

KIP Capital Management, Ltd.

Quick-Take Thesis

Exponent, Inc. (EXPO)

November 30th, 2020

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KIP Investment Process



Exponent®

Industry: Professional Services

Sub-Industry: Research & Consulting Services

Exponent Inc is a United States-based company that provides engineering and scientific consulting services on a project-by-project basis.

As of Nov 20th, 2020:

Market Cap: \$4.3 bn | **Enterprise Value:** \$4.1 bn

P/E: 55 | **P/B:** 12.55 | **EV/EBIT:** 47.43

Sales (2019): \$417m



**Is it an Outstanding
Business?**

KIP Investment Process

Is it an Outstanding Business?

Business

Is it understandable?

Total Shareholder Return Analysis

Price-Implied Expectations

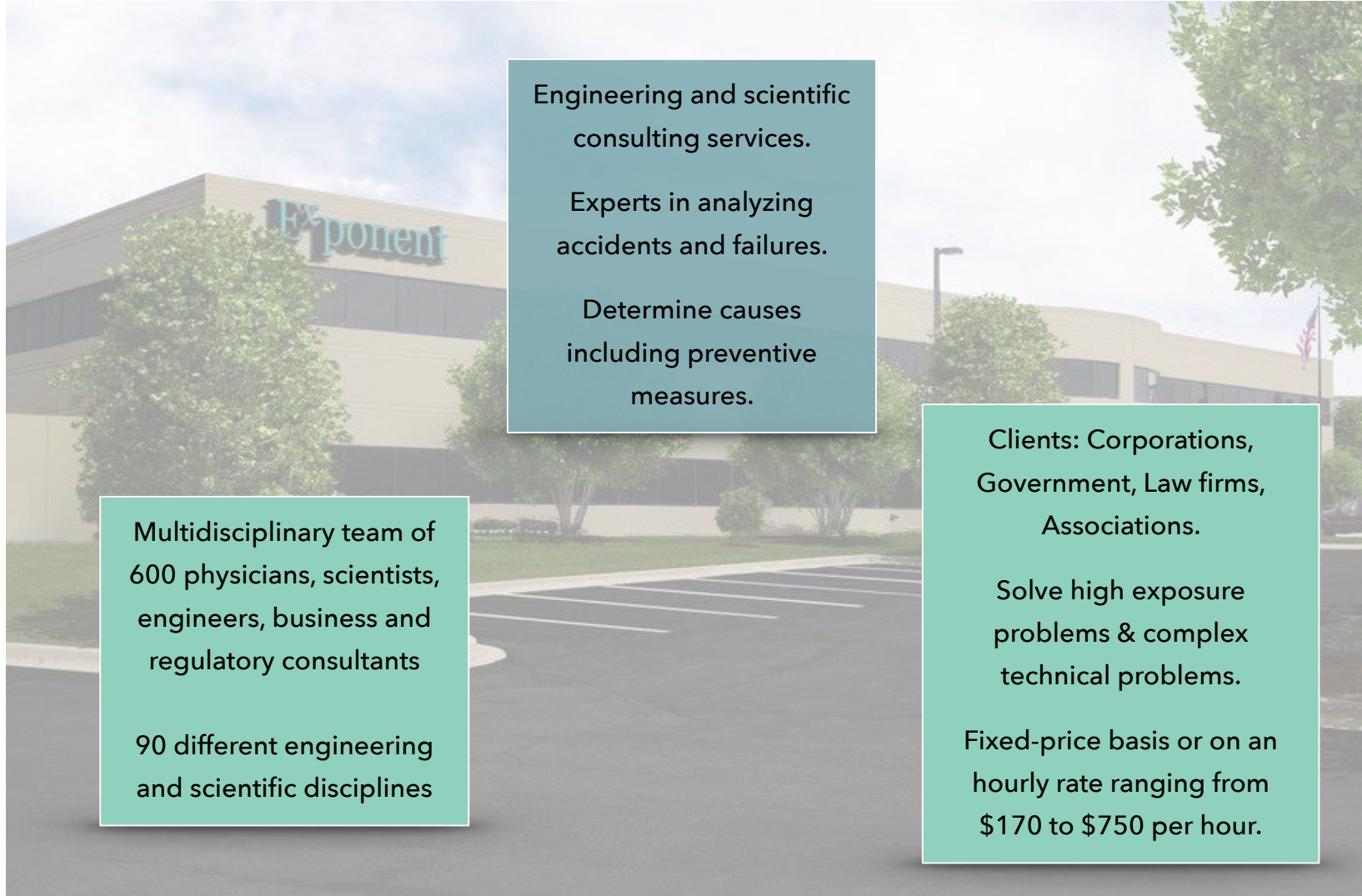
Performance History
Has it created economic value?

Moat Analysis
What has caused it to create value?
How long can it continue to create value?

Is it an Outstanding Investment?

Decision
Buy?
Sell?
Hold?

Understanding the Business



Engineering and scientific consulting services.

Experts in analyzing accidents and failures.

Determine causes including preventive measures.

Multidisciplinary team of 600 physicians, scientists, engineers, business and regulatory consultants

90 different engineering and scientific disciplines

Clients: Corporations, Government, Law firms, Associations.

Solve high exposure problems & complex technical problems.

Fixed-price basis or on an hourly rate ranging from \$170 to \$750 per hour.

