GlassHouse Research

12/12/18

Accounting Concerns Finally Catch up with the Roll-Up j2 Global

Who is GlassHouse Research? GlassHouse Research (GHR) is made up of former forensic accountants/analysts who have worked for prominent hedge funds on Wall Street, as well as boutique forensic accounting firms. Our purpose is to expose public companies that have been taking advantage of US GAAP as well as IFRS accounting for their benefit. We seek to find companies where GAAP (or even worse, non-GAAP) earnings are deviating from true economic earnings of the target firm.

Overall, we search for evidence of a "culture of fraud" within public companies.

Initiation of j2 Global, Inc. (JCOM) with a Target Price of $24.77

GlassHouse Research focuses on the ill-fated roll-up j2 Global, Inc. (JCOM), which uses a myriad of acquisitions to conceal non-reported organic declines and stagnant earnings.

- **JCOM's continued use of acquisitions concurrent with declining ROIC and organic growth will cause its demise:** While the company has recently enjoyed double-digit revenue gains that have astounded analysts, our own analysis of estimated organic growth detail a deteriorating core company underneath the multitude of acquisitions presented every year. **Contemporaneous with unfavorable trends regarding the firm's RNOA and ROIC metrics, we believe these trends indicate significant risk to the sustainability of future earnings.**

- **Acquisition accounting remains suspect at j2 Global, as current accounting concerns now attach a time catalyst to JCOM's share-price demise:** j2's once manageable goodwill balance has grown to a corpulent size on the balance sheet through persistent acquisitions. **Furthermore, we find dubious liability transactions within the company's acquisition accounting that lead us to believe future reserves are being artificially created.**

- **Sell-side analysts are fooled by deceptive non-GAAP exclusions that GHR will expose as neither non-recurring nor non-cash expenses:** j2 is the benefactor from one of the worst uses of non-GAAP exclusions we have seen in our experience. **TTM non-GAAP income ($6.04) now stands 134% above GAAP income of $2.58, representing the highest deviation in JCOM's history**. Persistent material exclusions of intangible amortization expenses, acquisition-related costs, and stock-based compensation obfuscate JCOM's true economic earnings.

- **j2 has reported suspect accounting practices in addition to retaining lower-tiered accounting firms in years past:** Using auditing firms such as BDO LLP and SingerLewak give GHR cause for concern as a company of this size and complexity should be using a Big 4 accounting firm. Also, JCOM's lack of accounting experience in key positions such as its CFO and anyone on its audit committee should raise red flags for their investors.

- **Premium valuation erroneously based on "adjusted" earnings is unwarranted given the material long-term structural issues and near-term accounting risk:** Using a sustainable earnings figure detailed in this report, **GHR will show why we believe an approximate 64.2% downside to JCOM's current share price is in its future.**

Company Background

j2 Global, Inc., together with its subsidiaries, engages in the provision of Internet services worldwide. It operates through two segments, Cloud Services and Digital Media.

The Cloud Services segment offers cloud services to sole proprietors, small to medium-sized businesses and enterprises and government organizations. This segment provides online fax services under the eFax, sFax, MyFax, eFax Plus, eFax Pro, eFax Secure, eFax Corporate, and eFax Developer names; on-demand voice and unified communications services under the eVoice and Onebox names; online backup and disaster recovery solutions under the KeepItSafe, LiveDrive, LiveVault, and SugarSync names; email security, encryption, archival, and perimeter protection solutions services under the FuseMail name; email marketing services under the Campaigner name; and customer relationship management solutions and customer support services.

The Digital Media segment operates a portfolio of web properties, including IGN.com, Mashable.com, PCMag.com, HumbleBundle.com, Speedtest.net, AskMen.com, MedPageToday.com, Offers.com, and Everydayhealth.com that offer technology products, gaming and lifestyle products and services, news and commentary related products, speed testing for Internet and network connections, and online deals and discounts for consumers, as well as professional networking tools, targeted emails, and white papers for IT professionals. This segment also sells display and video advertising solutions, as well as targets advertising across the Internet; sells business-to-business leads for IT vendors; promotes deals and discounts on its Web properties for consumers; and licenses the right to use PCMag's Editors' Choice logo and other copyrighted editorial content to businesses.

The company was formerly known as j2 Global Communications, Inc. and changed its name to j2 Global, Inc. in December 2011. j2 Global, Inc. was founded in 1995 and is headquartered in Los Angeles, California.

Roll-Up Model Obfuscates True Economic Earnings at j2 Global

j2 Global (JCOM) and its management are currently stuck in an incorrigible state where management *must* continue to acquire lackluster companies in order to push its top line to appease Wall Street. The bull case for JCOM lies within management's ability to leverage its cash from its declining eFax business into turnaround acquisitions on the Digital side of the house. The firm is also constantly touted as a major free-cash-flow generator, mollifying its investors and analysts on the street.

However, in our report we focus mainly on the unsustainability of JCOM's persistence of earnings, in addition to detailing how j2's cash generation is mainly a farce. While short-sellers have pointed out j2's fundamental headwinds in the past and for the most part got the timing wrong, we intend to show in our report newly-found accounting concerns that puts a time-catalyst on JCOM's ominous future.

> *If JCOM is using acquisitions as an integral part to its growth strategy and operations, why are analysts allowing management to remove acquisitions costs as one-time items?*

j2's management is stuck in an acquiring cycle where it currently enjoys all the benefits listed below. However, due to higher interest rates and limited future acquisitions, we believe once this acquiring cycle slows down (as we believe it is currently), this will cause the company to unravel over the next year.

- The acquiring of companies has caused revenues to inorganically rise by double-digits over the past seven years. Any setbacks to the top line growth will have devastating effects to the stock price and management knows this.

- The continued use of acquisitions has quietly masked a deteriorating e-fax division that is the core of JCOM's business.

- Management's lack of disclosures regarding organic revenue makes it extremely easy for them to mask unfavorable organic revenue trends from complacent sell-side analysts. The concealing of this metric would be akin to a retailer not disclosing their same-store-sales metrics.

- The use of purchasing assets through acquisitions allows management to tout a reported cosmetic Cash-Flow-from-Operations figure that does not take into account cash spent on acquisitions.

- This allows management to exclude highly substantial amortization expenses (where real cash was spent in the acquisition) from non-GAAP earnings because they are incorrectly deemed as "non-cash".

- Management is then able to exclude very-much recurring acquisition-related costs from non-GAAP earnings because management deems them to be "non-recurring" in nature. However, with 152 acquisitions executed in the last 10 years, we believe these expenses to be highly reoccurring based on this evidence.

- Furthermore, management can effectively "purchase" its R&D through acquiring companies. Therefore, management can now withhold on internal R&D expenditures to artificially improve margins. This is apparent at j2 with R&D margins falling to a 10-year low under 4% in the most recent TTM period.

