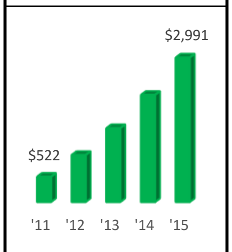
SELECTIVE
WEALTH MANAGEMENT

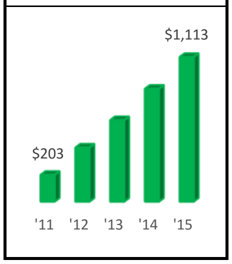
LinkedIn Corp
February 13, 2016

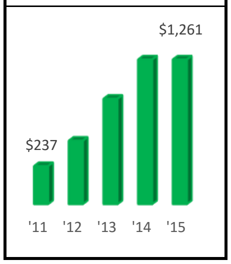
General Overview

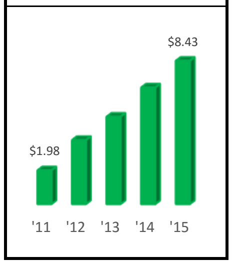
LinkedIn Corp ("LNKD") is the largest professional networking site in the world with more than 413 million registered members. The company owns and operates www.linkedin.com, a website where individuals can create and maintain user profiles that serve as a professional record of reference – all at no cost. Users benefit by forming professional connections, showcasing their talents, and networking for additional business opportunities. The massive database of professional profiles is an extremely valuable resource and more than 43,000 enterprises globally pay LNKD to access this network. Companies pay for recruitment tools to find qualified job candidates, advertising space to sell goods and services, and leads for business-to-business sales.

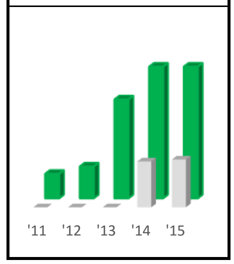
Revenue	Adjusted DOP	Growth Initiatives	Adj. DOP Per Share	Balance Sheet
$2,990,911,000	$1,113,104,102	$1,261,018,102	$8.43	Cash = $3.1 Billion
5-Year CAGR = 54.7%	5-Year CAGR = 53%	5-Year CAGR = 52%	5-Year CAGR = 44%	Debt = $1.1 Billion











Purchase Logic

LNKD is a sensational business that has been on the Selective watch list since the IPO. In the last 5 years the company has compounded revenue at a rate of 54.7% per year and, if management desired, the company could generate profits for owners of nearly $1 billion dollars per year. Due to the wide economic moat and outstanding long-term prospects of the business the price has been elevated for the past several years, which prohibited a purchase. It came as a surprise when LNKD declined more than 50% the week of February 5th, 2016 after management provided guidance that was below Wall Street's expectations. During the decline LNKD reached an attractive purchase point and we acquired a large stake in this outstanding enterprise at approximately 11x potential net income ('potential' is explained in detail later in the report). LNKD meets all the requirements of a Selective Company and falls squarely in the growth category; meaning the intended ownership period will be several years.

Key Metrics

The key metrics for LNKD are Revenue, Adjusted DOP, Growth Initiatives, Adjusted DOP per Share, and the Balance Sheet. These key metrics are defined on the following pages with a detailed explanation of the business fundamentals that drive each.

Revenue - $2,990,911,000

LNKD generates revenue through three business divisions: Talent Solutions, Marketing Solutions, and Premium Subscriptions. Each of these divisions have different growth rates, future prospects, and total addressable markets, but the one thing all three divisions have in common – they are very profitable.

