Corporate Executive Board Company (CEB) Memo

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Company Description

Corporate Executive Board Company [CEB] describes itself as the leading member-based advisory company. It provides its customers with value through its large database of solutions and industry best practices. CEB uses its large network of clients to identify systemic issues and opportunities in various industries, and then investigates the business processes behind member companies that have been able to solve these issues. The firm recently acquired SHL Group Holdings I, which offers cloud-based solutions involving talent management, and provides professional services as support for these solutions.

Thesis / Key Points

- **Innovative business model that provides a strong network effect**

  In a manner similar to social networking companies such as Facebook and Google's Youtube, CEB benefits from a strong network effect. CEB provides its customers with research results and solutions that stem from the best practices of its network of contacts. CEB's database consists of its history of interactions with member firms. VAR has indicated that CEB provides value to its customers through solutions derived from its previous work with companies that have similar issues. This means that, as CEB's customer base grows in size, its network, and consequently its product offerings, increase in value.

  Revenue has grown both internally and externally

  - CEB's contract revenue, which is derived from its sales to its customers, has also been growing significantly. Contract revenue grew from $447 million in 2010, to $499 million in 2011, to $561 million in 2012, representing growth rates of 11.7% from 2010 to 2011, and 12.5% from 2011 to 2012.
  - Externally, CEB's customer base grew by 467 member institutions from 2010 to 2011, an 8.9% increase. It then added an additional 352 institutions from 2011 to 2012, representing a 6.1% increase in the firm's overall number of clients.
  - Internally, CEB's revenue generated per customer has increased from $84,800/customer in 2010, to $87,000/customer in 2011, to $92,000/customer in 2012.
  - From these numbers, we can see that CEB's revenue increase is due to both attracting new customers, and generating more sales from its existing customers. These results are due to the network effect that CEB enjoys.

  Business Model should result in economies of scale

  - As CEB's database of clients and solutions grows in size, it should benefit from large economies of scale. The firm's offerings to new clients can increasingly rely on its previous work, as opposed to new research.
  - VAR has indicated that CEB places a high emphasis on solutions based on previous experiences and anecdotes, rather than solutions derived from empirical quantitative projections.
  - These sources indicate that variable costs for CEB should grow at a slower rate than revenue in the future. This was true from 2010 to 2011, as costs decreased as a percentage of revenue in these years, from 81% of revenue in 2010 to 80% of revenue in 2011. Costs increased in 2012 as a percentage of sales, but this can attributed to costs due their acquisitions in 2012. As CEB integrates SHL Holdings I and Valtera Corporation into its current corporate structure, we should expect costs to decrease as a percentage of sales in future years.

  Solutions are differentiated from competitors

  - VAR has indicated that CEB's business approach differentiates itself from its competitors. Unlike other consulting firms that target specific issues that its clients need addressed, CEB takes a more holistic approach to its problem solving by first evaluating a company's processes as a whole, and then identifying its systemic problems and largest opportunities. CEB's unique approach to consulting separates it from many of the other strategic consulting firms that are listed as its competitors. Thus, a firm can subscribe to membership in CEB's network, and still enter contracts with other consulting firms to help with specific business decisions and projects.
  - CEB's popularity can be seen through its subscription base. The firm's membership base include roughly 85% of the Fortune 500, as well as 85% of the FTSE 100. The presence of these firms in CEB's member base is evidence of CEB's performance, and serves as an additional draw factor for smaller firms that CEB attempts to attract.
  - This type of approach seems to be especially effective when attracting new clients. VAR has indicated that CEB business development employees will analyze a potential company and identify problems that CEB can solve. As a result, CEB's cold call response rate is roughly around 50%, which is significantly higher than the 6% response rates that are typical of cold calls.[1]

- **Past results indicate that CEB's approach to research yields insightful results**

  CEB's past projects have often resulted in business insights that challenge conventional knowledge and identify underlying problems and opportunities that other consulting firms missed or overlooked. Many of their research projects show the benefits of their holistic approach to problem solving. Some examples include the following:

  - A research report challenged conventional knowledge that increasing the number of managers would improve call center performance. Research found that call center performance could be improved more effectively through better training for the phone representatives. (Details in Exhibit 1)

promoted the value of old customers over new ones. Research found that customer loyalty programs have high diminishing marginal returns, and that failing to meet the expectations of old, established customers will lead to similar desertion rates as failing to meet the expectations of new, supposedly more fickle customers. (Details in Exhibit 1)

- A research report identified traits that set certain salespeople apart from others, which allowed them to succeed, even in difficult economic conditions. The report identified a group of salespersons that they called "challengers." Challengers are able to change the existing opinions of their customers and establish new opinions, which results in exceptional customer loyalty. (Details in Exhibit 1)
- These examples show how CEB's approach is able to provide a unique perspective to issues that are relevant to many firms within an industry. These research reports are coherent with CEB's approach of addressing the root problems of an industry, as opposed to advising the projects of a specific firm.

➢ **Unique Hiring Strategy provides CEB with employees with diverse and complementary skillsets**

VAR indicates that CEB's approach to hiring new associates serves as an additional source of differentiation from competitors. (Exhibit 1) Unlike other consulting firms that hire largely based on resume credentials and quantitative factors, CEB hires based on interest in the firm and ability to relate business problems to personal experiences from one's background. Thus, individuals who come from research based majors are seen as especially attractive.

Employees have various backgrounds that they can bring to the team

- VAR has shown that CEB associates come from all types of academic backgrounds. **(**Exhibit 1) This suggests that CEB has been able to attract talent without having to directly compete with other strategic consulting firms. CEB places a large emphasis on interest in the firm as a factor for potential hires. VAR has indicated that candidates with strong credentials have been denied interviews because they did not display sufficient interest in the firm prior to submitting their application.
- CEB's emphasis on hiring from diverse backgrounds is also reflected in their upper management, where top level executives include engineering majors, psychology and fine arts majors, computer science majors, as well as business and economics majors.
- This hiring strategy is coherent with CEB's overall approach to consulting, which is based largely on using relevant real-world experiences rather than mathematical analysis and quantitative metrics.

Misperception

➢ **CEB employees are not as talented because they don't have strong business oriented credentials** – CEB believes that all modern day knowledge-based jobs are, at their core, the same. They all involve pulling data from computers and then synthesizing the data. Thus, the backgrounds of employees will serve as the differentiating factor between firms. Given that almost all services industry jobs require training for their employees regardless of prior business background, CEB benefits from the wide variety of perspectives that come from hiring both business and non-business majors.

➢ **CEB does not have a niche because it doesn't address a specific need or area of expertise–** CEB's unique business model does not look to solve problems that are specific to a client, and thus they have been perceived as lacking a distinct niche in the consulting industry. CEB's point of differentiation, however, comes from the fact that it is the only firm that is able to operate its member-based subscription system effectively.

VAR See Exhibit 1 for details on VAR

How It Plays Out

➢ As the economy recovers and businesses look to expand and improve their operations, we expect that more firms will join CEB's membership base and further increase the value of the firm. Considering historical rates, look for CEB's membership base to grow by 600 and 750 member companies in 2013 and 2014 respectively.

➢ CEB's costs as a percent of sales should continue to decrease in future years as the firm benefits from economies of scale.

Risks / What Signs Would Indicate We Are Wrong?

➢ Since most firms see their membership subscription to CEB as non-priority spending, and a new, unprecedented, economic situation may lower CEB's membership subscription count as firms leave in order to cut costs. Since CEB's operations are based on its previous experiences, it may not react effectively to a new change in market conditions. Given the current state of the economy, this serves as a significant risk in CEB's short-term future. This risk is tempered by the fact that, although small companies tend to leave CEB quite easily, they tend to also resign with the company very easily when the economy recovers.

➢ CEB has also recently taken on a significant amount of long term debt. CEB reported total debt of $540 million on its balance sheet in 2012, which was used to finance its acquisitions of Valtera Corporation and SHL Group Holdings I. These acquisitions drastically increased operating expenses from $350 million in 2010 and $390 million in 2011, to approximately $540 million in 2012.

Signposts / Follow-Up

➢ CEB's recent acquisition of SHL Group Holdings I added a new stream of revenue. This new stream should be evaluated to determine if there is room CEB to grow and diversify its offerings through talent management.