With all the aforementioned reasons given, it is obvious to us why j2's management has continued motivation to use its acquisition growth strategy. Listed as the first Risk Factor in the firm's 10K, here is the excerpt management gives with regards to its growth strategy:

> **Acquisitions and investments in our business have historically played a significant role in our growth and we anticipate that they will continue to do so.**
>
> **We *must* acquire additional or invest in new or current businesses, products, services and technologies that complement or augment our service offerings and customer base in order to sustain our rate of growth**. We may not successfully identify suitable acquisition candidates or investment strategies, manage disparate technologies, lines of business, personnel and corporate cultures, realize our business strategy or the expected return on our investment or manage a geographically dispersed company. **If we are unable to identify and execute on acquisitions or execute on our investment strategies, our revenues, business, prospects, financial condition, operating results and cash flows could suffer.** [Emphasis added]

Here is CEO Vivek Shah detailing future acquisition plans in a recent JCOM earnings call:

> This is all to say that acquisition is part of our DNA and runs deep inside of the company. It's not just me and Scott waving a magic M&A wand. It's a – it's fundamental to what we do and who we are, and we recruit talent that can succeed in our environment.
>
> While we believe what we've built as an acquisition system is valuable, we're not alone. The marketplace refers to companies like ours with different labels, but the term often used is a "serial acquirer”.

Needless to say, j2 Global is a serial acquirer that tries to turnaround bloated companies through either slashing the acquiree’s workforce or by buying it at a perceived discount. While this strategy can work, what we take issue with is how j2’s acquisitions have obfuscated true economic earnings at the company. <u>Just as many managers have tried before with other roll-ups, we believe that management has touted many farce operating metrics that do not show j2’s true economic value.</u> As a result, we believe JCOM’s true value currently lies 64.2% below current market price, based on our analysis.

<u>**Estimated Organic Revenue Growth Turns Negative in Recent Years**</u>

GlassHouse Research ultimately believes that j2's organic growth rate is being withheld from analysts in order to conceal its deteriorating status. As discussed above, we relate the withholding of this metric similar to a retailer not disclosing its comps metric. The fact that management has been so resistant to disclose this metric gives us cause for concern. Below we reveal recent issues regarding JCOM's lack of disclosures relating to its organic growth rate:

1) Not to be found in any of j2 Global's press releases, management does not point out how much revenue growth was attributable to acquisitions per period. This is a very common excerpt in most acquisitive companies as the earnings release is the first thing analysts look at when a company reports its quarter.

2) The company spent over $200 million on acquisitions in 2017; a highly material figure for a firm of this size. However peculiarly and with no explanation given, JCOM *did not* disclose any pro forma financials for its acquisitions as it has in every year dating back to 2011.[1] <u>**We found that withholding this data made our own estimations of organic growth entirely impossible for 2018**</u> (more on this in later sections).

3) The company encourages analysts to focus on its non-GAAP earnings, free-cash-flow (sans acquisitions) and adjusted EBITDA metrics instead of what we believe are more accurate representations of the company which are organic growth: GAAP earnings and free-cash-flow including acquisitions.

4) The firm's organic growth rate was only previously asked about and discussed dating back to conference calls in 2011. Here, j2's CFO, Robert Turicchi gave ballpark figures regarding this rate. Curiously, analysts covering the name have not asked about this metric dating back over seven years.

5) Finally, in the Q4 2010 earnings call, Mr. Turicchi dodged a question regarding organic growth in 2011. When asked how much of the 2011 revenue growth was from organic growth, Mr. Turicchi replied, "Well, as I said, there's no M&A that is material to the guidance top or bottom line for 2011." While this was technically true due to JCOM having limited acquisitions in 2011, this failed to disclose that essentially all of

[1] The last time the firm did not disclose this information was in the 2011 10K when the firm spent a whopping $3.8 million on total acquisitions.

the 29.3% revenue gain that year was due to its PROTUS acquisition made on 12/03/10. In other words, no organic revenue growth.

We point out these past instances to show how management has been reluctant to disclose this very important figure even though it would help investors to judge the trajectory of its core business. While management will tout how this figure is not needed because purchasing companies is a part of its core business, we take issue with how the firm continues to exclude amortization expenses or acquisitions costs from their adjusted numbers, though they are so integral to the company's future success. JCOM cannot have it both ways in this regard.

Obvious to the JCOM investor, total revenues at the firm have grown at a double-digit pace dating back to 2011 (see Table 1, Page 9). However, throughout this period, we calculate an approximate organic growth figure that has been fairly flat, if not declining, since 2013. Furthermore, we calculate that the recent declines have accelerated in recent periods, leading us to believe the core business is suffering greatly in stealth. The lack of consistency and disclosures, based on our experience, can only mean that the core company is suffering without the help of acquisitions.

Based on disclosures of proforma financials and revenue contributed from acquisitions in JCOM's 10K and 10Q filings, GHR is able to calculate a base estimation regarding the firm's organic growth (or lack thereof). As discussed above, management did not disclose its proforma figures regarding its acquisitions in its 2017 Annual Report. However, the 10K disclosures did indicate that "For the year ended 12/31/17, these acquisitions[2] contributed $34.7 million to the company's revenues."

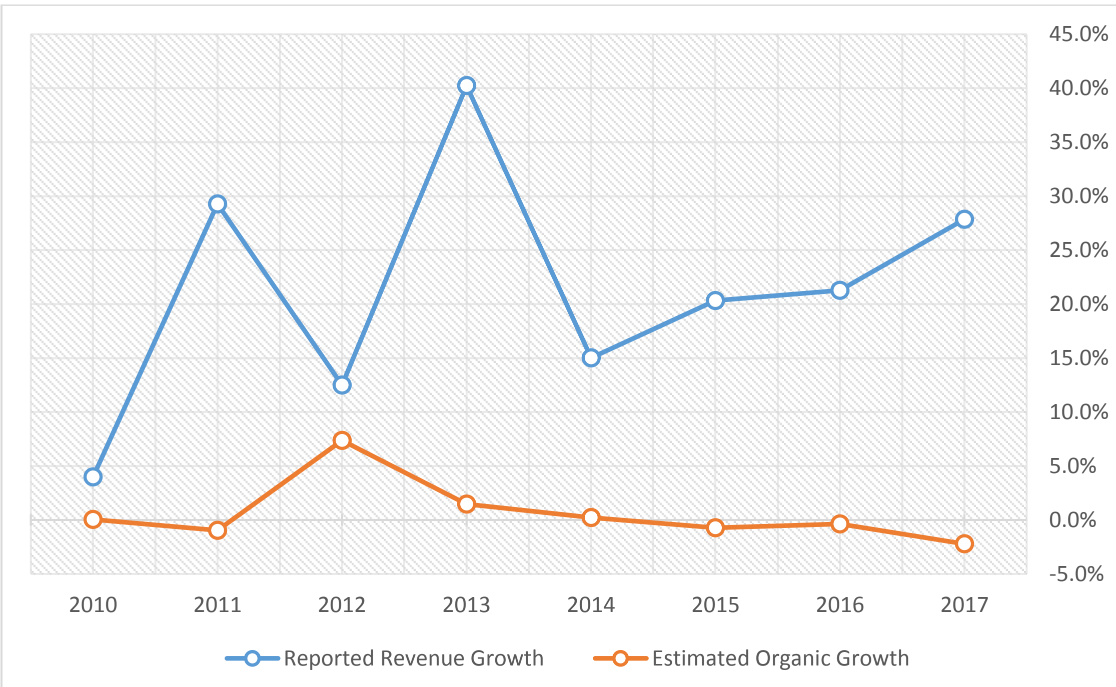
Therefore, while the $34.7 million figure provides us with revenue gained from acquisitions in 2017, we cannot ascertain the full organic revenue figure because these acquisitions were not all in effect as of 01/01/2017. Moreover, there were prior acquisitions in 2016 that did not fully annualize in 2017, skewing the data even more. Therefore, in order to estimate an accurate organic growth rate, we need to factor in both revenues acquired during the year as well as the difference in proforma and reported revenues in the prior year.[3]

