Five9 (Nasdaq:FIVN) Deserves a High Five

EXECUTIVE SUMMARY

Snapshot	
Rating	BUY
Share price (05/14/2018)	$30.31
Target price (NTM)	$40 - $43
52-week price range	$19.53 - 34.23

Q1 2018 Financial Results Crush Analyst Estimates

On May 1 Five9 Inc. ("the Company") reported their financial results for Q1 2018. Results crushed Wall Street expectations, and the share price closed the following trading day up 8%.

- Revenue: $58.9M vs estimates of $54.5-55.5M (+6.9% surprise)
- LTM enterprise SaaS revenue growth: 38% YoY
- EBITDA: $7.5M vs estimates of $3.9-5.5M (+56.3% surprise)
- Net income: -$0.6M vs estimates of -$4.3-3.5M (+84.3% surprise)
- Free Cash Flow: $7.6M vs estimates of -$0.2-3.4M (+343.6% surprise)

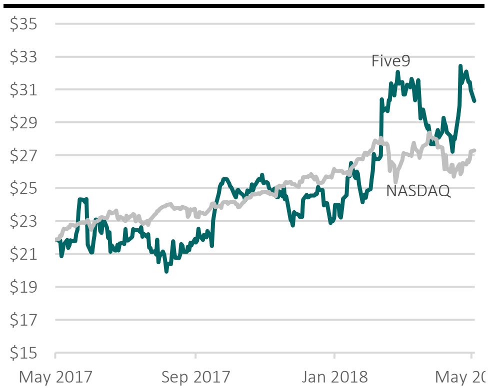
The Company also announced that Rowan Trollope, former SVP of Cisco's Collaboration Technology Group, will be assuming the CEO role, replacing Mike Burkland. Rowan is often regarded as one of the Silicon Valley's top executives, credited with overhauling Cisco's Collaboration business unit into a cloud model and driving double-digit growth.

Guidance & Outlook for 2018

We hold a bullish stance on Five9's performance over the next two years. Driven by its position as a market leader and extensive channel partner network, Five9 is well positioned as the incumbent provider to replace legacy on-premise systems as the industry shifts to the cloud.

It is highly probable that Five9 will double in size over the next three years, and shares today do not fully reflect this potential growth trajectory. Our investment thesis for Five9 is rooted in our estimated growth projections, as well as the slight undervaluation it is currently receiving. For FY2018 we have forecasted revenues of $251M and EBITDA of $13M, and a target EV/LTM valuation of around 9x.

Share Price Performance



NASDAQ Index performance is shown relative to FIVN

Financial Summary
(in millions of USD, shares in '000s)

	FY2016	FY2017	LTM	FY2018E	FY2019E	FY2020E
Revenue	162,090	200,225	212,116	251,126	316,419	401,852
EBITDA	1,848	2,594	7,111	22,842	34,806	44,204
Net Income	(11,860)	(8,969)	(4,321)	13,085	23,666	29,972
FCFF	5,707	8,456	16,380	30,556	42,225	56,132
Net Debt	(12,323)	(22,205)	(33,438)	(52,761)	(94,986)	(152,223)
EPS	$(0.23)	$(0.16)	$(0.07)	$0.24	$0.39	$0.47
Basic Shares Out.	52,342	54,946	56,339	58,150	60,366	64,126
EV/LTM Revenue	4.6x	6.8x	7.9x	8.7x	9.5x	10x
EV/FCFF	130.6x	161.0x	102.3x	71.2x	71.2x	71.6x

BUSINESS AND MARKET OVERVIEW

Business Overview

Five9 is a market-leading provider of cloud-based contact center software. The Company was founded in 2001 and raised nearly $200M in private funding before going public in April 2014. The primary product, Virtual Cloud Center (VCC), covers inbound, outbound, blended and omni-channel contact center solutions for sales & marketing and service & support teams. Five9 also provides out-of-the-box integrations with leading CRM platforms like Salesforce, Oracle, Zendesk and MS Dynamics. The Company's software is currently supporting 2,000+ customers, and managing 3 billion+ customer interactions a year. Customers include BlueCross BlueShield, Siemens, Expedia, DoorDash, Citrix, Quicken Loans and Fitbit.

Gartner's Magic Quadrant for Contact Center as a Service, North America

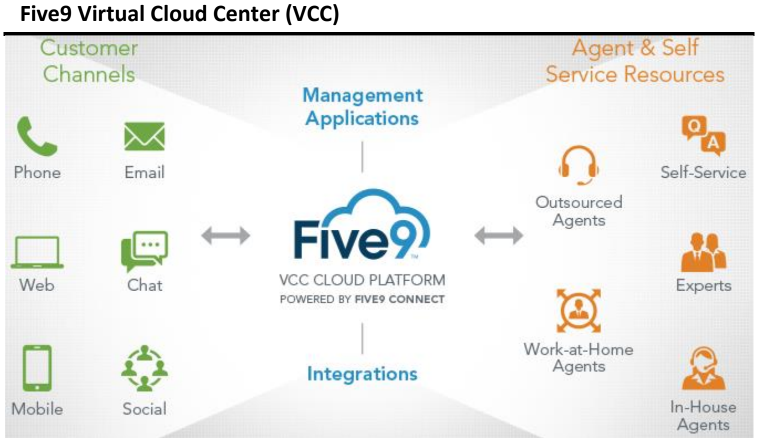
2017 Notable Awards

- Identified as a Leader, with the highest ability to execute, in Gartner's Magic Quadrant for Contact Center as a Service for the third year in a row
- CEO Mike Burkland awarded Ernst & Young's 2017 Entrepreneur of the Year in Northern California