Important Company Financial Data

Market Cap: 2.43B	2012 EBIT: 84.67M
P/E Ratio: 92.55	2012 EBIT Margin: 13.6%
52 Week Range: $42.33 - $76.71	2012 Net Income: 37.05M
Beta: 1.17	Current Share Price: $72.50

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Exhibit 1. Value Added Research

Individual – Role with the company	Notes and Insights
Thomas Monahan III – Chairman and CEO*	"CEB doesn't do arms and legs. We don't fix specific problems in a company, we fix general problems." "We ask companies what their problems are, and we make a list to find the most common and serious problems." "You can either go to a consulting company to solve all your specific problems, or you can go to CEB's database and see what research the company has done for other firms who had the same problem."
Lauren Pragoff – Director of Research	(On a project for Bass Pro Shops) "We found out that having a lot of customer loyalty doesn't matter. There are high diminishing returns. Failing the expectations of the most loyal members will be similar to failing the expectations of the newer or more fickle members."
Lance Guthrie – Winner of CEB case competition	"There was this case that CEB talked about that stood out to me, In the economic recession that were salespeople that were going above and beyond everyone else, even in turbulent times. They surveyed 6000 sales professionals, and found that sales professionals broke into five categories: hard worker, problem solver, relationship builder, lone wolf, and challenger. If you are a challenger, you confront clients and change their opinions, and they will be your customers for life, because you broke their status quo. The customers of challengers will always come back." "CEB liked people who talked about experiences and surveys rather than mathematical analysis. We won the competition because they liked how we drew on our personal experiences and anecdotes, instead of trying to wow them with math.'
Michael Khoo – Winner of CEB case competition (also interviewed with the firm)	"They hire all majors, they don't really care if you're a business major or not. They like other majors more if you can give them the same thought processes that a business major would." "CEB keeps track of who is attending their information sessions, and they select people based on information session attendance, as opposed to strong resumes. They want to see your interest in the firm. (A friend of mine) didn't get a first round interview even though he was an engineering double major with a 3.6."
Clifford Lance – Incoming CEB Associate	"I chose CEB mostly because they had great people, a competitive salary, and I thought the work was rewarding." "The CEB staff, since they pull people from research backgrounds instead of business backgrounds, are a really fascinating and diverse group on people. On my team there were 2 public policy majors, 2 Econ majors, 1 French lit major, and a business administration guy. They are all extremely nice and hyper intelligent but have their own quirks because of their backgrounds and research backgrounds"
Haley Jackson – Business Development Intern at CEB	"I research a company to identify opportunities where CEB can help before I call them. For instance, if I see that a firm lacks a CIO on their website, then they'll probably be a good candidate for CEB's IT program and so on." "We try to make the calls seem less like a sales call, and format them like an informal informational call. Even if they don't go forward with the ideas, it's still a valuable use of their time." "About half the time, the company will agree to a 30 minute informational session with my director."
Vice President of Customer Service for Time Warner Cable (CEB's client)	"Conventional knowledge a couple years ago was to increase the number of managers to decrease the phone rep to manager ratios in call centers. CEB did some research, and found the best way to increase phone call performance was to implement better training for the phone reps, rather than spend money on the managers."

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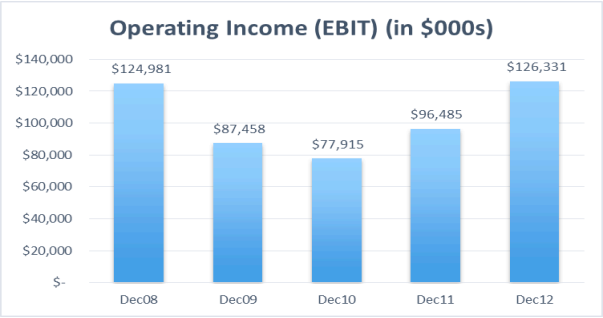
Exhibit 2. Historical Stock Performance

52 week increase: 66.94%

Exhibit 3. Operating Income and Earnings Before Tax

Operating took a hit during the economic recession, likely due to decreased subscription revenue from a loss in membership. Revenue has increased in recent years due to additional members and increased sales to current members. Unusual Expenses was not included in the calculation of operating expenses. Earnings before tax includes special items.