[2] This figure only includes revenues from acquisitions made in 2017.

[3] If the run rate for an acquisition or group of acquisitions is flat year over year (i.e., the acquisitions generate no growth in the following year), the acquisition-related gain received in the next year will be exactly equal to the difference between proforma and reported revenue for the prior year. Per the 2017 10K, proforma revenue exceeded as-reported revenue by $228.3 million in 2016. Furthermore, $34.7 million was contributed to revenues from acquisitions in 2017.

Using these variables, we estimate that JCOM's organic rate actually *declined* in 2017 by 2.2%, with the rest of the 27.9% reported growth coming from acquisitions. Our calculation of organic growth shows this figure to be declining from a recent high of 7.4% in 2011 to its current value at –2.2% (see Chart 1, below). This trend, combined with the recent lack of disclosure regarding the firm's proforma figures, lead us to believe that organic growth is continuing to deteriorate at JCOM within the first 9M of 2018.

Chart 1: JCOM Reported Growth Vs. Estimated Organic Growth



To make things a little bit simpler, let's only take a look at JCOM's recent Everyday Health acquisition that closed on 12/05/16. While this purchase was one of JCOM's better acquisitions in terms of future viability, we find that Everyday Health reported revenues of approximately $255.8 million in 2016. The target firm's top-line growth rate also stood near 10% YOY. Therefore, if we assume that Everyday Health could potentially report $281.4 million[4] in FY2017, we then can remove this figure from reported JCOM revenues of $1.12 billion to get only $836.4 million in sales (versus $874.3 million revenues in FY2016). Not exactly the high growth company management is proclaiming JCOM to be.

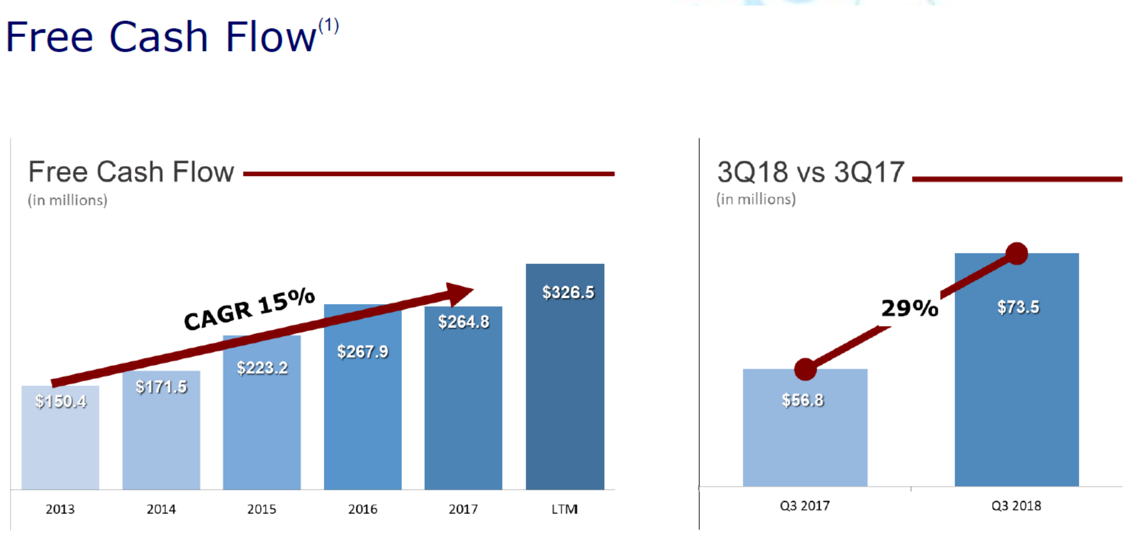
[4] $255.8 million x 110%

<u>Return on Invested Capital Exhibits Noticeable Decline</u>:

GlassHouse Research's standard measures of accruals are less reliable to identify quality-of-earnings risks at firms that have grown largely by acquisitions. For these firms, we believe that an analysis of EBIT margins, return on invested capital (ROIC) and return on net business assets (RNBA) can help identify changes in a company's quality of earnings risk profile.

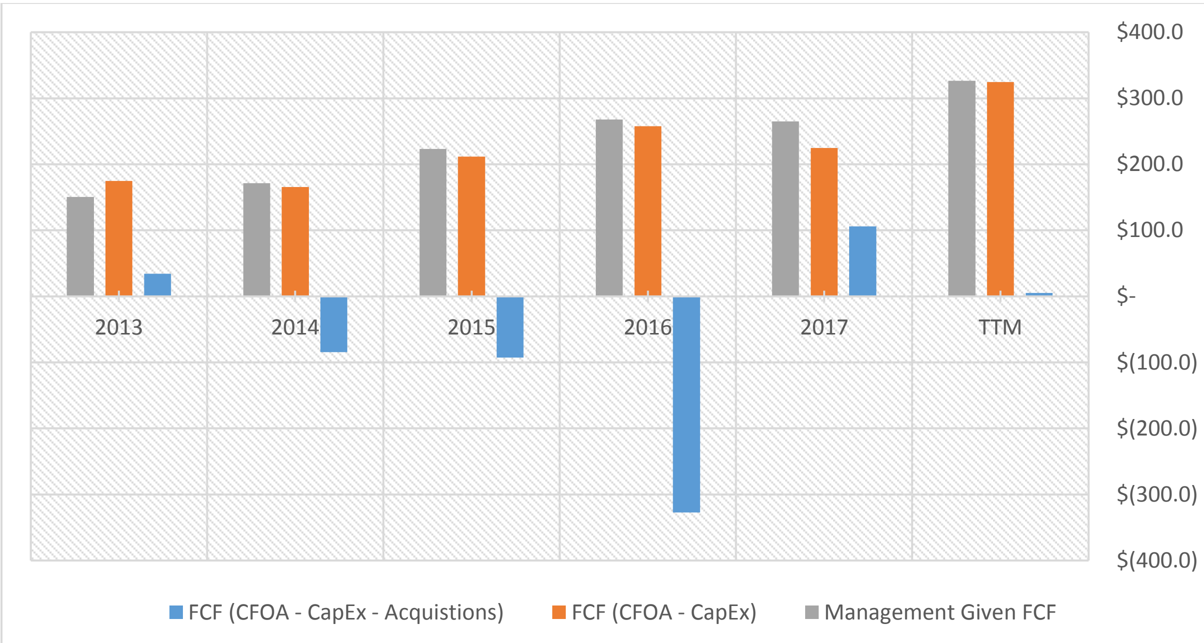
In the Q3 2018 earnings call, CEO Vivek Shah also invites us to look at j2's return on invested capital. Although, the company calculates this as "free-cash-flow divided by invested *equity* capital." He then goes on to say that the firm's ROIC metric has, "ranged between 33% and 50% over the past eight years."

