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RMNI Memo: Rimini Street Write Up in Value Investors Club

Many investors have probably seen some of the recent surveys around software spending and capex, notably that it may slow down in 2020 if respondents are answering truthfully. Even if it's not, it might not be the worst thing to have a counter-cyclical name in the portfolio that would benefit from a slowdown, while still maintaining many great qualities of a software business.

What if I told you there is a name like that, that also has these characteristics:

- 91% revenue retention, with potential to materially increase
- FCF positive, with potential to inflect in 2020-2021
- Gigantic TAM ($16 billion+) with still very low penetration
- Trading at ~1.2 2020 Annual Recurring Revenue
- Accelerating billings growth towards 20%+ in the back half of 2019, with ARR moving in that direction in 2020
- A new potentially disruptive product being rolled out in Q4 2019
- Limited R&D spend
- Strong, seasoned management team

Interested? Now for the hair:

- Significant insider selling since the company converted to a public company via SPAC in 2018, with potentially more still to come (although should be mitigating)
- Complicated capital structure including a large number of options, a large number of warrants, and an onerous preferred convertible preferred
- Perpetual legal battles with Oracle that will likely continue into 2021/2022
- Relatively low liquidity and low float because of high insider and closely held ownership (70%+)

Despite those concerns, we believe the risk/reward with Rimini Street (RMNI) at ~$4.00 a share has become extremely asymmetric to the upside, with our downside closer to $3 (1x ARR) and with plausible upside to $16 (4-bagger) over the next few years if things play out correctly. We are currently targeting $7.50 a share in a conservative Base Case scenario.

Background & TAM

RMNI was founded in 2005 by current CEO Seth Ravin, an old PeopleSoft VP (now Oracle's legacy ERP). His view, still unchanged, is that Oracle, SAP and others charge outrageous amounts for maintenance revenue at 95%+ margins that customers are forced to absorb because of the mission criticality of their products and future upgrades. The company was founded as a viable way for customers to move away from that vendor support.

RMNI is disrupting the traditional enterprise software support market by offering outsourced support for on-premise software at a 50% discount to the OEM software vendor's pricing along with superior customer service. They claim total cost savings can be 80-90%, as they are also saving the customer from costly upgrades and other nickel-and-dime costs the OEMs hit them with. They mostly support database and ERP platforms from Oracle and SAP, but they also now have a partnership to offer support services for Salesforce products, Microsoft products, IBM database products, and others. RMNI's core offerings currently cover >80% of the total database market. Oracle and SAP alone represent a ~$15 billion TAM. RMNI has carved out unrivaled market dominance within their market niche as they are approximately three times larger than the closest competitor, Spinnaker Support. Because of their relationships with

Oracle and SAP, the IT consulting companies (e.g. Accenture, Cognizant) do not offer the Level 4 support (vendor replacement) that Rimini does. One catalyst that we will elaborate further on is in Q3 and Q4 of this year they launched an Application Management Support (AMS) product for Oracle, SAP, and Salesforce that doubles their TAM.

RMNI Value Proposition to Customers

RMNI offers an undeniable value proposition for their customers with a dedicated primary support engineer assigned to each account with a guaranteed 15-minute response time. Their engineers are experts with an average of 15 years of product experience. These employees mostly consist of former Oracle or SAP engineers who helped design the products and wrote the original software code. Support cost for on-premise software is typically ~22% of the software license purchase price, which compares to RMNI's cost of ~11%. In addition to the base ~22% annual maintenance fee, the contracts typically contain an annual 2-4% cost increase tied to inflation rates. Over a ten-year ownership lifecycle, a $1 million on-premise license expense can have cumulative maintenance fees that exceed $2 million. RMNI's support offerings provide meaningful savings to their clients, not only from discounted maintenance fees, but also by 1) allowing the customer to avoid costly and unnecessary upgrades, 2) not having to pay for customization, and 3) freeing up IT staff to focus on other projects. We have spoken with several customers who have unanimously raved about Rimini on how painless the transition was from vendor to Rimini, and how superior the support levels were relative to Oracle or SAP. We have yet to find an unhappy customer; indeed, churn almost always occurs when the vendor ultimately decides to replace their legacy system.

Oracle Litigation

Their longstanding litigation with Oracle deserves further explanation, as it informs some of the current billings trends as well as acting as a major overhang on the stock. For those who don't want to get into the nitty gritty below, the relevant takeaways are:

1) Rimini's business model is legal but was found to "innocently" infringe in one area
2) The infringement, plus legal costs, was $120 million plus and RMNI had to quickly raise costly debt with strict covenants that limited sales and marketing spend
3) This hindered RMNI's growth until they were able to refinance on better terms and ramp up S&M again, which they have now done
4) The ongoing trial, "Oracle II", seems to be less existential and it should be noted that Rimini started Oracle II by suing Oracle (who then counter-sued)
5) Realistically Oracle II will not be over until late 2021 at the earliest

A major source of uncertainty around Rimini's future has been a prolonged legal courtroom battle with Oracle over the legality of the entire business model. Oracle's legal challenges of the legitimacy of outsourced third-party software support predates the creation of Rimini Street. Oracle once sued a company called TomorrowNow, which was also co-founded in 2002 by Rimini's current CEO and co-founder Seth Ravin. TomorrowNow was subsequently acquired by SAP. Oracle then continued its litigation with Mr. Ravin's new company (RMNI) starting in January 2010 (Oracle I, Case No. 2:10-cv-0106). In the lawsuit, Oracle claimed that Rimini Street committed copyright infringement among other business torts based on the process that Rimini used to provide support to Oracle's customers and the way in which Rimini accessed and preserved copies of Oracle's software source code. In February 2014, the district court granted partial summary judgement to Oracle, agreeing some of Rimini's business practices engaged in "innocent copyright infringement." As a result, Rimini changed the way it accessed its customers' software and its service processes. In October 2014, Rimini initiated a new lawsuit against Oracle seeking a declaration that its new processes did not infringe on Oracle's copyrights. This second lawsuit ("Oracle II") has just finished the discovery phase and recently held hearings on discovery motions and should be seen in court in 2021. Note this case has both the original suit where Rimini is suing Oracle, but also a countersuit where Oracle sued Rimini.

In October 2015, a jury returned a verdict and found in favor of Oracle on its remaining copyright claims and claims under the California Comprehensive Data Access and Fraud Act ("CDAFA") and Nevada Computer Crimes Law

("NCCL"). Based on the jury's determination they awarded damages in the sum of $50 million. **With prejudgment interest and attorney's fees added, the total monetary judgment was $124.3 million, an amount that forced Rimini to quickly raise debt (which made it expensive) and hamstrung them from a Sales and Marketing perspective** (see below). Additionally, the district court issued an extensive permanent injunction against Rimini on certain business processes.

