# Buy HubSpot

David Gardner | May 10, 2018 | Buy Recommendation

**CURRENT PRICE:** HUBS $ 221.75 ↑ $ 2.66 (1.2%)

**Invest Foolishly!** *We recommend owning 15 or more stocks for at least three to five years. Begin with three* Starter Stocks*. Once you're under way, then consider our monthly new ideas to help build out your* Rule Breakers *portfolio.*

A lot has changed about marketing in the past decade or so. The traditional TV or radio spot has been joined by the banner ad, and then by more sophisticated contextual ads and videos, and now by mobile promotions. Yet two things have remained constant: Most ads are annoying, and every new method of delivering them is met by counter-technologies that help us avoid them.

**HubSpot** (NYSE: HUBS) is short-circuiting this whole system, and in doing so it's built a Rule Breaking juggernaut. HubSpot is the pioneer of "inbound marketing" — instead of soliciting customers with your marketing materials, you publish content that customers seek out themselves. You might have experienced it yourself if you've ever read a heartwarming story about kids recovering from illness and been tempted to click the "donate" button, or followed an Instagram account for its beautiful photography and realized there are related products for sale. Maybe you've browsed through a buyer's guide on choosing the best bicycle, watched a video tutorial, or even visited **GoPro**'s (NASDAQ: GPRO) YouTube channel. HubSpot gives its clients the tools to create this content, promote it, and profit from it.

At first blush, it may seem like HubSpot has hit on a great idea but maybe not a great business. After all, it can't own the concept of inbound marketing or prevent others from imitating its tools. But the company has proven, by multiple metrics, that it's only gaining momentum as a leader. That shows up in revenue growth, in margins and, importantly, in its community. Members who bought shares after our first recommendation last summer are beating the market by almost 50 percentage points; if you're not one of them, today is a great time to get started.

### WHAT IT DOES

HubSpot serves small and medium-sized businesses with cloud-based sales and marketing tools aimed at attracting leads — an approach known as inbound marketing.

### WHY BUY

- HubSpot continues to grow revenue, subscribers, and margins at a rapid pace.
- The company's growing ecosystem supports its leadership position and provides a competitive advantage.
- New products promise to extend the company's extraordinary growth.

### BUYER'S GUIDE

- **Industry:** Cloud Software
- **Size:** Mid Cap
- **Region:** North America
- **Risk:** 11 out of 25

### KEY DATA

- **Headquarters:** Cambridge, Mass.
- **Website:** HubSpot investor relations
- **Sign of a Breaker:** First Mover
- **Market Cap:** $4.3 billion

- **Cash/Debt:** $504 million / $298 million
- **Revenue ('15/'16/'17):** $182 million / $271 million / $376 million
- **Earnings ('15/'16/'17):** ($46 million) / ($46 million) / ($40 million)
- **Recent Price:** $111.30

**Talk About HUBS**

## Freemium Brilliance ...

HubSpot has been expanding at a rapid clip since going public in 2014. Here are a few highlights (we'll hear about results from this year's first quarter the day this is published):

- When we originally recommended HubSpot last August, about 25,000 small-to-medium-sized businesses were paying users. By the end of 2017, that had climbed to 41,593.
- Revenue was up 39% last quarter and for 2017 as a whole.
- Gross margin is on the rise, hitting 81% in the fourth quarter, despite a decline in average subscription prices as the company aggressively courts new customers.
- Adjusted operating margin has also swung into positive territory for both the last quarter and the year as a whole, and the company had consistently positive free cash flow in 2017.

HubSpot benefits from inbound marketing itself in the form of its freemium business model: Customers come in, try a basic version of the platform for free, fall in love with it, and subscribe. This cuts HubSpot's customer acquisition costs, makes buyers more informed about what they need, and keeps competitors at arm's length. "Think of it as adding a particularly angry alligator to the moat surrounding the HubSpot castle," said CEO Brian Halligan on the company's last investor call.