First of all, the way management is calculating their ROIC metric is highly misleading and rarely used within the industry.[5] If management is *only* using equity in the denominator to calculate their internal metric, this would essentially nullify the over $1 *billion* in debt the firm has accrued throughout the last seven years. Furthermore, the use of their already adjusted/inflated FCF figure is laughable due to the 1) high volatility nature of free-cash-flow and 2) the amount of cash spent on acquisitions being excluded from FCF.[6]



5 Stated competitor Open Text (OTEX), discloses its ROIC calculation as "EBIT / (Debt + Equity – Cash – Deferred Tax).
6 From JCOM's Q3 2018 Earnings Presentation Slides

Chart 2: Analysis of Free-Cash-Flow
($ in millions)

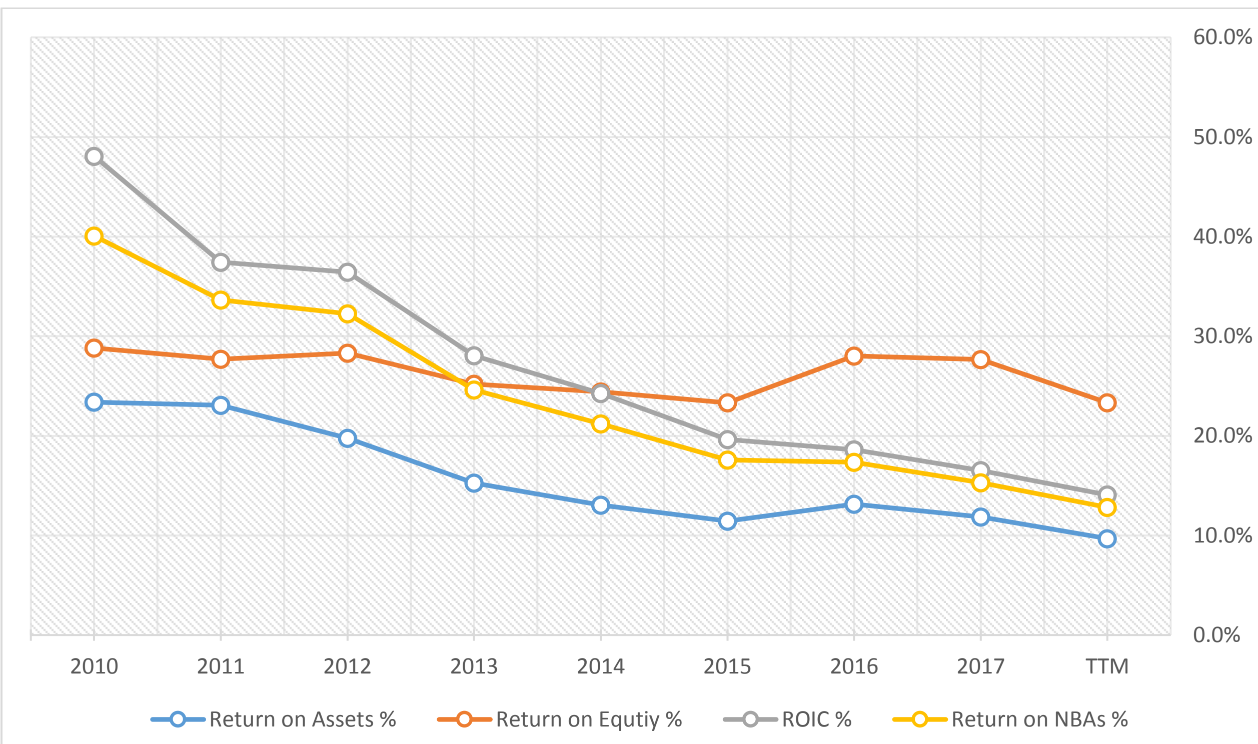


Within a normal company that uses acquisitions sparingly, we could justify the use of free-cash-flow without the impacts of acquisitions. However, the same train of thought *cannot* be used here with a serial acquirer such as j2 Global. Overall, we believe management may be misleading when diverting analysts to calculate ROIC in their stated manner. As such, we will provide the calculation in a variety of metrics. Therefore, our reader can come to their own conclusions about the long-term sustainability of JCOM's operating/acquiring model.

In our calculations, we used EBIT in our numerator as our earnings proxy. Additionally, we calculated our metrics using average assets, equity, invested capital (including both equity and debt) and net business assets. In each one of these cases, we observe a precipitous decline in each of these metrics, which contrasts sharply with management's recent comments (see Chart 3, Page 12). Focusing in specifically on ROIC, where we include both debt and equity unlike j2 management, this metric has declined in a stair-step fashion every year since the company took on debt in 2011. And at the end of the fiscal year 2017, this metric decreased 208 bps to 16.5%, again the lowest metric reported in the last five years (trailing average 25.4%). Exacerbating the issue, this ratio now stands at a new low of 14.1% as of 09/30/18, exhibiting to our team that the more acquisitions j2 brings on using debt, the less efficient it is becoming.

Turning to one of Warren Buffet's favorite metrics, return on net business assets (RNBA), we find a similar result of declining profitability. Here we calculate j2 with a current RNBA of 15.3%, down 205 bps from the prior year. Again, this is a fiscal-year low for the firm and stands well below the five-year trailing average of 22.6%. For the TTM, metrics are even worse which stands at 12.8% as of 09/30/18.

Chart 3. Return on Capital Metrics (Using EBIT as Earnings Proxy)



In the latest earnings call, CFO Robert Turicchi discussed leverage and future acquisitions by stating the following:

> So we remain, I think, somewhat lightly levered, about a little over 2x total debt to trailing 12-month EBITDA… So I think that we clearly have the capacity to do almost another turn of leverage. We've talked about maintaining 3x or under

> total debt to EBITDA. So that gives us capacity for, call it, another $400-and-some million if necessary. And I think that given how we're structured, we've got several pockets that if we needed to access that capital, we could put it.
>
> We can put certainly some of that downstairs at cloud. I think we know the rate structure there very well, given the fact we have existing trading debt. And we have historically had bank debt that would essentially is the cloud level, albeit not in a while…
>
> And what we really look at is not the marginal cost of capital, which is a fair way to look at it, but what is our weighted average cost of capital. So that's being biased up by the equity. So our WACC is close to 10%. We want to earn a spread over that WACC when we invest money, hence the roughly 20% returns that we look for in M&A.

