Chegg, Inc. (NYSE: CHGG)

Brown Socially Responsible Investment Fund
September 29, 2020

Macro Update

<u>Markets:</u>

- Gold prices down 0.6%, largest weekly decline since March
- Tech continues to be top performing sector of S&P 500
- Jobless claims increased slightly since last week
- Census Bureau released reports on housing market statistics + durable goods market in August
    - New home sales up 4.8%, highest since 2006 despite low supply
    - Durable goods orders up 0.4%
- Palantir IPO being valued at $22 Billion (around $10 a share), valued earlier this month at $8.8 billion
    - Surge in the IPO market – newly public shares rising an average of 24% on first day of trading (best first-day average since tech bubble)
- FTSE Russell adding Chinese government bonds to its key indexes

<u>Politics:</u>

- Trump nominates Amy Coney Barrett to Supreme Court
- Trump announces prescription drug-discount cards for senior citizens on Medicare
    - Cost of $6 billion
- $2.4 trillion coronavirus aid bill proposed by House Democrats

<u>Other:</u>

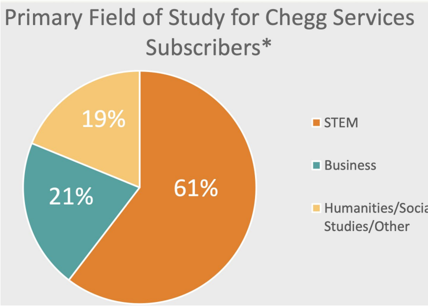
- California plans to ban sales of gas-powered cars by 2035
- Johnson & Johnson Coronavirus vaccine enters Phase 3 trials

Finance Pitch

Company Overview

At a Glance:

- Chegg is an online student-first learning platform that provides personalized educational tools and services to students
- Market Cap: $8.4B & Paid Subscribers: 3.7 million
- 90% of operations are domestic and 10% international

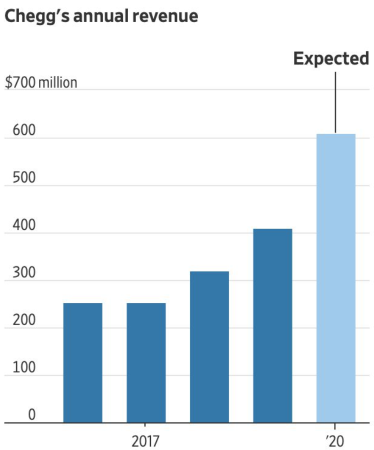


Products/Services:

- **Chegg Required Materials** → print and online textbook rental/selling
  → ~19% of total revenue
- **Chegg Study** → subscription service for textbook solutions and Q&A
- **Chegg Writing** → subscription service for plagiarism detector, proofreading, citation creation
- **Chegg Math Solver** → subscription service for math solutions and explanations
- **Chegg Tutors** → pay-per-lesson online tutoring service
  → all together ~81% of total revenue

Strategy:

- Focus on online tutoring and selling study materials and services because the textbook industry is highly competitive
- In the last 5 years, Chegg has acquired Imagine Easy Solutions (2016), Cogeon (2017), WriteLab (2018), StudyBlue (2018), Thinkful (2019), and Mathway (2020)
- Chegg's competitive advantage is that there are no direct competitors that own both a textbook business and an online learning subscription service
  - Having a widely recognized textbook service makes it an easy conversion for subscribers because they offer textbook solutions



Industry Overview

Key Competitors

- Grand Canyon Education (NYSE:LOPE)
  - Online education platform and management system; does not possess textbook rental/tutoring capabilities of CHGG
- Quizlet and Khan Academy
  - Not traded publicly; Quizlet does not offer expansive tutoring option, Khan does not offer textbook services.