Business Segments & Revenue Breakdown

2019 Total Revenue: \$417m

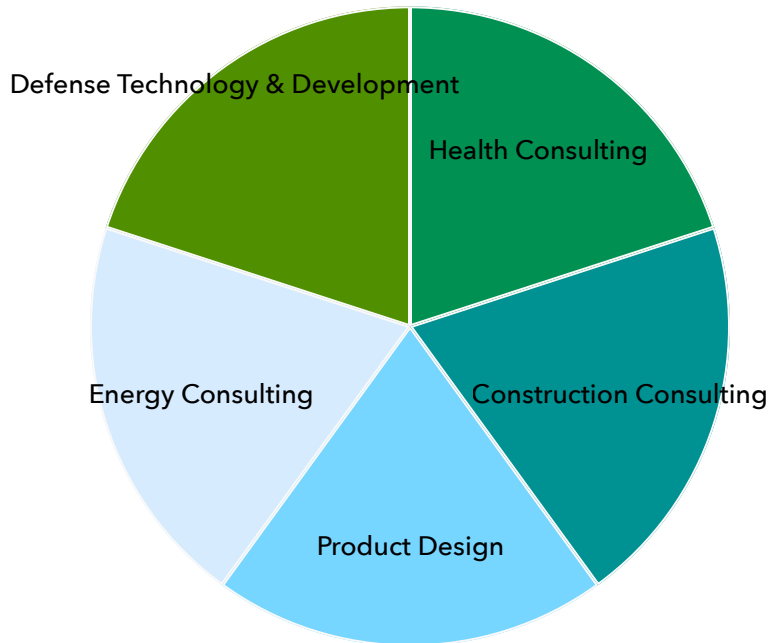
Covers chemical regulation and food safety, ecological and biological sciences, environmental and earth sciences and others.

Environmental and Health
19%

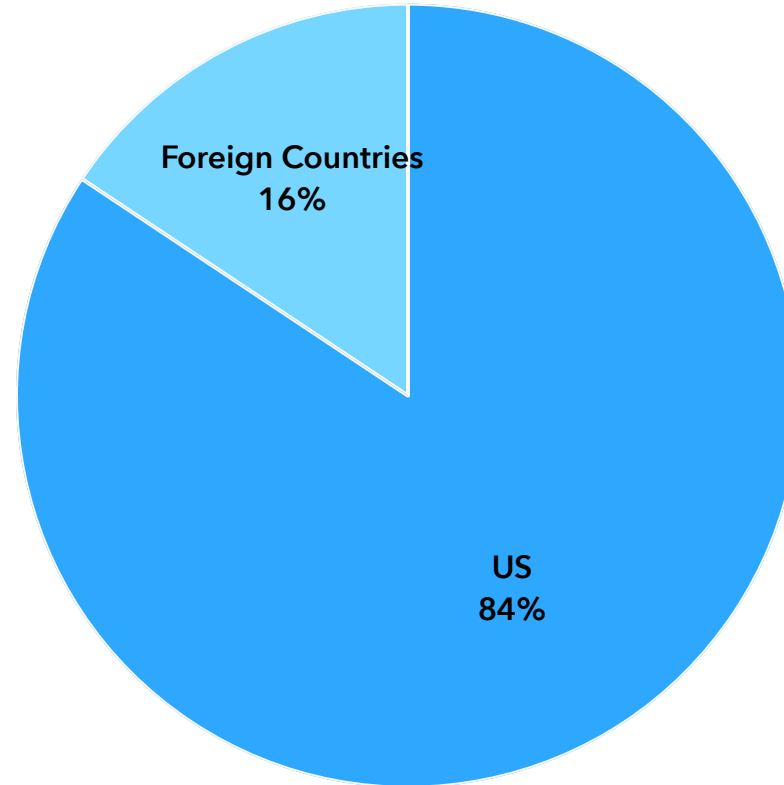
Engineering and Other Scientific
81%

Covers Biomechanics, biomedical engineering, buildings and structures, civil engineering, construction consulting, etc.

Growth Opportunities



Segment Revenue by Geography



KIP Investment Process

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Economic-Value Creator

EXPONENT INC - EXPO

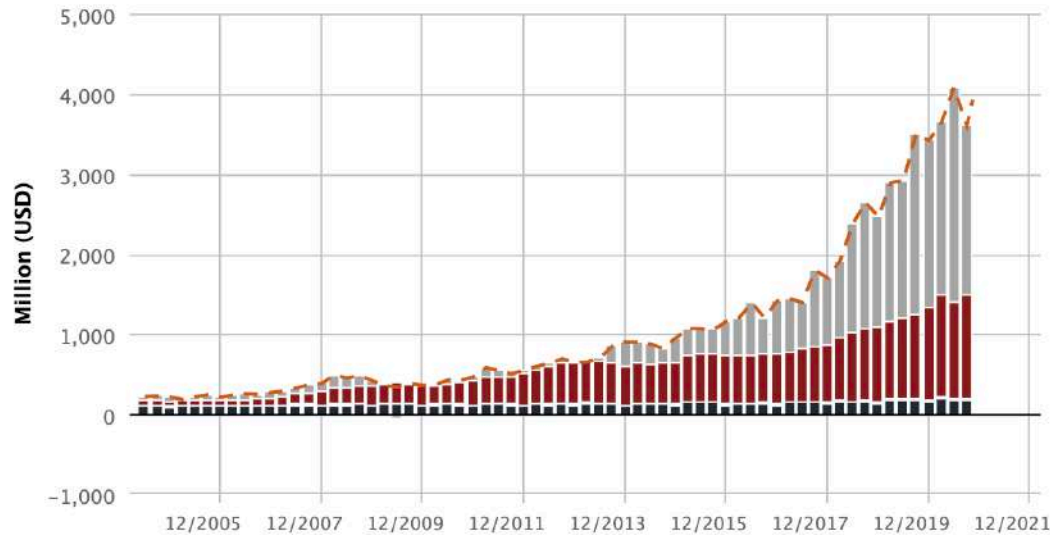
View Data in US Dollars

United States, North America

Comm

Show Goodwill & Special Items

Enterprise Value Components ?



■ FVA Future Value Added MVA-CVA
 ■ Current Value Added CVA (EVA/COC)
 ■ Goodwill & Special Items
 ■ Capital ex GW & SI
 - - Market Value

ROIC (5-yr Avg.)

