



SCD EXCLUSIVE REPORT

10/23/18

RENOWORKS SOFTWARE

RW.V / ROWKF:PINK, \$.32 CAD

Shares Outstanding Basic/Diluted: 33.6M/36.8M

Paul Andreola

paul@smallcapdiscoveries.com

Brandon Mackie

brandon@smallcapdiscoveries.com

Investment Highlights

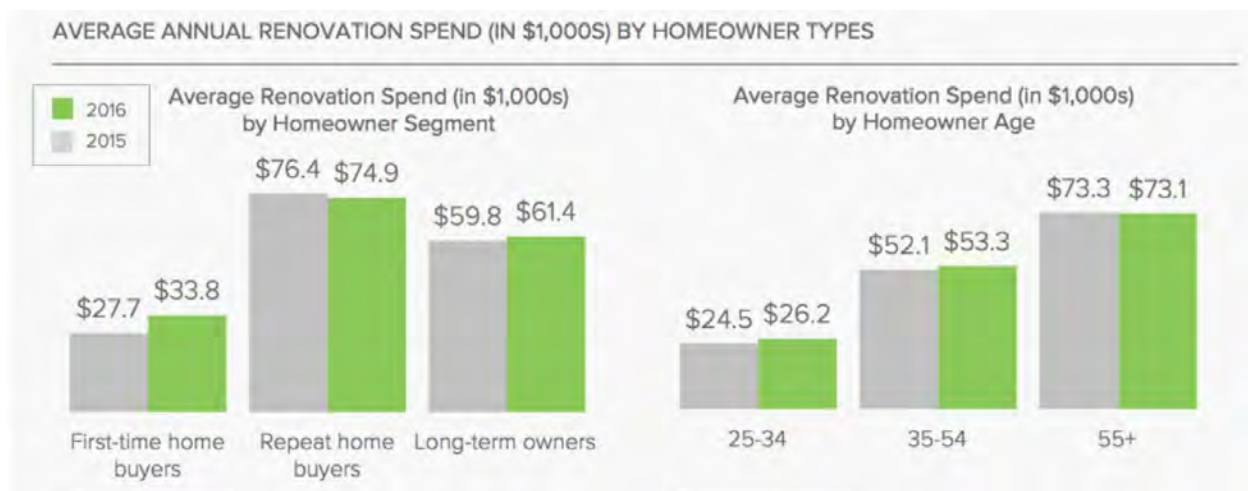
- High margin SAAS business
- Massive addressable market opportunity
- Unique software advantage with difficult to replicate assets
- Little direct competition
- Just hit profitability with business model torqued to drop additional revenues to the bottom-line
- Partnerships provide the groundwork for major disruption of the renovation market
- Recent announcement of Geomni/Verisk partnership has potential to drive large customer adoption/revenue stream
- Incentivized management team, 50% insider ownership

Introduction

Renovating your home is an expensive undertaking. Costs can run well into the tens of thousands of dollars.

A CIBC poll from 2017 reported an astounding 86% of Canadians expected their renovations to cost more than they planned for. More than 31% admitted to “blowing the budget” on a previous project.

A 2017 Houzz and Home Survey reported that the average renovation spend is between \$34,000 and \$75,000.

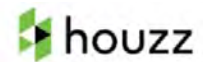


Most home renovations are done for appearances. According to the Renoworks 2018 Consumer Remodeling Survey, 60% of homeowners take on a project to make the home look better.