In October 2016, RMNI filed two appeals—one challenging the court's judgment after the jury trial and one challenging the injunction. Rimini asked the Ninth Circuit to decide if the damages ($14.4 million of "lost profits", $46 million of attorneys' fees) were warranted and challenged the copyright judgment. In January 2018, the court affirmed in part and reversed in part, but the one important conclusion from the ruling was what Rimini is doing is within the confines of legal competition and thus the removed the existential risk:

"Oracle licenses its proprietary enterprise software for a substantial one-time payment. Oracle also sells its licensees maintenance contracts for the software that are renewed on an annual basis. The maintenance work includes software updates, which Oracle makes available to purchasers of the contracts through its support website. ***At all relevant times, Rimini Street, Inc. provided third-party support for Oracle's enterprise software, in lawful competition with Oracle's direct maintenance services."***

Rimini has continued to appeal the district court's decisions and filed a petition for a hearing with the Supreme Court over the damages.

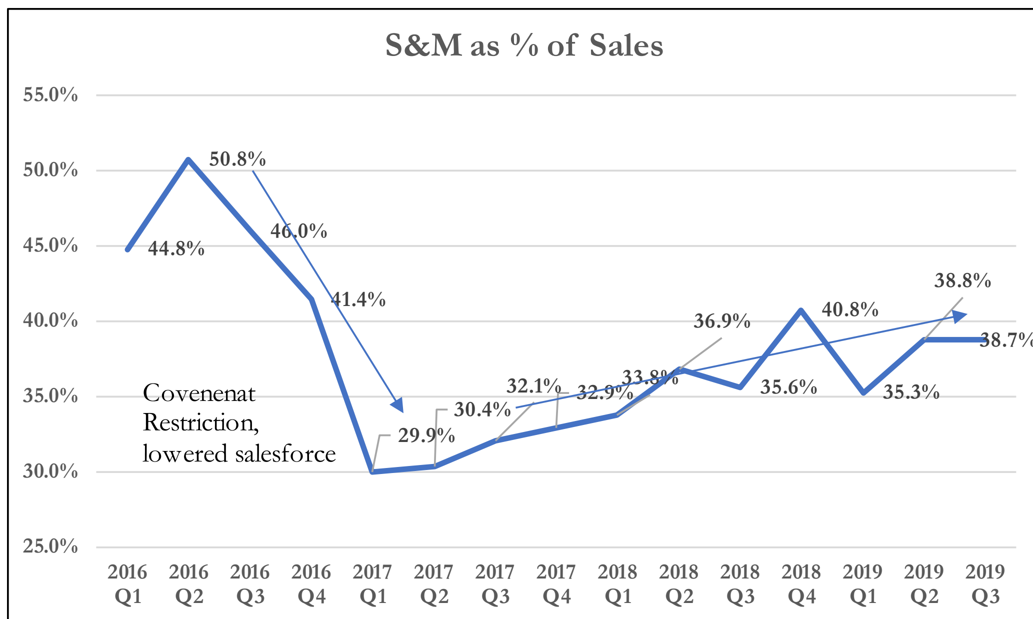
Despite Rimini effectively winning in its confirmation of business legitimacy, the litigation has been a major expense for Rimini, costing them about $20 million annually, and it is likely to continue in the lead up to the hearings for their counter suit. We view this high annual legal bill as an expense necessary to build up a business of scale, in lieu of traditional R&D needed to build most large recurring revenue businesses. In the late 2019/2020 timeframe, this litigation cost will fall considerably in absolute dollar terms and will continue to fall as a percentage of revenue as Rimini compounds the top line. **We think the worst of this overhang has passed and there is ultimately no existential risk to Rimini,** with the courts confirming that their business of providing third party software support is entirely legal (see our emphasis of the bolded quote in above court ruling).

With Rimini now on the offensive with the second lawsuit, **it is possible the litigation goes from largest overhang to potential catalyst**. Oracle has a long history of bold attack ad campaigns that smear the competition combined with aggressive litigation tactics. Rick Bennett, Oracle's former ad man describing Larry Ellison said, "Larry played a zero-sum game. You have to destroy your competition. It's quite Darwinian. The concept of firing a token shot is alien to Larry's mentality. If he's going to take a shot at you, he's going to go for the heart, or the head, or the dick." When competitors wrote letters complaining of Oracle's advertising campaigns that contained falsehoods about the competition Ellison once said, "Hey, I'm paying for a litigation department. Let 'em litigate!" When you study Oracle's history and come to the realization that this has been their modus operandi since inception, it helps put into context the lawsuits between Oracle and Rimini Street. Oracle goes after everyone even if there is not a legitimate reason for litigation.

Paradoxically, Oracle's high-profile litigation with RMNI has **potentially been a major factor in staving off competition** for a few years and locking Rimini into a solid leadership position due to the lawsuit and exorbitant legal costs scaring some smaller players from even attempting to enter the market. In fact, outside of much smaller competitor Spinnaker Support out of Colorado, we are unable to locate another real competitor to Rimini.

Historical Growth and Sales & Marketing Spend

RMNI has historically grown revenue at the 30%+ level until late 2017/early 2018 when they were forced to reduce their sales force in order to comply with covenants (more on this below). They have rebuilt the salesforce over the last twelve months from high 50s sales reps to nearly 80 reps (30%+ salesforce growth) and thus while ARR growth has slipped to around 10%, there is good reason to believe this can revert upwards in the coming quarters/years and that the company can return to 20%+ growth. You can see below how this transpired:



We estimate RMNI is still less than 2% penetrated within their potential addressable market of Oracle and SAP clients (using a Total Addressable Market of ~40k on-premise ERP SAP clients and >20k ORCL EBS and PeopleSoft clients that are users of software supported by RMNI). While still in the early innings, RMNI has already gained enough traction to hit critical mass (~$290 million in Annual Recurring Revenues end of 2019) and demonstrated operating scale with solid positive cash flow. We have been impressed with how RMNI's co-founders have been able to bootstrap their way to a ~$290 million revenue company without major capital raises.

Market Opportunity: What About the Cloud?

At the recent Needham Growth Conference (January 15th), the company stated the following:

"Gartner came out with a piece and they talked about that they had seen a 50% increase in inquiries about 3rd party maintenance in the past year versus the prior year and they made the observation that they believe this is becoming more of a mainstream alternative for companies. **They went as far as to say that 2019 revenue for third party was $351 million, with us at 71% market share…and they think by 2023 it will be $1 billion dollars."**

That's roughly a 30% market CAGR Gartner is estimating (note we are still trying to track down the source document on this), and if you assume Rimini maintains their dominant market share, it would imply over $700 million in ARR exiting 2023 (not even taking into account the AMS opportunity).