±37%

WACC

±6%

Invested Capital (5-yr Avg.)

\$170m

Market Cap (as of 20/11/20)

\$4.3 bn

Insight: A consistent wide ROIC-WACC spread. An average of \$170m of Invested Capital has generated \$50m annually in economic-value.

Growth History

Value creating growth typically results when:

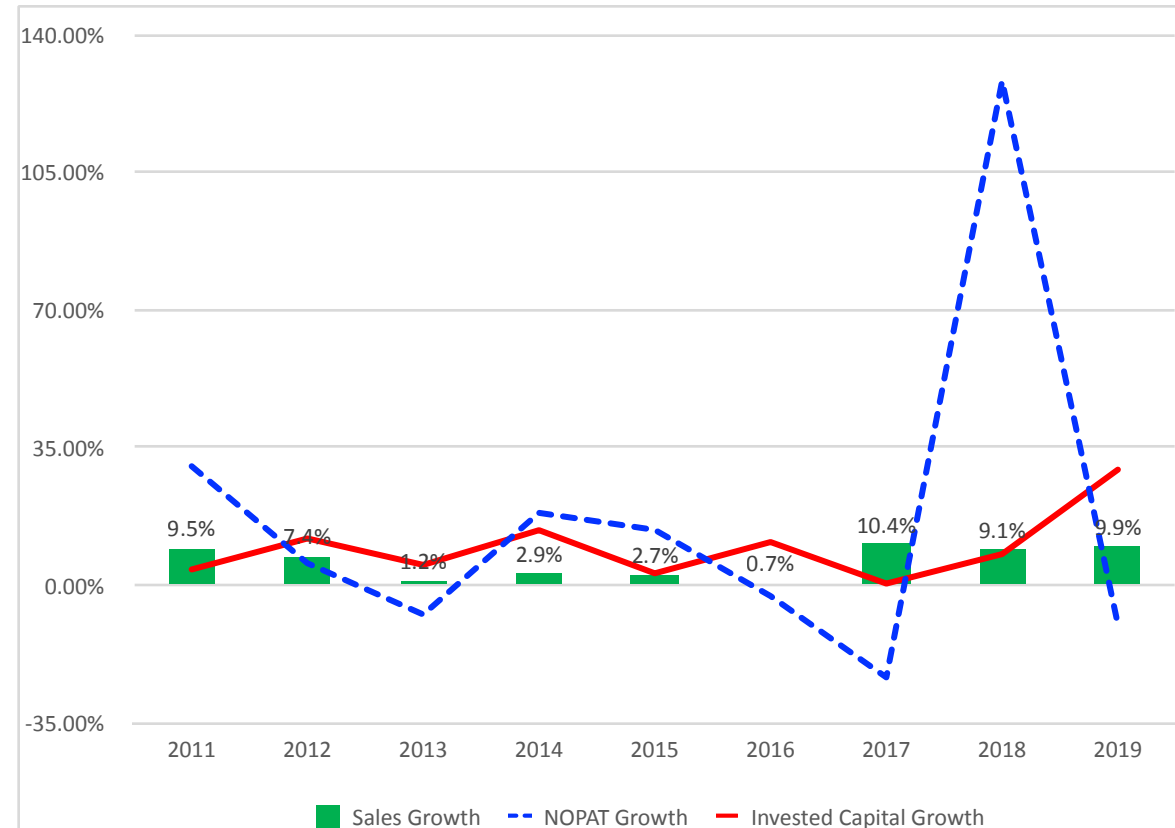
$$\Delta \text{NOPAT} > \Delta \text{Sales} > \Delta \text{Capital}$$

$$\Delta \text{NOPAT} \gg \Delta \text{Capital}$$

(EXPO)	CAGR%	
	Last 5-yrs	Last 10-yrs
Growth Trends		
NOPAT Growth	1.75X	2.63X
Sales Growth	1.37X	1.68X
Invested Capital Growth	1.61X	2.24X

Observations:

- NOPAT Growth has exceeded its Sales Growth and Invested Capital Growth over both the past 5- years and the past 10-years . A great sign. 👍
- Invested Capital growth has exceeded Sales growth but Capital has been invested at ROICs far exceeding WACC, resulting in value creation.



Insight: Growth in NOPAT has consistently exceeded growth in Invested Capital resulting in value-creation