Talent Solutions (63% of Revenue in 2015). Talent Solutions is comprised primarily of subscription services and advertising services for enterprises around the world. Companies pay roughly $899 per month to utilize LNKD's Recruitment tools to find and hire talent. These tools provide recruiters access to LNKD's network of professionals, as well as robust search features that far exceed the capabilities of any business even 5 years ago. The Talent Solution subscriptions are an effective way to lower the cost of recruiting at major corporations around the world. LNKD currently has more than 43,000 companies subscribed to Talent Solutions with revenue retentions rates estimated at more than 85%. In the last twelve months this segment grew 45% year-over-year. The sensational growth of this segment during the last 5 years can be attributed to the 'greenfield' opportunity as LNKD sold the recruitment solution to customer all over the world. As LNKD penetrates the market the growth rate will decelerate, but at maturity this segment will be significantly larger and generate substantial profits for the company. It is our expectation that Talent Solutions will grow at a rate in excess of 12% for the next 5 years.

- "I used LinkedIn to search for a Marketing VP and saved $30,000 I would have otherwise paid a headhunter." –Anonymous CEO (quoted in Forrester Report, July 2004)
- "LinkedIn helped me to easily find and contact 10 product managers, one of whom I ended up hiring. LinkedIn saved me a significant amount of time and effort" –Jeremy Liew, GM, Netscape
- "Through LinkedIn I was able to find the perfect match for a sales manager opening, and it saved us over $20,000 in search costs" –Adam Honig, CEO, Akiba

Marketing Solutions (19% of Revenue in 2015). Marketing Solutions sells digital advertising slots to marketing firms that are placed on LNKD's website. With more than 100 million unique monthly visitors LNKD generates tremendous revenue from this channel and the opportunity is still in the early stages. We anticipate that growth in Marketing Solutions will be lumpy, ranging from -10% to +30%, with an average growth rate of 15% for the next 5 years. LKND has some competitive advantages against other digital advertisers, such as Facebook, that stems from the networks affluent user base. The average LNKD member earns more than $75,000 per year and a typical purchase from a digital ad on LNKD is in excess of $200; compared to $164 for Facebook.[1] Advertisers around the globe will continue to find ways to generate high returns on investment for their marketing dollars through the LNKD network.

Premium Subscriptions (18% of Revenue in 2015). Premium Subscriptions are monthly subscriptions sold to members of LNKD's website for services such as job placement. Job seekers can pay $30 per month to search potential job opportunities and place their resume at the top of the stack. This particular division is in its infancy and has higher churn rates coupled with lower sales and marketing costs, making it more volatile as a revenue source, but highly additive to the bottom line. We believe that Premium Subscriptions will fluctuate over time and range between -20% to +30% with an average of +10% for the next 5 years.

New Products (0% of Revenue in 2015). Our investment thesis centers around continued growth for the three existing business divisions of LNKD, but we believe the company will be able to generate substantial revenue from ideas that are currently unknown and untapped. Large networking sites, such as Facebook, Google, or LinkedIn, continue to find new ways to monetize the vast amount of data collected from their users. The average LNKD user has a college degree, earns more than $75,000 per year, and generates roughly $20 in annual revenue for LNKD (compared to $11 for Facebook). These individuals routinely post information about their employment status, skill sets, and create unique content to demonstrate professional expertise. LNKD is in the early innings of monetizing this vibrate community of professionals. We can think of a myriad of ways that LNKD can continue to generate additional revenue – one example – LNKD could charge members an annual fee to verify different certifications that are industry specific (i.e. A financial professional could pay $10 per year to have their CFA designation posted and officially verified by LNKD.) This would make certifications easier for employers or customers to verify; and also create a global database of certifications that could be easily queried to find job candidates. With more than 400 million users, if 10% of the users maintained an average of 2 certificates at $10 per year, it would generate an additional $800 million in revenue at almost no added cost. This example is intended to highlight one potential way additional monetization can occur. While not central to the investment thesis, it is highly probable that LNKD will generate more than $5 billion in annual revenue 10 years from today from ideas that are currently unknown.

Overall Expectations. Revenue growth between 5% and 40% per year for the next 10 years with an average compound rate of 15%. Our investment thesis hinges on the three operating divisions that currently exist, but we see very strong upside in leveraging the extensive data created by members on LNKD's network and would not be surprised by an additional $5 billion in annual revenue 10 years from today.