One obvious worry is the ongoing shift to cloud-based software and away from on-premise. While many of our other software investments are benefitting from this cloud adoption trend, RMNI focuses on the stickiest on-premise applications that are not shifting to the cloud as quickly. Applications that require significant amounts of customization are especially slow in their rate of cloud adoption. Gartner estimates that by the end of 2021, 86% of Database software spending will still be for on-premise and 81% of spending on Financial Management Systems will still be on-premise. Cloud adoption for RMNI's end markets is increasing at roughly 1.5% per year and cumulatively their total addressable market still adds up into the tens of billions of dollars.

After speaking with customers and former salespeople, we believe recessionary economic conditions would actually help accelerate the adoption of RMNI's services. Normally in a recession a software firm's sales cycle may get elongated as large purchase decisions are put off. However, in the case of RMNI, the value proposition is very clear-cut as the cash savings come immediately--within 90 days of the implementation period or sooner (a 30-day written notice is typical to notify Oracle that a customer will no longer be using their support). For RMNI customers, the switch requires little upfront investment, has a short and smooth implementation process, and provides immediate cash savings. For a company paying Oracle $1 million a year in maintenance, switching to Rimini literally will save them $500k in cash that can be deployed immediately elsewhere or saved for the corporation.

To summarize, we believe the company has many years of growth left in their core markets, and are already attacking the emerging cloud opportunity by moving into adjacent markets (AMS, see below) and working with cloud vendors like Salesforce and, soon, Workday and ServiceNow.

Billings Modeling/Framework.

RMNI has 78 sales reps at the end of Q3, with a goal of having around 80 before they stop and "digest". This is up from the mid-50s in 2017 and low 60s throughout most of 2018. In other words, they have spent 2019 ramping up their salesforce by ~30%. Importantly, per management, it takes a rep 9-12 months to be a fully productive rep and get to full quotas.

While we do not believe all 78 currently have full quotas ($2 million a sales rep), we believe they are getting much closer to that point.

What would a full 78 productive reps hitting their quota mean for the company?

Here are the inputs to our calculation here what 2020 billings could look like if they had 78 full capacity reps:

1) Sales reps: 78
2) Quota per rep: $2,000,000
3) Renewal base: ~$290 million (estimated ARR end of 2019)
4) Renewal rate: 80%

Taking these numbers, we can get renewal billings (not part of a sales rep's quota) and new billings:

Renewal billings= $290*80%= $232 million.

New billings= 78* $2,000,000= $156 million.

Total billings= $388 million.

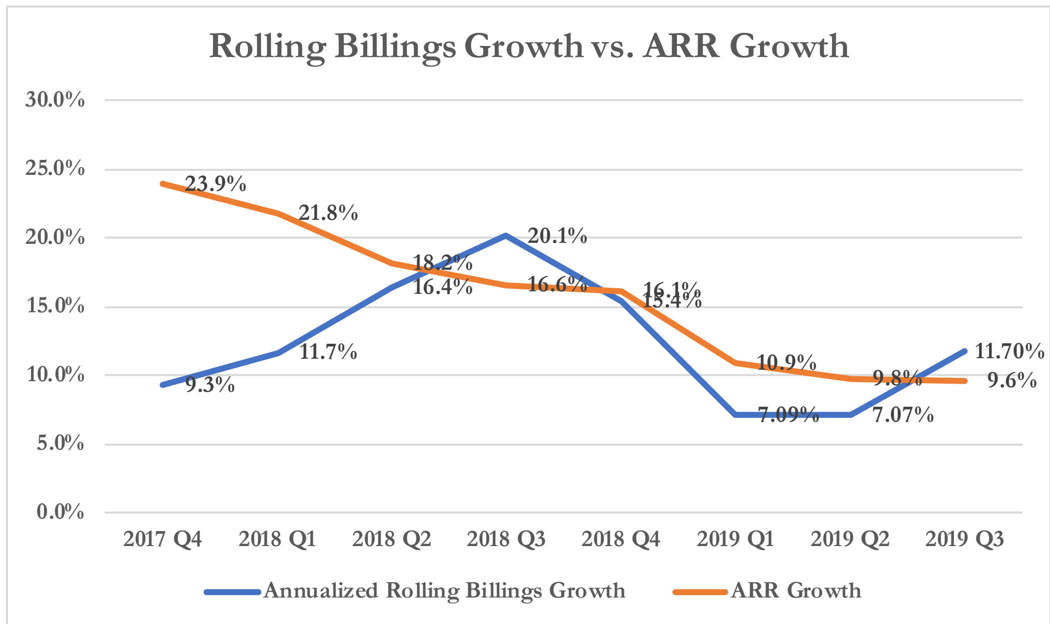
Note renewal billings are not factored into sales rep's quota.

If the company were able to manage $388 million in billings, it would represent ~25% billings growth (pending Q4 numbers).

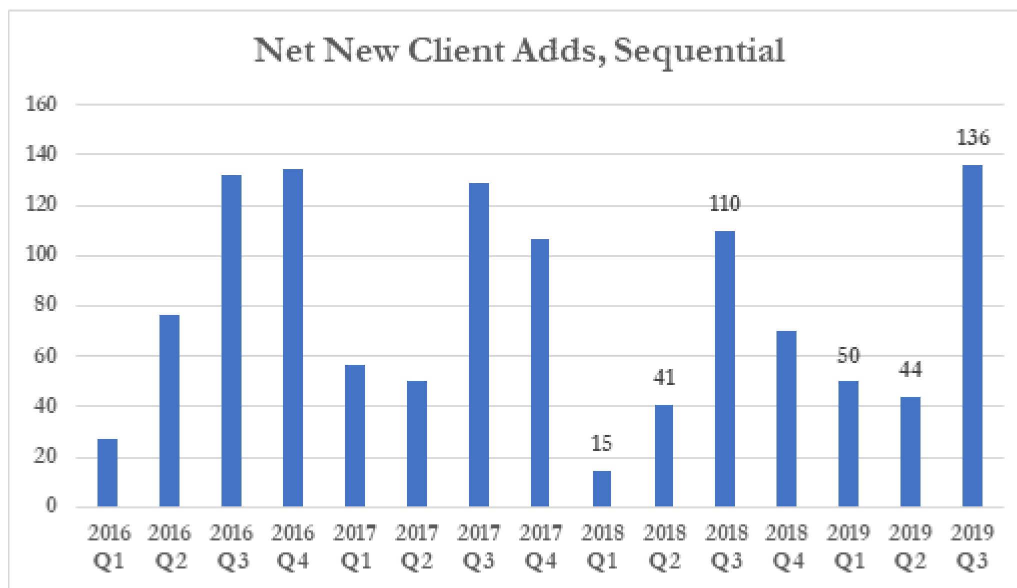
Now, there are puts and takes to this and that model is only as good as the assumptions in it. Perhaps a little more realistic, or conservative is that 10 of the reps are only at half quota.

This would put total billings at $378, or ~21% billings growth. Of course, there could be upside or downside to quota as well. Reps can go above quota due to the burgeoning AMS opportunity and/or renewal rate could be closer to 85% (we think this is their goal), but the point is we don't think it's necessarily unreasonable to think they can achieve 20% billings growth in 2020.