With a stated WACC of approximately 10%, we believe these declining metrics tell a different story from j2's vociferous CEO and CFO. By going off his stated metric of ROIC (Adjusted FCF / Equity), we can see how analysts may believe things are going smoothly at the firm. As detailed in the Chart above, we can observe the difference in our own calculated metrics. By using FCF that does not take into account acquisitions and only equity as the denominator, we can see the contrasts between all the stated metrics.

This leads us to believe that the recent myriad of acquisitions employed by j2 Global has, in Peter Lynch's terms, "diworseified" the overall company. Even when faced with a self-reported higher WACC near 10%, j2 management plans to keep the acquisition train churning in order to keep the top line moving.

j2 Global's Acquisition Accounting May Have Employed Springloading Tactics

With the plethora of acquisitions occurring at JCOM, we always remain suspect of serial acquirers who, through the use of business combination accounting rules, may use "springloading" in order to build future reserves. Thus, when analyzing JCOM's full arsenal of acquisitions dating back to 2010, our analysts paid very close attention to certain liability accounts that could hold augmented reserve accounts. This is in addition to the total amount of goodwill, which would be the offsetting plug. However, due to the fact that JCOM provides very few disclosures regarding its acquisitions at the individual level, this makes it much harder for GHR to fully analyze these accounts with 100% precision. Although, by analyzing j2's Everyday Health (EVRY) purchase in late 2016 as well as j2's acquisitions taken in aggregate, we intend to demonstrate the magnitude of these accruals.

Outsized level of liabilities recorded in Everyday Health acquisition: On 12/05/16, j2 Global acquired Everyday Health (a former public company with the ticker: EVRY) for $493.7 million in cash. According to JCOM's 2016 10K, the company assumed $59.1 million in accounts payables and accrued expenses (these two accounts are curiously not broken out). However, when looking at EVRY's balance sheet in Q3 2016, we find that this line-item had a balance of only $45.1 million as of 09/30/16. Therefore, we find it peculiar that only two months later, this account was listed as 31% ($14.0 million) higher when there doesn't appear to be any seasonality or corresponding revenue growth to go with it.

This is a material level of unexplained liabilities assumed relative to the size of Everyday Health's operations. Due to the fact that EVRY was generating TTM GAAP losses of $23.4 million as of 09/30/16 (the last quarter the firm was public), we will use operating profits to demonstrate the materiality of our aforementioned figure. The unexplained amount of acquired liabilities ($14.0 million) was equivalent to 89.1% of TTM operating profit ($15.7 million) generated through 09/30/16. Because of the materiality of these unexplained liabilities, we believe that j2 and Everyday Health may have built in, or springloaded, outsized reserves for future use at JCOM.

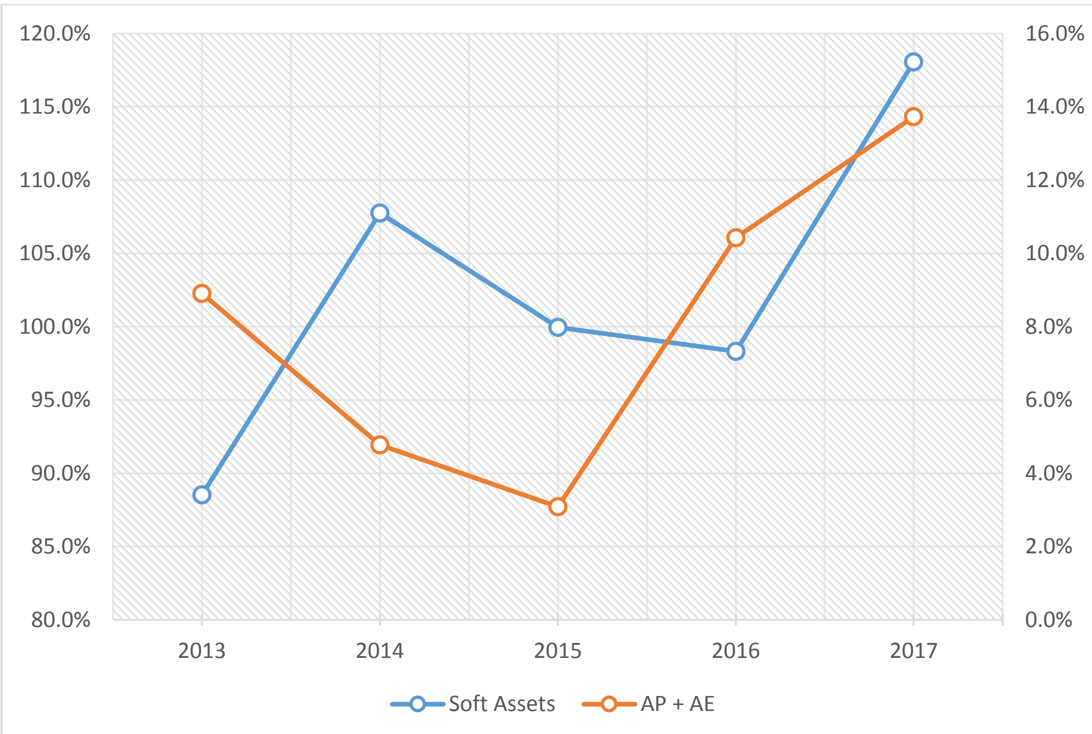
Acquisitions of nonpublic companies portray similar traits: We find similar patterns of unusually high liabilities recorded in connection with several acquisitions of j2's acquired nonpublic firms. Because these companies were private before their respective acquisition, there is no way we can assess whether the acquired liabilities appear fairly-sized relative to the size of the target company's reported financials. Even still, when taken in aggregate for the fiscal year, appear to be outsized and growing over time (see Chart 4, on Page 16).

- **Fiscal Year 2015:** JCOM purchased Firstway, Nuvotera, EmailDirect, SugarSync, Popfax, Salesify, LiveVault, and Offers.com among other smaller companies for a total of $314.0 million in 2015. The amalgamation of all these acquired companies lead to $172.6 million in purchased goodwill, $141.3 million in intangibles and $9.7 million in accounts payables and accrued expenses (AP & AE). Thus, we observe that the AP & AE balance was only 3.1% of the total consideration; we can use this as a baseline of what we believe is normal for this account. Furthermore, soft assets (goodwill + intangibles) made up 100.0% of the total amount spent in the year.

- **Fiscal Year 2016:** The company purchased VaultLogix, Callstream, Publicaster, STMP, Integrated Global Concepts, Fonebox and Everyday Health among other smaller companies for a total of $596.1 million in 2016. The amalgamation of all these acquired companies lead to $333.2 million in purchased goodwill, $252.9 million in intangibles and $62.2 million in AP & AE. Thus, we observe that the AP & AE balance jumped up to 10.4% of the total purchase price spent, leading us to believe liability reserves could have been used by management. Moreover, soft assets made up 98.3% of the total amount spent in the year.