Key Offerings

- Automatic Call Distribution (ACD) – intelligently routes incoming calls to the correct agents
- Interactive Voice Response (IVR) – incoming calls and routine operations handled through a virtual agent with voice recognition
- Computer Telephony Integration (CTI) – brings a caller's history onto the agent's screen to enable personalized interactions
- Omni-channel solutions – supports requests through phone, emails, chat, social media, mobile and web
- Outbound call solutions – designed for outbound calling teams
- Real time analytics and reporting capabilities
- Workforce management (WFM) – in partnership with third-party providers to manage human capital scaling
- Global Voice – leverages international public clouds to support global deployments

Five9 Virtual Cloud Center (VCC)



The Contact Center Landscape

Investors often categorize Five9 in the enterprise telecommunications market and compare it to companies like Mitel and RingCentral. Unfortunately, this is too broad a generalization that dilutes the value Five9 brings to the table. In fact, the space should be considered as three distinct segments – Private Branch Exchange (PBX), Unified Communications (UC) and Contact Center (CC).

- PBX can be thought of as an enterprise's internal phone system. Employees leverage the PBX platform to answer and transfer calls through local lines or VoIP without affect incoming external calls. The hosted PBX market is expected to grow at 15% CAGR to reach $10B by 2023. Companies in this space include Nortel, Vonage, Nextiva and RingCentral.

- UC is an adjacent piece that refers to the integration of communication channels within an enterprise. These channels might include chat, VoIP, SMS, video conferencing, etc. The UC market is expected to grow at 13% CAGR to reach $74B by 2024. Companies in this space include Skype for Business, ShorTel, Avaya, 8x8 and Mitel.

- CC is a separate segment that specifically covers contact center management. Contact centers often must work in conjunction with an enterprise's IT telecommunication systems, like PBX and UC, but it is incorrect to say they are the same. In most companies, budgets for PBX and UC come through different business units than for CC. Companies in this space include Genesys, Avaya, Aspect and Five9.

Most providers like Cisco, Avaya and BroadSoft provide a combination of offerings which can create confusion as to how the lines in the market should be drawn. Over the past few years though, CC has begun diverging from other IT telecommunication systems. Corporate strategies are now focused on the 'customer journey' and questions have changed from, "how do we cut costs in customer service" to, "how do we enhance the overall customer experience." The contact center is now viewed as a fundamental touchpoint in the customer engagement process, and less as a feature of internal IT telecommunications.

Contact Centers Transition to the Cloud

In the past, the CC market was largely dominated by a handful of on-premise IT telecommunications providers like Avaya, Cisco and Nortel; but, because of the rapid transition to the cloud and new emphasis placed on the customer experience, this landscape has been completely altered. Nortel went out of business, Aspect filed for bankruptcy, Avaya also filed for bankruptcy and Mitel was taken private by private equity groups.

Cloud solutions, in general, offer a host of benefits versus on-premise solutions including lower up-front costs, faster deployment, flexibility and scalability. Five9's cloud VCC also provides seamless integrations into the industry's leading CRM platforms which is a key differentiator for companies reevaluating their CC setups.

A company is more likely to select a CC solution that is on-demand and can integrate with their current Salesforce platform versus one that cannot.

Although the majority of the market is still held by legacy providers, namely Avaya, these companies are having a difficulty bringing a viable cloud solution to market, and customer numbers continue to dwindle. The cloud CC market is expected to grow at 25% CAGR to reach $20B+ by 2022, and Five9's management team believes cloud penetration to-date has only reached 15%. This opportunity to transition the on-premise market to cloud is massive. Being the last standalone provider in the space, Five9 is well positioned to dominate this market.

The Last Standalone Cloud Contact Center Provider

Aside from startups and SMB market players, Five9 is the last standalone pure-cloud CC provider. The Company's two main competitors were both acquired in 2016. Interactive Intelligence was acquired by Genesys in what was largely seen as a cloud consolidation move, and inContact was acquired by NICE Systems in an effort to provide a cloud offering.

