Rand Worldwide (RWWI) $1.66 November 2014

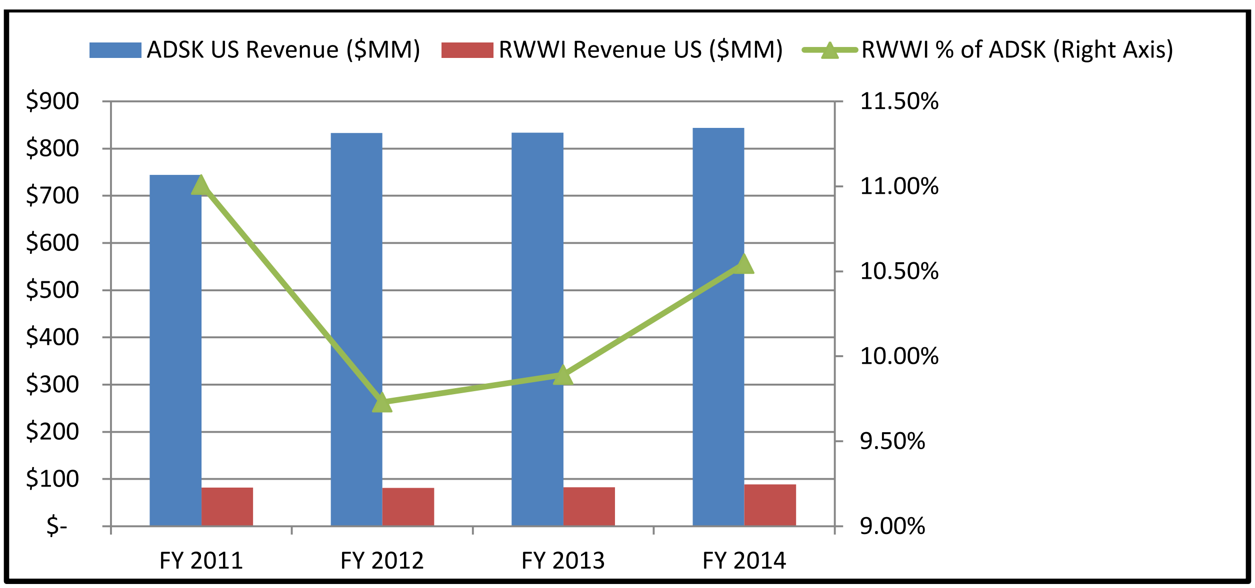
Rand Worldwide just completed a large tender offer that reduced shares outstanding by 47%. The tender offer also resulted in Peter Kamin purchasing a large block of shares and gaining majority control. Rand Worldwide now has a quality chairman at the helm and trades at a very attractive valuation. Capital allocation will no longer be a concern and shares should re-rate as this highly cash flow generative business pays down debt, buys back more shares, or potentially initiates a dividend.

Ticker:	**RWWI**	**Current Price**:	**$1.66**
Action:	Long	Market Cap (M)	$48.5
Expected Timeframe:	1-3 years	Enterprise Value(M):	$72.5
Asset Class:	Common Equity	Target Price:	$3.00
Target Allocation:	2-5%	Benchmark:	S&P 500
Catalysts: Decrease of debt, tender offer, dividend, going private transaction			

Overview

Rand Worldwide (Rand) is a value added reseller of design software. For all practical purposes, they are simply a reseller of Autodesk software, as 2/3 of their revenue was from Autodesk software and subscriptions. As expected, sales of Autodesk are correlated to sales of Rand. The chart below shows US sales of Autodesk versus sales of Rand in the US.

Chart 1. Rand sales, Autodesk sales Source: Company filings, author calculations



Some of the revenue included above is for training and may not necessarily be for Autodesk. In general, Rand generates about 1/10 of the sales that Autodesk generates in any given year. The dependence on Autodesk is the biggest opportunity and biggest risk.

Autodesk is attempting to shift their business to a subscription based model. This will result in lower upfront revenues, but should enhance the number of potential customers who could expense the cost of software rather than capitalize it. Longer- term Autodesk wants to increase their subscriptions by 30% and wants to take their non-GAAP operating margin to 30% by fiscal 2018. This is a hefty goal and is an effective doubling of current non-GAAP operating margin.

