Capital Executive LLC

Investment Research

Angie's List (ANGI)

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Operating Relationships

Capital Executive LLC recognizes the incredible value within ANGI. But something is wrong given the relative performance of ANGI in the market! ANGI has generated a ***negative*** return for its shareholders since its IPO on 11/15/11, whereas YELP has generated a ***positive*** return for its shareholders of more than 400% since its IPO on 3/1/12. Why is there such a significant difference?

At the end of the day, both ANGI and YELP should basically operate from the same business model. Essentially, both provide consumption advice through the consumer review. The only difference is the target market. YELP targets restaurants, bars and coffee establishments, whereas ANGI targets the home repair, yard maintenance, automobile restoration and health care segments of the market.

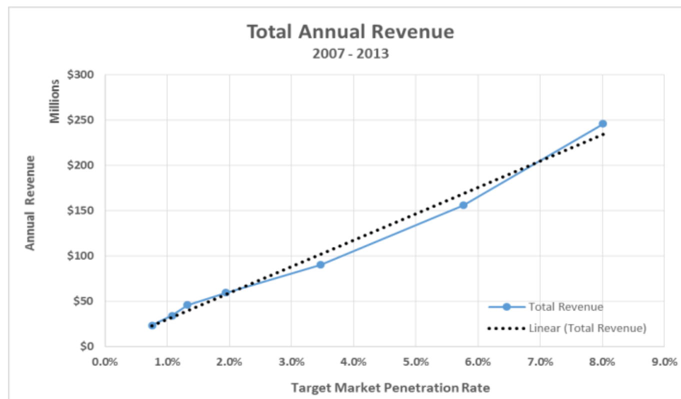
Given the similarities, why has ANGI so dramatically underperformed in the equity market? Several reasons: a) the consumer pricing strategy; b) the quality of the data; c) and an inefficient allocation of capital.

Using the annual operating data of ANGI from 2007 thru 2013, with the target market penetration rate as the independent variable (x) and total revenue as the dependent variable (y), a simple regression analysis produced the following results.

Regression Statistics	
Multiple R	0.993866214
R Square	0.987770051
Adjusted R Square	0.985324061
Standard Error	9771314.41
Observations	7

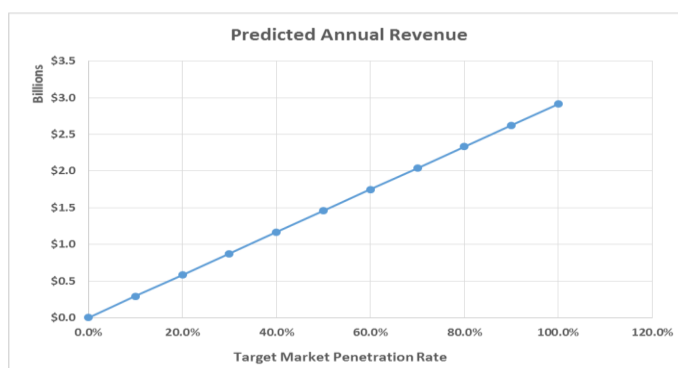
In statistical parlance, an R Square of ~.987 indicates a very strong relationship between the variables. It begs a question: where is the real-value for ANGI? Is it the penetration rate (membership) or is it the paid subscription? Economically, these variables have to be contrasted because one variable (price) undermines the other variable (quantity) – or in this case: the target market penetration rate.

The following graph illustrates the statistical relationship between the target market penetration rate and the total revenue generated by ANGI from 2007 thru 2013.



The statistical relationship between the variables is so strong, the predicted line (black dots) is right on top of the actual line. This creates a reasonable argument for extrapolating the strong, operating relationship between the target market penetration rate and total revenue!

To help illustrate the real-value of membership for ANGI, the following graph extrapolates the strong, established, operating relationship between the target market penetration rate and total revenue.



Granted, the preceding graph is theoretical, but it is based on the operating relationships developed by ANGI from 2007 thru 2013. Furthermore, it's a reasonable argument, and it's clearly impressive in terms of potential. In addition, the operating relationships don't even consider ecommerce. If the potential of ecommerce is considered, the demand line (total revenue) shifts up – perhaps significantly. Maybe the potential is $5B, or $10B, or $25B. It's difficult to gauge because the degree of the actual demand shift will be determined by ANGI's penetration into ecommerce.

Unfortunately, ANGI will never realize anything close to this potential under the current, consumer pricing strategy. Price (by definition) creates an impediment to consumption. And ANGI complicates this impediment with a tiered consumer pricing strategy. Each pricing tier not only impedes penetration but also multiplies the impediments to consumption when factored together. It's a misguided strategy given the current environment!

Please change the consumer pricing strategy. The value is in the membership – not the membership fee! Still require membership registration, including credit information. But give away the consumer membership! Take a leap of faith and provide an altruistic service to the consumer!

If the service really creates value in the market, the consumer will naturally gravitate to the service. This will create a bigger a market for the service provider, which creates significant value for the service provider, making it extremely efficient to sell the value of ANGI in the market. And thereby, create significant value for the ANGI shareholder!

The question for the shareholder to consider: "Why has ANGI generated a ***negative*** return for its shareholders since its IPO?" The two main reasons: the consumer pricing strategy and an inefficient allocation of capital.

In the beginning, ANGI had to sell a consumer paid membership because the service provider had greater control in the market. But the market has changed! Decision making information has become ubiquitous within the United States. Therefore, the value is in the membership (because it creates a market for the service provider) – not the membership fee!