Notable Deal Activity in the Contact Center Space
($ in millions of USD)

Date	Type	Target	Buyer	Est Revenue ($)	Transaction Size ($)	Implied EV ($)	EV/ Revenue
4/24/2018	M&A	Mitel Networks	Searchlight Capital	1,149.8	2,000.0	2,000.0	1.7x
2/2/2018	M&A	Broadsoft	Cisco	361.9	1,900.0	1,528.9	4.2z
1/29/2018	M&A	Spoken	Avaya	-	-	-	-
12/18/2017	IPO	Avaya	-	2,000.0		1,779.5	0.5x
1/19/2017	Bankruptcy	Avaya	-	2,200.0	-	-	-
12/1/2016	M&A	Interactive Intelligence	Genesys	426.2	1,400.0	1,241.0	2.9x
9/19/2016	M&A	Calabrio	KKR	-	200.0	200.0	-
5/18/2016	M&A	inContact	NICE	542.7	940.0	860.8	3.4x
3/9/2016	Bankruptcy	Aspect	-	400.0	-	-	-

Strategically Leveraging Partnerships

Five9 has developed strategic partnerships with leading CRMs, service providers and independent software vendors (ISV) in the space. The Company has nurtured a deep partnership with Salesforce in particular. The two companies often use a combined go-to-market strategy which has helped solidify Five9's position as a premier Salesforce-compatible solution. As Salesforce transitions its client base from Classic to Lightning, we expect this to help spark contact center reevaluations and result in more business for Five9. Five9 also leverages its ISV partner network to provide complementary software offerings like WFM, collaboration tools, PBX and more.

The extensive partner network has been a key driver for Five9's success over the years. Last quarter, over half of the deals booked were influenced through partners.

CEO Rowan Trollope at the Helm

As of December 2, 2017 Mike Burkland resigned from the CEO role, although he remains with the team as Executive Chairman of the Board of Directors. The Company announced on its latest earnings call that Rowan Trollope would be stepping into the CEO role effective May 3, 2018. Rowan is coming from Cisco's executive leadership team, where he led the $5B Application group, led the Collaboration group, ran the APM division after their $3.7B acquisition of AppDynamics and oversaw the development of the Spark product.

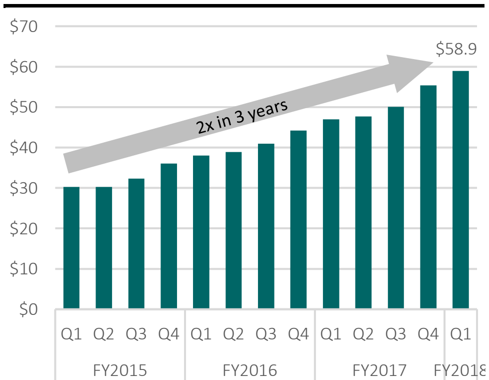
We have full confidence in Rowan's ability to take Five9 to the next level in terms of both market expansion and technology innovation. We will be especially interested in hearing his perspective on international expansion and AI product development.

Focus on Growth

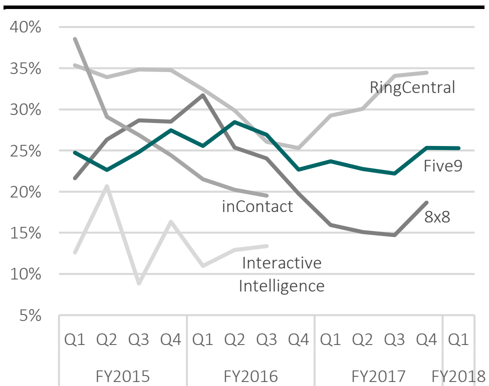
Five9 has strategically positioned itself as part of the broader cloud customer experience offering, and integrated its applications with the top CRMs. This makes the company an attractive target for acquisition from the perspectives of legacy systems providers, cloud application providers moving into the customer engagement space, and cloud CRM providers.

Management had previously stated that a sale to a strategic buyer would make sense after the company grew into the $400-500M revenue range. This would have implied an exit within the next 3-4 years at current growth rates. Recently though, management's sentiment seems to have shifted away from M&A as an end goal, and more towards growth. Especially with a new CEO in place, we think plans for a near-term acquisition may be on the backburner.

Quarterly Revenues
($ in millions of USD)



YoY Revenue Growth



FINANCIAL OVERVIEW

Revenues Continue to Grow Quarter-over-Quarter, Year-over-Year

Since going public in 2014, Five9 has grown its top line every single quarter except once in Q2 2015 when revenues were flat. Last quarter the company reported $58.9M in revenue, bringing LTM revenue to $212.1M with a 98% dollar-based retention rate.

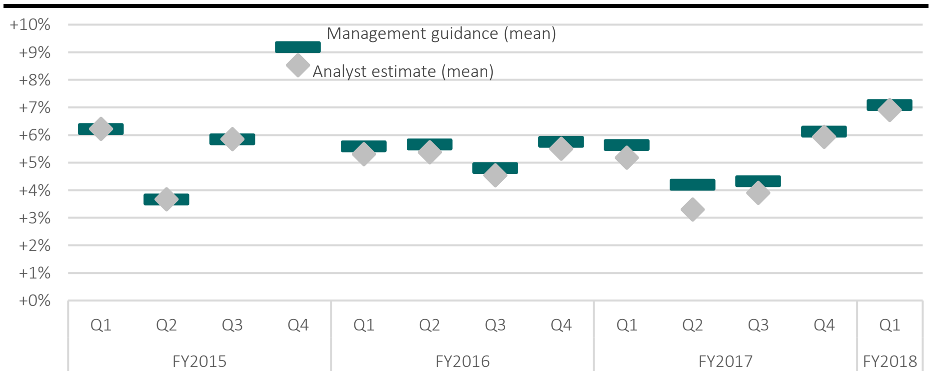
The Company grew at 25% CAGR and nearly doubled its revenues within the last three years. In comparison, Interactive Intelligence and inContact, prior to their acquisitions, were only growing at 20% and 13% respectively. Taking into account Five9's track record of growth, its current market leadership advantage and a large addressable market, it is not unlikely that Five9 will double in size again over the next three years.