<u>Adjusted DOP</u> – Between $633 Million and $1,113 Million

Adjusted DOP ("<u>D</u>igital <u>O</u>perating <u>P</u>rofit") is a term we've coined specifically for digital companies to highlight the potential net income of the business. As a digital enterprise the GAAP reported results look materially different then a brick-and-mortar counterpart – even for similar economic results. In order for a brick-and-mortar company to grow, the business would have to generate operating profit, pay taxes, and then purchase additional property and equipment to increase production. This may include more inventory, new manufacturing lines, a new factory, etc. The purchase of plant, property and equipment is not an expense on the income statement immediately, but rather, it is charged off through depreciation over long periods of time. These companies report a healthy GAAP net income and typical ratios, such as Price to Earnings, can be readily applied to value the business. Digital businesses are different.

When a digital business is growing the company's operating profit is predominately invested into hiring more individuals for software programming and sales and marketing. Research & Development ("R&D") and Sales & Marketing ("S&M") are the digital equivalent of adding production. The Digital Operating Profit estimates how much money LNKD would earn if the company elected *not* to grow the business. This would be equivalent to Operating Profit for a brick-and-mortar business.

In order to calculate Adjusted DOP three variables must be estimated:

1) The level of S&M required to offset customer churn and maintain the current recurring revenue run rate. This is the Maintenance S&M.
2) The level of R&D required to maintain a leadership position in the market. This is the Maintenance R&D.
3) The level of Capital Expenditures required to maintain leadership in the market. This is the Maintenance CapEx.

Spending in these three areas maintains the company's competitive position and the remaining cash flow could be extracted as profit - which is the Adjusted DOP. Below is the formula for calculating this metric:

$$Adjusted\ DOP = Gross\ Profit - Maintenace\ (S\&M + R\&D + CapEx) - G\&A + Stock\ Compensation$$

Gross Profit = $2,572,053,000

- Obtained from the company's 10-K filing.

Maintenance S&M = Between $294 Million and $774 Million

- In order to calculate the maintenance S&M two figures are estimated - the S&M conversion rate and revenue retention rate for each division of the business. The S&M conversion rate is a measure of how much revenue is generated for each dollar spent on S&M. This figure steadily declines for all businesses overtime as the channels for growth become more competitive and sales and marketing efforts yield diminishing returns. In 2015 the S&M conversion rate was over 100% for LinkedIn – meaning each dollar of S&M generated one dollar of revenue. The revenue retention rate for each business division is not publically provided, but was estimated based on retention rates for similar businesses. Additionally, we've assumed that replacing Premium Subscriptions is less expensive than Talent Solutions since these subscriptions are sold directly through the website at much lower acquisition cost. The table below provides estimates of the churned revenue and the level of S&M required to offset this churn based on various retention rates.

Maintenance S&M Estimates

	2015 Revenue	Retention Rate	Churned Revenue	S&M Maintenance Cost
Talent Solutions	$1,884,273,930	80% - 93%	$131M - $376M	$213M - $610M
Marketing Solutions	$568,273,090	90% - 100%	$0 - $57M	$0 - $57M
Premium Subscriptions	$538,363,980	20% - 40%	$323M - $430M	$80M - $107M
Total	$2,990,911,000		$454M - $864M	$293M - $774M

Maintenance R&D = $775,660,000

- Obtained from the company's 10-K filing. A large portion of the R&D expense is for new product development, however, due to the need to maintain the user experience we assumed the full R&D budget is required to maintain the company's competitive position. This is a conservative assumption.

Maintenance CapEx = $420,000,000

- Obtained from the company's 10-K filing. The entire depreciation and amortization expense was included for maintenance.

G&A = $478,734,000

- Obtained from the company's 10-K filing. A portion of the G&A should be allocated to growth, but the entire amount was included to be conservative.