- **Fiscal Year 2017:** Lastly, the company purchased sFax, Wecloud AB, MyPhoneFax, EZ Publishing StreamSend, Humble Bundle, BlackFriday.com, OnTargetJobs and Mashable Inc., among other smaller companies, for a total of $203.9 million in 2017. The amalgamation of all these acquired companies lead to $121.8 million in purchased goodwill, $118.9 million in intangibles and $28.0 million in AP & AE. Thus, we observe that the AP & AE balance again spiked higher to 13.7% of the total consideration; a trend that our analysts find troubling. Additionally, making a new five-year high, soft assets made up 118.1% of the total amount spent in the year.

Chart 4: Soft Assets and Liabilities Acquired Relative to Total Consideration



What the prior data distinctly shows us is that JCOM is allocating more and more dollars spent on purchases to acquired AP & AE, according to j2's 10K. The contra-asset to these liabilities lies within goodwill, which we see increasing heavily as well over the last five years. This leads us to believe that management could be building robust reserves through acquisitions, only to release them later to create artificially inflated margins.

Soft Assets for JCOM are highly outsized relative to peers: Furthering our analysis on goodwill and intangible assets, let us look at these two accounts as a whole on JCOM's balance sheet. We would expect these two figures to continue to grow over time as 1) JCOM is a serial acquirer and 2) JCOM is in an industry where soft assets are prevalent over hard assets such as inventory or PP&E. However, based on our analysis of JCOM's balance sheet and soft assets relative to peers, we believe that JCOM remains at risk for heightened impairment charges in the future. This is especially true after analyzing j2's recent acquisitions in our later sections.

After analyzing goodwill and intangible levels at JCOM's stated peers[7], we have found dangerously high levels of soft assets at j2 Global. We also find it highly peculiar for a company as acquisitive as j2 Global is, that managers have not taken any meaningful amount of impairment charges since their buying spree began over the last 10 years. Delving into the figures for JCOM, we find that, on average, soft assets at the company have risen by 29.4% every year dating back to 2012. At the end of 2011, j2's soft assets only reported a balance of $377.1 million. However, since this time, management has been on a spending spree acquiring new companies causing this balance to spike to its current level of $1.81 billion (72.0% and 173.4% of total assets and equity, respectively) at 09/30/18.

These values are highly outsized when viewed against j2's peer group. For example, the peer group reported a 51.1% average (51.5% median) soft asset ratio relative to total assets (see Chart 5, Page 18). However, even more concerning, j2's peers only reported an average ratio of 84.8% (median 80.5%) relative to total equity. This average ratio lies 8,858 bps below j2's current balance, a truly vast difference with its peer group who are highly acquisitive as well. Many academics also cite material impairment risk when soft assets rise above 100% of total equity, where in JCOM's case, its value dwarfs that figure.

[7] Peer group includes IAC/InterActiveCorp (IAC), TripAdvisor Inc. (TRIP), LivePerson, Inc. (LPSN), LogMeIn, Inc. (LOGM), Zillow Group, Inc. (ZG), salesforce.com, inc. (CRM), OpenText Corporation (OTEX), and The Ultimate Software Group, Inc. (ULTI).

Chart 5. Soft Assets JCOM vs Peers

So what does all this mean for JCOM? Taken as a whole, there are significant risks with JCOM's outsized soft assets which are twofold: 1) the firm is at risk for elevated impairment charges in future periods and 2) management is taking on more goodwill/intangibles than needed in its acquisitions in order to build liability reserves. The decline in ROIC contemporaneous with large increases in goodwill and intangibles assets are frequently cited by academics as a sign of deteriorating quality of earnings. Based on our extensive research and the magnitude of the divergence from peers, this leads us to believe that impairments and other unfavorable earnings quality issues lie ahead for JCOM.

<u>Non-GAAP Exclusions Masks JCOM's True Economic Earnings</u>

You cannot pay your bills with non-GAAP earnings

A salient point of our thesis revolves around JCOM running into significant cash flow problems that will continue to hinder the firm as they acquire more companies. The reader can see below how management will try and steer analysts to their suggested cash flow metrics which are front and center in the latest press release (11/06/18):

> Net cash provided by operating activities increased to $89.8 million compared to $67.3 million for Q3 2017. Q3 2018 free cash flow increased 29.3% to $73.5 million compared to $56.8 million for Q3 2017.

We view the above highlighted metric of cash from operations or free-cash-flow to be highly misleading in an acquisitive company such as JCOM. It puts the company in a situation where their highlighted metrics can be easily manipulated, with sustainable earnings becoming highly obfuscated. It is a very easy game to play.

- Acquire several new companies every year, whether if they fit in with your expertise or not (like a fax company moving into dying websites).

- Spend less and less on normal operating expenses such as R&D. Give out more and more salary in easily removable from non-GAAP stock-based compensation. Non-GAAP margins will look amazing.

- Purchase all your customer acquisition costs through acquisitions so that you do not have to spend on that internally. Then when it comes time to amortize those very real significant expenses, exclude them from non-GAAP so no one pays attention. When anyone asks why this large expense is being excluded… proclaim the words "non-cash" repeatedly until they stop asking. Again, non-GAAP EPS will explode higher.

- Even though the main source of your stated growth comes from acquisitions and your 10K states that you *must* continue to acquire companies for growth, *always remember* to remove acquisition-related costs from non-GAAP income. These are cash items, but again, no analyst will care or ever ask you about them.

- NEVER disclose organic revenue growth. Confuse analysts with performance metrics that are easily manipulated such as CFOA and FCF, which *do not* include acquisition costs. Even adjust FCF to be a higher number, because why not? This is because all your true costs will be hidden under the "Acquisition of Businesses, net of cash received" line-item on the Cash Flow Statement… trust us, no one will look there or in the "Business Acquisition" footnotes.

As the reader will come to see in the below section, non-GAAP earnings for JCOM are substantially higher than the company's as-reported GAAP earnings. For example, in the trailing 9M period, non-GAAP EPS of $4.25 was 172.4% higher than GAAP EPS of $1.56. Throughout all of 2017, non-GAAP EPS of $5.64 was 99.3% higher than GAAP earnings of $2.83 per share.

In prior periods, j2 Global has made several recurring material adjustments in converting GAAP earnings to non-GAAP earnings. However, we will focus on the rising share-based compensation (SBC), acquisition-related integration costs and amortization expenses. It is our view that each of these expenses should be considered recurring economic costs of the business. Thus, in general, we believe that the company's GAAP earnings are a better proxy for JCOM's sustainable economic earnings.