Looking into the adjacent UC segment, RingCentral's growth rate has sharply increased over the last year returning to 35%. We see this to be a strong indicator of cloud transformation in the space, and a good sign for Five9's future growth potential.

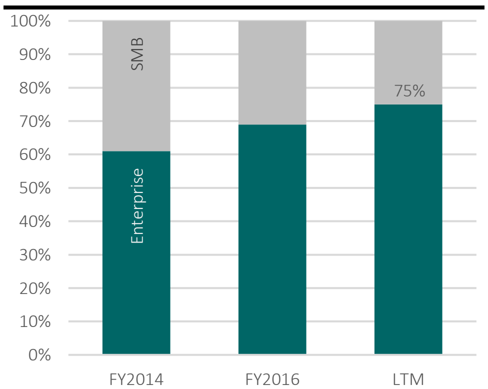
Results Outperform Guidance Every Single Quarter

Five9 has consistently beat their own quarterly revenue guidance and analyst expectations over the past three years. Management's revenue guidance for Q2 2018 is between $56.0-56.8M which equates to 17-19% YoY growth. While it is true that quarters have historically been slow due to seasonality, with accelerated growth coming in the 3rd and 4th quarters, we are fairly confident that the guidance range provided is on the conservative side and thus expecting another quarter of modest outperformance in Q2 2018.

Revenue Outperformance vs Guidance and Estimates

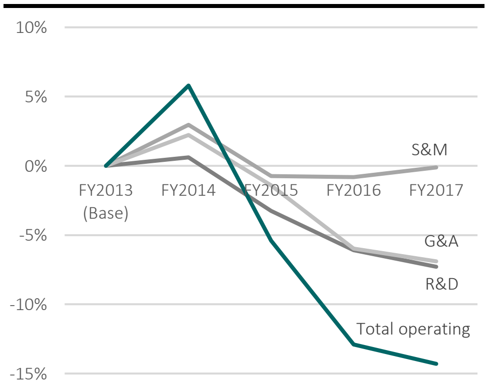


Enterprise vs SMB Revenue



Expenses as a % of Revenue

Using FY2013 as a base comparison year



Enterprise SaaS Growth is Taking Off

Five9 initially began as an SMB-centric solution, but is rapidly shifting into the large enterprise space. Enterprise revenues currently represent 75% of total revenues.

- LTM enterprise SaaS revenue grew 38% YoY
- Average deal size grew from $560K in FY2016 to $640K in FY2017
- Closed three $1M+ enterprise deals in Q1 2018, replacing legacy Cisco and Avaya systems

This shift is one of the most attractive things about the Company. Larger deployments mean larger revenues, easier opportunities for upsells and a higher degree of operating leverage.

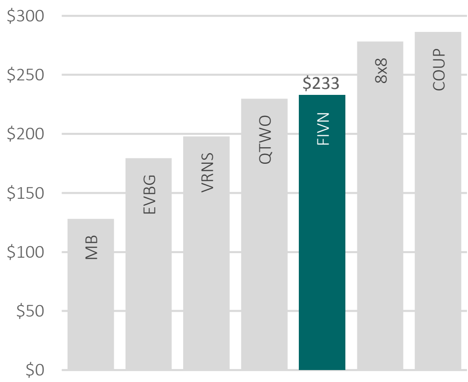
Last year Five9 released Global Voice, a solution that allows clients with an international presence to leverage regional public clouds as a point-of-presence (POP). Calls are handled between the caller and a local POP as opposed to a distant Five9 data center. This helps maintain low latency and high call quality. This technology is likely to help drive business with larger multinational enterprises over the upcoming years.

Revenues Will Increasingly Flow Through to the Bottom Line

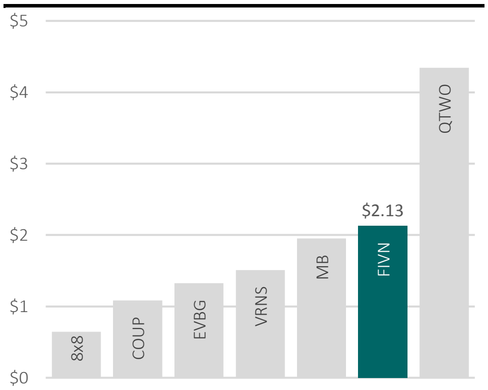
The larger deals, $160M asset base and 860 employees are allowing Five9 to begin realizing economies of scale. The Company is now able to provide the same level of service at a relatively fixed level of overhead. The gross margin has improved by 470 basis points over the last two years, and total operating expenses as a percentage of revenue have dropped by 880 basis points over the same period. The only expense that needs to scale in-line with growth is, understandably, sales & marketing.