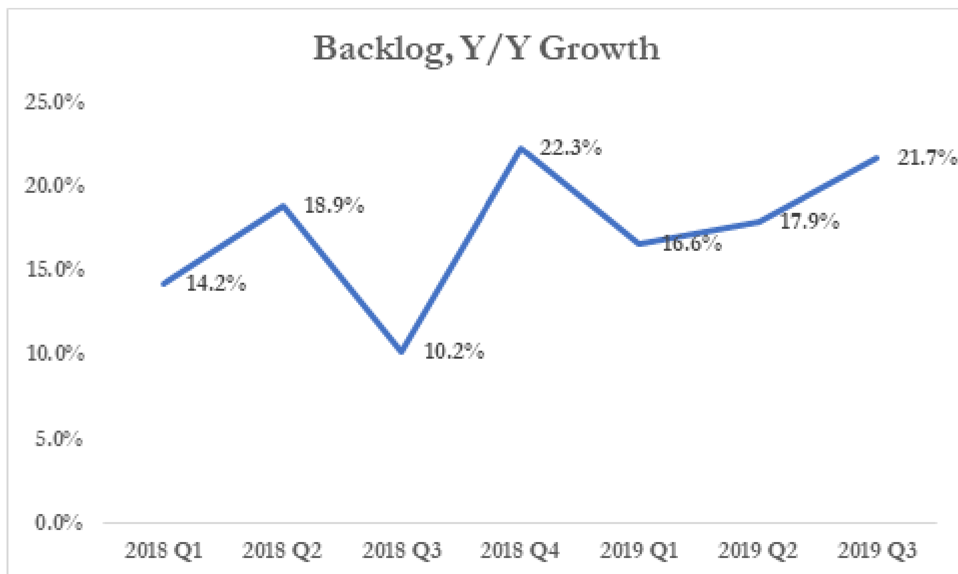
The last two quarters have already shown some preliminary encouraging trends, with rolling billings finally inflecting higher above ARR growth on the back of a strong 17% annualized billings growth in Q3. This is important because the way they define ARR (just taking quarterly subscription revenue and annualizing) means billings should lead ARR growth.



Customer growth was also quite strong in Q3:



Additionally, a metric they only disclose in their IR presentation (for some reason), Backlog, grew 22% y/y in Q3 and has been accelerating in Q2 and Q3.



Backlog combines both Unbilled Backlog and Deferred revenue. Unbilled backlog reflects multi-year contracts that have not been billed yet and has been growing at a 30% y/y clip the last few quarters.

We would also note the CEO has made more openly bullish statements about their prospects recently, stating three different times on the Q2 call about his expectation for strong back half billings (which was confirmed in Q3):

"We continue to expect investment returns to become more visible in Billings growth in the second half of 2019, followed by accelerated revenue growth in 2020."- Q2 call

"So because we have seen more of that moving into pipe -- moving through the pipe and closing, I think this is where you'll see your bookings growth coming in the back half of the year as we've talking about."- Q2 call

"We look forward to at the next call and providing additional color on the businesses as we continue to push for bigger bookings in the second half of the year."- Q2 call

As recently as mid-January the company reiterated stronger growth in 2020 (from Needham Growth conference):

"That capacity should be becoming productive in the next quarter and we expect to see some return on that investment and help push our growth rate up from these current levels…we were running lean on sales infrastructure, sales staff, generating pipeline, and all that's been addressed, the investments have been made, and we're expecting this year to see some results."

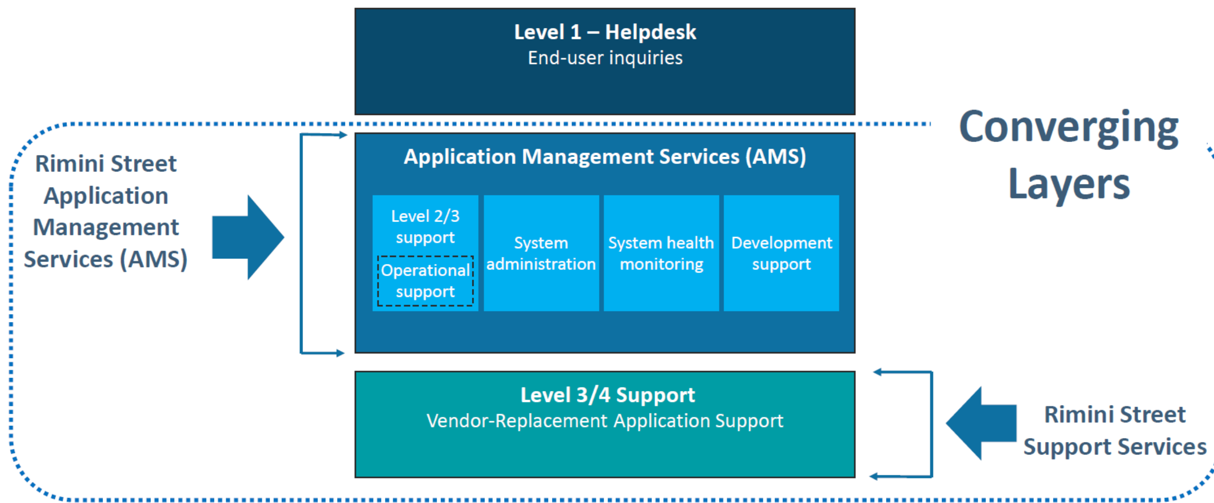
Total billings growth in Q3 was actually above 30% but annualizing the billings growth by only using short term deferred revenue growth resulted in more normalized billings growth of 17%, so they are on track as they move towards Q4.

The AMS Opportunity

Over the last two quarters the company has rolled out an opportunity that at first glance is an obvious strategic move that massively expands TAM while also diversifying from their more controversial vendor replacement revenue streams. This opportunity is providing Application Management Services (AMS) for both Oracle and SAP (in addition to already providing it for Salesforce).

The Oracle product was announced on November 8th while SAP was a bit earlier, in early August .

What is AMS? It's basically the "middle line" of defense for technical support. In industry parlance it is "Level 2 and Level 3" support, as opposed to Level 1 (mostly basic helpdesk functions like forgotten passwords) and Level 4 (vendor owned/replacement where Rimini historically plays):



A use case example might be "payroll can't print the paychecks they need to print because the system isn't working" or "why is there a network bottleneck in Building 2 coming from the ERP?" The interesting thing about this is that there is kind of a blur between the handoff from the AMS consulting team and the dedicated Rimini support specialist. In fact, Rimini management claimed to us that their support team frequently takes care of issues they would dub "AMS issues" with the relatively inexperienced AMS team will often say "let the Rimini guys handle it."

