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Fear factor

Evan Lorenz writes:

"No, it's not really different this time," was the gist of the conclusion of Morgan Stanley analysts Keith Weiss et al. last month as they asked and answered the eternal cyclical question. Software valuations, a handful as elevated as 20 times estimated 2019 sales, are at decade highs and, yes, risks are skewed to the downside, they said. In preview, *Grant's* is bearish on Everbridge, Inc. (EVBG on the Nasdaq), a kind of emergency phone tree in the cloud.

"Software-as-a-service" is the designation of this subsector du jour. Such apps are typically hosted on the cloud, and vendors like Everbridge rent them (or the licenses to use them) by the month, rather than in perpetuity. Assuming customers renew, the lumpy business of a one-time sale is transformed into the very different business of recurring income streams. Missing, of course, is that initial, satisfying lump of revenue.

It's a big difference. The most highly valued SaaS companies in the Morgan Stanley universe reported negative adjusted earnings per share over the trailing 12 months. To divine which of these companies can translate today's heavy investment outlays into tomorrow's net income is work that falls to Mr. Market.

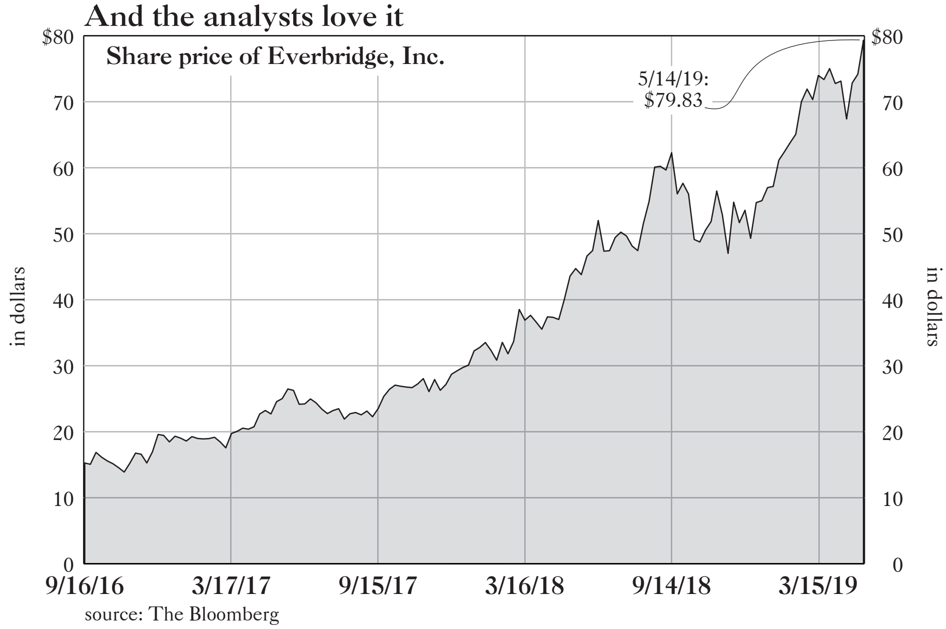
Everbridge is the leading SaaS provider of emergency notifications. Maybe you've received one. They warn you about fire, flood, mass murders, etc. Everbridge manages the lists of people to contact and sends the emails, texts or voice messages with the words you don't want to hear.

Founded as National Notification Network, LLC in November 2002, the company invokes the 2001 terrorist attacks as its raison d'être. "Everbridge is really borne out of the shadow of Sept. 11, where people were running into buildings when they shouldn't have been, and people were staying in buildings when they shouldn't have," CFO Patrick Brickley told the Raymond James Institutional Investors Conference on March 4. Nor does management forget to keep the fear factor omnipresent. The opening slide of a June 14, 2018 analyst day presentation shows a disembodied hand holding a gun pointed at blurry passersby on a busy street.

Everbridge sells to governments (30% of first-quarter revenues), corporations (57%) and healthcare providers (13%). Stock in trade consists of products called Mass Notification, Population Alerting and Safety Connection. An Everbridge-outfitted customer can send alerts to U.S.-based populations, to countries or regions outside the 50 states and to individuals at their last known location. Add-on services include IT Alerting (which notifies techies to system outages), the Visual Command Center (which maps a customer's assets and potential threats on a single screen) and Crisis Commander (a mobile app that provides communication and emergency recovery plans to staff during an urgent situation).

"Really what we've done," CEO Jaime Ellertson told another set of conference-goers on Feb. 27, "is bring to-

And the analysts love it



source: The Bloomberg

gether five or six initial applications to help an organization understand contextually when an event occurs. So we bring 100 different forms of risk data in through one provider: ourselves."