Profitability History

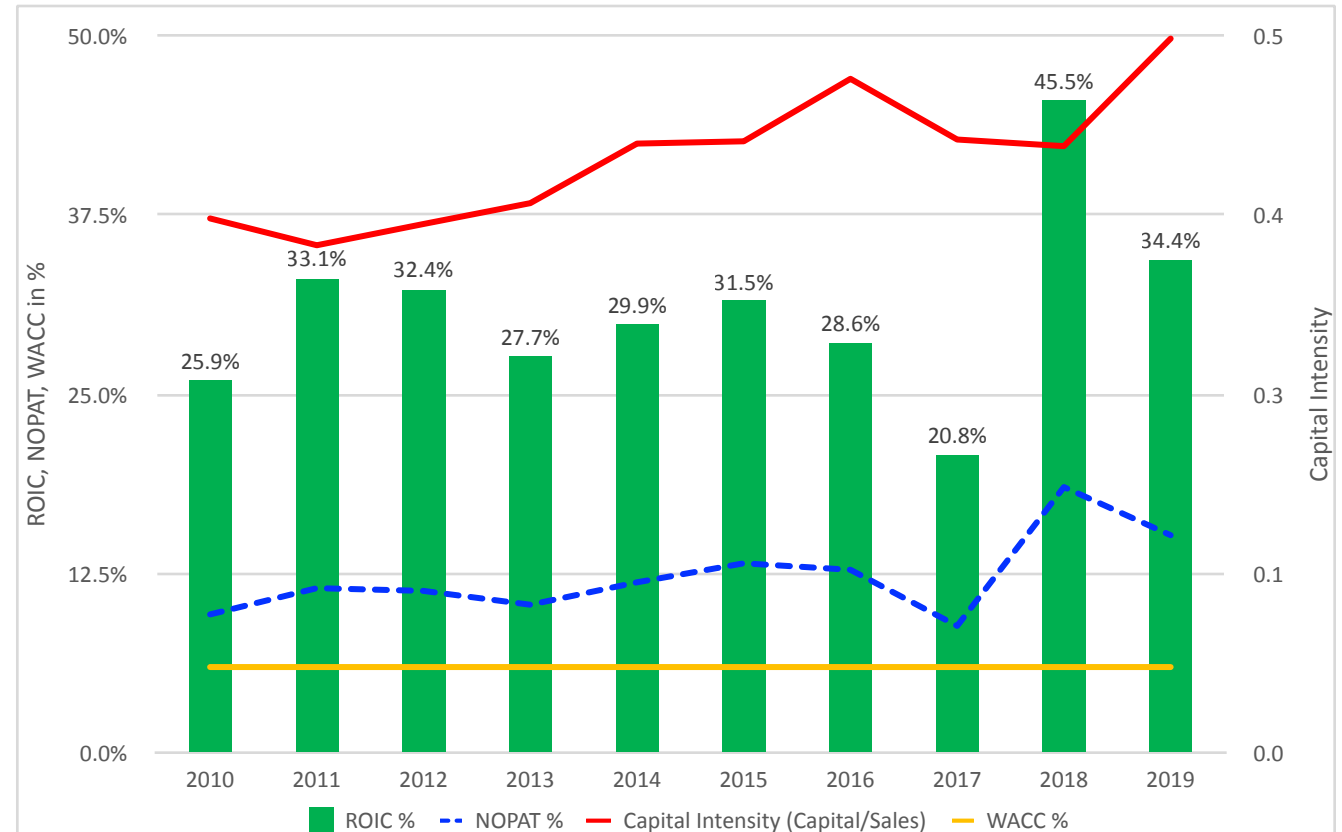
$$\text{ROIC} = \text{NOPAT}\% \uparrow / \text{Capital Intensity}\% \downarrow$$

Higher ROIC is driven by either higher NOPAT margins **or** lower Capital Intensity **or both**.

Exponent, Inc.	Median	
ROIC Drivers	Last 5-yrs	Last 10-
NOPAT %	13.2%	11.7%
Capital Intensity	0.43	0.42
ROIC %	31.5%	30.7%

Observations:

1. NOPAT% has ranged in the Median 12% to 13%.
2. Capital Intensity% has ranged in the Median 42% to 43%.
3. ROICs has remained constant at c.30% significantly higher than the WACC @6%. A great sign 👍



Insight: High NOPAT Margins and a low Capital Intensity result in ROIC margins far exceeding WACC resulting in value-creation.

Economic Profit (EVA) Positive

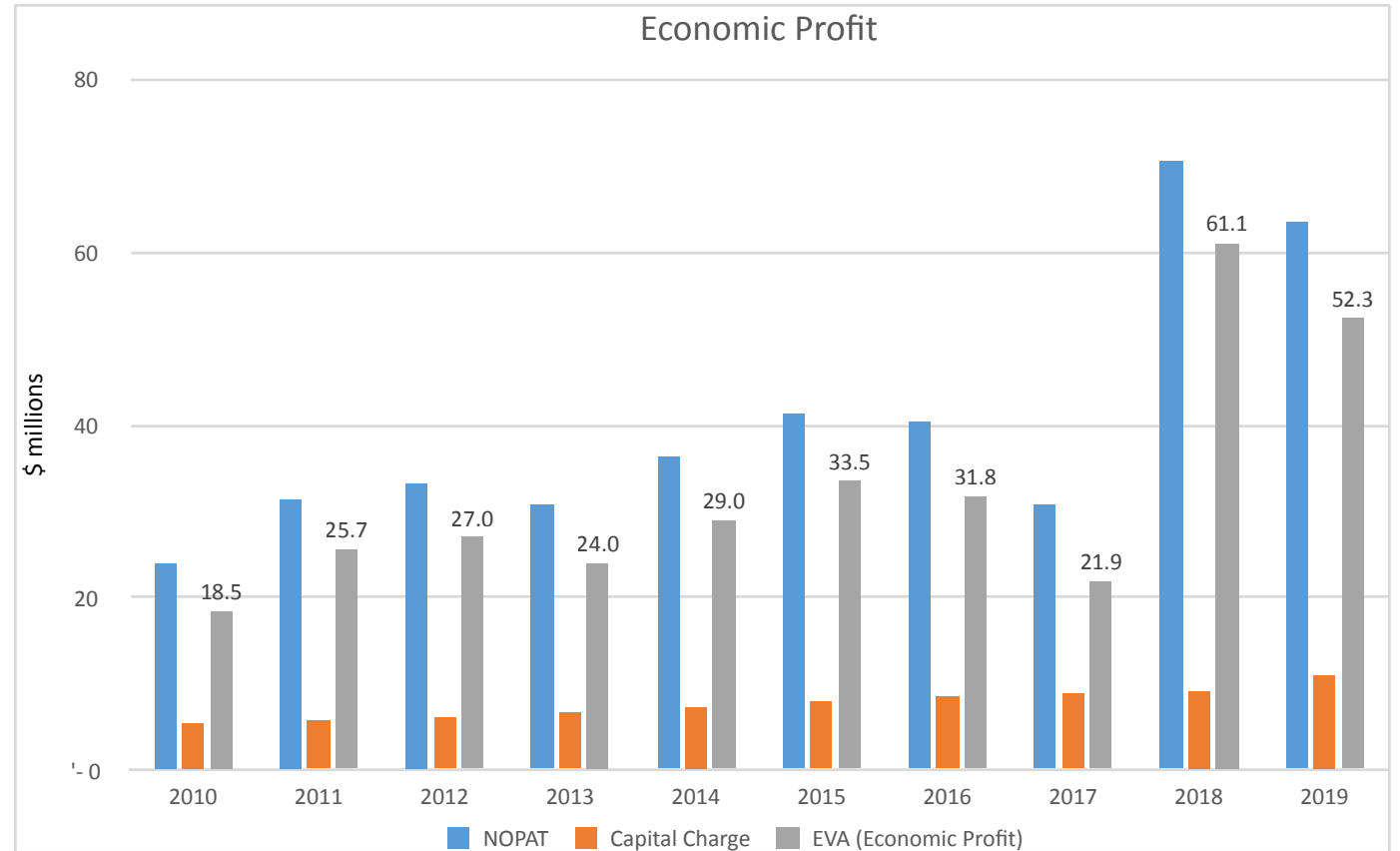
$EVA (\$mm) = NOPAT - \text{Capital Charge}$.

