VOSS
CAPITAL

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Still Buying PAR: Bull Thesis on Track, Bear Case Debunked

Stock price: $7.05	Market Cap: $115 million	EV: $107 million

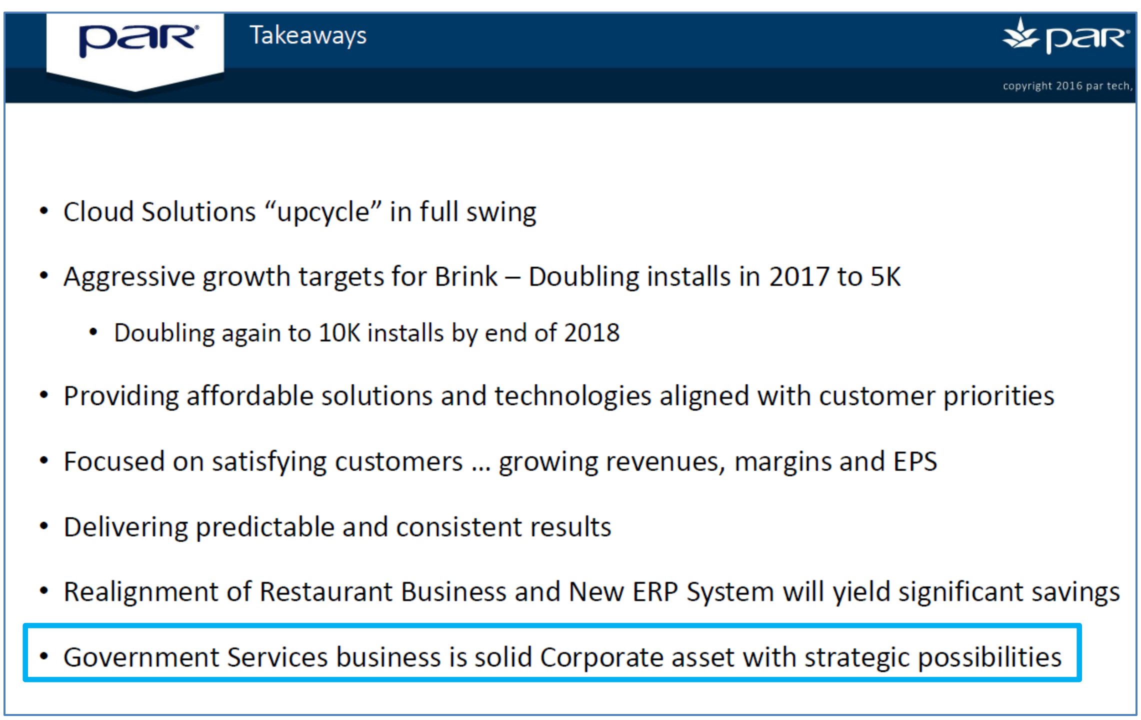
PAR Technology Corp. (PAR) remains a top holding for us at Voss Capital, even as it has moved from ~$5.50 to over $7.00 in the last few months. Our immediate base case target price has moved up from $11.00 previously to $13.50 now as our Brink SaaS segment valuation has risen materially. In short, the good things are getting better and the bad things are getting less bad, strengthening the likelihood of the Bull case playing out and lowering the probability of the Bear Case we laid out. Below is a note reviewing some of those factors and how they have changed at the margins since we first shared the idea publicly.

The Good is Getting Better

If you could boil down the Bull Case that we presented to the two main points, they would be that the Government business would be on track to be sold at the end of the year, creating a pure play Restaurant Technology company, and that Brink would continue to show strong momentum and rapidly grow its intrinsic value. We believe the likelihood of a sale of the Government business has increased, and that Brink has shown even greater momentum than we anticipated.

