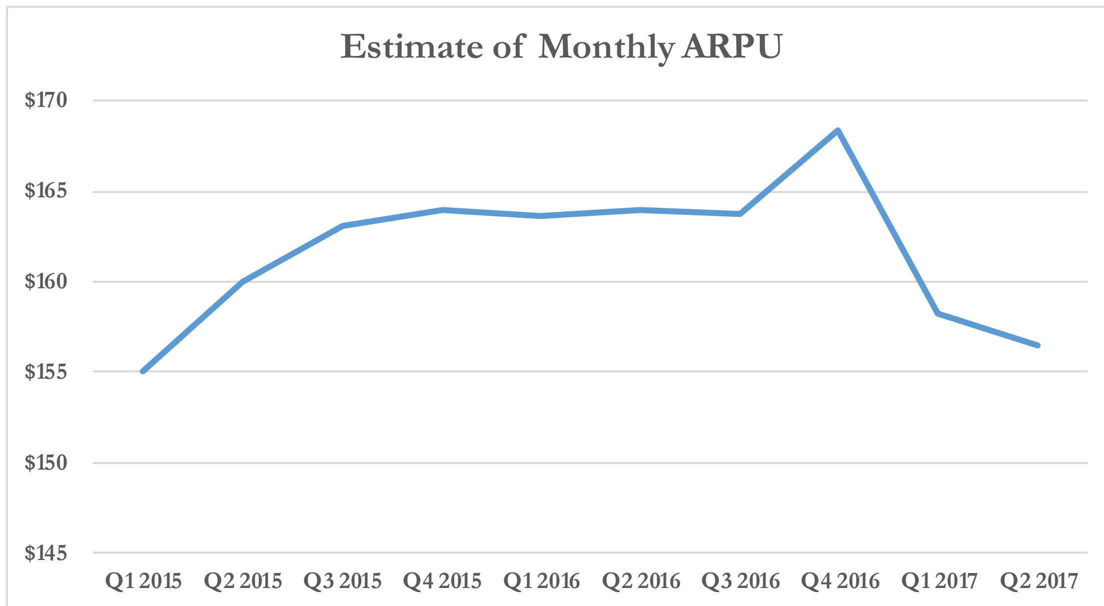
Tier 1 Restaurants	US Locations (2015)	Comment
Subway	27,103	Long term hardware
McDonald's	14,259	Long term hardware, probably 2019
Starbucks	12,521	
Dunkin' Donuts	8,431	
Pizza Hut	7,822	Long term hardware
Burger King	7,126	
Taco Bell	6,121	Long term hardware
Wendy's	5,722	
Domino's	5,200	
Dairy Queen	4,511	Believe signing is imminent
KFC	4,270	Long term hardware
Little Caesars	4,237	
Sonic	3,557	
Arby's	3,342	Believe contract is signed
Carl's Jr./Hardees	2,958	Long term hardware
Popeyes	2,539	Long term hardware
Jack in the Box	2,249	Recent hardware
Chick-fil-A	1,983	
Panera	1,972	
Chipotle	1,971	

Note that Five Guys Burgers is not on this list but is PAR's largest announced customer. They have over 1,500 units in North America **and have 1,500 more in development**, so this could end up being another major Tier 1 as it's completely rolled out.

While it's harder to estimate the runway of non-Tier 1s, we think the outlook is still bright. For instance, we have heard of Brink either being purchased or being on the verge of being purchased by material Tier 2 players like Smoothie King (800 units) In-N-Out Burger (326), and Bruegger's Bagels (260). We believe there could be many more like this that Brink is negotiating with.

#2- What Will the ARPU Be?