Higher EVA always translates to higher value creation which is driven by:

1. Growing NOPATS
2. Lower Capital Charge

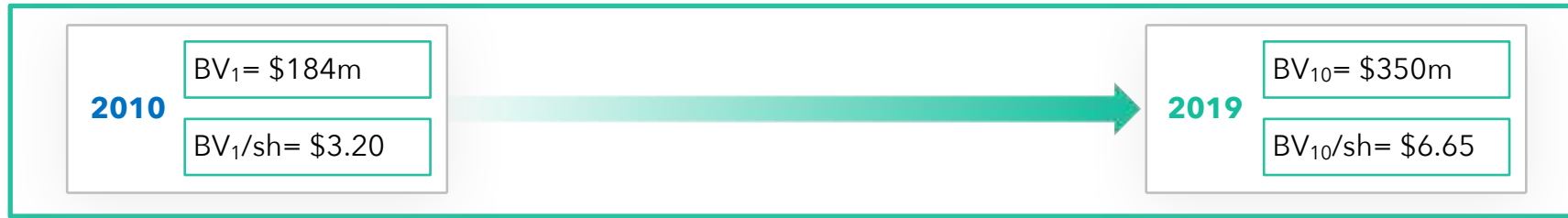
Observation:

A steady compounder. NOPAT has steadily grown over the years. EVAs has grown proportionately. A great sign. 👍



Insight: Consistently positive and significant Economic-Value creation trend.

Judging Capital Allocation



Cash Generated by the Business

Σ NOPAT = \$402m 94%	Σ Asset Sales = \$0 0%
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Cash Raised from Shareholders

Σ Equity Issuances = \$24m 6%
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Cash Raised from Lenders

Σ Debt issuances = \$0 0%
--

Sources of Capital: \$426m

Cash Used in the Business

Σ Growth Capex = \$29m	7%
Σ Changes in Non-Cash Working Capital = (\$9m)	-2%
Σ Acquisitions / Mergers = \$0	0%

Cash Returned to Shareholders

Σ Cash Dividends = \$138m 35%	Σ Share Buybacks = \$237m 60%
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Cash Returned to Lenders

Σ Debt Repayments = \$0 0%

Uses of Capital: \$395m

Value Created (Δ BV + Cash Returned) = 2.81X BV₁
Per-Share basis = 1.89X BV₁ per sh

Capital Allocation

Insight: Business is a prolific cash-generator.

Cash has been returned to owners as mostly share buybacks and also dividends. Owner's equity per sh. has doubled.

Business is extremely capital-light. ZERO-DEBT company.

A Deep-Dive would reveal:

- Past Spending Patterns - comparing First-5 years to Last-Five years to spot shifts in sourcing and spending.
- Analysis on Return on Incremental Investment (ROIIC) trend over time.

KIP Investment Process

Is it an Outstanding Business?

Moat Analysis

What has caused it to create value? How long can it continue to do so?

Requires a Deep-Dive

Total Shareholder Return Analysis




Performance History
Has it created economic value?

Business
Is it understandable?

Is it an Outstanding Investment?

Decision
Buy?
Sell?
Hold?

Competitors

<div style="border: 1px solid black; padding: 5px; display: inline-block;">Save Comparison</div>	 Exponent Exponent is an engineering and scientific consulting company.	 Clarivate Clarivate Analytics is a provider of insights and analytics focused on scientific and academic research.	 Tetra Tech Tetra Tech is a provider of consulting and engineering services.
Founding Date	1967	2016	1966
Type	Public	Public	Public
Tags	Business Products & Services bioengineering building management compliance engineering management consulting safety	Technology enterprise software intellectual property legaltech	Energy & Utilities construction management energy services infrastructure management consulting sustainability waste management

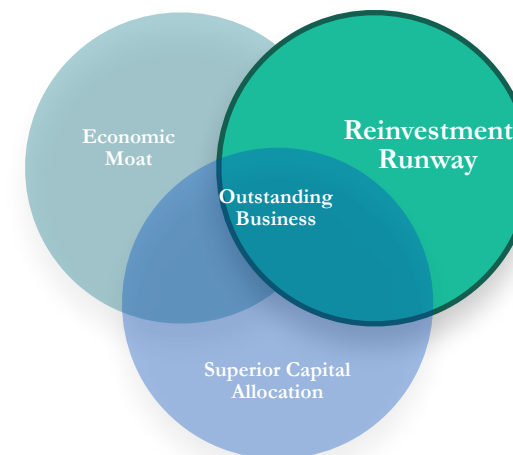
Insight: Exponent has a unique value proposition and faces little competition.
 Key competitive differentiator: Range of Disciplines.