The changing composition of revenue is also important to note. Five9 currently resells connection usage minutes to its SMB clients at little to no margin. Large enterprises,

FY2017 Revenue/Employee vs Comps
($ in '000s of USD)



FY2017 New Revenue Generated per Incremental $ of S&M+G&A Spent vs Comps



on the other hand, tend to purchase these minutes through their own telecomm platform providers and not Five9. This is creating a shift in SaaS versus usage revenue of about 2-3% a year. We believe this has the potential to add a marginal improvement to the gross margin over time.

Operating Metrics	FY2014	FY2015	FY2016	FY2017	LTM
Operating Leverage	*-1.1*	*1.6*	*2.7*	*0.5*	*2.5*
Return on Total Assets	*-30.4%*	*-21.3%*	*-6.2%*	*-4.5%*	*-2.1%*
Return on Assets	*-32.2%*	*-26.0%*	*-11.3%*	*-7.0%*	*-4.2%*
OCF/Assets	*-21.0%*	*-13.0%*	*6.0%*	*9.0%*	*11.4%*
OCF/Revenue	*-23.5%*	*-10.0%*	*4.2%*	*5.5%*	*8.9%*

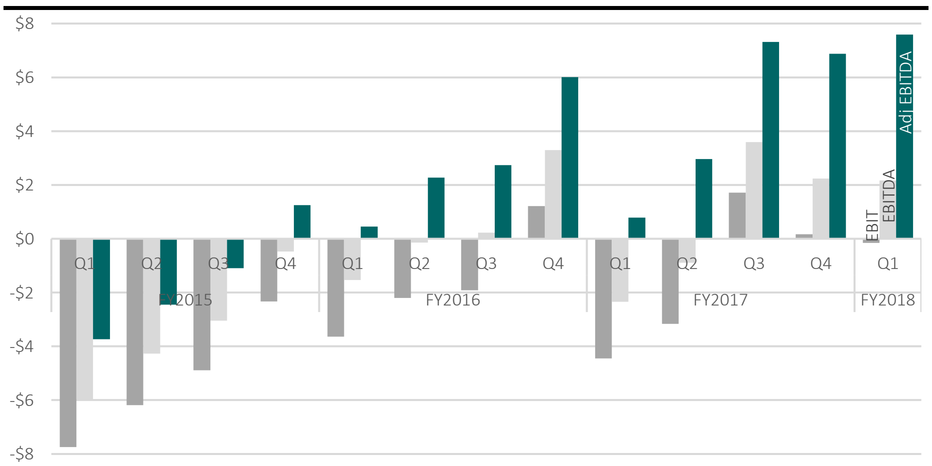
In summary, every new large enterprise customer signed will result in an incremental boost to margins, and we expect higher operating leverage to help magnify returns.

Sustainable Profitability → Even More Growth

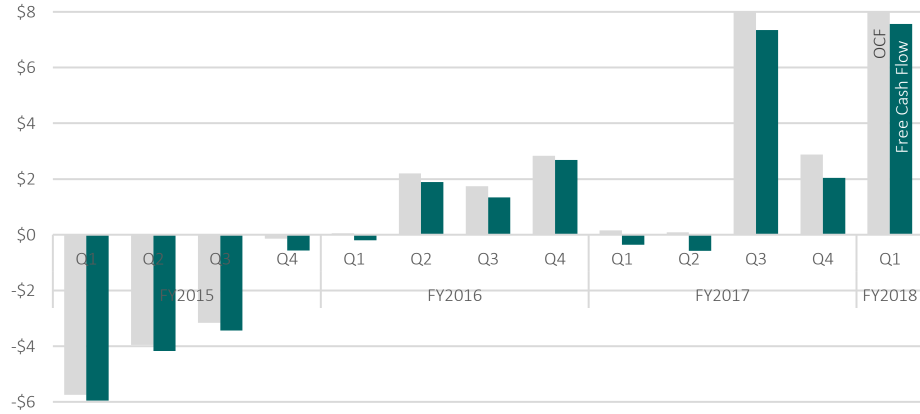
On an adjusted EBITDA basis, Five9 has been profitable since Q4 2015; however, this could be attributed towards the generous usage of stock-based compensation over the last two years. Regardless, we still see both unadjusted EBIT and EBITDA margins turning positive in the 2nd half of 2016, as well as three straight quarters of positive EBITDA since Q3 2017.

Most importantly, cash flows are now sustainably positive. As the company reduces its line of credit, this growing cash flow along with the $60M in cash on the balance sheet, will help keep the door open for investments in new technologies, ramping up the sales team or even tuck-in acquisitions.

EBIT, EBITDA, Adj EBITDA
($ in millions of USD)



OCF, FCF
($ in millions of USD)



A Slightly Undervalued Opportunity

For valuation purposes, we compared Five9 against a sample of comparable cloud enterprise software companies ("Comps"). These companies are similar in size, $1-11B in enterprise value, and growth rate, 20-40% LTM revenue growth.