1) Sale of Government Business

Nothing is assured here, but management has gone from never having flat out stated their intent to sell the Government business, to having now referred to the Government business as having "strategic possibilities" on multiple occasions:



We are now more confident the Government business will be sold either by the end of 2017, or in early 2018. The exact valuation is hard to pinpoint, but we still believe it should garner between $40 and $50 million, at least, which would be about 6x-7x 2017 EBIT compared to trading comps in the 10-14x range. Management has sounded confident that given the growing backlog and expected strong military spending under the Trump administration, the Government business can grow revenues (mid-single digits) while expanding EBIT margins closer to the 8% range (from closer to 7.4% in 2016).

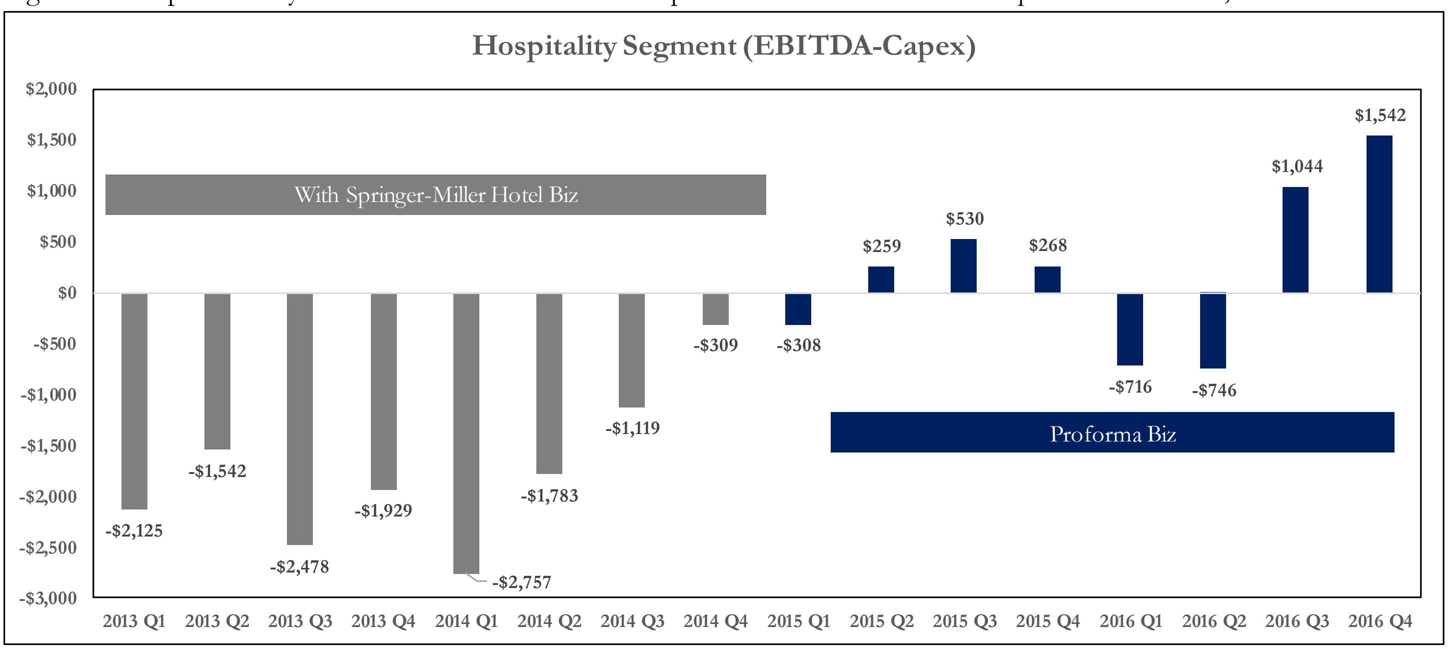
At the $38 million in net proceeds we originally forecasted in our Base Case, **the Pro-Forma Restaurant business would have an Enterprise Value of around $65 million** at the current price of $7.05.