The final step in calculating Adjusted DOP is to add back the stock compensation expense. Stock compensation is a non-cash expense and fluctuates based on the market value of the stock. The real expense for stock compensation is not the dollar figure reported in GAAP statements, but the dilution experienced annually by shareholders. LNKD has averaged a 6% share dilution through options and grants for the last 3 years and is slated for an additional 5% dilution in 2016. This is accounted for in Adjust DOP per Share. It is important to note that the stock compensation expense is paid for by owners through dilution, but is paid for in cash by Wall Street. The reported GAAP figure is the cash payment from Wall Street and is not meaningful when considering the cash generation per share.

Example: Imagine a company with 1,000,000 shares outstanding. Employees are granted 50,000 shares as stock compensation during the year. The company earns $10,500,000 before stock compensation expense and pays out 100% of profits as dividends to all shareholders. At the end of the year the dividends per share is equal to $10 regardless of the reported stock compensation expense. However, when this is reported for GAAP purposes the stock based compensation expense is calculated as the number of shares granted multiplied by the share price. If the price per share is $150 dollars (15x earnings) then the reported stock based compensation would be $7,500,000 and the company would report a profit of $3,000,000. If the price per share is $300 dollars (30x earnings) then the reported stock based compensation would be $15,000,000 and the company would report a loss of -$4,500,000. In both scenarios the owners of the business can mail out $10,500,000 in dividends or $10 per share. This is the economic reality that matters to us. To summarize, the reported stock based compensation expense is based on the value of the shares in the market. The real economic cost to owners is *dilution*.

Stock Based Compensation = $510,2740,000

- Obtained from the company's 10-K filing

The Adjusted DOP has compounded at a rate of 53% for the last 5-years and we anticipate this number to compound in excess of 20% for the next 5 years. This will be driven by the top line growth in revenue combined with operating leverage inherit in the business.

<u>Adjusted DOP Per Share</u> – Between $4.79 and $8.43

The Adjusted DOP per Share is calculated as the Adjusted DOP dividend by the number of shares outstanding. This has compounded at a rate of 44% per year for the last five years. The Adjusted DOP per Share will grow less quickly than the Adjusted DOP due to the annual dilution for employee compensation. LNKD currently dilutes at a rate of approximately 6% per year, which is relatively high compared to Google or Microsoft at less than 2% per year. We anticipate the dilution per year to decrease as the company grows, but the overall stock based compensation in dollar terms to increase. It is our expectation that Adjusted DOP per Share compounds at a rate of approximately 15% for the next 5 years.

Historical Dilution

Year	2015	2014	2013	2012	2011
Shares Outstanding	132,074,709	125,118,124	120,530,835	109,503,684	102,417,188
YoY Dilution	6%	4%	11%	6%	-

<u>Growth Initiatives</u>

The Adjusted DOP is not realized as income on an annual basis, but rather, is reinvested into various growth initiatives. LNKD has the advantage of being able to reinvest these potential profits before tax by hiring additional software engineers and sales and marketing representatives. The investment in growth initiatives is calculated by adding the dollars spent on capital expenditures and S&M beyond the maintenance requirement. This figure, like Adjusted DOP, is likely conservative. A large portion of the R&D expense is for new product development and should be considered as a growth initiative. We anticipate 100% of Adjusted DOP to be allocated to growth initiatives for the foreseeable future.

Balance Sheet

The company maintains a stellar balance sheet with $3.1 billion in cash and $1.1 billion debt. We anticipate LNKD to fund future operations from cash flow from operations. It is our expectation that the debt will be paid off entirely in 2019 (when the Notes are due) and the cash balance continue to rise.