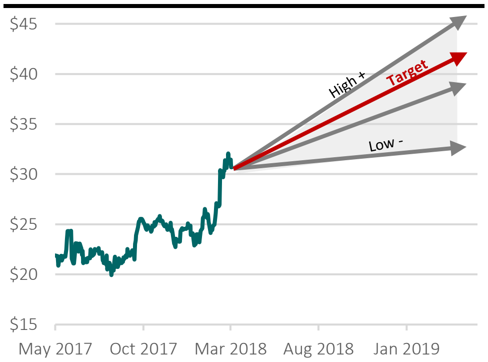
On the face, Five9 is fairly valued given its historical operating metrics, but we feel there are a number of factors that will drive an increase in the valuation over time, that have yet to be fully factored into the valuation.

First, Five9 is a market leader in its space. In Q1 2018 the company won deals against their top competitors 75% of the time. As the transition to cloud continues to disrupt the market, Five9 is well positioned as the incumbent to replace these legacy on-premise systems. We do not believe an appropriate leadership premium has been factored in to the current valuation. This may be because the company is viewed as still in the early stages of entering the large enterprise space, where the bulk of the market remains, but we have difficulty identifying competitive solutions that could pose a real threat. Five9 is leading the market today, and as it capitalizes on that position, we expect a significant leadership premium to arise.

Secondly, Five9 is growing its enterprise SaaS business at 38%. This, along with the size of these deals, is an underappreciated metric. 38% growth is extremely high, and is a good representation of the speed at which Five9 is actually winning market share. This revenue stream also improves the operating leverage and overall financial profile of the Company. We believe this metric to be a more accurate representation of the company's true growth rate versus the 25% overall.

Finally, we expect the operating leverage to increase dramatically. Cloud software companies are typically valued off growth, but one that is growing and profitable is even better. Cash flows are already positive, and this capital can be used to either buyback shares or invest in new opportunities.

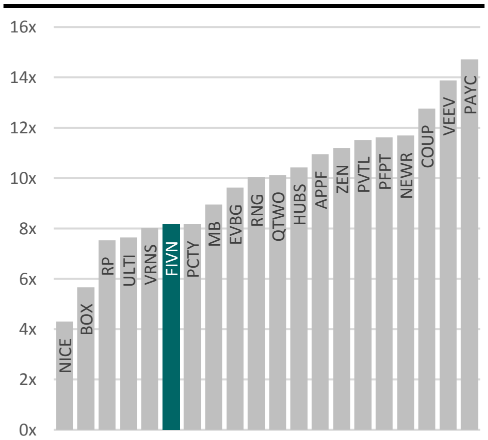
Implied Share Price Scenarios



Implied Share Price Scenario Analysis

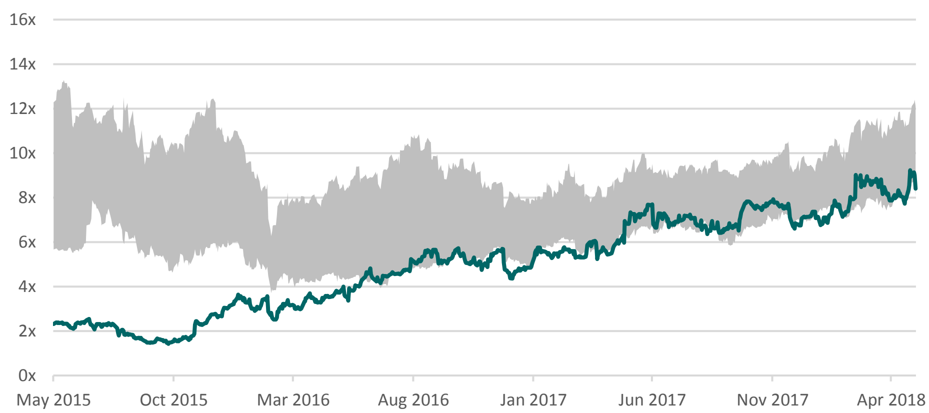
NTM Growth Rate Scenarios		EV/LTM Revenue 7.0x	7.5x	8.0x	8.5x	9.0x	9.5x	10.0x
Low --	*18.0%*	$30.90	$33.06	$35.21	$37.37	$39.53	$41.69	$43.84
Low -	*20.0%*	$31.41	$33.60	$35.80	$37.99	$40.19	$42.38	$44.58
Low	*22.5%*	$32.05	$34.29	$36.53	$38.77	$41.01	$43.25	$45.49
Mid	*25.0%*	$32.69	$34.98	$37.26	$39.55	$41.83	$44.12	$46.40
High	*27.5%*	$33.33	$35.66	$37.99	$40.32	$42.66	$44.99	$47.32
High +	*30.0%*	$33.97	$36.35	$38.72	$41.10	$43.48	$45.86	$48.23
High ++	*32.0%*	$34.48	$36.90	$39.31	$41.72	$44.14	$46.55	$48.96