Comparing Competitors

Name	Ticker	Common Market Cap - TFQ (Current)	Sales - TFQ (Current)	NOPAT Margin - TFQ (Current)	Capital - TFQ (Current)	Capital Intensity (Capital/Sales) - TFQ (Current)	ROC (NOPAT/Capital) - TFQ (Current)	Cost of Capital - TFQ (Current)	EVA Spread - 3 Year Average	Future Growth Reliance - TFQ (Current)	Country	GICS Sub-Industry
TETRA TECH INC	TTEK	\$6,346	\$2,995	6.6%	\$2,050	69%	9.5%	4.7%	3.6%	38%	United States	Environmental & Facilities Serv
CLARIVATE ANALYTICS PLC	CCC	\$11,082	\$1,053	7.4%	\$4,249	368%	2.0%	5.0%		87%	United Kingdom	Research & Consulting Services
EXPONENT INC	EXPO	\$4,112	\$407	17.6%	\$188	47%	37.3%	5.3%	34.0%	62%	United States	Research & Consulting Services

Observations:

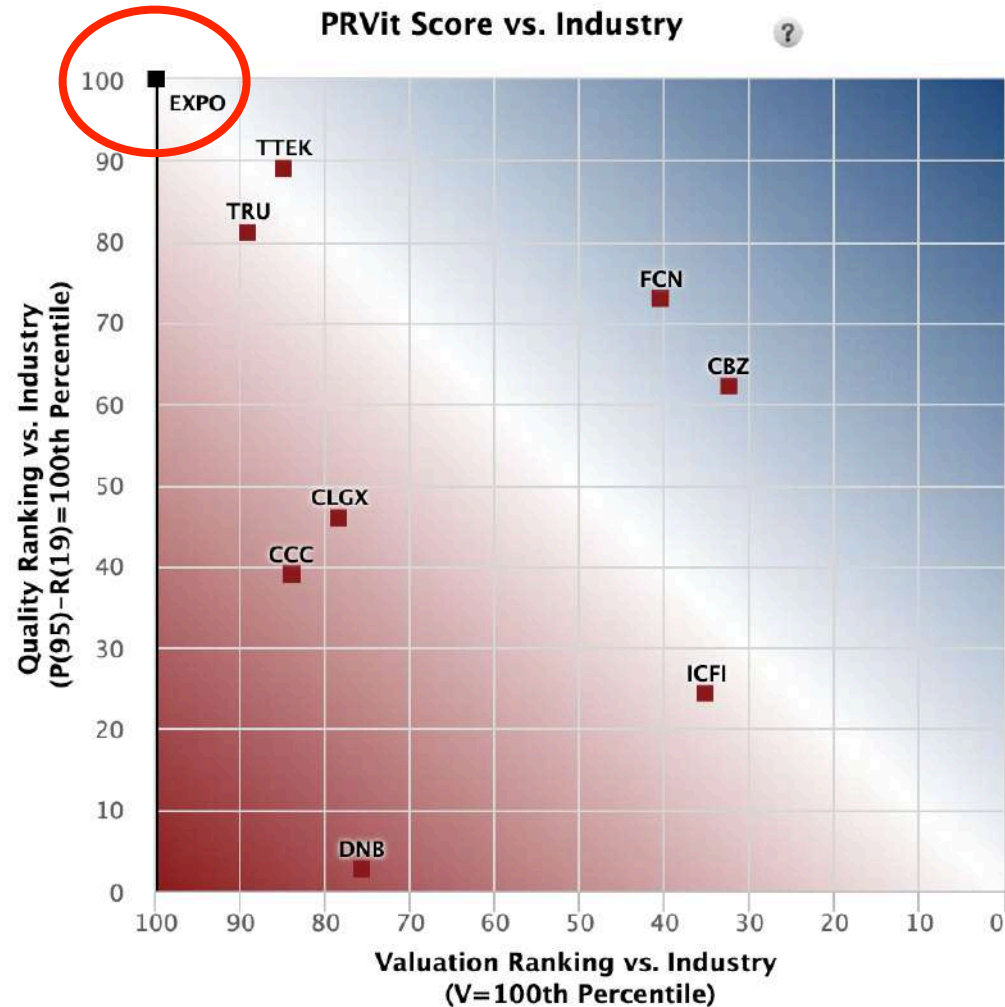
- EXPO is the smallest player by scale, with only \$400m in sales.
- However it is the most profitable with NOPAT margin at 16%-18%.
- Simultaneously, it is the least Capital Intensive at 47%.
- Ultimately, Exponent's ROC% far exceeds its competitors at 37%.
- The market is pricing-in 62% in growth of EVA over the next 5 years.



FGR quantifies the portion of the stock's Enterprise Value that is dependent on future growth in EVA. A high FGR indicates that much of the stock's Enterprise Value is dependent on growth in EVA.

Insight: Best-in-Class in its industry by all measures.

Competitive Analysis



Insight: Outstanding Business with a high valuation

KIP Investment Process

Is it an Outstanding Business?

Management
Are they shareholder-friendly?

Requires a Deep-Dive

Total Shareholder Return Analysis

Decision
Buy?
Sell?
Hold?

A stone castle tower with a crenellated top is reflected in a body of water. The scene is dimly lit, suggesting dusk or dawn. A teal-bordered white box is centered in the lower half of the image, containing the text "Is it an Outstanding Investment?".

**Is it an Outstanding
Investment?**

KIP Investment Process



Price-Implied Expectations of Value Drivers

(EXPO)

Last Traded Price @	\$82.50		
Market-Implied CAP (MICAP)	10.0	years	
Price-Implied Growth Projections	MICAP		
	Factor X	CAGR	Last 5-ys
Sales Growth	3.81X	14.30%	6.49%
NOPAT Growth	3.76X	14.15%	6.02%
ROIC		36.3%	31.5%

Exponent Stock Price



25th March: \$59

Observations:

- ▶ Current Price of \$82.50 **implies**:
 - Sales will grow 3.82X in the next 10 years from current \$417m to \$1,600m.
 - NOPAT will grow 3.76X in the same duration from current \$63m to \$238m.
 - Growth will occur at an average ROIC rate 36%.
- ▶ Will the business be able to deliver this performance? Unlikely!