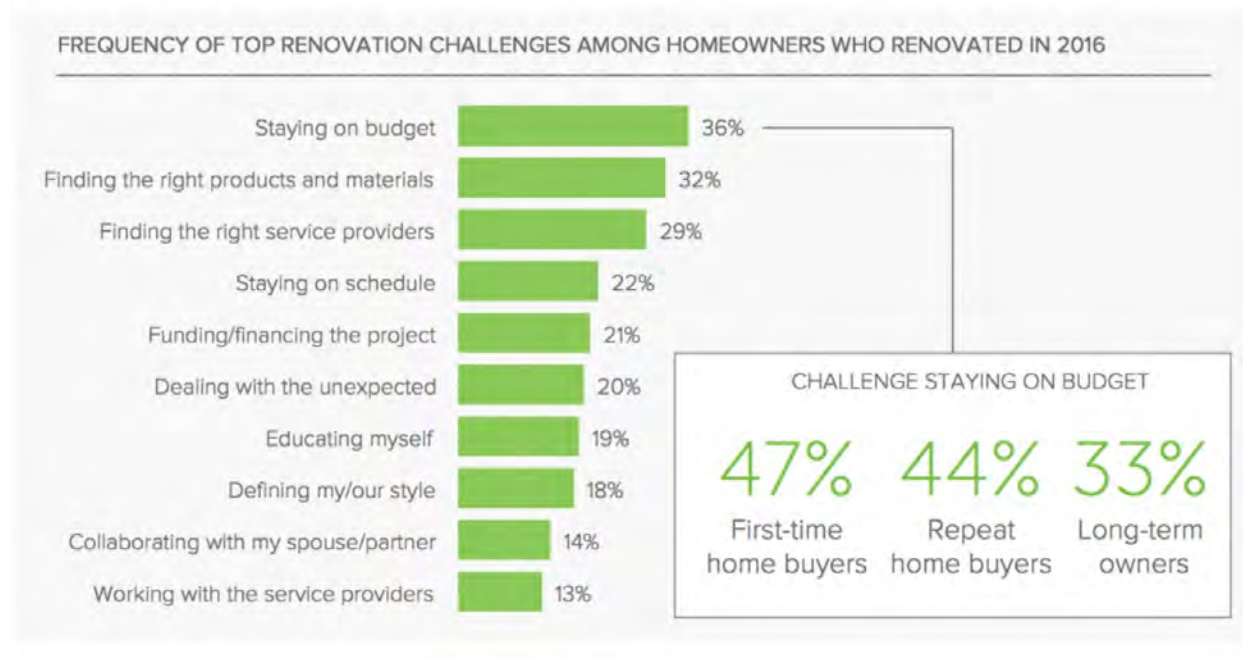
But imagining a new basement carpet or granite countertop is hard. You get a small sample of material and you guess.

No surprise then – the same Houzz and Home survey found choosing the right materials is the second biggest challenge homeowners face.

Learning the Ropes



Homeowners cite staying on budget, finding products, and finding service providers as top challenges during renovations. Budget management is a much greater challenge for recent home buyers than for long-term owners. First-time home buyers are 50% more likely than long-term owners to have difficulty staying on budget, and with nearly everything else (see Appendix C).



Enter Renoworks. Their mission is to make remodeling and home buying decisions easier.

The renovation value chain today is fragmented and slow. Consumers find contractors and suppliers from websites guided by reviews from strangers. Contractors must visit the home before they can deliver an estimate.

Design choices are guesses at best – made from Google searches results, catalogs, and pen and paper. Consumer must browse the web and brochures for hours to get good designs.

The renovation industry is archaic – and it's in need of a disruptor (think Uber or AirBnB). A disruptor that brings the whole process together under one roof to create efficiencies that now don't exist.

This is the Renoworks vision.

Visualization software is their starting point. It makes choosing easy for homeowners by letting them see what the finished product will look like before its done. Renoworks will now leverage their software to become the hub that connects the rest of the industry.

Business Overview

The Renoworks visualization software (called Web Visualizer) lets the homeowner preview product options on pictures of their own home (floor, cabinets, home exterior, etc). The software includes access to an extensive library of products from the largest manufacturers and distributors.

Let's briefly step through how it works.

First the contractor takes a picture of the area to be renovated. That picture is then uploaded. Next either the contractor or Renoworks performs a "masking" process to identify surfaces (what is roof, what is siding, trim, etc).