2) Brink Strength

Brink is pretty clearly starting to inflect positively, which is already showing up in the numbers and is accompanied with equally strong future commentary from management. Management has reiterated their target of ~5,000 units at the end of 2017 and 10,000 units at the end of 2018, which would represent **four consecutive years of steady 100%+ unit growth**. They also reiterated they could hit these targets with minimal to no contributions from Tier 1 restaurant wins. Perhaps most importantly in regards to the future of Brink, they officially announced their first formal Tier 1 win.

a) Q4 Units/Profitability

In our view Q4 was the first real test of management's credibility, as they were forecasting a material uplift in implementations. We believe they did roughly 185 units in Q4 of 2015, and 354 in Q3 of 2016, so their implied forecast of 450-500 units in Q4 2016 seemed steep to us, but they did it. They implemented 482 units and moved their Annual Recurring Revenue run rate (ARR) to $4.5 million, up from about $2 million last year and up 25% sequentially. Shown in the chart below, Hospitality segment profitability continues to improve on a sequential basis, as well.



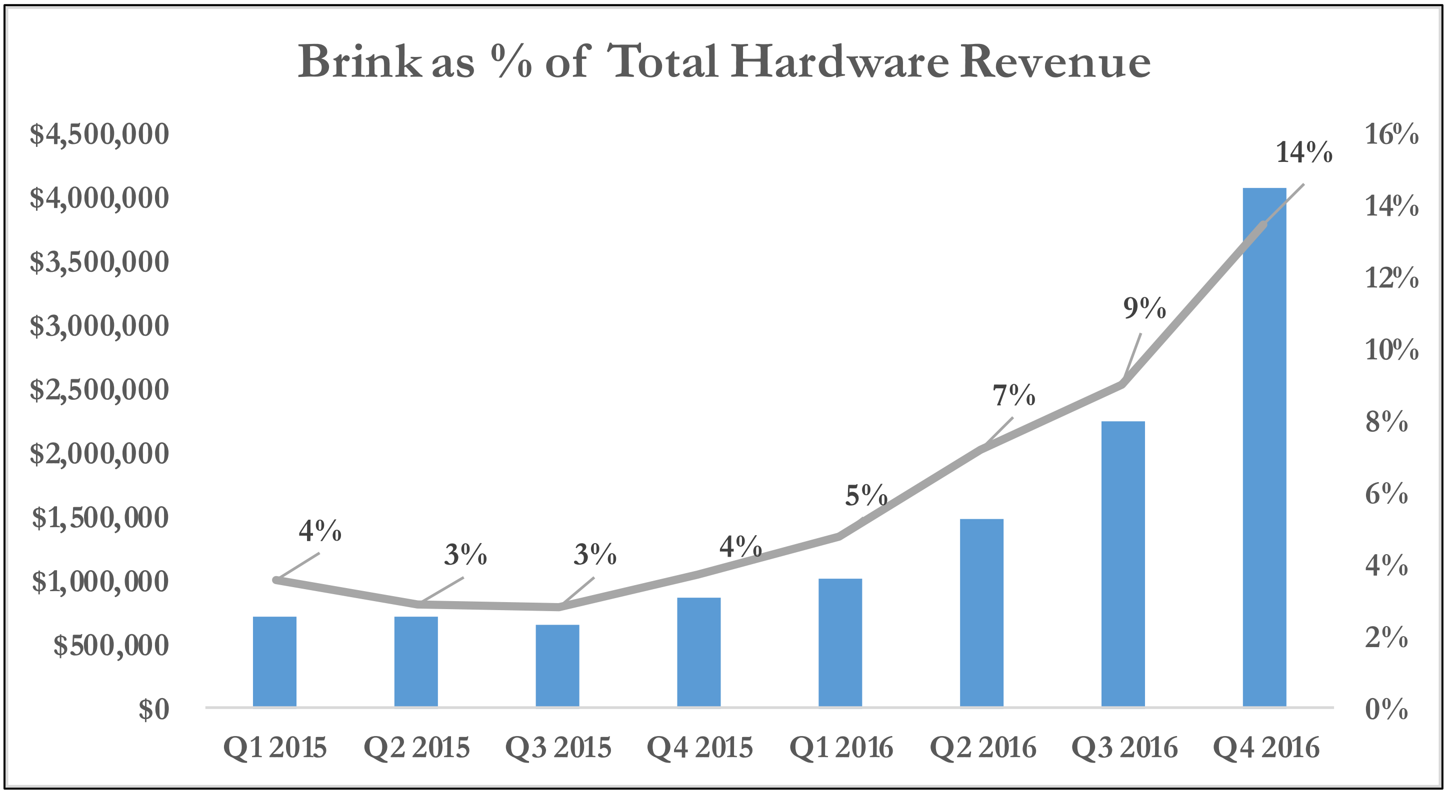
b) Tier 1 wins

As mentioned, PAR announced a 5,000 unit contract Tier 1 win (based on number of locations, we believe this could be Dairy Queen), of which they expect to get the vast majority of units over the next 2-3 years, starting with implementations in late 2017 and then really accelerating implementations in 2018 and 2019. We believe most Tier 1 restaurants will ultimately pick one vendor to partner with, as there are numerous benefits of having the vast majority of franchisees on one POS software platform (as compared to hardware, where consistency is less important). PAR also announced a second Tier 1 win (4,000 units, we believe could be Arby's) that was in final stages of contract negotiations but already had a planned roll out starting in August of 2017. Lastly, they announced that they were in various stages of the sales pipeline with "several more" Tier 1 chains (we believe Popeye's, KFC, McDonald's, and others).