The brilliance of this model stems in part from HubSpot's active developer community. By integrating into other apps like Google Analytics, **Facebook** (NASDAQ: FB), **Twitter** (NYSE: TWTR), **Shopify** (NYSE: SHOP), and **Salesforce.com** (NYSE: CRM), HubSpot's platform becomes a key part of an ecosystem that fosters loyalty. Better integration also helps win commitment from users who are still trying out the platform — and those users, in turn, attract more developers. HubSpot Connect has gone from around 100 app integrations last December to around 135 as of mid-February.

## ... At a Deserved Premium

HubSpot's success hasn't gone unnoticed. I mentioned that this stock has been a big winner for us since last August. Go back to its 2014 IPO, and it's up 345%. Those big gains have left its valuation looking a bit rich. With HubSpot's stock priced at about 11 times last year's sales, it's trading at a premium to its few public-market peers, like Marketo (acquired in 2016 for 7.4 times sales); Eloqua (acquired in 2013 for 9.1 times sales); **SharpSpring** (NASDAQ: SHSP) (4.3 times sales); and even Salesforce.com through its Pardot platform (8.9 times sales for the company overall).

**GET MORE INFO**

- See why HubSpot scores a Risk Rating of 11 out of 25.
- See how you can tell if this investment is going right — or wrong.

Two thoughts on that. First, with sales growing so quickly, it won't take long for HubSpot's valuation to start looking better (for instance, it's trading at about 8.8 times estimated 2018 sales). And second, the company is now producing both free cash flow and an adjusted profit. Considering its stellar gross margin, management's claim that it can eventually produce an operating margin of 20% to 25% looks quite reasonable. That means those fast-rising sales are quickly delivering more profitability.

Most analysts see top-line growth decelerating in the years ahead — an inevitability as sales grow larger. But this may not happen as quickly as expected. The company has built itself largely on its Marketing Hub, the core product aimed at creating and managing inbound marketing campaigns. It has helped extend its remarkable growth with Sales Hub, which, along with its free customer relation management product, is aimed at helping sales staff manage their leads. Currently, about a quarter of the company's subscribers use both sales and marketing products, what the company refers to as its Growth Stack. And the stack itself is growing: This year the company is launching Customer Hub, a third subscription product aimed at customer support.

The bigger picture is that HubSpot isn't just focused on building inbound marketing campaigns. It's also, as Halligan puts it, "becoming the growth suite for SMBs." That means we're likely to see new products and new acquisitions.

We view HubSpot as a company with a very long tail of growth and high potential profitability. It has competitors, but they are either small, privately held operators or operating divisions within large companies hoping to upsell. HubSpot is in a sweet spot: an innovator that has the edge both in the quality of its software and the ecosystem that reinforces its success.

## Risks and When We'd Sell

- HubSpot's rich valuation isn't the only risk it presents. The company is confident about its prospects, and it hasn't been shy about investing in the future. It issued $400 million in convertible debt last year, giving it a current debt-to-equity ratio of about 142%. That's not by itself outrageous — the notes are not due until 2022, and non-cash interest obligations before then are modest. But it raises the specter of future dilution if the company can't produce enough cash flow to repay the notes.

- The company also can't count on its community to fend off all competitors. Marketing automation firm Pardot, though tiny at the time, was rumored to be an important reason behind Salesforce's 2013 acquisition of ExactTarget for $2.5 billion. Given that Salesforce is an ecosystem unto itself, it could potentially pose a threat to HubSpot in the future, while the company must also pay attention to small, low-priced competitors nipping at its heels.

## The Foolish Bottom Line

Much like Shopify in e-commerce, HubSpot has shown how rewarding it can be to focus on the small-to-medium-sized businesses that don't have their own IT departments and are priced out of enterprise software. Far from offering cut-rate solutions, the company has an expansive vision of how it can improve sales and marketing for its clients. It's not just helping to build campaigns that customers love, it's also building a suite of analytical tools that will help businesses grow. We expect it to grow your portfolio, too.

*Karl Thiel contributed to this report.*

## Choose What You Want to Do With This Stock

By adding HUBS to your Favorites, you will be notified whenever our team recommends buying *or selling* HUBS.