The CEO describes the opportunity as follows:

"Think of it as an expansion of products that we're offering clients. We have been watching this part of the business for a long time. And we've been looking at this $19 billion space and the adjacent fees to where we've been. And we worked with Application Management companies for a long time. Our clients have been coming to us complaining about the value, complaining about the service they get and saying to us that we are their most trusted provider, we're the ones that have the expertise because of our people with an average 15 years of experience versus what they get with the Application Management group, which is very inexperienced hub because there it's a last legal contract so that… systems integrators can be in a position to pick up other consulting work within the organization. And because they haven't focused on this business, they put these motors skills resources with the clients, there's a lot of frustration, there's terrible rating of client satisfaction. We saw this as another opportunity to take our expertise and our existing space, all of our talent and move downstream. And this is really interesting. We are today the most trusted and knowledgeable group of people because we are the highest level of the support chain, which is the vendor replacement side. We're the ones that create fixes, we do the diagnostics, we create the updates, we do the tax legal and regulatory researching development. And we are moving downstream into an area where we normally hand these updates over to a team that applies them. And they run the systems day to day. And now we're going to do that for client as well. So, this has been another poll by clients into this business, and it's been very well received by our clients. It increases our footprint of the client. It increases our stickiness..."

Unpacking and expanding on that quote, here is what we find interesting about the AMS opportunity:

a) **Doubles RMNI's TAM**: Direct TAM for Salesforce, Oracle, and SAP is $15 billion+, with a total AMS TAM of over $80 billion, growing 5% a year.
b) **ARPU Uplift**: The ARPU uplift could be tremendous if this initiative gets traction. For instance, for a non-AMS customer paying RMNI $1 million a year, management estimates that same customer could pay Rimini $2-3 million a to take over AMS, meaning the ARPU uplift could be 2-3x per customer. Per CEO on the Q2 call: "***So in many cases, you could see us double or triple the amount of money coming from that customers invoicing them every year compared to just doing the vendor replacement support.***"
c) **Less Legal Risk**: It is fundamentally competing against a different group of players (IT consulting like IBM, KPMG, Deloitte, Accenture, etc.) so there is not the same kind of legal overhang for this initiative. Additionally, it is a quite fragmented industry with, according to management with "1,000 providers covering 24% market share."
d) **Poorly Served Industry**: It's an industry with terrible customer satisfaction ratings, with even the top player scoring a 2.9 out of 5 and the average rating of 2.79 (per Gartner). Constellation Research, an IT advisory services firm, noted that they see a "massive customer satisfaction gap in the Application Management services market. The battle for

price over value, process over better outcomes has led to a broken market." Rimini, on the other hand, has consistently scored extremely well on customer satisfaction, making the cross-sell more credible.

e) **Strong Overlap**: Rimini management claims they already get roped in to providing a lot of the AMS support, and that customers have frequently told RMNI they should get into this industry.
f) **Strong Initial Uptake**: Even with only a relatively recent launch, our understanding is that RMNI has already acquired "dozens" of customers including a few materially large customers.
g) **Customer Life Extension:** Management believes it can improve customer retention, as they are requiring a customer be on the Core RMNI solution to sign up for AMS. So, at the very least it should be a bump for revenue retention but could also materially extend the natural lives of some customers.

Given AMS is described as a "loss leader" by the consulting space (Seth estimates they get 10-15% margin, although our discussions with competitors indicate margins are all over the map, in the 10-40% range) to rope in higher margin consulting contracts, how does Rimini attack this market? We believe they will fully advertise themselves **as a higher priced option**, but one where the customer will be happy with the support and where the support is more integrated with Level 4. Importantly, **Rimini will only be pitching AMS to existing customers**, or bundling it with new customers, so there is some inherent leverage in their own model since they are already providing some of the support functions that one would expect the consultants to be providing.

Net-net, we believe they are targeting margins below their core 63-65% gross margins (say, 50%), but still way above a typical consultant gross margin in the space. If these margins come in at 50%, and Rimini is able to increase their core margins to mid to upper 60s like we believe they can (ironically partially because some work is getting offloaded to the new AMS support), we believe they can maintain a blended gross margin in the low to mid 60s and over time get a blended margin of 65%, although some of this depends on the eventual mix of AMS. If AMS **really** takes off, it will undoubtedly lower gross margins, but still be adding healthy, recurring gross profit dollars.

Note on Customer Retention and Happiness

We believe RMNI has roughly an 80% customer retention rate, although commentary from management suggests it was a bit lower than that recently, but they have ambitions to get it higher, closer to 85% (with AMS a driving force behind this). 80% is obviously not great if you were to compare it to a traditional software company. Revenue retention is higher, in the low to mid 90% range, but that still is not the level a high-end software company will obtain. At the same time, several customer checks indicate extreme satisfaction with the product. So what gives? It's important to understand that many customers signing with RMNI typically have a natural end of life. In fact, management points out that many customers signing with RMNI think they will only be with Rimini for 2-3 years, then end up lasting 5-7 years as their long-term transition to the cloud takes several years longer than they wanted or realized.

We will not pretend RMNI is in the same league as 90-95% customer retention Enterprise Software companies who have no real natural exit point, and this absolutely needs to be taken into account when considering what an appropriate EV/ARR multiple might be for the company (as lower retention materially lowers LTV/CAC). In our view, it also makes earnings/cashflow more important as the payback period needs to be shorter for customers who last 5 years vs. 10-20 years. In other words, RMNI has less wiggle room than others to hide low margins behind higher growth. At the same time, 20%+ software growers can trade at 8-10x sales, while RMNI is closer to 1x sales.

With these things said, we do believe that revenue retention can rise to closer to 100% as they continue rolling out AMS to their existing clients. Additionally, Seth has always preached a balanced approach to growth and profitability, and we believe 2020's cost structure will be more or less flat exiting Q4, so growth can drop nicely to the bottom line. The company has stated they will be GAAP profitable in 2020, and given their tailwind they get from deferred revenues, FCF could be quite strong, depending on growth levels. If they are able to generate reasonably strong FCF in 2020 and 2021, it could help unlock the full bull case as they will have greater cap structure flexibility.