Maximize the penetration into the target market by giving away the consumer membership! Replace the membership fee with an ecommerce transaction fee and a business development fee to the service provider. This pricing strategy reinforces itself in the market. By increasing the size of the market (memberships), ANGI creates more value for the business development fee, which reinforces the potential of an ecommerce fee. The goal is 100% penetration into the target market!

The current consumer pricing strategy of ANGI has destroyed significant shareholder value, because it has failed to recognize the real-value of membership! The membership creates the market, and the market creates the value for the service provider! But a consumer membership fee actually creates significant impediments to the growth of the ANGI consumer membership! It's a self-defeating strategy! The real-value is in the membership – not the membership fee!

The consumer membership creates the market, and the market creates the value for the service provider! ANGI sells the value of the market to the service provider! ANGI creates significant value for the shareholder!

Why is Facebook (FB) so valuable in the market? A market cap of ~$165B. Because Facebook (FB) has recognized the real-value of membership! The goal is to achieve 100% penetration into the target market.

Seriously, how many members would Facebook (FB) have today using the consumer pricing strategy of ANGI? Not ~1.2B! The consumer membership creates the real-value for ANGI – not the membership fee!

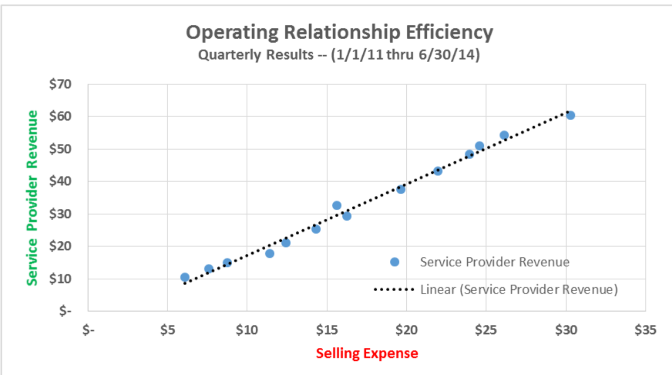
ANGI's consumer pricing strategy fails to recognize the real-value of membership! If the real-value is in the membership, then maximize the membership by giving it away to the consumer! Guaranteed! Losing the consumer membership fee represents only a fraction of the value created by offering a significantly larger market through the increased consumer membership.

Eliminate the impediments to membership and increase the size of the market by replacing the consumer membership fee with an ecommerce transaction fee and a business development fee to the service provider!

Using quarterly operating data of ANGI (1/1/11 thru 6/30/14), with selling expense as the independent variable (x) and service provider revenue as the dependent variable (y), a simple regression analysis produced the following results.

Regression Statistics	
Multiple R	0.994777584
R Square	0.989582442
Adjusted R Square	0.988714312
Standard Error	1.761702652
Observations	14

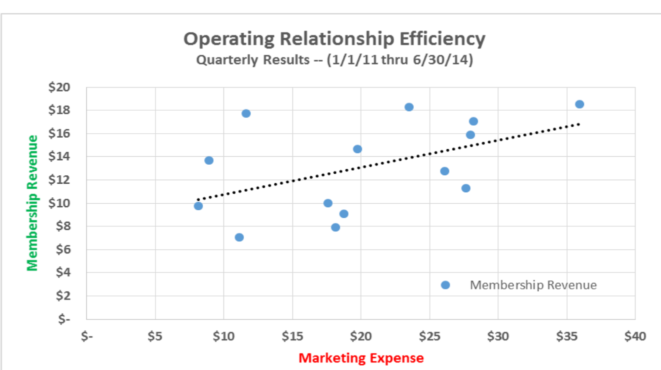
An R Square of ~.989 indicates a very strong relationship between the variables. The following graph illustrates the relationship.



A similar analysis of marketing expense as the independent variable (x) and membership revenue as the dependent variable (y), produced the following:

Regression Statistics	
Multiple R	0.490367951
R Square	0.240460727
Adjusted R Square	0.177165788
Standard Error	3.625427262
Observations	14

An R Square of ~.24 indicates a very WEAK statistical relationship between the variables, which is illustrated in the following chart.



The relationship between marketing expense and membership revenue is so inefficient, ANGI has to expense $1 just to generate $.65 cents in membership revenue. On the other hand, for every $1 of selling expense, ANGI has been able to generate approximately $1.92 in service provider revenue. So, which is the more efficient allocation of capital?

Based on the operating relationships already established within ANGI, the chart illustrates the revenue potential of reallocating a marketing expense to a selling expense.

Actually, the revenue potential is even greater because the operating relationships were developed under a consumer pricing strategy that created significant impediments to the growth of the ANGI membership. The larger the market, the greater the value! Give away the consumer membership and increase the size of the market offered by ANGI!

The current business model of ANGI is unsustainable. The organization hasn't turned an annual profit since 2007, illustrated by the negative owner's equity position on the balance sheet. It's either the strategy or the execution of the strategy. But organizations should create shareholder value – not destroy it! Something is wrong!

Guaranteed! A change in the consumer pricing strategy combined with a more efficient allocation of capital would generate incredible shareholder value, because it addresses the main reasons driving the significant underperformance of ANGI!

For more information about Capital Executive LLC, please visit the website listed below.
Sincerely,
Ken Copley
Capital Executive LLC