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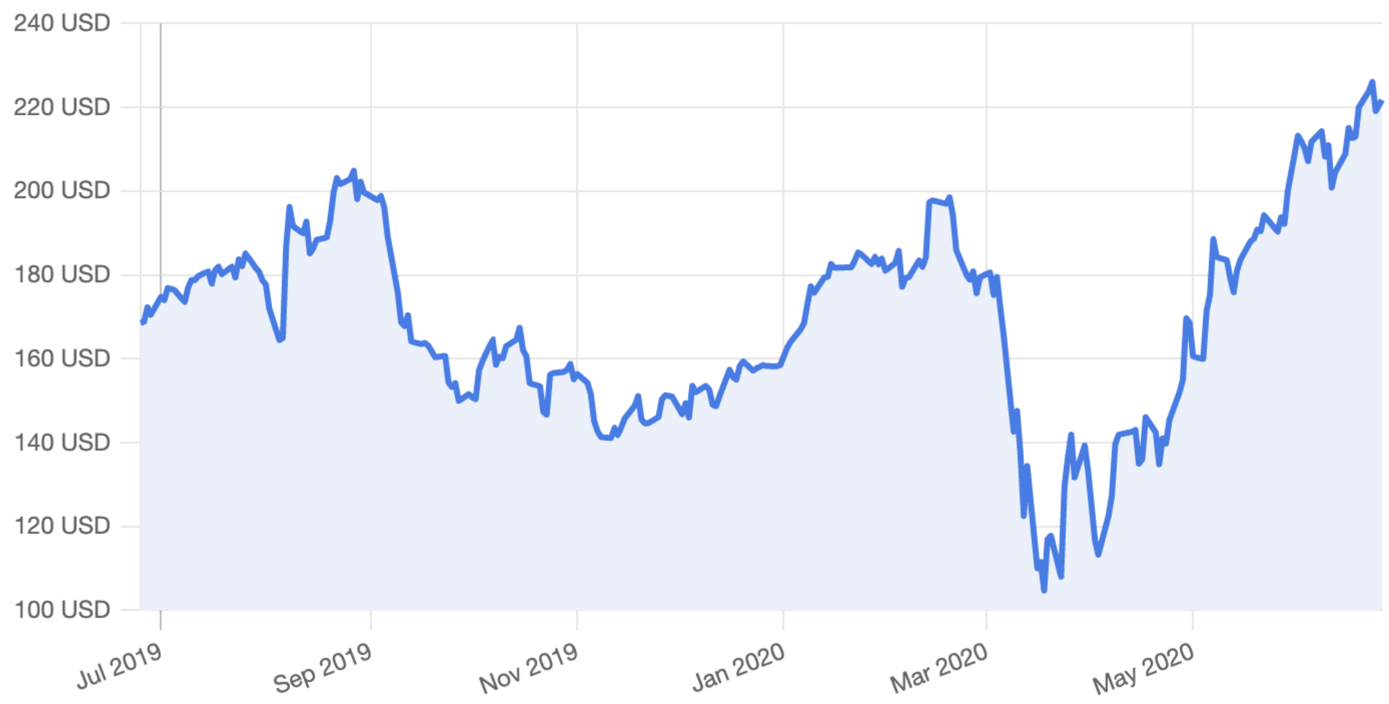
*David Gardner owns shares of Facebook. Karl Thiel owns shares of Facebook. Tom Gardner owns shares of Facebook, Shopify, and Twitter. The Motley Fool owns shares of Facebook, GoPro, HubSpot, Salesforce.com, Shopify, and Twitter. The Motley Fool has a disclosure policy.*

## See the Trends

The Motley Fool thinks buying and holding for at least 3-5 years sets you up for success.




1W 1M 3M 6M YTD 1Y 5Y 10Y MAX

Price Vs S&P

## From the Company Page

Last updated June 25, 4:15 p.m.

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| **Current Price** | $221.75 | **Today's Change** | $2.66 (1.2%) |
| **Exchange / Symbol** | NYSE: HUBS | **Market Cap** | $10B |
| **Beta** | 1.58465 | **Earnings Per Share** (Trailing 12 Months) | -$1.41 |

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