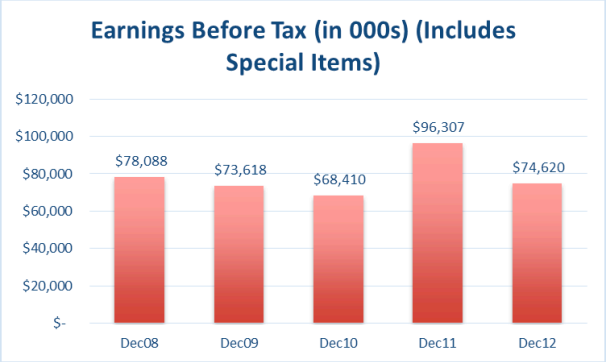


Exhibit 4. Revenue/Customer

Revenue per customer has increased from 2010 to 2012, indicating the CEB is generating more sales from its existing customers, in addition to adding new customers to its network database.

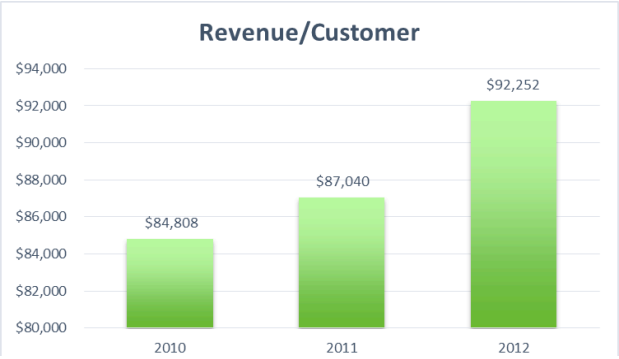


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Exhibit 5. Membership Base

From 2010 to 2012, CEB's membership base has been increasing, which has been a source of increased revenue. As the economy continues to improve, more companies are expected to subscribe to CEB's services.