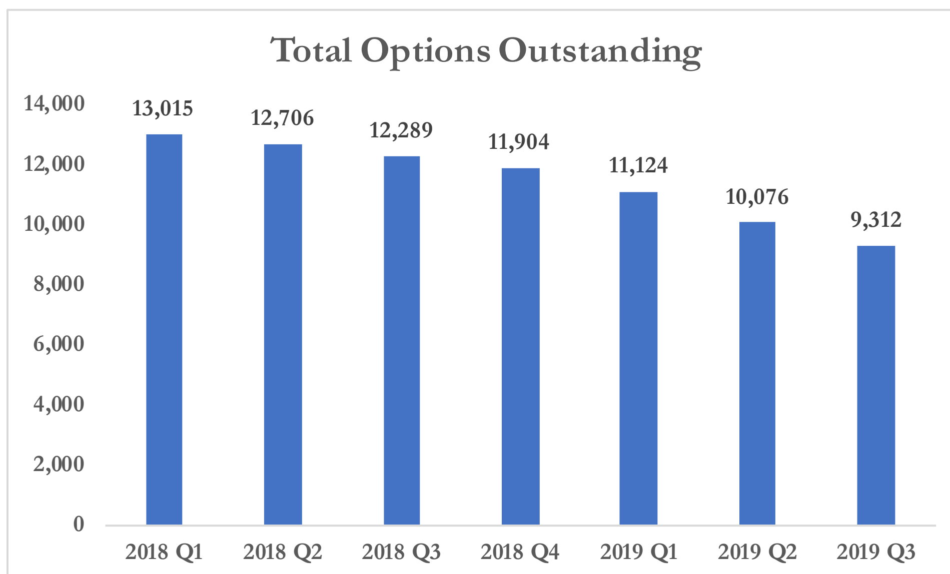
Insider Selling and Cap Structure

One nasty anchor on the stock has been the insider selling. Indeed, coming out of the SPAC the stock was closely held with numerous employees holding options that were just getting liquid after many years as a private company. Additionally, some of their options were expiring, forcing a conversion and sale for tax efficiency. One larger holder and original founding

member, Tomas Shay, who left the company in March, has been particularly brutal on the stock, selling over 1.6 million shares during 2019 and basically selling 15,000 shares a day (with an average volume of 40-50k, so over a third of the volume) until going under the 5% ownership mark. Based on the filing disclosures, which showed exactly how much he sold each day from 8/22 to 10/18, we estimate he was nearly 20% of total volume in that period and may still be. If you add other insider sales in that period, we estimate it was nearly 1/3 of all volume. We recently noted an 500k share block trade (on an 800k+ volume day) that we hope (believe?) was Shay finishing up his sales, although we would love confirmation of this.

Is there reason to think this insider selling should start abating? We think there are a couple of reasons to be optimistic.

First, the options outstanding have come down substantially each quarter, although there are still a bunch:



Total vested options are also significantly lower than that, at 7.5 million shares. We would note that of the 2.4 million shares exercised through Q3, 2019, the average exercise price was $1.20, with the current average strike price of vested options at $3.95, right around today's closing price. We wonder how many more of these remaining options have the really low strikes in $1.20 and lower range that will necessitate exercising and selling.

	Shares	Price (1)	Term (2)
Outstanding, December 31, 2018	11,904	$ 4.00	5.1
Granted	634	5.38	
Forfeited	(419)	7.73	
Expired	(408)	6.88	
Exercised	(2,399)	1.20	
Outstanding, September 30, 2019 (3)(4)	9,312	4.52	5.2
Vested, September 30, 2019 (3)	7,459	3.95	4.3

Finally, we believe management is painfully aware that this is an anchor on their stock price, and we believe they are exploring options to accelerate cleaning out remaining chunks of sales that need to occur, although this is more speculative on our part.

More significantly, we had a chance to speak in depth with two of the VPs who have been selling some of their shares, Kevin Maddock (SVP, Global Sales-Recurring Revenue) and David Rowe (SVP and CMO), and came away impressed not only with their ongoing passion and strategic visions, but also got the sense they were frustrated with the stock price and would have preferred not to have exercised expiring options and sold in this circumstance, but claimed it made economic sense from a tax perspective to do so. In any case, we believe this has been a strong technical drag on the stock but believe it will be less of an issue in 2020 and beyond.

Complicated Capital Structure

In addition to the unusual number of outstanding options, there are also other complicating factors to the capital structure, including warrants, RSUs, and Convertible Preferred equity that is essentially low covenant debt (high dividend payout).

Below is how management shows it, which we think deserves some clarification:

Pro Forma Capital Structure [1]

67.1 million Common Shares Outstanding

2.9 million Restricted Stock Units

9.3 million Stock Options with an average strike price of $4.52

3.4 million Warrants with an exercise price of $5.64, 6/23/2023

14.7 million Warrants with an exercise price of $11.50, 10/10/2022

15.4 million Series A Convertible Preferred with a conversion price of $10.00, 7/19/2023

Totals 112.8 million fully diluted common share equivalents

Net Cash $42.2 million

So how should think of the fully diluted enterprise value? We think it is far too simplistic to simply sum all the shares up, add the current carrying value of the preferred, and call it a day.

For instance, the 14.7 million options that strike at $11.50…these shares will not even consider converting until the stock triples from here, and even then, the warrants will offset the dilution with significant cash.

At the current price, we estimate the effective EV as follows:

1) 67.1 million common shares
2) 2.9 million RSUs
3) Warrants having zero impact on net EV
4) Preferred Equity carrying value of $154 million
5) ~2 million remaining "low strike" options

This comes out to an effective EV of around $400 million at $4.00 after factoring in $42 million in unrestricted cash.

Note On the Convertible Preferred

For those wanting to get in the weeds on the Convertible, here are a few additional notes on it as we understand it:

1) Holder option to convert to Common share at $10.00 a share at any time, which would create 15.4 million shares of Common Stock currently, based on the 152,967 shares outstanding currently. At current price, this would not happen.
2) Mandatory conversion July 19, 2023. This is either by cash buyout or by converting to Common Shares "in lieu of cash payable upon redemption." It is not clear to us still what factors influence whether this is a cash conversion or stock conversion.
3) Rimini Option Before July 19, 2021. Company can redeem up to $80 million of the shares but there is certain restriction such as, after the cash redemption, the company must still have $75 million of cash on their balance sheet. So, in order to redeem the full $80 million, they would need to have ~$160 million of cash on their balance sheet. They would also need to "make whole" the holders so, pay out dividends that the holders would have gotten through July 19, 2021. Given the $50 million currently of cash on balance sheet, and potential to burn more, this is not a likely outcome short term.

4) Rimini Option After July 19, 2021. Assuming the stock price is above $11.50, the company can convert the stock to common stock up to a certain percentage based on trading liquidity (60-day trading window). If the stock is indeed above $11.50, this would be a no brainer for RMNI to do.

This structure has a 10% cash dividend payout and 3% PIK share payout, so it's quite expensive paper and RMNI would be wise to rid itself of it the first chance they get.

The Virtuous Cycle Bull Case

How could things change as the stock price rises?

As a starting exercise, assume the stock appreciates to $16.00 (we know, but just as an exercise bear with us) over the next three years, and ARR grows from $300 mm to $490 million by the end 2022 (~18% CAGR).

In this case there would be about 117 million total shares:

Starting Common Stock	70,000
Warrants Converted	18,128
Preferred Equity Converted	17,000
Options Converted	9,312
Total	**114,440**

However, the EV would not simply be $16* 114= $1.83 billion.

The warrants would generate $188 million in cash on their own, and the Options would either generate cash of $40 million or would have cashless exercises that would lower the overall dilution.