Insight: Expectations of 14% CAGR Growth in Sales and NOPAT for the next 5 or 10 years is IMPOSSIBLE for this business.

KIP Investment Process

Is it an Outstanding Business?

Price-Implied Expectations

Total Shareholder Return Analysis

Moat Analysis
What has caused the company to create value?
How long can the company continue to create value?

Performance History
Has it created economic value?

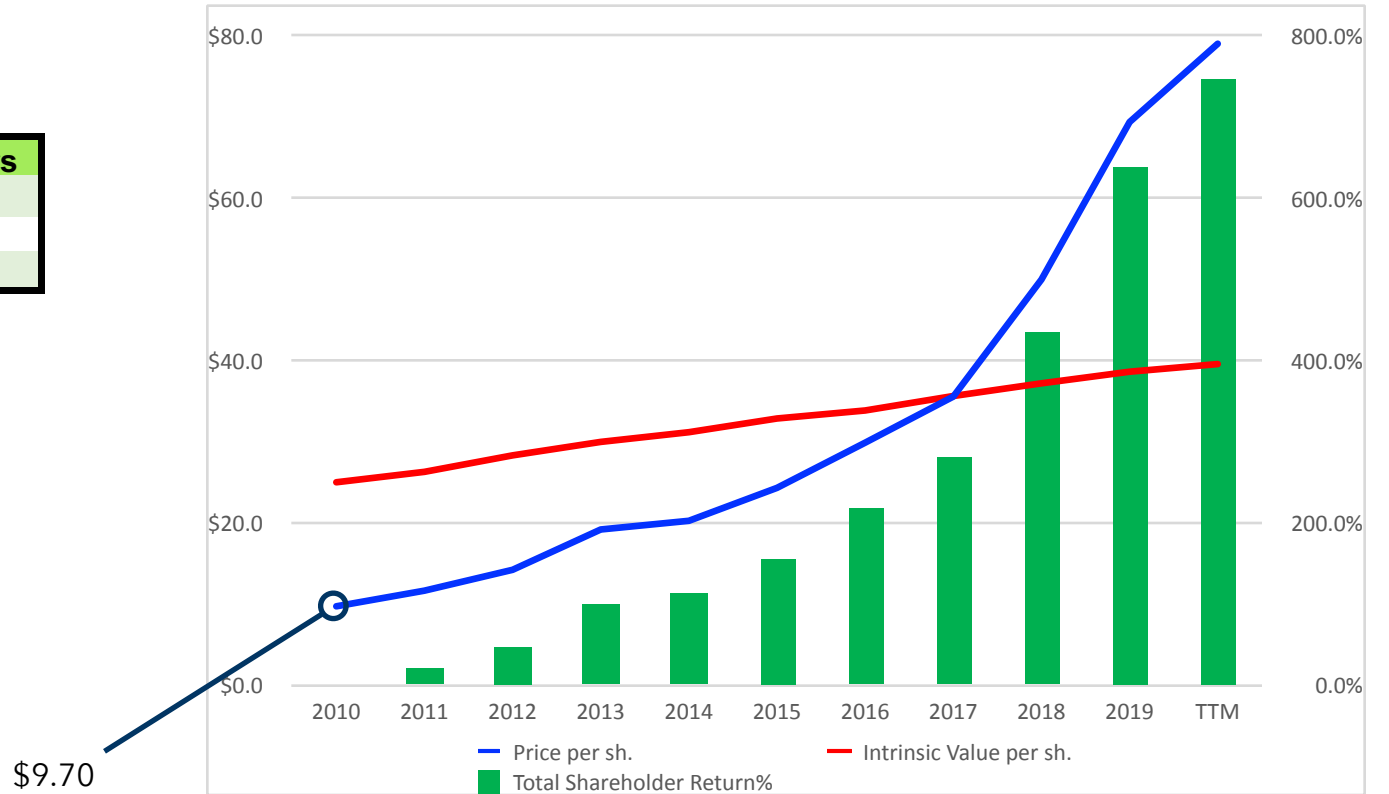
Business Model
Is it understandable?

Is it an Outstanding Investment?

Decision
Buy?
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Historical Value Creation vs Total Shareholder Return

(EXPO)	CAGR%
	Last 10-yrs
Intrinsic Value per sh.	4.68%
Shareholder CAGR%	24.32%
Total Shareholder Return	8.82X



Insight: Price has lagged Intrinsic Value from 2010 to 2016, a buy-opportunity. Price has significantly exceeded Value since 2018.

Shareholder-Return Implied Expectations

Sensitivity Analysis : EPS Growth CAGR%

Buy-Price Hold Duration:	\$82.50 per share 5 years	EPS CAGR% Median P/E	Past Trends	
			5-vr	10-vr
			15.78%	14.38%
			37.6X	29.1X

Price Gain CAGR%	P/E Ratio Forecast				
	24.3X	27.0X	30.0X	33.0X	36.3X
12.2%	32.1%	29.3%	26.6%	24.2%	21.9%
13.5%	33.6%	30.9%	28.1%	25.7%	23.3%
15.0%	35.4%	32.6%	29.8%	27.4%	25.0%
16.5%	37.2%	34.3%	31.5%	29.0%	26.6%
18.2%	39.1%	36.2%	33.4%	30.9%	28.4%

Choose an Investor Return% and P/E Multiple → to impute EPS Growth Rate%.

E.g. a 15.0% Return at a P/E of 30.0X implies an EPS Growth CAGR% of 29.8%.