Amortization expenses: The most material item excluded in computing non-GAAP earnings is the amortization of purchased intangible assets. During the 9M ended 09/30/18 (FY2017), j2 excluded $1.78 ($1.82) in EPS in amortization expense in the presentation of non-GAAP earnings, representing an increase of 29.0% (19.0%) YOY. Amortization expense represented an astonishing 41.9% (32.3%) of total non-GAAP earnings during the 9M 2018 (FY2017). As a percentage of non-GAAP earnings, amortization expenses have risen in stair step fashion, from 0% in 2012, all the way to 41.9% in the latest 9M 2018.

> *In the past, fraudulent managers would at least have the decency of extending the lives of their intangibles assets in order to lessen their amortization expense. Today's managers are so lazy that they just exclude amortization expenses all together, and no one seems to care.*
>
> *-GHR*

As part of the firm's press release, JCOM gives the following boiler-plate explanation for removing the expenses:

> Elimination of amortization of patents and intangible assets that we acquired.

How helpful. Essentially, JCOM management views acquisition-related amortization expense as a non-operating and non-recurring activity. However, amortization expense is a very real economic expense that results from the prior cash outlays for acquisitions. Because JCOM relies heavily on acquisitions for growth, we believe the exclusion of amortization expense from the presentation of non-GAAP earnings overstates the economic earnings of the firm.

The ONLY way analysts should feel comfortable with a company that excludes its amortization from non-GAAP earnings would be if the life of those intangible assets were long-term or near indefinite. Is that the case here with JCOM? Are they buying long-term intangible assets (that consist of customer relationships, trade names, patents, and others) that will hold their value over time?

As you can see from JCOM's own filings, they believe ALL of their intangibles have an expected life of only 4.8 to 11.2 years (with the majority of customer relationships having an 8.9-year lifespan). GHR's own internal calculations estimated the average useful life of its intangibles to be 6.4 years, based on the disclosed intangible assets and amortization expenses at the end of 2017. Because of this, we here at GHR believe that these very real and substantial expenses absolutely should not be excluded from adjusted earnings.

Acquisition-related integration costs: The second-largest adjustment recorded by JCOM is disclosed as "acquisition-related integration costs". During the 9M ended 09/30/18 (FY2017), the firm excluded $0.39 ($0.42) in EPS related to acquisitions from non-GAAP figures. These excluded charges end up comprising 9.2% and 7.4% of 9M 2018 and FY2017 non-GAAP earnings, respectively. Again, we present management's robust disclosure regarding the reasoning behind the exclusion:

> Elimination of certain acquisition related integration costs.

While most of the time our analysts would agree with removing these costs as one-time items, we cannot reconcile how a self-described "serial acquirer", which has taken eight consecutive years of acquisition charges would ever deem them to be "nonrecurring". Similar to amortization expenses, these charges continue to grow in both absolute and relative terms over time with no end in sight.

Share-based compensation: The third-largest exclusion is related to share-based compensation (SBC), which represented 7.3% of non-GAAP earnings in the 9M 2018. In a common theme, this exclusion is up from the 6.4% ratio reported in FY2017.

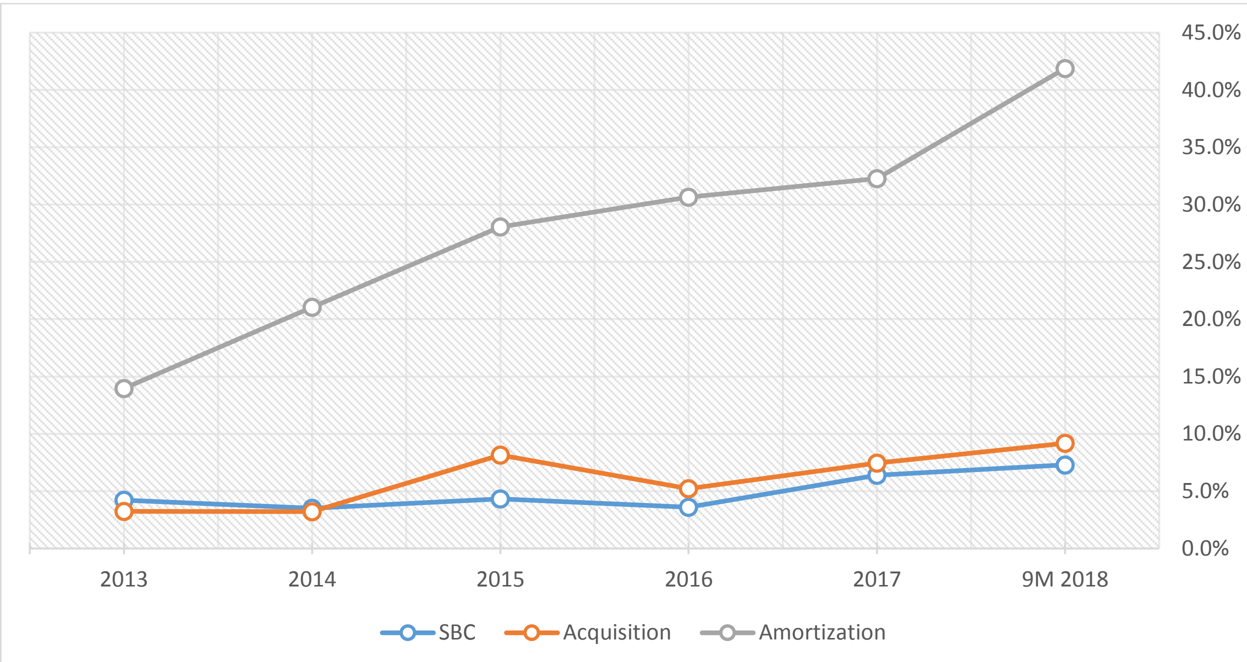
In general, GHR views all of the prior exclusions as reoccurring and true expenses for JCOM. Managers remove these expenses because they can, and no analysts will hold them responsible. Yes, every other company removes these expenses as well, but not all companies are like JCOM. Analysts must understand that the aforementioned costs are very real expenses that take cash away from the company or dilute its shares. As such, while not perfect, we believe turning to GAAP earnings display JCOM's earnings better than the management focused adjusted earnings, CFOA or adjusted FCF.

However, even GAAP earnings may be overstating the firm's profits relative to economic earnings. In this regard, we note that both GAAP and non-GAAP earnings may have benefitted from the establishment of outsized liabilities in several recent acquisitions as discussed earlier.