Once surfaces are identified, any product from 300+ manufacturers can be applied to the surfaces. You can specify angles, lighting and shadows to get as much realism as possible.

Look at the before and after pictures below:

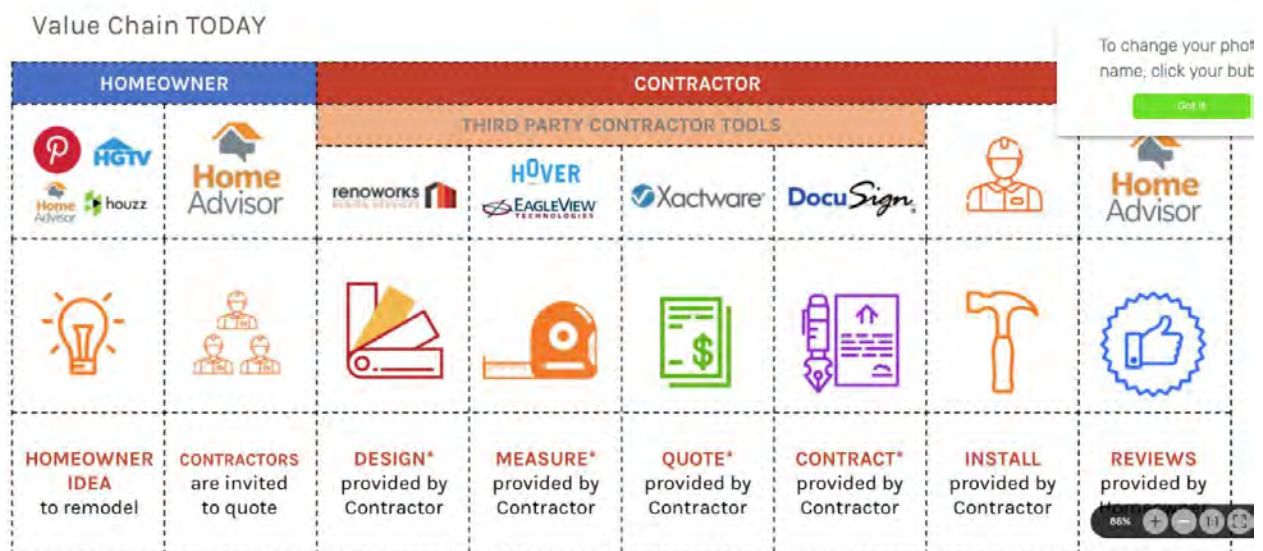


The “before” shot shows the house pre-reno. The visualization shot is the digitized photo after surfaces have been identified and product applied (in this case siding, stone, shutters, trim and shingles have been added). The after shows the house after the job is complete.

Customers

Renoworks' niche is at the design stage of the home renovating process. This is right in the middle of the value chain.

Their platform connects home product suppliers to purchasers. Not surprisingly, they offer products to both groups.



Their customers are contractors, building product manufacturers and home builders. Each of these end markets gets a targeted visualization product. In all cases it's the same visualizer that underlies the product suite.

Contractors

Renoworks offers an online version of their visualization app to contractors called Renoworks Pro. The app is accessible on desktop, tablet or smartphone.

The contractor takes a few pictures of the space and uploads them to the app. From there they can guide the client through design options.

Alternatively, they can use Renoworks design services. In this model the contractor sends photographs to Renoworks professionals who digitize for them.

The app offers many competitive advantages to contractors.

First, their client gets a clear visual of the end product. This limits conflicts in expectations.

Second, the contractor can easily guide the customer through many options, including those they may not have considered.

Contractors can use the app as a tool to maximize value delivered to customers. Contractors can also use the product library to show how additional renovations would look. A customer is more likely to expand the project scope if they see the positive impact on the space.

Manufacturers

Building product manufacturers are engaged by Renoworks in a few ways.