Insight: An Investor Return% of 12 to 18% for 5 years, @PE 30X in year-5, implies an EPS Growth of 26% to 33%..
a highly unlikely scenario for this business!!

EPS Growth Implied Expectations

Sensitivity Analysis : Investor Return% CAGR

Buy-Price Hold Duration:		\$82.50 5	per share years	Past Trends		
				5-yr	10-yr	
				EPS CAGR%	15.78%	14.38%
				Median P/E	37.6X	29.1X

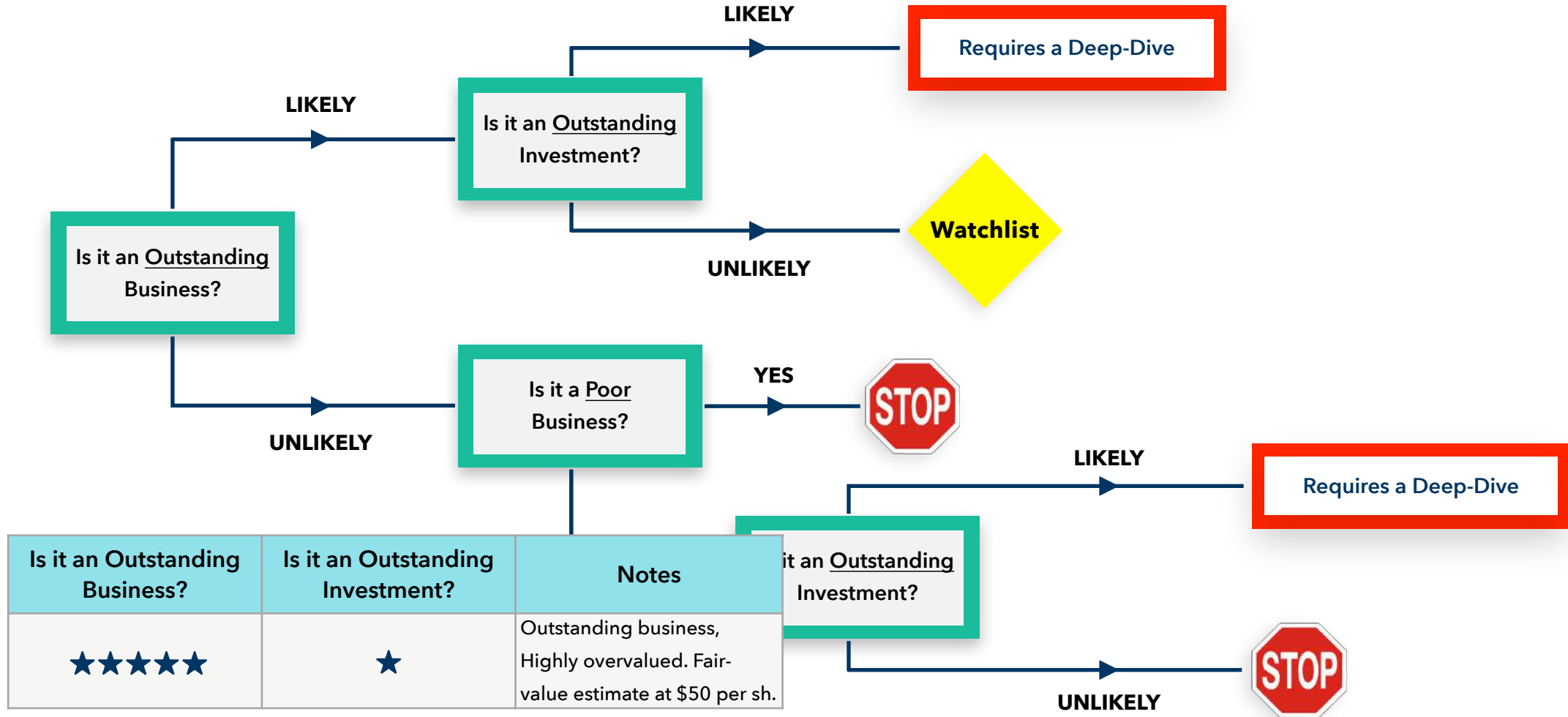
EPS CAGR Forecast	P/E Ratio Forecast				
	24.3X	27.0X	30.0X	33.0X	36.3X
12.2%	-3.7%	-1.8%	0.2%	2.1%	3.9%
13.5%	-2.6%	-0.7%	1.4%	3.2%	5.2%
15.0%	-1.4%	0.6%	2.6%	4.6%	6.5%
16.5%	-0.2%	1.9%	3.9%	5.9%	7.8%
18.2%	1.2%	3.2%	5.4%	7.3%	9.3%

Forecast a EPS Growth CAGR% and P/E Multiple → to impute Investor Return%.

E.g. a 15.0% EPS Growth rate at a P/E of 30X implies an Investor Return CAGR% of 2.6%.

Insight: An EPS Growth CAGR range of 12% to 18%, @PE 30X in year-5, implies an highly unimpressive Investor Return of 0% to 5%.

Conclusion



Deep-Dive - Further Areas of Investigation

▶ **Dig Deeper:**

- Deeper industry analysis. Deeper understanding of Porter's Five Forces.
- Work through the "**Measuring the Moat**" checklist.
- Deeper Competitive Analysis. How are their business models are different, how do they compete, etc.

▶ **Field research:**

- Speak with customers, understand their perspective on the product/service, and its pricing.
- Texus interviews of Former Execs, Employees, Competitors, Customers.

▶ **Management incentives:**

- Read CEO letters to shareholders, Earnings Call Transcripts.
- Deeper analysis of recent acquisitions (if any). Judge the quality of the acquisitions and explore reasons behind why those decisions were made.
- Contact management. Ask them questions that remain unanswered. eg: What are their thoughts on competitive strategy for the company, and how do they look at competition?
- How is management incentivized and paid? What is their background/experience? Are they shareholder friendly?

Q&A