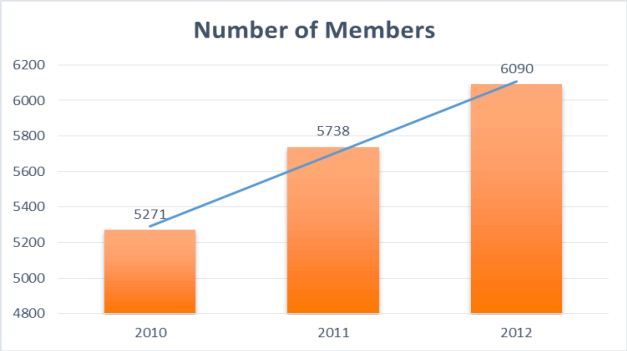

Exhibit 6. Discounted Cash Flow Analysis

Target Price: $86.00

ll values in 000 USD	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Terminal Value
evenue Sources												
lembership Revenue	$ 558,352.00	$ 442,906.00	$ 438,907.00	$ 484,663.00	$ 581,196.00	$ 639,315.60	$ 703,247.16	$ 773,571.88	$ 850,929.06	$ 929,214.54	$ 1,014,702.27	
evenue growth Rate	-21%	-1%	10%	20%	10%	10%	10%	10%	9%	9%	9%	
HL Segment Revenue	0	0	0	0	$ 58,592.00	$ 64,451.20	$ 70,896.32	$ 77,985.95	$ 85,784.55	$ 94,363.00	$ 103,799.30	
evenue Growth Rate	N/A	N/A	N/A	N/A	10%	10%	10%	10%	10%	10%	10%	
otal Revenue	$ 558,352.00	$ 442,906.00	$ 438,907.00	$ 484,663.00	$ 639,788.00	$ 703,766.80	$ 774,143.48	$ 851,557.83	$ 936,713.61	$ 1,023,577.54	$ 1,118,501.58	-
rowth Rate	-21%	-1%	10%	32%	10%	10.0%	10.0%	10.0%	9.3%	9.3%	9.3%	9.3
xpenses												
ost of Goods Sold	$ 173,950.00	$ 147,019.00	$ 155,769.00	$ 167,258.00	$ 223,766.00	$ 246,318.38	$ 270,950.22	$ 298,045.24	$ 327,849.76	$ 358,252.14	$ 391,475.55	
OGS as a percent of Sales	31.2%	33.2%	35.5%	34.5%	35.0%	35%	35%	35%	35%	35%	35%	$ -
G&A Expense	$ 237,790.00	$ 185,438.00	$ 184,761.00	$ 203,992.00	$ 251,833.00	$ 274,469.05	$ 298,045.24	$ 323,591.97	$ 351,267.60	$ 378,723.69	$ 408,253.08	$ -
G&A as a percent of Sales	42.59%	41.87%	42.10%	42.09%	39.36%	39%	38.5%	38.0%	37.5%	37.0%	36.5%	
nusual Expense	$ 43,255.00	$ 19,406.00	$ 12,645.00	$ -	$ 41,663.00	$ 20,000.00	$ 20,000.00	$ 20,000.00	$ 20,000.00	$ 20,000.00	$ 20,000.00	
epreciation and Amortization	$ 21,631.00	$ 22,991.00	$ 20,462.00	$ 16,928.00	$ 37,858.00	$ 42,226.01	$ 46,448.61	$ 51,093.47	$ 56,202.82	$ 61,414.65	$ 67,110.09	
epreciation and Amortization as a percent	3.87%	5.19%	4.66%	3.49%	5.92%	6%	6%	6%	6%	6%	6%	
otal Expense	$ 476,626.00	$ 374,854.00	$ 373,637.00	$ 388,178.00	$ 555,120.00	$ 563,029.44	$ 615,460.07	$ 672,746.68	$ 735,336.18	$ 798,406.48	$ 866,854.72	
perating Profit (EBIT)	$ 81,726.00	$ 68,052.00	$ 65,270.00	$ 96,485.00	$ 84,668.00	$ 140,737.36	$ 158,683.41	$ 178,811.14	$ 201,377.43	$ 225,171.06	$ 251,646.85	$ -
ther Income (Expense)	$ (3,638.00)	$ 5,566.00	$ 3,140.00	$ (178.00)	$ (10,048.00)	$ -	$ -	$ -	$ -	$ -	$ -	
nterest Expense	$ -	$ -	$ -	$ -	$ 11,882.00	$ 11,882.00	$ 11,882.00	$ 11,882.00	$ 11,882.00	$ 11,882.00	$ 11,882.00	
arnings before Tax	**$ 78,088.00**	**$ 73,618.00**	**$ 68,410.00**	**$ 96,307.00**	**$ 74,620.00**	$ 128,855.36	$ 146,801.41	$ 166,929.14	$ 189,495.43	$ 213,289.06	$ 239,764.85	
ax Expense	$ 33,291.00	$ 27,989.00	$ 28,047.00	$ 38,860.00	$ 37,569.00	$ 51,542.14	$ 58,720.57	$ 66,771.66	$ 75,798.17	$ 85,315.62	$ 95,905.94	$ -
et Income	**$ 44,797.00**	**$ 45,629.00**	**$ 40,363.00**	**$ 57,447.00**	**$ 37,051.00**	**$ 77,313.22**	**$ 88,080.85**	**$ 100,157.49**	**$ 113,697.26**	**$ 127,973.44**	**$ 143,858.91**	**$ 7,296,199.6**

IPV	2,887,545,112	**Risk Free Rate**	0.05%
otal Stocks Outstanding	33,610,000	**Beta**	1.1
arget Price	86	**Market Risk Premium**	12.0%
ax Rate	40%	**Required Rate of Return**	13.3%
		Debt Interest Rate	2.2%
		Book Value of Debt	$ 540,000,000
		Market Value of Equity	$ 2,436,725,000
		WACC	11.25%

Working Capital Assumptions:											
linimum Cash Balance as % of Sales	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0
ays Sales Outstanding	100.0x	100.0x	100.0x	100.0x	100.0x	100.0x	100.0x	100.0x	100.0x	100.0x	100.
nventory Turnover (prod. cost/ending inv.)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/
ays Payable Outstanding (based on tot. op. exp.)	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x	12.