First Renoworks integrates their visualizer into the manufacturer's website.

Second, manufacturer's products are included in the Web Visualizer app provided to contractors. Contractors using the visualizer have access to the libraries, as do their clients.

It's like an online showroom for the manufacturer.

Third, manufacturers can use the software development kit (SDK) to automate the build out of their product catalog.

The SDK accesses the software via APIs and automatically populates product permutations. Some manufacturers have *millions* of variations on their products. The API makes building out this library automated and efficient.

Home Builders

Builders use the visualizer to show home buyers options available on countertops, windows, exterior options, and the like. The app is usually white-labeled and integrated into the builder's website.

The SDK kit was also developed with builders in mind. In the [initial press release](#) announcing the SDK kit, Renoworks said the kit led to the "adoption of its leading visualization platform with several top US Homebuilders."

Competition and Advantage

Home design and interior modeling software packages are common. They typically include "rendering" tools used to model out a space using blocks and lines. Some are 2-D, some 3-D.

There are also products that let you to see what other people have put in their homes. Houzz is a leader in this space. But these tools are limited because they don't let you see what a product would look like in *your* space.

Finally, there are tools that let you take pictures and convert them into floor plans for you.

Compared to these, the Renoworks Visualizer is unique.

The only direct competitor to Renoworks is US-based Chameleon. Chameleon has a similar visualization product that takes pictures, digitizes them and allows you to overlay colors and textures.

But what sets Renoworks apart from Chameleon – and really all other rendering tools – is the extensive library accumulated over decades.

We can't stress enough how key this library is to our investment thesis.

Renoworks has been building their library of digitized products for 18 years. They added an average of 30 manufacturers *per year* over the last 3 years. And they now have 300+ manufacturing partners with literally millions of product combinations.

This is *extremely* important to a homeowner. Having a full suite of materials they can visualize and compare lets them sleep well at night.

Industry Overview

Americans will spend more than \$340 billion on remodeling in 2018. In Canada that number is expected to hit \$75 billion.

The average homeowner spends \$11,000 on home improvements. But there's a wide variance – lots of little jobs (like painting) and a few bigger jobs.

There are over 5,000 manufacturers across North America so the opportunity remains large. Renoworks has also made progress overseas, recently signing on manufacturers in Europe and Australia.

The challenge here is industry fragmentation – both on the contractor and end-user side.

The Renoworks Vision

We've already talked about where Renoworks fits into the value chain today. Now let's look ahead at where they might evolve to in the future.

Their long-term vision is industry consolidation and disruption. Rather than have different companies responsible for design, measurement, listings, quoting and signing contracts, why not have them all under one roof?



Recent partnerships with Zillow (ZG:NASDAQ) and One Click Contractor are evidence the evolution is happening. Renoworks also took another big step in this direction with their recently announced partnership with Geomni.

Geomni is owned by Verisk (VRSK:NASDAQ), a \$20 billion public company. They have a unique and powerful dataset – roof and building data acquired from drone flyovers for over 90% of homes in the United States. Renoworks can now use this data to create a visualization of each property.

Renoworks will integrate Geomni’s measurement technology and data onto their platform through this partnership. Now Renoworks can recreate homes without having to visit the residence.

Manufacturers and contractors can also now recreate a home profile and populate it with product options without ever having to step foot on the property. This is BIG.

Renoworks suggested to us that they could provide reports to these clients for \$150. This is a *great* value for homeowners.

They gave us the example of siding company James Hardie, which could now download a visualization report for the home of any customer, complete with their products.

Renoworks also gains access to Geomni’s massive client base. Geomni has a foothold in the insurance, architecture, emergency response, and urban planning industries.

Geomni is especially strong in insurance – imagine an adjuster using Renoworks’ visualization to complete a hail damage claim without ever having to step foot on the property. We’re talking

hundreds of millions of savings per year.