Industry Outlook

- The global Online Learning Market size was 171 Billion in 2019 and is expected to grow at a CAGR of 10.85% during 2019 - 2025.
- Chegg Services Revenues grew 57% year-over-year to $126.0 million, or 82% of total net revenues, compared to 86% in Q2 2019
  - 3.7 million and 3.5 million: number of Chegg Services subscribers including and excluding Mathway (Chegg's new calculator acquisition) respectively, an increase of 67% and 58% year-over-year, respectively
- CHGG looking to continue investing in Chegg Study Pack, subscriber model that provides access to all Chegg Services (according to CEO Dan Rosensweig)
- Confidence in transition to online learning increases

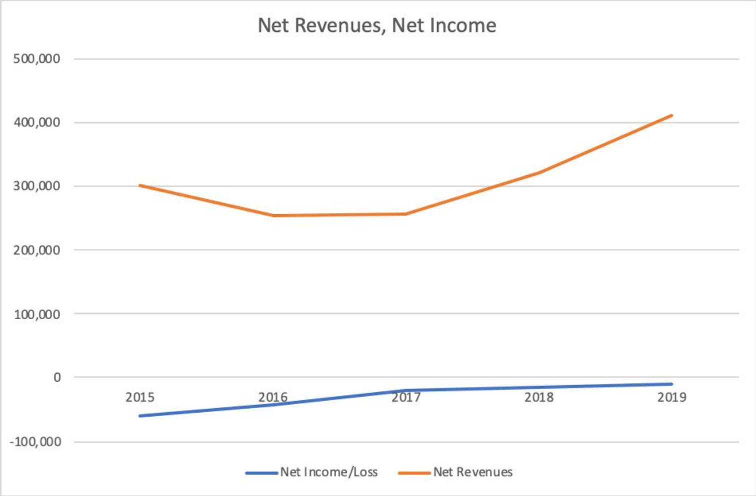
Comparables

Company	Market Cap. ($B)	P/S (TTM)	YoY Revenue Growth (TTM)	EBITDA Margin	FCF Yield	Leverage Ratio (D/E)	Beta
Chegg (NYSE: CHGG)	8.66	17.18	39.61%	26.14%	1.03%	1.86	0.93
Pluralsight (NASDAQ: PS)	2.45	4.82	42.3%	-24.44%	N/A	2.20	1.44
K12 (NYSE: LRN)	1.095	1.05	4.3%	10.09%	3.29%	0.01	0.48
Barnes & Noble Education (NYSE: BNED)	0.114	0.07	-14.7%	0.40%	N/A	0.63	1.45
2U (NASDAQ: TWOU)	2.14	3.28	53%	-27.56%	N/A	0.39	1.36

Income Statement Overview

<u>**2020 Q2:**</u>

- **Net Revenue** increased to $153m, a **63% YoY** increase
  - **57% YoY** increase in **Revenue from Chegg Services** (82% of Revenue) resulting from a **67% YoY** increase in subscribers
- $10.6m in **Net Income**, a **622% YoY** increase
- **EPS** increased to 0.09 from -0.02
- Margins: 60.9% **Gross Profit Margin**, 14.4% **Operating Margin**, 6.9% **Net Margin**, 36% **EBITDA Margin**
  - Gross Margin down **14% YoY** due to higher customer support fees and higher textbook costs, attributed to greater customer growth and engagement
  - 10% of Operating Expenses incurred due to June 2020 acquisition of Mathway



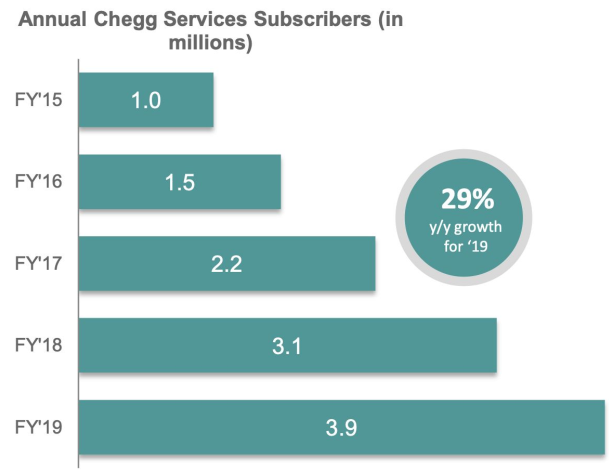
<u>**FY 2019:**</u>

- **History of Losses**
  - **Net Losses** of $9.6m, $15.6, and $20.4m in 2019, 2018, and 2017, respectively
- **Decreasing Operating Margins** (77% in 2018 vs 73% in 2019)
- Both **Chegg Services** and **Required Materials** (textbooks) segments are seeing growth
  - **31%** and **17%** growth in 2019, respectively