EV/LTM Revenue

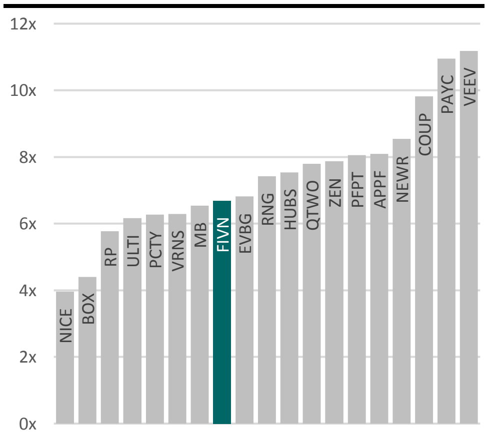


EV/LTM Revenue vs Comps

Range represents 25-75th percentile of Comps

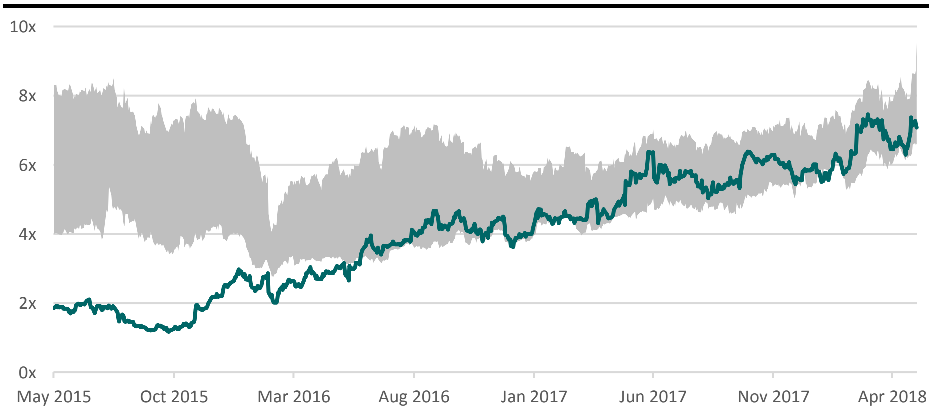


EV/NTM Revenue

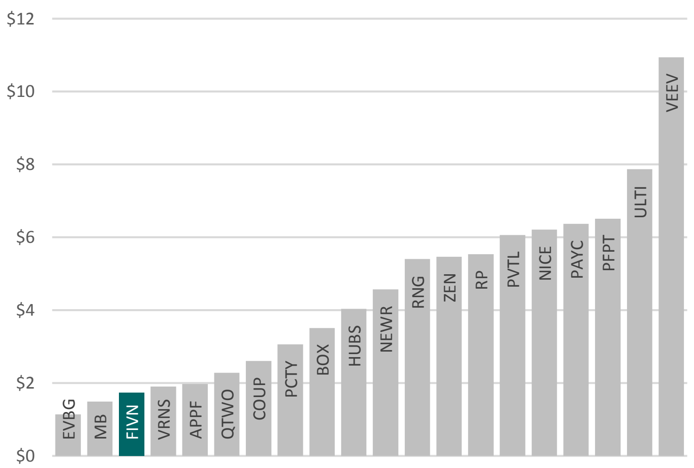


EV/NTM Revenue vs Comps

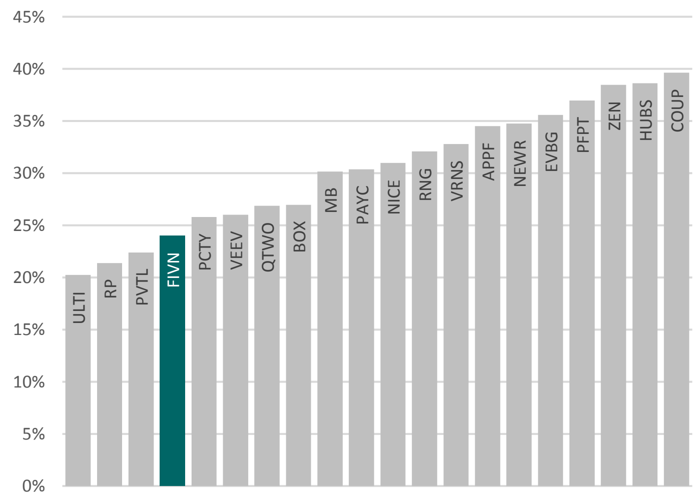
Range represents 25-75th percentile of Comps



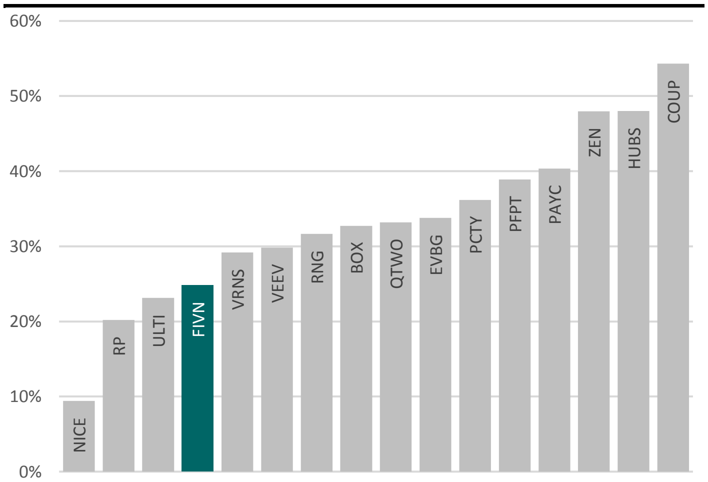
Enterprise Value
($ in billions of USD)



