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RESEARCH

MATTERSIGHT (MATR \$3.40)

TRAPPED IN DEADLY SUCCESS

KRIS TUTTLE - NOVEMBER 7, 2016

We've been following Mattersight (NASDAQ: MATR) for years now. The company positioning in "personality based routing" very much intrigued us. As did their IP, proprietary data and high gross margins.

Yet the shares have done nothing but go down as shown in the chart below. Mattersight has been successful with some very large customers and spent most of their time getting "new logos" in their sales pipeline. Unfortunately, customers are either unwilling or unable to deploy the "high ROI solution" quickly. It's a sad story of customers who have ended up in control of the timing of any bookings or revenues that the company can recognize. This has been an ongoing struggle for the company but they have been unable to come up with a solution.



Management has not been able to change their sales process to focus on business that can be won and recognized more efficiently. Instead, they "close" on business that can't be booked because the customer has complicated deployments to do first and/or needs to hire "thousands of people."

In this arena "success" and "new logos" don't drive growth and profits for investors. It does make the company an attractive M&A prospect though. Instead of looking for a "CFO hire that can move the stock price up" the team should hire bankers to get the best deal from the more established companies – here's why:

- 1) Customer support is business critical and the ability to route customers more effectively in call centers, online support or even chat bots is important and offers high ROI.
- 2) Integration is a challenge though, especially when myriad channels are involved which is now most often the case. Larger companies like Cisco, Avaya and NICE can handle these situations.
- 3) While rich in IP and customers, Mattersight is too small in terms of revenue and market presence to attract high quality talent or system integration firms. This is now mostly true with investors as well.
- 4) The Mattersight business model, despite having high gross margins, is capital intensive. That makes it a poor fit for a small company with cheap equity and limited access to financing.
- 5) In the hands of a large technology company or systems integration firm, the Mattersight software and IP would generate significant revenue and differentiation.

Although there is no way out of this pickle for Mattersight, they can still have some leverage in the M&A process thanks to their IP position and customer relationships. The longer they wait though, the worse it might get given their ongoing losses.

Who should buy MATR? The list is long considering that it might be service companies like Accenture as well as technology vendors like Cisco (NASDAQ: CSCO) and NICE Systems (NASDAQ: NICE). Private equity companies (TPG and Silver Lake) purchased Avaya but are now looking to sell it, or pieces of it, to reduce debt and make it more "nimble."

There are other angles here. We could imagine a more modern company like ServiceNow (NYSE: NOW) or even Zendesk (NYSE: ZEN) taking a serious look. Because Mattersight also has built up a proprietary database, they are more attractive and they might also appeal to a broader, more data-oriented buyer as well.

Of the group, NICE makes the most sense to us although they did just buy inContact (SAAS) for \$940M. From a valuation standpoint, the deal was done at just over 3x run-rate revenue. If we apply the same to MATR we get a \$120M price or about \$4.80/share. Not enough to pop champagne but the best option at this point.

M&A bankers start your engines!

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<sup>1</sup> Bloomberg, Thomson/Reuters/FirstCall, S&P Capital IQ and FactSet.