Balance Sheet and Cash Flow Statement Overview

Balance Sheet:

- **Assets:** 96% increase in 2019, only 3% in 1H20 driven by declining long-term assets.
  - Management advises stronger returns in 4Q to align with the academic year and long-term returns from print textbook library expansion.
- **Liabilities:** 5% increase in liabilities in 1H20; **90%** increase in deferred revenue.
  - Management cites pandemic-related setbacks.
- **Ratios:**
  - ROE: **0.11** (in line with industry average)
  - Liquidity & Leverage Ratios: current ratio: **8.20** (20.20 in 4Q19); interest coverage: **0.88** (0.11 in 1H19).



Statement of Cash Flows:

- **Cash Flow from Operations:** **$122,205** in 1H20 (v. **$47,846** in 1H19), **155%** increase.
  - Pandemic-driven increases in subscriber growth and use of learning platform.
- **Cash Flow from Investing:** **$178,482** used in 1H20 (v. **$464,749** in 1H19), **61.60%** increase.
  - Driven by strategic plan to expand Chegg Services and capex investments to meet increased demand.
- **Cash Flow from Financing:** **$46,065** used in 1H20 (v. **$597,937** in 1H19), **92.30%** decrease.
  - Decrease in cash used driven by paused share repurchase and senior note issuance programs.

	Q2 2016	Q2 2017	Q2 2018	Q2 2019	Q2 2020	4-Year CAGR
Free Cash Flow ($M)	2.58	7.58	11.76	20.47	34.25	
YoY Increase ($M)	-	5	4.18	8.71	13.47	91%

Growth Drivers

Large and Expanding Market Opportunity

- Currently only serves 3.9 million of 54 million US, CA, AU, and UK University and High School students
- However, there are still 48 million students across the globe that use English as a medium of instruction outside those countries.
- Used by students across several fields of study
- Chegg has grown its subscriber level at a 5-year CAGR of 29%

Strong Brand Awareness

- 87% of college students have heard of a Chegg service due to strong results (>90% of students said Chegg improved their studies)
- Marketing spending as a % of revenue hasn’t increased in 5 years and 37% of college students know what Chegg is without assistance

Acquisitions help strengthen and diversify services

- In 2019, Chegg acquired Thinkful Inc, a skills-based learning platform that offers professional courses such as software engineering and data science.
- 85% of subscribers got a job within 6 months
- Bundling of services of Chegg Study, Math Solver, and Writing for $19.95/month

Risks

Macro

- Biden plans to raise capital gains tax
  - May cause a sell-off in stocks

Industry (Online Education)

- Finite customer duration
  - Main customer base is degree-seeking students, who tend to stop using Chegg after they complete their degree
- Colleges investigating the use of Chegg, possibly deterring its use

Company

- P/S ratio of ~17
  - Chegg may be valued too steeply
- Chegg was not profitable during FY '19, losing $9.6M
  - COVID-19 may be a short-term push
- Numerous competitors: Khan Academy, Course Hero, Quizlet
  - Many of these companies offer free services
- Technological concerns may plague Chegg
  - In 2018, Chegg experienced a data breach
  - Shares dropped 14% over the next two days

Investment Thesis

Reasons to Buy:

1. Underpenetrated and growing online education market
2. Diversified service offerings
3. Sustained top line growth
4. Strong brand recognition

Reasons to NOT Buy:

1. High valuation
2. Online education market is filled with competitors that offer free services
3. Long history of losses

Finance Vote

ESG Pitch

Environmental [Jerry]

Key Issues	Opportunity	Risks
Waste and carbon emissions	Reduction in printing materials and paper waste through electronic textbooks and shared notes	None (environmental) May raise copyright issues
Greenhouse gases and fuel	Reduction in traveling for students and tutor for physical tutoring	None
Health and disease	Support and improvement for online learning, reducing the need to seek in-person education during the COVID pandemic	None