Renoworks wants to facilitate *every* piece of the renovation valuation chain. It's a lofty goal but you can see how partnerships with Zillow, OCC and Geomni are getting them closer.

We see the industry disruption potential as a wild card. We like the business they have right now. They've hinted they can evolve that business into something much bigger. And that's where this story can become a real home run.

Let's look at that opportunity next.

Revenue and Growth

Renoworks breaks up their business into 5 segments: Licensing, hosting, implementation fees, maintenance and design services.

Licensing, hosting and maintenance revenue capture recurring visualization software revenues. This includes licensing of the white label app for builders/manufacturers or access to the Renoworks Pro app for contractors (the average fee is \$80/month).

Recurring revenue has been about 50% of revenue historically, though this percentage has declined recently as the design services business has grown.

Design service revenues are generated from contractors who don't have the time to prepare a list of project options for their customers. Renoworks has design service professionals that create design reports displaying options for the renovation. These reports sell for \$50-\$100.

While this isn't strictly "recurring" revenue, we can assume contractors will continue to order reports as they move from job to job.

Renoworks also generates implementation revenues from builders and manufacturers when they build out their product libraries. This is the only revenue stream that is one-time in nature.

Of the 5 businesses, design services has shown the most growth recently:

RW - Segment Revenue	Q2 18	Q1 18	Q4 17	Q3 17	Q2 17	Q1 17
Licensing	\$ 358,218	\$ 314,946	\$ 311,984	\$ 306,492	\$ 319,207	\$ 310,174
Hosting	\$ 83,769	\$ 82,772	\$ 83,133	\$ 90,099	\$ 95,860	\$ 96,936
Implementation fees	\$ 262,620	\$ 143,078	\$ 297,040	\$ 159,419	\$ 177,495	\$ 204,843
Maintenance	\$ 5,856	\$ 5,921	\$ 5,982	\$ 16,375	\$ 16,425	\$ 16,409
Design Services Revenue	\$ 336,703	\$ 226,014	\$ 151,367	\$ 158,395	\$ 207,208	\$ 76,786
Recurring Revenue	\$ 450,712	\$ 401,820	\$ 374,622	\$ 414,284	\$ 430,900	\$ 449,530

Financials

RW - Quarterly Financials	Q2 18	Q1 18	Q4 17	Q3 17	Q2 17	Q1 17
Revenue	\$ 1,048,167	\$ 772,731	\$ 752,566	\$ 800,356	\$ 818,951	\$ 702,391
(-) COGS	\$ 278,011	\$ 255,290	\$ 285,530	\$ 215,561	\$ 227,191	\$ 187,968
Gross Profit	\$ 770,156	\$ 517,441	\$ 467,036	\$ 584,795	\$ 591,760	\$ 514,423
(-) OPEX	\$ 758,863	\$ 825,447	\$ 767,779	\$ 800,392	\$ 742,648	\$ 636,964
Operating Income	\$ 11,293	\$ (308,006)	\$ (300,743)	\$ (215,597)	\$ (150,888)	\$ (122,541)
Key Metrics						
Revenue Growth y/y	28%	10%	4%	10%	21%	6%
Gross Margin	73%	67%	62%	73%	72%	73%

Renoworks just turned profitable again. They spent the last few years investing in their business, building out their product library and refreshing the application.

The operating profit they generated last quarter was a bit of a break out. We finally saw the impact of stellar growth in Design Services.

Design Services has been growing steady since its inception early last year. But until last quarter, revenue gains were too small to impact the financial statements much.

Design Services are not technically “recurring” – but should grow nicely as contractors move jobs and new ones come on board.

Licensing revenue also saw a sequential jump of 10% in the second quarter.

The other bump in the second quarter came from implementation fees. Higher implementation fees are good – it likely means more clients – but it’s also a lumpy revenue stream.

Renoworks is showing they can leverage operating expenses with rising revenues. While revenue increased 20% year-over-year, operating expenses remained flat. This is a great sign in our experience.