We do not believe the market is fully appreciating these wins yet. For perspective, just winning Dairy Queen (5,000 units) is equal to their entire install base at the end of 2017. **Dairy Queen alone will add in the range of $8-11 million in annual recurring software revenues** and gives us much greater confidence they will roll into 2019 at over $20 million in annual recurring SaaS revenue. **We currently ascribe Brink SaaS revenue stream a valuation of $100 million, based on 5x 2018 run rate sales** (vs. PAR's current pro-forma EV of $65 million), but see material room to grow that valuation if they execute. This sales multiple is materially below private market comps and other public, fast growing revenue SaaS companies, especially on a growth-adjusted basis.

c) Hardware pull through

A common critique of PAR is that it will, eventually, have major hardware sales issues as restaurants have fewer POS terminals. We had argued that this worry was overstated and Q4 gives us confidence that hardware, at worst, will experience mild declines in the coming years. The reason we feel that way is that hardware sales associated with Brink software sales is quickly becoming a large percentage of the company's total hardware sales. We note that the Brink Tier 1 win also included full hardware and hardware maintenance services. Although self-serve terminals and online ordering/pickup sound intriguing to save on labor, in reality there are a lot of challenges in rolling that vision out.



d) Brink Expansion

Somewhat to our surprise, they are already talking about launching Brink internationally in 2018 (most likely in the UK and Australia), and are talking about adding Table Service restaurant capability in 2018. We knew this was part of the original plan given PAR had merged their PixelPoint research & development resources and had been receiving interest from various table service chains like Red Lobster and TGIF, but we did not know the timing. Selling Brink internationally and to full table service restaurants widens an already large total addressable market opportunity, and is not in our forecast or models at all at this point to derive our longer term valuation.

The Bad Getting Less Bad

Nearly all our concerns have become less of a concern, which is important for a stock like PAR because there was a lot of hair on the name when we started acquiring.