Key Takeaways:

- Low environmental risk, unclear of possible improvements
- Did not state any environmental goals or initiatives

Social [Hailey and Mukul]

Key Issues	Opportunity	Risks
Data Privacy and Security	• In March, Cengage partnered with Chegg to adopt a set of 'anti-counterfeit best practices,' to stop counterfeit textbooks.	• Three major data breaches since 2018 (40 million customer records, employee details) • Typically, security spend has been associated with maintaining regulatory compliance. Hence, many companies like Chegg end up doing the minimum required (which often is not enough)
Consumer Behavior	• Create a dialogue between experts and students to supplement the material learned in class on demand at all hours of the day as opposed to waiting for a professor's availability. • Provides access to online textbooks, matching students with colleges and scholarship opportunities, and preparing study tools for standardized exams which increases accessibility to these resources.	• With the homework help and textbook solutions feature, students could look up the answers instead of trying to solve a problem themselves and not use the information as supplementary material. • Chegg could have an unintentional consequence of creating a culture of ignoring academic integrity as people can just lookup the material necessary.

Key Takeaways:

- Fairly strong social profile: Consistent positive reports on diversity of corporate leadership
- Concerns surrounding data privacy and protection as well as consumer behavior as students could use Chegg for unethical reasons including posting exam questions

Governance [Amy]

CEO - Dan Rosensweig

- CEO since 2010; 10 years of experience with the company
- Previously served as the CEO of Guitar Hero
- Annual total compensation $9 M (2019)

Executives and Board of Directors

- 9 executives: 3 women, 2 people of color (1 BIPOC)
- 8 board members: 3 women, 1 person of color

Opportunities

- Diverse executive and board member expertise
- Relatively diverse board compared to its competitors
- No major scandals in the past

Risks

- Not a lot of experience in education
- Data breaches

CORPORATE VALUES

Carbon Footprint	Pollution Prevention	Water Conservation	Data & Privacy Protection	Consumer Health, Wellness & Safety	Employee Ownership, Satisfaction, Benefits &	Workplace Health and Safety	Integrity of Corporate Governance	Ethical Practices	Usage of Conflict Materials	Forced Labor	Diversity of Corporate Leadership
											5

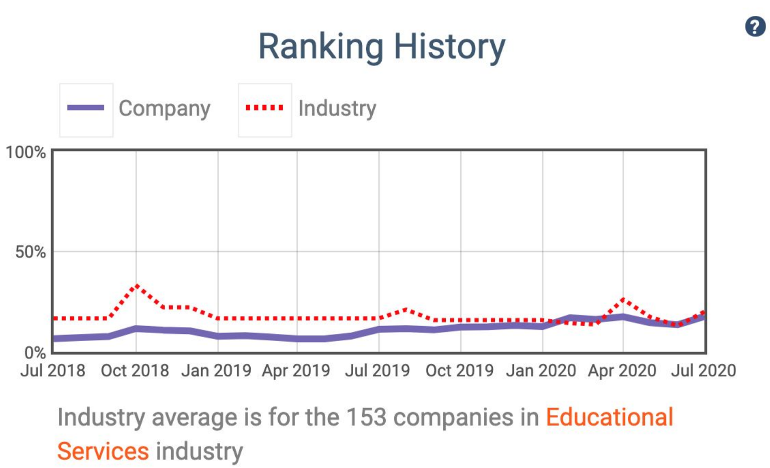
ESG Comparables [Dana]

Highlights

- Creates a platform for supplementing student learning, that can be particularly useful during times of online learning.
- Access to online resources
- Partnership with Cengage to adopt ‘anti-counterfeit best practices.’
- Consistent positive reports on diversity of corporate leadership

Risks

- 3 data breaches in the past 3 years, the first of which affected 40 million customers.
- Is being used by students to cheat in exams, but Chegg has been able to provide the appropriate information to schools and has lots of safeguards in place to limit cheating.
- Potential backlash from schools if cheating persists, including banning students from the site.