perating Projections	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Terminal Value
Vorking Capital												
ash	$ -	$ 44,290.60	$ 43,890.70	$ 48,466.30	$ 63,978.80	$ 70,376.68	$ 77,414.35	$ 85,155.78	$ 93,671.36	$ 102,357.75	$ 111,850.16	$ -
ccounts Receivable	$ -	121344.1096	$ 120,248.49	$ 132,784.38	$ 175,284.38	$ 192,812.82	$ 212,094.10	$ 233,303.51	$ 256,633.87	$ 280,432.20	$ 306,438.79	
nventory	$ -	$ -	$ -	$ -	$ -	$ -						
ccounts Payable	$ -	$ 5,718.90	$ 4,833.50	$ 5,121.17	$ 5,498.89	$ 7,356.69	$ 8,098.14	$ 8,907.95	$ 9,798.75	$ 10,778.62	$ 11,778.15	
et Working Capital	$ -	$ 159,915.81	$ 159,305.69	$ 176,129.51	$ 233,764.29	$ 255,832.81	$ 281,410.31	$ 309,551.34	$ 340,506.48	$ 372,011.33	$ 406,510.79	
ash Flow												
evenues	$ 558,352.00	$ 442,906.00	$ 438,907.00	$ 484,663.00	$ 639,788.00	$ 703,766.80	$ 774,143.48	$ 851,557.83	$ 936,713.61	$ 1,023,577.54	$ 1,118,501.58	
Operating Costs)	$ 476,626.00	$ 374,854.00	$ 373,637.00	$ 388,178.00	$ 555,120.00	$ 563,029.44	$ 615,460.07	$ 672,746.68	$ 735,336.18	$ 798,406.48	$ 866,854.72	
BIT	**$ 81,726.00**	**$ 68,052.00**	**$ 65,270.00**	**$ 96,485.00**	**$ 84,668.00**	**$ 140,737.36**	**$ 158,683.41**	**$ 178,811.14**	**$ 201,377.43**	**$ 225,171.06**	**$ 251,646.85**	
Taxes)	$ -	$ (27,989.00)	$ (28,047.00)	$ (38,860.00)	$ (37,569.00)	$ (51,542.14)	$ (58,720.57)	$ (66,771.66)	$ (75,798.17)	$ (85,315.62)	$ (95,905.94)	
et Income	**$ 44,797.00**	**$ 45,629.00**	**$ 40,363.00**	**$ 57,447.00**	**$ 37,051.00**	**$ 77,313.22**	**$ 88,080.85**	**$ 100,157.49**	**$ 113,697.26**	**$ 127,973.44**	**$ 143,858.91**	
dd Depreciation	$ 21,631.00	$ 22,991.00	$ 20,462.00	$ 16,928.00	$ 37,858.00	$ 42,226.01	$ 46,448.61	$ 51,093.47	$ 56,202.82	$ 61,414.65	$ 67,110.09	
ross Cash Flow	**$ 66,428.00**	**$ 68,620.00**	**$ 60,825.00**	**$ 74,375.00**	**$ 74,909.00**	**$ 119,539.22**	**$ 134,529.46**	**$ 151,250.96**	**$ 169,900.07**	**$ 189,388.09**	**$ 210,969.01**	
linus CAPEX	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	
hange in Net Working Capital	**$ -**	**$ (159,915.81)**	**$ 610.11**	**$ (16,823.82)**	**$ (57,634.78)**	**$ (22,068.52)**	**$ (25,577.50)**	**$ (28,141.03)**	**$ (30,955.13)**	**$ (31,504.85)**	**$ (34,499.46)**	
et Cash Flow	**$ 66,428.00**	**$ (91,295.81)**	**$ 61,435.11**	**$ 57,551.18**	**$ 17,274.22**	**$ 97,470.70**	**$ 108,951.95**	**$ 123,109.92**	**$ 138,944.94**	**$ 157,883.23**	**$ 176,469.55**	**$ 8,950,137.5**

iscount Rate:	11.25%
et Present Value (000s):	$2,887,545.11

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The webpage in question: http://orgs.comm.virginia.edu/mii/website/index.html?location=memos

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[1] http://smallbusiness.chron.com/success-rate-cold-calling-10031.html