In any case, this would give the company an implied EV of ~$1.6 billion, with $300 million of net cash (assuming no additional cash generation between now and then, and no legal liabilities, both which should probably be taken into account and are perhaps a wash).

In this case, assuming 65% gross margin, the stock at $16.00 would be trading at:

3.25x 2022 ARR

5x 2022 gross profit

~17x FCF

These are not aggressive multiples for a stock whose overhangs would presumably be materially lower.

To summarize, the RMNI street virtuous bull cycle (and Bull Case) goes as follows:

1) Return to 18-20%+ billings growth (with potential to exceed that) which validates the fundamental thesis that increasing S&M spend can drive ARR, e.g. "demand is there"
2) Stock appreciates to $12-16 on the back of these good results to only 3x ARR over next 18 months
3) $11.50 Warrants are exercised which simultaneously generates material cash for the company, giving more flexibility on dealing with their pricey convertible preferred, and materially increases the free float
4) General positive fundamental momentum leads to more sell side coverage, which in turn drives up the average volume which is supportable because of larger float
5) Company comes out of it with a far cleaner capital structure, more sustainable volume/liquidity trading the stock, and emerging operating leverage, right as the Oracle II trial is wrapping up

Obviously, this is dependent on the stock price moving up substantially. And to do that, point #1, in our minds, becomes paramount. The fundamentals will need to force the rest to happen, in our view.

The key question, for which we cannot say "Yes" definitively to but have attempted to show why it's possible or likely, is whether they can accelerate their growth.

Base Case Valuation and Comps

The above was illustrative of how a Bull case might play out, but for now, given our limited visibility into the true pipeline of the company and some of the other inputs in our model (total quota carrying capacity, current customer retention, % of reps hitting quota, etc.) we are more conservative in a Base Case Valuation. Instead, we are targeting 2x 2020 Annual Recurring Revenue, assuming ARR is around $290 million at the end of 2019 and grows 15% to $339 million by the end of 2020.

This produces a target price of ~$7.50, or 70% upside from $4.44.

Base Case

	2019	2020	2021	2022
Total Salespeople (end of year)	78	80	85	90
Total Productive Salespeople	**61**	**74**	**82**	**88**
Quota	2000	2000	2000	2000
Quota %	84%	85%	85%	85%
Customer Retention	78%	80%	80%	80%
New Billings	102,480	125,800	139,400	149,600
Renewal Billings	207,879	232,000	266,943	297,120
Total Billings	**310,359**	**357,800**	**406,343**	**446,720**
ARR (end of Year)	**290,000**	**333,679**	**371,400**	**416,543**
ARR Growth	8.8%	15.1%	11.3%	12.2%
	2019	2020	2021	2022
Gross Margin	62%	63%	64%	65%
Gross Profit	**172,519**	**196,459**	**225,625**	**256,082**
S&M as % of Sales	38%	37%	34%	32%
S&M	**105,737**	**115,381**	**119,863**	**126,071**
S&M Per Salesperson	1,356	1,442	1,410	1,401
G&A as % of Sales	16%	15%	14%	12.5%
G&A ex Legal	44,521	46,776	47,593	49,246
Legal Costs	14000	14000	24000	20000
Insurance Recoupment	0	0	0	0
Change in Deferred Revenue	16,052	22,980	26,902	26,374
EBIT	8,260	20,302	34,169	60,764
Cash EBIT	24,312	43,283	61,071	87,138
Cash Interest (Prf Div)	15,408	15,850	16,300	16,780
Pretax Income	-7,148	4,452	17,869	43,984
Cash Pretax Income	8,904	27,433	44,771	70,358
Cash Taxes	1800	3463	4886	13071
Tax Rate	8%	8%	8%	15%
Cash Net Income	7,104	23,970	39,885	57,288
Capex as % of Sales	0.5%	0.5%	0.5%	0.5%
Capex	1391.3	1559.2	1762.7	1969.9
FCF	**5,713**	**22,411**	**38,123**	**55,318**
uFCF	**21,121**	**38,261**	**54,423**	**72,098**

These forecasts frankly do not anticipate much success with the AMS initiative. We suspect the company internally has higher billings growth targets in 2020, whereby they actually hit quota from their reps, and perhaps improve their renewal percentage marginally.

A target of 19x FCF, 2x ARR, and under 3.5x gross profit does not seem all that demanding. We took some higher growth IT consulting firms like EPAM and GLOB as comps, a lower growth comp (VRTU), and then some software names with lower than average gross margins to come up with a hybrid comp table.

					2020 Multiples		
	EV	MC	Gross Margin	2020 Sales	EV/Sales	EV/GP	EV/FCF
EPAM	$ 12,822	$ 12,780	35.5%	22.2%	4.6x	13.0x	39.4x
GLOB	$ 4,581	$ 4,404	40.1%	23.2%	5.6x	14.1x	76.4x
VRTU	$ 1,701	$ 1,299	29.8%	9.0%	1.2x	3.9x	22.4x
QTWO	$ 4,009	$ 4,223	54.6%	30.7%	9.6x	17.7x	-846.0x
APPF	$ 4,428	$ 4,230	60.2%	27.5%	13.6x	22.6x	
APPN	$ 3,316	$ 3,565	67.4%	16.3%	10.7x	15.9x	-249.4x
FIVN	$ 4,373	$ 4,494	64.0%	14.5%	11.9x	18.5x	109.6x
Services Median	**$ 4,581**	**$ 4,404**	**35.5%**	**22.2%**	**4.6x**	**13.0x**	**39.4x**
Software Median	**$ 4,191**	**$ 4,227**	**62.1%**	**21.9%**	**11.3x**	**18.1x**	**-249.4x**
RMNI	**$ 389,121**	**$ 277,200**	**63.0%**	**15.1%**	**1.2x**	**2.0x**	**11.3x**
RMNI Delta from Services Median			27.5%	-7.1%	-3.4x	-11.0x	-28.2x
RMNI Delta from Software Median			0.9%	-6.8%	-10.0x	-16.1x	260.7x

The one comp on this list that seems in the same ballpark to RMNI is VRTU, growing ~10%, only 1.2x sales. However, we would note it trades at 22x FCF and has HALF the gross margin of RMNI, so still trades at a significant premium.

Beyond that, the comps make RMNI look like it's in its own little world. If RMNI were to get growth back to the 25-30% range, a $16 valuation might actually look quite low over time.