Historical Performance of Key Metrics

Year	'11	'12	'13	'14	'15
Total Revenue	$522,189,000	$972,309,000	$1,528,545,000	$2,218,767,000	$2,990,911,000
Adjusted DOP	$203,211,705	$410,935,436	$619,190,297	$857,790,018	$1,113,104,102
Growth Initiatives	$236,576,705	$394,174,436	$655,482,297	$1,050,155,018	$1,261,018,102
S&M Conversion	473%	273%	171%	132%	100%
Share Count	102,417,188	109,053,684	120,530,835	125,118,124	132,074,709
Adjusted DOP per Share	$1.98	$3.77	$5.14	$6.86	$8.43
Cash	$577,504,000	$749,549,000	$2,329,301,000	$3,443,309,000	$3,119,382,000
Debt	$0	$0	$0	$1,081,553,000	$1,126,534,000

Summary of Key Metrics

Metric	**Expectations**
Revenue	Growth ranging from 5% to 40% Average of 15% for 10 years
Adjusted DOP	Growth ranging from 5% to 50% Average of 20% for 5 years
Growth Initiatives	100% of Adjusted DOP allocated to growth
Adjusted DOP per Share	Growth ranging from 0% to 40% Average of 15% for 5 years
Balance Sheet	Debt free with future growth funded from operations

Risks

There are several short-term and long-term risks associated with the ownership of LNKD. The greatest risk in the near term is excessive dilution based on an increase in the stock based compensation. The current stock program is highly dilutive and any increase in share issuance could materially impact investment results in the short term. We view this as the most substantial risk, but one well worth taking given the sensational quality of the business.

In the long-term the biggest risk is competition from Facebook. There is a possibility that the largest social network in the world might attempt to become the largest business network in the world, but we view this risk as remote. The professional and personal lives of individuals have historically been separate and it would take substantial effort to maintain a single profile that functioned as both. We anticipate these two realms to remain separate indefinitely. Overall, LNKD is an exceptionally high quality business that is growing rapidly and debt free.

The Moat Around The Metrics

LNKD provides a valuable service for all stakeholders. Members benefit from a free network that elevates their professional profile and opens up new business opportunities. Enterprises benefit by subscribing to various products and services that lower recruiting costs, increase the ROI on advertising, and increases sales productivity. LNKD's business model is well protected from competition due to several factors working in tandem:

1) Switching Costs. LinkedIn members put substantial time into creating a high quality professional profile. Members typically are not inclined to duplicate this effort on a competing platform. With more than 413 million profiles it would take substantial time for members to switch their professional profile to a new network.
2) User-Payer Disconnect. The service is free for members (User), whereas revenue is generated from enterprises accessing the network (Payer); meaning competitors cannot entice members to their network based on price competition. Members would have to be enticed to switch through superior value, which would be difficult considering the strong network effect.
3) Network Effect. Every additional profile increases the value of the network for all other members. The more members that join the network, the more enterprises around the world utilize LinkedIn for job placement and sales. The value of the network continues to increase for each member as new members are added and new enterprises utilize services for recruiting.

Conclusion

LinkedIn Corp is the largest professional networking site in the world with more than 413 million registered members. The massive database of professional profiles is an extremely valuable resource and more than 43,000 enterprises globally pay LNKD to access this network. Companies pay for recruitment tools to find qualified job candidates, advertising space to sell goods and services, and leads for business-to-business sales. In the last 5 years the company has compounded revenue at a rate of 54.7% per year and is still in the early earnings of growth. The key metrics for the business are Revenue, Adjusted DOP, Growth Initiatives, Adjusted DOP per Share, and the Balance Sheet. The moat around the business stems from the switching costs members experience when considering another network, a disconnect between the users of the service (members) and the payers of the service (enterprises), and a strong network effect. As a Selective Company with a long runway for growth we intend to hold LNKD for several years.

Works Cited

1) http://www.fool.com/investing/general/2016/02/17/investors-may-not-be-enamored-with-linkedin-corp-b.aspx
2) *LNKD Annual Report - SEC Filing 10-K.* EDGAR, 2015.