The bull case for Everbridge hinges on growth, actual and prospective. In the first quarter, sales jumped by 40% year-over-year, to $42.8 million; trailing 12-month revenues weighed in at $159.4 million. As for potential growth, management modestly estimates next year's "total addressable market" to be $41 billion, a cool 257 times current trailing revenues.

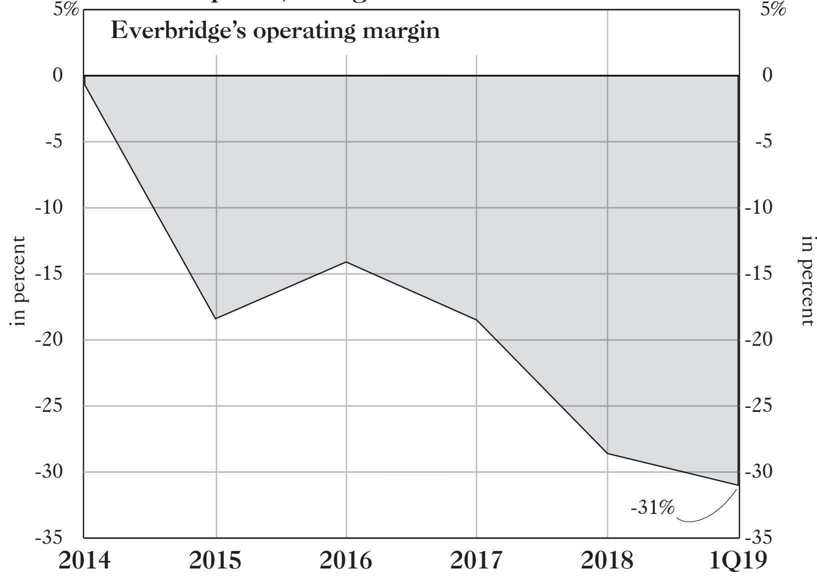
What could facilitate this mighty expansion? The blessing of the Federal Risk and Authorization Management Program, for starters, bulls contend. FedRAMP, which rates the quality of cloud-based software, last August bestowed its seal of approval on Everbridge (as it had done on competitor BlackBerry Ltd.). The federal imprimatur can only help in securing additional public-sector business, the bullish case proceeds. For instance, in December, the European Union directed its member states to implement a public warning system by mid-2022.

Corporate demand, too, holds promise, the Everbridge fan base argues. "As more and more of these bigger enterprises buy and adopt the [Everbridge] strategy, you're talking multi-product sales and for them to turn on another module, think of it as just flipping a switch," says Terry Tillman, who rates EVBG a buy for SunTrust Robinson Humphrey, Inc.

Based on these drivers, analysts pencil in 34% year-over-year revenue growth for 2019. "I believe they can be a 30% grower for a multi-period run," advises Scott Berg, who rates EVBG a buy for Needham & Co. "That is an important threshold right now. Anything growing greater than 30% a year is getting a premium valuation multiple, so I expect that to last."

Of the 13 analysts who cover Everbridge, 11 say "buy" and none says "sell." The shares change hands at 15.3 times trailing enterprise value to sales, triple the NYSE FANG+ Index average. And while 7.2% of the float is sold short, much of that short interest is traceable to the presence of a convertible bond, the Everbridge senior unsecured 1½s of Nov. 1, 2022, of which $115 million is outstanding—to hedge the bond, you short the shares into which it's convertible.

Growth spikes, margins weaken



source: company reports

The bear case begins with the observation that, since it went public in 2016, Everbridge has logged faster growth in its share count than in its revenues. Thus, between the third quarter of 2016 and the first quarter of 2019, quarterly sales have expanded by 115% to $42.8 million, while shares outstanding have leapt by 118%, to 32.3 million. Issuance is up owing both to generous stock-based compensation ($26.9 million in the 12 months ended March 31) and to management's recourse to secondary offerings to top up the corporate coffers. The latest secondary raised $146 million on Jan. 15.

Then, too, Everbridge has failed to leverage its rapid growth into widening margins. Sales surged by 40% in the first quarter of this year, and by 41% and 36% in the full years 2018 and 2017, respectively. Yet operating margins fell to negative 31% in the first quarter, from negative 29% and negative 18% in 2018 and 2017. Naturally, management prefers that analysts subtract certain non-cash charges, chiefly stock-based compensation and the amortization of acquired intangibles, from operating expenses, though not even these adjustments materially change the conclusion.