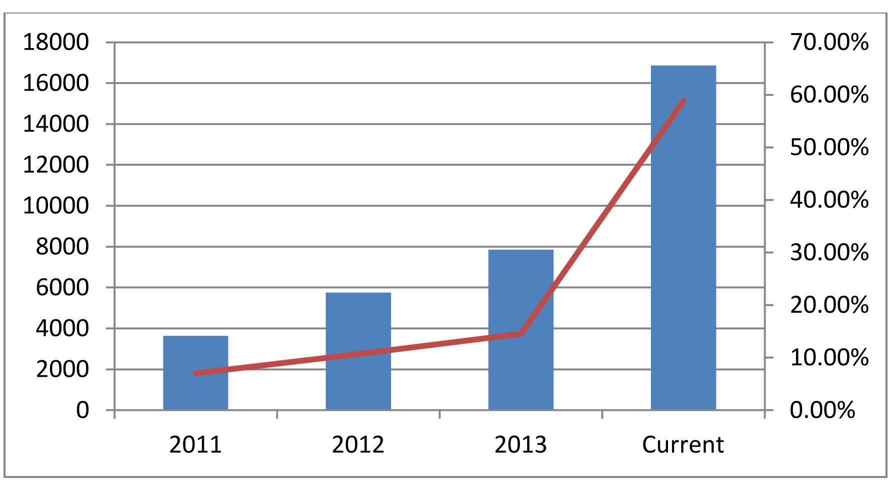
So far, management of Autodesk has been optimistic and has reported good success regarding the transition. For instance, in the Q2 2015 results, management raised their guidance rates for billings, revenue and subscription, while also hinting their operating margin would come in at the high end of guidance. Obviously some of this is part of the earnings game dance, but it's at least a step in the right direction.

Peter Kamin

Peter Kamin is the former head of ValueAct. While other members of ValueAct like chasing large companies, Kamin clearly enjoys chasing after unknown names with his partnership, 3K Limited Partnership. Their website does a pretty good job of outlining what they do, and what they look for in investments.

3K LP found a lot of things they liked in Rand and has been acquiring shares for several years now. On September 29, 2014 Rand launched a tender offer that took outstanding share count down by ~27.5 million shares and allowed Kamin to increase ownership significantly. The chart below shows Kamin's share ownership over the past four years and his ownership of the total company.

Chart 2. Peter Kamin's Ownership of Rand Worldwide. Source: Company Filings



It should be pretty obvious that Kamin likes the business and thinks it will do well going forward. To achieve the share repurchases, Rand took on a $21 million term loan and a $10 million revolver, drawing $3 million of the revolver. Prior to the repurchase the company had excess cash on their balance sheet and no debt. The table below shows the pro forma capitalization of the company.

Table 1. Capitalization of Rand Source: Company Filings. All Figures in thousands except per share

Total Assets	$47,681
Total Liabilities	$40,660
Equity	$7,021
Shares Outstanding	29,242
PF Book Value/share	$0.24
Current Price	$1.66
Current Market Cap	$48,541
Current EV	$72,542

Taking on debt and acquiring a significant chunk of shares indicates one thing, Kamin thinks Rand is worth a lot more than $1.20, and given the illiquidity of his stake, probably a lot more than current prices.

Valuation

I think that Rand offers a compelling valuation by itself and I believe there are a number of events that will cause shares to re-rate higher. The table below shows my expectations for 2015.

Financials are a bit confusing now thanks to the divesture of Rand Secure, a division that lost a significant amount of money over the past few years. Rand also discontinued their international operations in 2012 so the income statement, COGS, and operating expenses have been impacted for the past two years. Going forward, Rand is focused on the US, and they are pretty much focused on Autodesk products. This makes things simpler for investors and creates a cleaner story that is easier to understand.

A big use of cash goes towards debt repayment. This starts at $3.15 million per year now and climbs to $5.25 million in 2018. While these payments are considerable, the resulting decrease in debt should accrue back to equity holders. At current prices, Rand is valued at 5.4X EV/EBITDA and 5.5X P/FCF ratio relative to 2015's projections. Management guides to EBITDA increasing to $16.07 million and $19.68 million in 2016 and 2017, respectively. If those targets are hit I believe that FCF available to common owners will come in above $7 million in 2016 and $8.7 million in 2017. These figures are after mandatory debt repayments that total $10.5 million.