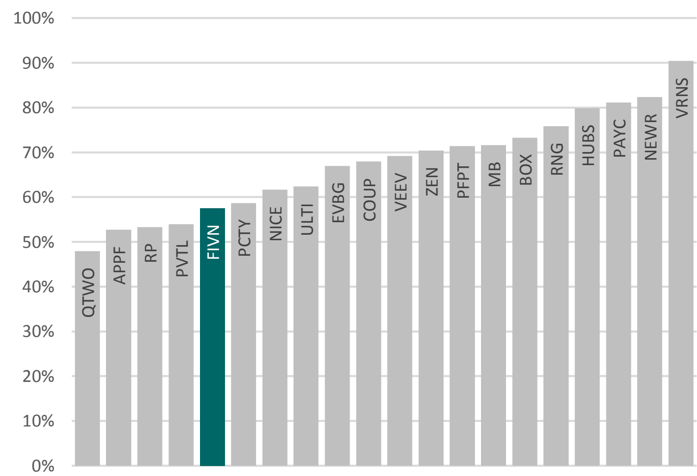
LTM Revenue Growth



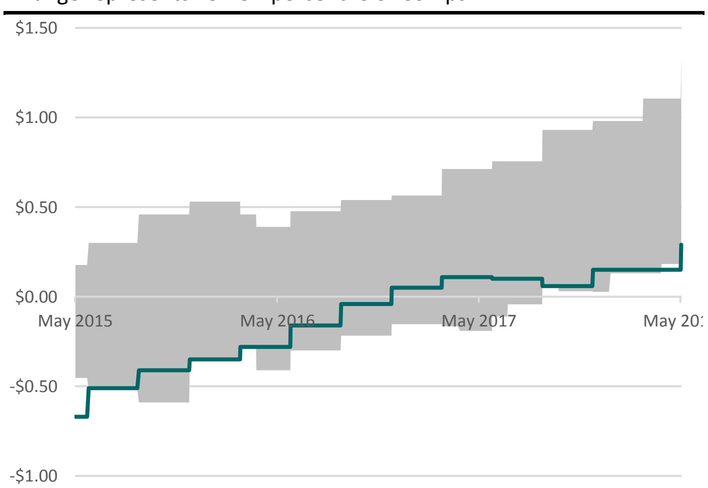
3YR CAGR



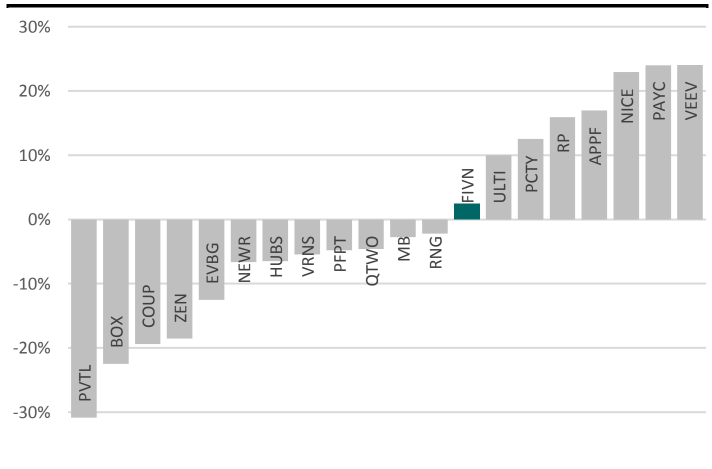
Gross Margin



Free Cash Flow/Share
Range represents 25-75th percentile of Comps



EBITDA Margin



Forecasted Income Statement
(in millions of USD, shares in '000s)

	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Sales	162,090	200,225	251,126	316,419	401,852
COGS	66,934	83,104	98,449	122,239	151,579
Gross profit	95,156	117,121	152,677	194,180	250,273
R&D	23,878	27,120	30,700	37,365	49,836
S&M	52,748	66,570	75,406	95,481	121,767
G&A	25,072	29,151	32,297	37,043	47,954
Total operating expenses	101,698	122,841	138,403	169,889	219,557
EBIT	(6,542)	(5,720)	14,275	24,291	30,716
Extinguishment of debt	(1,026)	-	-	-	-
Interest expense	(4,226)	(3,471)	(929)	(1,369)	(1,915)
Interest income and OCI	(12)	490	700	994	1,421
EBT	(11,806)	(8,701)	14,045	23,916	30,222
Income taxes	54	268	240	250	250
Net income	(11,860)	(8,969)	13,805	23,666	29,972
EBITDA	1,848	2,594	22,842	34,806	44,204
Adj EBITDA (excl SBC)	11,491	17,937	44,312	61,702	80,370
Basic shares outstanding	52,342	54,946	58,150	60,366	64,126
Diluted shares outstanding	52,342	54,946	61,150	63,366	67,126
EPS (Basic)	$(0.23)	$(0.16)	$0.24	$0.39	$0.47
EPS (Diluted)	$(0.23)	$(0.16)	$0.23	$0.37	$0.45

DISCLOSURE

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