ESG Vote

Elevator Pitches

Ørsted A/S (OTCMKTS: DNNGY)

Company Overview

- Danish multinational energy developer
  - Onshore (87%)
  - Offshore (4%)
  - Market and Bioenergy (9%)
- Leading offshore wind developer
  - **29%** Global installed wind energy capacity
- Industry Competitors:
  - NextEra, First Solar; Iberdrola, ENEL Green Power, BP, ExxonMobil, Shell

ESG

E: 88% Renewable; carbon neutrality by 2025 and zero-emission by 2040

S: Quarterly worker safety disclosures

G: 3 women on board, 0 POC (of 9); Danish State owns majority share

Financials

- FY 2019: **$11B** in Revenue
  - **30.5%** Gross Margin, up **10%** from FY 2018
- 33.46% YTD Return (vs. -48.68 for S&P 500 Energy Sector)
- -20% change in revenue, 11% in EBITDA (YoY)
- P/E: 56.6 (Comps avg: 31.26)
- D/E: **1.06** (Comps avg: 1.02)
- ROI (5Y): 8.6 (Comps avg: 3.54)
- **53%** increase in CapEx in FY 2019

Growth Drivers:

- 42% increase in onshore and offshore wind power generation YoY
  - 30 GW installed renewable capacity target by 2030 (11 GW current)
- National and corporate carbon commitments
- 20-year fixed feed-in-tariff with Taiwan, CPPA with TSMC
- US solar and wind acquisitions
- 4x offshore wind capacity in North Sea by 2030 (IEA)

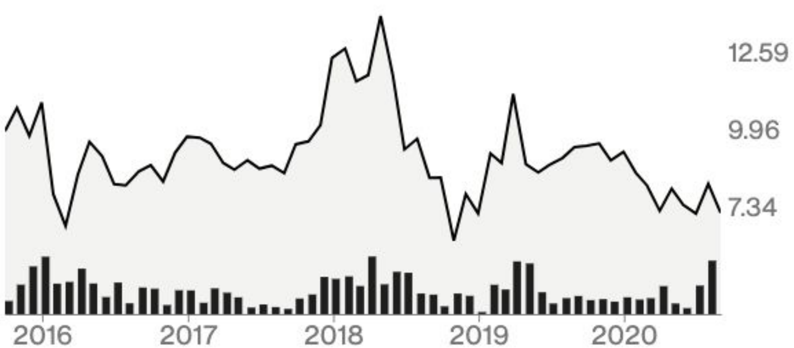
Risk Factors:

- Currency exposure
- Immaturity of US renewable market
- COVID-19 construction delays

Xinjiang Goldwind Science & Technology Co. (2208.HK) GOLDWIND

Company Overview:

- Second largest wind turbine company worldwide and largest Chinese wind turbine manufacturer
- Main operating segments:
- Wind Turbine Generator Manufacturing and Sales (77%)
    - Development, manufacture and sale of wind turbine generators and components
- Wind Power Services (12%)
    - Consultancy and maintenance services
- Wind Farm Development (11%)



ESG (Good and Bad):

E: Largest producer of wind turbines, the most efficient form of renewable energy in China, which recently pledged carbon neutrality by 2060

S: Goldwind Public Welfare Foundation, brackish water treatment in Xinjiang

G: 22% female board representation, executive compensation unavailable

Financials:

- **FY 2019: 26.83%** sales growth ($5.5B) and **22%** 3-year CAGR
    - EBITDA and EPS decreased due to one-time operating expenses
- Nonetheless, EPS rose **24.5%** last quarter and is projected to increase further over the next year
- P/E of **11.0x** and EV/EBITDA of **10.1x** significantly below industry averages
- D/E of **.64x** extremely conservative

Growth Drivers:

- Leading position in wind turbine industry in China and globally
- Considerable growth opportunities in both markets
- In 2019, external wind turbine sales increased **39.4%** YoY
- China, with leading carbon emissions announced pledge to carbon neutrality by 2060, and wind is the most efficient form of renewable energy

Risks:

- International failure to reach environmental and sustainability goals
- Efficiency improvements of other renewable energy sources (solar, hydro, etc.)
- Decreased growth of Chinese economy