Risks

1) **Oracle II Litigation**: While we believe this is unlikely to be anywhere near the impact of Oracle I, specifically financially (e.g. $124 million fine that they only partially recovered), this will at the very least remain an overhang on the stock through 2021, and there is always the possibility of Oracle III (Oracle is very creative). Our biggest concern in this trial is that Oracle finds a way to make the implementation of Rimini's process so difficult and manual that it would continue to crimp gross margins.
2) **Billings Do No Materialize:** Although there are some good signs in the last couple quarters of billings and other KPIs reaccelerating, it is certainly possible we have overestimated the runway and demand, and that the AMS opportunity turns out to be less game changing than we think it might. If RMNI's growth hangs in around 10% (or drops to 5%) on a higher salesforce, the thesis would be damaged.
3) **Limited Buyout Potential:** For most of our small cap software names, a piece of the thesis will often be someone would be interested in acquiring the company given its strategic fit. In this case the list of strategic acquirers would likely be smaller given the obvious ones (Accenture, Cognizant, etc.) need to maintain strong relationships with Oracle and SAP. We believe there might be some Indian IT consulting companies that do not care about rocking the boat, and certainly private equity could come back and re-acquire the company, but in general we don't have an acquisition as a strong likelihood.
4) **Seth's Health:** Read the disclosures in the K, but Seth has a weight problem which has now manifested itself into some other health problems. We believe after meeting with other senior management they have a solid bench and a "plan" if something unfortunate happens, but in reality, Seth (along with Sebastien Grady) have been the driving life force behind the company.
5) **2020 Lowball:** After speaking with Seth, we get the impression he is determined to establish a "beat and raise" profile. When they came out of the gate as a public company, they were missing on estimates. In 2019 they have generally been beating guidance but not by enough to raise guidance. **Now, with 2020 we believe they will set a bar they are quite confident they can beat and will expect to show "beat and raises."** This is particularly true given they are trying to get a good new CFO to come on board. So, the risk here is their guidance for 2020 is weak enough that we will not benefit until Q2-Q3 and it becomes apparent they were sand bagging.

6) **AMS Drags on Gross Margin:** While we believe Seth has a well thought out plan here, generating 50% gross margin in an industry doing closer to 15% seems a challenging proposition. There is certainly a risk they settle for lower gross margins and our modeling is overestimating their longer-term profitability.
7) **Closely held stock:** The market is generally not favoring smaller, less liquid, cheap stocks. It is possible one of the major private equity holders, GP Investments and Adams Street Partners, decides to dispose of their position. While this would materially increase the float, it would likely weigh on the stock. Adams Street currently holds ~35% of the company with GP near 15%. Seth also owns ~20% of the company.

Summary

While we don't have quite the same visibility we like to have on our other top software names, there are some very encouraging signs that the company can return to 20% growth and kick off a virtuous cycle for the stock that could quickly double it. At worst, the asymmetry between our fairly draconian bear case of $3 at 1x ARR versus what we believe is a similarly plausible Bull Case of $16 suggests excellent risk/reward.

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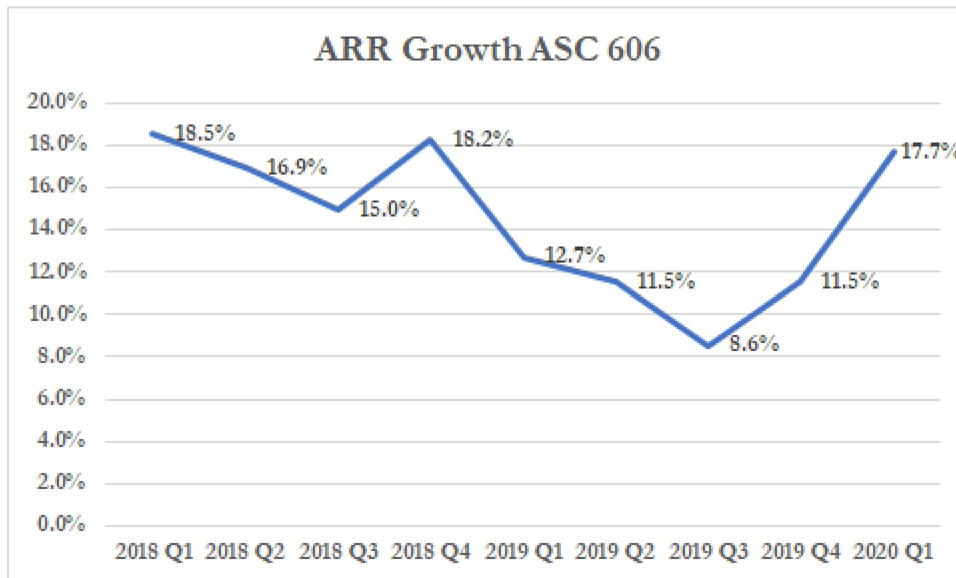
Rimini Street Post-Quarter Update in Value Investors Club

Rimini Street remains one of our top ideas after their Q1 report. We are raising our base case ARR estimate to a range of $340-$365 mm, which puts their end of year EV/ARR at ~1.1-1.15x on 13-21% growth, with solid FCF generation. EV/Gross Profit would be under 2x. These are multiples normally reserved for distressed companies who are being disrupted, not companies who are benefitting from the recession, accelerating their growth, and generating FCF.

Most positive is that Annual Recurring Revenue growth accelerated from 12% to nearly 18%, back to 2018 levels. It underscores two main points of our thesis, namely that the increased salesforce is helping drive sales and that the company at least does OK in a recessionary environment.



Seth seemed quite bulled up on the opportunity in front of him on the call, noting they had ditched their strategy to "digest" their salesforce and are now adding more salesforce due to growing pipelines. His only caution in not immediately raising guidance was some exposure the company has to some of the beat up industries (like retail).

On an LTM basis, the company has now generated $23 mm in FCF, with $22 mm coming on Q1. Admittedly a lot of this FCF was solid collection of receivables (although Q1 also faces a seasonal decline in deferred revenues), but we believe management continues to take a balanced approach between growth and profitability and is focused on ongoing FCF generation and GAAP profitability.

The only nit we would really pick is that, in the quarter, computed billings were relatively flat y/y. We believe there were two things impacting billings: a) their exposure to Brazil caused a material currency hit to deferred revenue and b) They are winning customers in some cases (and possibly renewals) by giving more flexible billings terms, as in billing quarterly vs.

annual. This would partly explain why ARR growth was so impressive while billings growth less so. Rolling billings (LTM vs. LTM -4q) growth was still a solid 17%.

Overall, though, all the thesis points remain intact and the stock simply has not moved:

1) Cheapest software company with any scale in the entire software universe

2) Accelerating growth

3) Recession beneficiary

4) Strong management team

5) Strong incremental margins that will result in good cash flow generation

6) Large new market (AMS) to partly diversify away from their core business and materially improve revenue retention by upselling

7) Strong chance that guidance gets raised in the next quarter or two

						Implied Multiples	
	2021 ARR	**CAGR**	**FCF**	**Target Price**	**Up/Down**	**ARR**	**FCF**
Bear	350,400	9.9%	17,783	$4.00	-4.8%	1.08x	21.28x
Base	377,027	12.7%	37,241	$7.50	78.6%	1.87x	17.64x
Bull	426,500	21.3%	61,540	$16.00	281.0%	3.33x	23.09x

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