1) **Management competence**: We got a fair amount of pushback on Karen being in the CEO role and the appearance of nepotism associated with it. We felt Karen was doing pretty much all the right things, and that she was underrated, but that it would be important to see operational progress. In our minds Q3 and Q4 both showed substantial operational improvements. Additionally, Karen has been giving us more metrics around Brink (backlog, ARR, units, etc.), implying a Government sale, and showing consistently strong effort on the investor relations front. We believe if her name were not Sammon people would be quick to congratulate and get behind her. The bar had been set low, so it could be considered an ongoing tailwind to our thesis as more people come around to her (the equivalent of the market climbing a "wall of worry"). Once people are on board with Karen, the narrative can turn to "well, she has the vast majority of her wealth wrapped up in PAR, and she is aligned with shareholders."
2) **The "noise" is dying down**: Q1-Q3 in 2016 were just chock-full of noise, ranging from the CFO getting fired (and the associated costs) to writing down old internal software platforms, to finding some import/export issues in China. We won't say everything is completely "clean" now, as Q4 did have some adjustments, but we will note the following has happened since our write up:
    - **a)** Insurance has fully collected on CFO dealings, case is closed (no further charges).
    - **b)** New CFO has been hired.
    - **c)** $1.3 million paid to remediate China issues, with that representing the vast majority of costs.
    - **d)** Most importantly, no real new noise in Q4.

    While some viewed the noise as Karen not having control over the company, we viewed it as Karen consciously taking the opportunity to clean up the organization from the ground up. We believe the CFO issues led directly to the China issue, and that things will get better from here, not worse.

3) **Cash balance:** A concern after Q3 was the rising inventory levels and lower cash balances. At end of Q3, cash stood at $2.9 million and that was with them drawing down their revolver for $4.8 million, so they were in a slight net debt position. Fast forward to end of Q4 and their cash balance jumped to $9 million and the entire revolver was paid down. In addition to solid underlying cash flow, they cleared some inventory, and also had a huge jump in deferred revenue, which we believe is a large customer prepaying for hardware maintenance and possibly some hardware as well.

What Still Worries Us?

1) **Brink Execution**: Now that they have the huge and growing backlog, execution and *how* Brink shows up in the financials is important. For instance, will they need to aggressively hire implementation staff and developers to continue accelerating Brink roll out or is the overhead scalable from here? Would that mask some of the underlying margin improvement?
2) **Government**: Despite an upbeat outlook, the Government segment had a really bad quarter, with a 20% decline in revenue (almost inexplicable given rising backlog).
3) **Hardware in Back Half of Year**: Karen noted she had confidence in McDonald's hardware strength in the front half of the year but the back half "would depend", meaning hardware could have a hiccup in Q3 and/or Q4. While we still think Brink provides a great buffer, the optics of lower or flat growth in hardware could impact overall growth and investor sentiment. McDonald's is also, as we understand it, generally one of the most profitable Tier 1s they work with.
4) **SureCheck**: We ascribed little value to SureCheck in our original write up, noting it had strong optionality but not much visibility. Very little has changed here in our opinion. By our estimates its recurring revenue base is still pretty stagnant, despite some wins in the quarter (we believe IKEA and Google Cafeteria). We still think they have a strong product with a large market, but it's not clear that the pipeline is being groomed or managed effectively, and the visibility is nowhere near the same as it is for Brink.
5) **China**: We would like to see that issue fully resolved and put to bed, which we believe happens in the next couple quarters.

Putting it all together, this company is clearly on the brink of getting up to par. Here is a summary output of our updated valuation estimate:

Sum of Total Parts Updated Valuation

Base Case SOTP

Segment	Value ($000s)	Per Share	Comment
Government Business	$42,600	$ 2.59	7x EBIT minus $5 mm in taxes
Hospitality Business	$160,470	$ 9.77	1x 2018 Sales, 3x GP, 12x EBITDA
Net Cash	$8,868	$ 0.54	Based on current cash holdings
Real Estate/Receivable	$9,000	$ 0.55	$5mm R/E, $4mm for receivable
Total	**$220,938**	**$ 13.45**	
Current	$7.05		
Upside	90.8%		

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