The second piece of the puzzle is what the ultimate ARPU, or average revenue per user (or in this case, per restaurant) will be. By our calculations, piecing together disclosures over the last 6-8 quarters, we believe the ARPU has remained reasonably steady in the $155-$165 range, although it did dip a little lower recently (we calculate this by taking the average number of units and dividing by what management reports is the ARR for the quarter, divided by 12):



There are some puts and takes here. For instance, we believe that Tier 1s will generally be lower than average, perhaps in the $130-140 range. On the other hand, management has expressed strong confidence that ARPU can rise materially over the next few years. This can come in a few ways:

1) **Additional Services: t**here are a number of these, from their Kitchen App to Loyalty Cards to building additional back office and other products (e.g. Restaurant Management Software or Digital Signage software).
2) **API Services:** some of the Tier 1s may "use" PAR to build APIs between Brink and their other software. For instance, as we understand it at least one of the two Tier 1s is doing this. Brink then generates high margin, relatively consistent, interchange revenue based on volume of API use.
3) **Table Services.** It is our understanding that table service restaurants have higher ARPUs. Although we do not model table service becoming a major piece of revenues it could support ARPU incrementally.

ARPU is a little harder to forecast but we do believe in a Base that they can roughly hold their ARPU (perhaps with a dip in 2018 as they ramp up Tier 1s, then with slow, modest growth as they continue rolling out new services).

#3- What EV/Sales Multiple Might Brink Get Off This Base?

Below is a table of our Bull/Base/Bear case on units/ARPU, resulting run rate revenue, and then our valuation assessment based on a sales multiple:

Valuing Brink's Software Business Under Different Scenarios							
						NTM	
Brink Software Revenues						**Multiple**	**Value**
Bull Case	**2017**	**2018**	**2019**	**2020**	**CAGR**		
Units Installed End of Year	5100	11000	22000	34000	88%		
ARPU	$170	$180	195	210	7%		
Revenue Run Rate (000)	$10,404	$23,760	$51,480	$85,680	102%	9.00x	$771,120
Base Case	**2017**	**2018**	**2019**	**2020**	**CAGR**		
Units Installed End of Year	4610	8510	15410	26510	79%		
ARPU	$165	$160	165	170	1%		
Revenue Run Rate	$9,128	$16,339	$30,512	$54,080	81%	7.00x	**$378,563**
Bear Case	**2017**	**2018**	**2019**	**2020**	**CAGR**		
Units Installed End of Year	4100	7000	10000	12000	43%		
ARPU	$155	$155	150	145	-2%		
Revenue Run Rate	$7,626	$13,020	$18,000	$20,880	40%	5.00x	$65,100

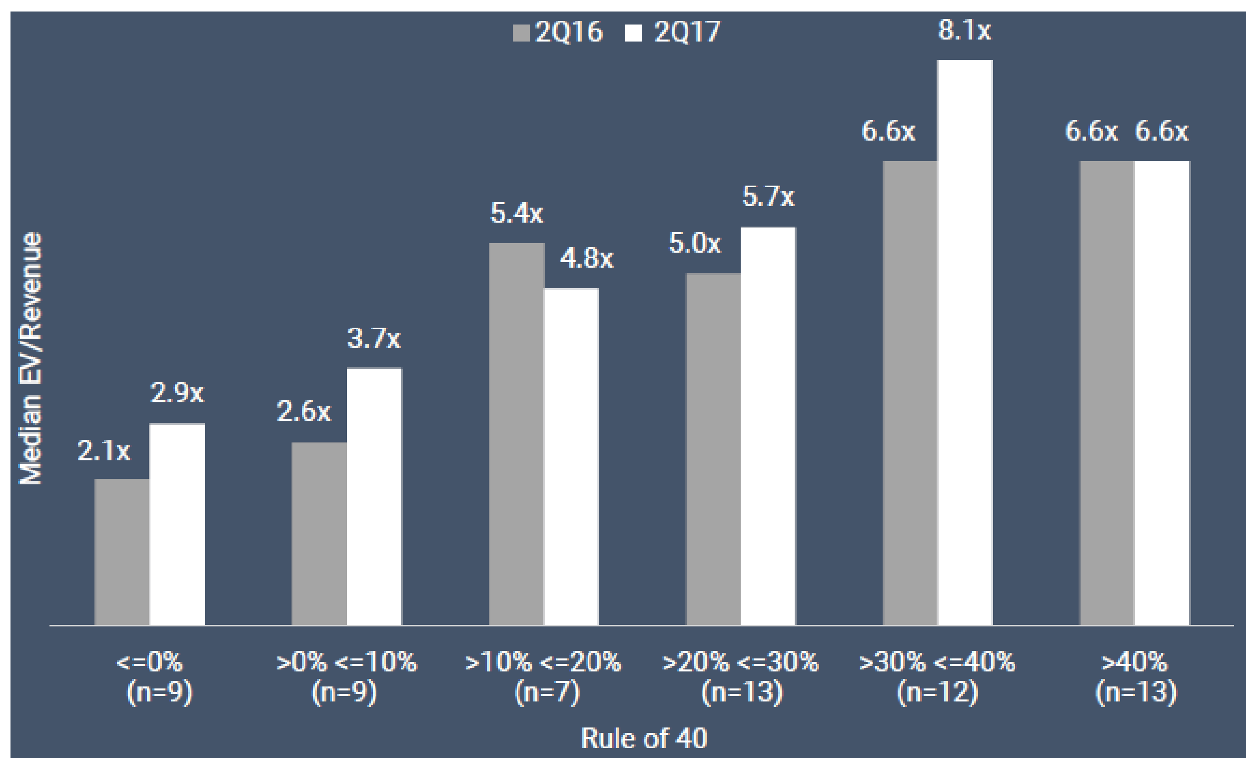
How did we come up with 7x for the software revenue annual recurring revenue?