Neither has a favorable accounting change helped margins. Prior to Jan. 1, 2018, Everbridge amortized the cost of its sales commissions over 12 months. Ever since, it's used four years. The upshot is that $10.3 million in commission expenses didn't hit the P&L last year. Without the switch, operating margins would have looked substantially worse than the ones that the front office chose to report. Thus, on a GAAP basis, negative 36% in 2018 vs. negative 18% in 2017; on an "adjusted" basis, negative 14% in 2018 from negative 6% in 2017.

Worshippers at the shrine of growth forgive much. They have forgiven, in this case, the lack of management-supplied clarity on the impact of acquisitions on revenue. Even attentive listeners to the corporate earnings calls are left to wonder where, if at all, the corporate buying spree of the past two years makes its mark on the P&L.

Last year's acquisitions were these: Unified Messaging Systems A.S.A. for $31.9 million in April, PlanetRisk, Inc. for $2 million in May and Respond B.V. for $2.3 million, also in May. In aggregate, they contributed 9% to 2018 sales, according to the auditor's report in the 10-K, which, if true, would imply that year-over-year growth slowed to 27% in the 9 months ended Dec. 31, 2018 from 36% in full-year 2017.

The geographic breakdown of Everbridge's sales also hints at deceleration. UMS, last year's biggest acquisition, and Respond are based in Norway and the Netherlands. Together, the two were responsible for a 164% surge in 2018 international revenue. In the absence of any comparable M&A infusions, domestic sales rose by 27%.

Nor will FedRAMP approval necessarily prove the rain-making event that some bulls seem to be counting on. "We've already been selling into the Federal markets," says Everbridge spokesman Garo Toomajanian. "FedRAMP alone does not expand our market opportunity. What it does is, it makes it easier for us to delve into the federal marketplace because we are sort of 'preapproved' as a software-as-a-service vendor."

Most city, state and federal contract approvals are publicized by the awarding government agency. "I looked at the past three to four years at every single thing that was on Google for every government contract," says a short-seller who asks to go nameless.

Emergency-notification contracts, which are denominated in pennies per head of population, tend to be small—30 cents to 40 cents per person per year for small governments and less than a dime per head for bigger governments. The New York state notification deal, which Everbridge won, pays just 8 cents per person per year. "Even if Everbridge covered the entire United States, and Everbridge covered every citizen three times over by state, local and federal government contracts, the most the company can get for U.S. government revenue is $100–150 million," our bear observes.

The EU directive may well generate additional sales, though not necessarily at the level that the Street anticipates. In 2013, Unified Messaging Systems won the emergency-notification contract for the Kingdom of Sweden, population 10.2 million. In 2017, the last reported period before its acquisition by Everbridge, UMS generated 16.8 million Norwegian krone ($2 million at current exchange rates) in Sweden, or 19 cents per person. According to a Nov. 30 Needham report, Belgium, Lithuania, the Netherlands and Romania have already implemented event notifications. And while it's true that France and Germany are missing from the list, the rate they are likely to pay Everbridge or a competitor would likely be closer to New York State's 7 or 8 cents per person than to Sweden's 19 cents.

France, Germany—and then what? Everbridge, according to none other than Everbridge, has already signed "9 of the 10 largest U.S. cities, 9 of the 10 largest U.S.-based investment banks, 25 of the 25 busiest North American airports, six of the 10 largest global consulting firms, six of the 10 largest global auto makers, all four of the largest global accounting firms and five of the 10 largest U.S.-based health insurers."

And as even a quick Google search will verify, there's plenty of competition in the emergency-notification industry. "A lot of companies focus on marketing and political messages, but also do things like emergency notifications," says Ron Kinkade, the director of marketing for EVBG competitor Call-Em-All. "There are some other big companies in addition to Everbridge like Trumpia and Send Word Now, which has several different divisions. Then you have companies like EZ Texting and CallFire that do a lot of different things. A lot of companies will sometimes build their own solution using an opensource platform like Twilio."

Twilio, Inc. (TWLO on the Big Board) is a larger ($16.6 billion market cap to Everbridge's $2.6 billion), faster-growing (revenue grew 71% year-over-year in the year ended March 31) SaaS company. If "a lot of companies" can build their own Twilio-facilitated emergency platform, Everbridge's addressable market may not be the $41 billion piñata it's cracked up to be.

Maybe the insiders, too, have their doubts. In March, Kenneth Goldman retired as Everbridge's CFO, a role he had served since April 2015. Jaime Ellertson has announced that he will be stepping down as CEO, a post he has held since September 2011 (he will remain on as executive chairman after the board of directors has found his replacement). Everbridge co-founders Cintawati Putra and Steven Kirchmeier left the company years ago. In the past 12 months, insiders have sold 1.4 million shares, or 4.4% of shares outstanding, for proceeds of $77.5 million.

Fear takes many forms, including apprehension about a justifiable decline in the share price of your employer's company stock.

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