Table 2. 2015 Projections. Source: Author's calculations, company filings.

All Figures in (000's)	FY 2015
Service Revenue	$51,170
Service Revenue	$23,480
Commission Revenue	$20,293
Total Revenue	**$94,942**
Cost of Product Sales	($32,749)
Cost of Service Rev	($15,763)
Total Cost of Revenue	**($48,512)**
Cash Operating Expenses	($35,165)
Taxes	($3,600)
Interest Expense	($894)
EBITDA	$13,292
FCF	$8,798
Debt Repayment	($3,150)
FCF Available to Common	$5,648
FCF/Share to Common	**$0.19**

The opportunity to own a company that is growing both EBITDA and FCF at more than 18% per year is quite compelling. Better yet, the business is working capital light and requires minimal future investment. Even with the debt repayments, Rand should have a minimum of $5 million of cash leftover. I think there are three possibilities for this cash.

1. Use the cash to pay down debt above and beyond the minimum payments.
2. Buy back shares or pay out a dividend
3. Acquire something

I believe option #2 is the most likely. Kamin currently owns 16.869 million shares, leaving 11.77 million shares out there. Predicting potential purchase prices for a potential tender is all speculation, but $5 million goes a long way. If we assume a $2.50 share price, $5 million of excess cash buys back 2.00 million shares. Given the projections of rapidly growing EBITDA and FCF, buybacks make a lot of sense. Between the growing FCF generated each year and redemption of debt, a little under $10 million per year should accrete to shareholders, perhaps not on a dollar to dollar basis, but pretty close. This is attractive relative to a current market cap of $48.5 million.

Given the likely accretion to shareholders, I think the company is worth at least 8X FCF. An 8X multiple would give zero value to the revenue growth or better business model (subscription revenues) which should be conservative. At 8X my 2015 FCF calculations, Rand is worth $1.60/share, roughly in-line with today's price. This will only grow as FCF grows thanks to lower debt and increased revenue.

As a sanity check, Rand looks undervalued on an EV/EBITDA basis as well. The table below shows the equity value growth as debt is repaid, and EBITDA grows as I project it will.

Table 3. EV/EBITDA Projections. Author's Calculations

	Current	7X 2015 EBITDA	7X 2016 EBITDA	7X 2017 EBITDA
Enterprise Value	$72,542	$93,044	$110,627	$137,151
Net Debt	$24,000	$15,202	$4,973	-$7,936
Equity Value	$48,542	$77,842	$105,655	$145,088
Per Share	**$1.66**	**$2.66**	**$3.61**	**$4.96**

Any sort of valuation exercise is an art, but this paints a nice picture for patient investors.

Risks

The 800-lb gorilla in the room is the dependence on Autodesk. I think the overall chance of Autodesk ending the contract is very low. There are a number of resellers who have been involved with Autodesk for several decades. In 2014 Rand was selected as a Platinum Partner for Autodesk, a technical designation given to a total of seven resellers. In my opinion, the bigger risk that relates to Autodesk is the long-term sales/profit goals. While it seems unlikely, Rand may get hit with lower ceded commissions if Autodesk attempts to drive operating margin to hit their long-term goals.

In the Q3 2015 call, Autodesk seemed to address this and discussed their goals for driving operating margin expansion. They admitted that their channel partners spend less on sales and marketing and part of Autodesk's margin expansion would come from reducing marketing spend on Autodesk's end. "Valued-added reseller" is a very real thing in this case (or so it seems).

Finally, Autodesk sales can be cyclical. While some of the cyclical nature is taken out thanks to subscriptions, this is not completely eliminated. Autodesk sales in the USA held up better during the Financial Crisis compared to total worldwide sales. This is not a guarantee of future success, simply a reference point to the past.

Conclusion

Purchasing shares of Rand gives investors plenty of good options thanks to a highly cash flow generative business and a chairman who is fully aligned with the common shareholder. Investors can expect proper capital allocation, and with that, a re-rating of shares over time.

Shares of Rand currently trade at attractive valuations of 5.5X EV/EBITDA and 8.6X P/FCF(after debt repayment). I believe these metrics are depressed due to the low investor awareness, and historical financials which masked the true earnings power. As cash from operations is used to pay off debt, initiate a dividend, or repurchase shares, the company should be valued as a growing cash machine and not as a dying business.