Renoworks is a high margin business. If they can manage operating expenses, we should see a lot of torque as Renoworks crosses the line of profitability. We’re confident this leverage will allow a good portion of RW’s future revenue growth to fall to the bottom line.

Valuation

Here’s a summary of Renowork’s capital structure and valuation metrics:

Renoworks Metrics		
Price	\$	0.32
Shares Outstanding		33,662,000
Options		3,142,000
FD Shares		36,804,000
Market Cap (\$M)	\$	10.8
(+) Debt	\$	0.1
(-) Cash	\$	0.4
EV	\$	10.5
EV/Sales		3.2
EV/EBITDA		NA
P/E		NA

Gross margins are around 70% (they were 73% last quarter). Paying 3.2x sales for a SAAS business with 70% gross margins is not particularly expensive.

SAAS businesses with strong recurring revenue often trade at 7-8x sales. But to get that kind of multiple you need to show growth.

Renowork's business has not grown much over the last few years. They've also not been profitable for some time. This is likely why shares remains discounted.

But it looks like years of investment are finally paying off. If Renoworks can build on second quarter results with more growth and profitability – shares could soon look *really* cheap.

Risks

- **Growth.** Design services is growing but the rest of the business has been flat. We're counting on growth from recent released partnerships to aid core business growth.
- **Lumpy.** About 25% of revenue comes from the Implementation segment. This is a lumpy revenue stream (last 3 quarters were: \$297k, \$143k, \$262k). It can make the financials of any given quarter look quite good or quite bad.

- **Obsolescence.** Software requires constant updating and renewal to succeed. This means continued investment.
- **Cash.** Renoworks has just \$400,000 on hand, which means they can't ramp expenses to chase growth just yet. They also have little breathing room to manage hiccups (like say a significant client loss).
- **Size.** Renoworks is the classic small fish in a big pool situation. This is good and bad – on one hand they have a big market opportunity. But on the other hand, they need to engage larger customers that don't always embrace change.
- **Fragmented market.** The contractor market faces is an extremely segmented industry. Renoworks has to chip away at the leaders and count on word of mouth marketing to bring in clients.

Management / Insiders

Renoworks was founded in 2002 by Greg Martineau, an industry veteran with 30 years of home remodeling experience. Greg became Chairman and hired longtime friend Doug Vickerson as CEO in 2008. Martineau holds a significant position in the company with 3.9 million shares.

Doug was previously Vice President of Selling and Marketing at Guest-Tek Interactive and leads the sales efforts at Renoworks as CEO. Vickerson owns 2.8 million shares and has another 550,000 options.

Rounding out the board are Nairn Nerland and Bob Schultz. Nairn Nerland is a technology veteran who served on the executive team alongside Bill Gates at the Corbis Corporation. Nairn tells us his monthly 1-on-1's with Bill were some of the most nerve-racking experiences he can remember. Nairn and Schultz are the largest stockholders in the company, with 5.2 million and 3.7 million shares respectively.

Overall the insider ownership is significant at 16.1 million shares owned (almost 50% of shares outstanding). The team is well aligned with shareholders.

The Bottom Line

Renoworks has high-insider ownership, a high margin SAAS business and is starting to show growth after years of fits and starts.

They've crossed into profitability. And further revenue growth should add positively to the bottom line. Once profits expand, the market will be forced to take notice.

This is our “long-game” thesis: expand profitability through license wins and design services growth.

But the best part is you get a massive lottery ticket if a few things go right.

Renoworks has partnerships with the biggest players in the space – Zillow, One Click Contractor and Geomni/Verisk. They landed all these partnerships because of their unique and hard to replicate product library assets.

If Renoworks can properly monetize these assets – and disrupt the home renovation value chain along the way – shares could be worth multiples of where they are today.

Disclosure: Paul, Brandon, and Keith are long RW.V