If you look at US tech companies with >30% projected sales growth and greater than 70% gross margins, the median EV/Sales NTM ratio is 7.5:

	EV/Sales NTM	Growth	Gross Margin
Facebook, Inc. Class A	9.3	32%	86.3
LogMeIn, Inc.	4.8	37%	84.8
Alteryx, Inc. Class A	6.3	39%	81.3
2U, Inc.	7.5	37%	79.1
Atlassian Corp. Plc Class A	8.4	32%	78.3
MuleSoft, Inc. Class A	6.9	37%	73.9
ServiceNow, Inc.	8.0	32%	71.3
BlackLine, Inc.	8.0	32%	70.5
Instructure, Inc.	5.1	32%	70.5
Median	**7.5**	**32%**	**78.3**

We think Brink would be growing twice as fast, at least, and have higher gross margins (we assume 85% but believe live customers can be even higher as the business scales).

Another common technique employed (admittedly quick and dirty) is the "Rule of 40", whereby you add up the sales growth and EBITDA margin to come up with a number. For instance, a company growing at 20% with 10% EBITDA margins would get a score of 30. The higher the score, the higher the multiple, as this SEG report shows below:



As of Q2 2017, companies with a score greater than 40% were getting between a 6.6x and 8.1x EV/Sales multiple. We believe Brink, which management claims is already cash flow positive, would have a score materially above 40%.

Finally, we borrow research from Jeffery's John DiFucci that outlines why a SaaS company like this should get, in a run off situation with negative growth, a 4.5x multiple on their software subscription revenues. DiFucci shows that the average software company, because of growth, trades materially higher than that, with an average above 6x. Given Brink's stronger growth and best of breed niche status, we believe it would command a premium to the average.

We could do lots of additional analysis around growth rates, salesforce efficiency, etc. but ultimately we believe if they achieve that kind of growth, and have more visibility into further growth, a 7x sales multiple could be conservative.

Brink in Aggregate

The reason estimating the unit base is so important is that Brink software brings along other material revenue, in the form of hardware and then hardware maintenance contracts, that is relatively straightforward to model. These two areas are less valuable, for sure, but they can get large enough to become meaningful.

Our modeling is based on conversations with IR/management and makes the following assumptions:

1) **75% Hardware pull through: when a customer buys Brink software:** 75% of the time they will also purchase PAR hardware. Management has said 80% here, but since some Tier 1s may not need to purchase as much hardware given they are hardware customers already, we are lowering this assumption a bit. Note we believe both Dairy Queen and Arby's would be mostly new hardware customers.
2) **The average store purchases roughly $7,000 in hardware.** We think this will end up being low for Tier 1s, who need more hardware, but would prefer to keep this conservative.
3) **$1,000/per year/per store for hardware maintenance**

Based on these estimates, and using data the company has given us on conference calls to corroborate these assumptions, we get the following for "non-software" Brink revenues:

Brink Hardware and Maintenance Revenue					CAGR	Multiple	Value
Total Restaurant Installs	2157	3900	6900	11100			
Hardware Take Rate	75%	75%	75%	75%			
Brink Hardware Installs	1618	2925	5175	8325			
Hardware Revenue Per Install	$7,000	$7,000	$7,000	$7,000			
Brink Hardware Revenues	**$11,324**	**$20,475**	**$36,225**	**$58,275**	73%	0.50x	$29,138
Hardware Maintenance/Store/Year	$1,000	$1,000	$1,000	$1,000			
Brink Hardware Maintenance	$2,727	$5,051	$9,176	$15,945	80%	2.00x	$31,890

We apply a .5x sales multiple, or less than 2x gross profit, to the hardware revenue, and 2x on the hardware maintenance revenue (higher gross profit multiple given consistency and visibility). This adds about $60 million to the value of Brink as a whole.

In our Base Case, then, total Brink related revenue would be valued at $440 million, or $27.17 per share.

	Revenues	Multiple	Value	Per Share
Brink Software ARR	$54,080	7.00x	$378,563	$23.40
Brink Hardware	$58,275	0.50x	$29,138	$1.80
Brink Hardware Maintenance	$15,945	2.00x	$31,890	$1.97
Total	**$128,300**	**3.43x**	**$439,590**	**$27.17**
Fully Diluted Shares	*16,178*			

What About the Rest of PAR?

This leaves the Government, SureCheck, Pixelpoint, and the rest of the hardware and hardware maintenance business as additional value drivers. Although it is a little hard to estimate the value of the remaining hardware/hardware maintenance businesses because some of it may blend into Brink (e.g. if Taco Bell becomes a customer, their hardware and maintenance revenue would be Brink revenue from the above exercise).

Nevertheless, here is our best, reasonably conservative estimates of what the rest of the businesses could be worth, along with Brink:

PAR in Aggregate	Revenues	Multiple	Value	Per Share
Brink	$128,300	3.43x	$439,590	$27.17
SureCheck ARR	$10,000	5.00x	$50,000	$3.09
Government	$70,000	0.50x	$35,000	$2.16
Pixepoint License and Maintenance	$5,000	3.00x	$15,000	$0.93
Non-Brink Hardware	$75,000	0.50x	$37,500	$2.32
Non-Brink Hardware Maintenance	$20,000	2.00x	$40,000	$2.47
Total	**$308,300**	**2.00x**	**$617,090**	**$38.14**

The 3.4x multiple for Brink feels conservative to us (assuming they hit their numbers!), as MICROS and Radiant were sold in very low growth mode for about 3.5x sales, nearly 9x recurring revenues, and 7x gross profit (vs. our estimate of 3.4, 6x recurring, and 6x gross profit for Brink, which would still be growing materially).

Key Risks

1) **Execution**: we believe the opportunity set is there, but getting to the levels we have forecast will require materially accelerating the implementation capacity for Brink. It is possible they run into issues trying to install such large numbers of restaurants daily/weekly. Additionally, if they screw up a large Tier 1, it could result in Brink losing its "cool" status as top cloud restaurant POS.
2) **Competition**: as of now we believe NCR and Oracle (owners of Radiant and MICROS, respectively), are really dragging their feet coming up with a compelling restaurant cloud product. We have discussed this in more detail in our formal write up, but certainly "waking the giants" is a possible scenario, where one or both could try a scorched earth strategy to take share from Brink (e.g. aggressive price cuts).
3) **Tier 1 Pricing**: it's possible we are too high on our Tier 1 ARPU assumptions, or that the upselling management believes is possible over the next few years does not come to fruition.

Upside Optionality

1) **SureCheck**: we are assigning a 3 year, $50 million value on SureCheck. This would assume they get to $10 million in ARR over the next three years. Management has stated they believe SureCheck will ultimately be larger than Brink, so it's possible SureCheck begins to fire on all cylinders and becomes materially larger than we have forecast here. For instance, just a couple larger customers signing on for SureCheck could make the $10 million look small, or if Walmart agrees to convert to a SaaS model.
2) **International**: we are modeling very little international expansion for Brink, but the company has repeatedly targeted 2018 to begin pushing internationally. This is not reckless expansion, in our opinion, as the Tier 1 customers they are signing have large international markets.

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