Table 1: GAAP to Non-GAAP Reconciliation Analysis

Period Ended:	9M 2018	2017	2016	2015	2014	2013
GAAP EPS	**$1.56**	**$2.83**	**$3.13**	**$2.73**	**$2.58**	**$2.29**
Amortization Expense	1.78	1.82	1.53	1.17	0.72	0.43
Acquisition Related Costs	0.39	0.42	0.26	0.34	0.11	0.10
Share-Based Compensation	0.31	0.36	0.18	0.18	0.12	0.13
Interest Costs	0.08	0.29	0.07	0.12	0.00	0.00
Investments	0.12	0.05	0.00	0.00	0.00	0.00
Tax Expense from Prior Years	0.01	0.04	-0.05	-0.35	-0.12	0.00
Sale of Businesses	0.00	-0.40	-0.10	0.00	0.00	0.00
Convertible Debt Dilution	0.03	0.04	0.01	0.01	0.00	0.00
Other	0.00	0.24	0.00	-0.02	0.02	0.14
Non-GAAP EPS	**$4.25**	**$5.64**	**$4.99**	**$4.17**	**$3.42**	**$3.08**

Chart 6: Exclusions as a % of Non-GAAP Earnings



GAAP vs. Non-GAAP Earnings Surprises

What we find quite concerning when analyzing JCOM's recent earnings surprises (below) is twofold. First, when looking at the firm's recent positive non-GAAP earnings surprises, we observed that JCOM was only able to beat estimates by an average of 1.5% dating back to Q4 2016. Within these eight periods, JCOM was able to beat or meet consensus non-GAAP EPS in seven of those periods. With the amount of subjectivity involved with non-GAAP exclusions, we at GHR believe it would be quite easy for management to either pay out more in SBC or report heightened acquisition charges to just beat out non-GAAP estimates every period.

Furthermore, where JCOM was able to either meet or beat in seven of the last eight periods pertaining to non-GAAP earnings, the firm has pathetically missed GAAP earnings estimates in every one of the last eight periods. We do not believe this to be a coincidence. <u>Again, where the company was able to beat non-GAAP figures by 1.5% every period, the firm pitifully missed GAAP earnings by an average of 16.0% every quarter since Q4 2016.</u>

Table 2: GAAP & Non-GAAP Reported Earnings and Consensus Estimates

NasdaqGS:JCOM (USD)	FQ4 2016 - Dec 2016	FQ1 2017 - Mar 2017	FQ2 2017 - Jun 2017	FQ3 2017 - Sep 2017	FQ4 2017 - Dec 2017
EPS Normalized	1.49 A	1.19 A	1.33 A	1.34 A	1.79 A
Final Est.	1.42 E	1.19 E	1.32 E	1.32 E	1.82 E
Median	1.43 E	1.21 E	1.34 E	1.33 E	1.81 E
High	1.48 E	1.33 E	1.37 E	1.40 E	1.95 E
Low	1.34 E	0.97 E	1.24 E	1.24 E	1.75 E
Std. Dev.	0.04	0.11	0.05	0.05	0.06
No. of Estimates	7/7	7/7	7/7	7/7	7/8
Acctg. Standard	US GAAP	US GAAP	US GAAP	US GAAP	US GAAP
EPS (GAAP)	0.89 A	0.52 A	0.63 A	0.66 A	1.02 A
Final Est.	1.01 E	0.60 E	0.68 E	0.67 E	1.12 E
Median	1.02 E	0.60 E	0.71 E	0.66 E	1.05 E
High	1.07 E	0.63 E	0.73 E	0.73 E	1.45 E
Low	0.91 E	0.56 E	0.58 E	0.62 E	0.85 E
Std. Dev.	0.06	0.04	0.06	0.04	0.25
No. of Estimates	4/4	2/3	4/4	4/4	3/3
Acctg. Standard	US GAAP	US GAAP	US GAAP	US GAAP	US GAAP

NasdaqGS:JCOM (USD)	FQ1 2018 - Mar 2018	FQ2 2018 - Jun 2018	FQ3 2018 - Sep 2018
EPS Normalized	1.22 A	1.50 A	1.53 A
Final Est.	1.20 E	1.44 E	1.51 E
Median	1.23 E	1.45 E	1.52 E
High	1.28 E	1.49 E	1.56 E
Low	1.08 E	1.36 E	1.46 E
Std. Dev.	0.06	0.04	0.03
No. of Estimates	8/8	8/8	8/9
Acctg. Standard	US GAAP	US GAAP	US GAAP
EPS (GAAP)	0.38 A	0.57 A	0.61 A
Final Est.	0.59 E	0.76 E	0.83 E
Median	0.58 E	0.81 E	0.81 E
High	0.68 E	0.82 E	0.95 E
Low	0.52 E	0.66 E	0.74 E
Std. Dev.	0.07	0.07	0.07
No. of Estimates	4/4	3/3	5/5
Acctg. Standard	US GAAP	US GAAP	US GAAP

Changes in Methodologies and Limited Disclosures Regarding JCOM's Performance Metrics Leaves GHR Perplexed

j2 Global provides various (and sometimes varying) performance metrics throughout many of its deliverables to investors. Annual/quarterly reports and excerpts from transcripts and presentation slides all provide these performance metrics in one fashion or another, sometimes with different reported figures between them! After extensive research, it is apparent that consistency among its performance metrics is not a forte of the firm.

Throughout prior years, we will focus on frequent occasions (especially throughout the tenure of CFO Scott Turicchi) where j2 provided figures that turned out to be errors, changed their figures over time, or did not disclose given statistics in audited financials instead only mentioning them on presentation slides or calls. In our experience, this magnitude of inconsistency between financials is usually deliberate and meant to obfuscate failing financials. We go into detail with these findings below:

Buried Revision in Average Revenue per User Results in the Metric Exploding Higher:

- A main performance metric given by j2 in the Cloud segment is average revenue per user (ARPU), however this definition/calculation changed drastically in Q2 2014 with very little disclosures or reasons why.

- In Q1 2014, the quarter before this metric was changed, ARPU was disclosed as $12.67, reaching a recent low for JCOM. Previous CFO Kathleen Griggs, attributed the less than desirable value to "… the growth in our larger corporate accounts and international users."

- However, magically in next year's filing after this calculation was changed. Specifically, the figure was revised upwards to $13.78, with only added excerpts given in the firm's footnotes, but nothing in the press release or earnings call (see Exhibit 1 & 2 in the Appendix).

- According to the Q1 and Q2 2014 10Q filings, JCOM changed the definition of its customer in its calculation from "direct inward-dial number (DID)" to "Cloud Business Customer". After this change was made, it appears to reduce the negative impacts of JCOM's larger corporate accounts; the company's ARPU metric has shot upwards and never looked back to the $15.61 value as of 09/30/18. In other words, management did not like the trend ARPU was heading when using its old methodology, so they changed it (with little disclosures to analysts/investors) in order to make this metric look much better over time.

- Other discrepancies involving ARPU lie within the firm's given slide presentations during each earnings call (see Exhibit 3 & 4 in the Appendix). Specifically, in the Q3 2015 presentation slides (Exhibit 3), we see the company disclose APRU figures as $15.28, $15.26, $14.95, $14.79, and $14.06 in Q3 2016, Q2 2016, Q1 2016, Q4 2015, and Q3 2015, respectively.

- However, just one period later, in the Q4 2016 earnings presentation (Exhibit 4), we can see that these figures were revised higher to $15.32, $15.31, $15.00, $14.84, and $14.09 in Q3 2016, Q2 2016, Q1 2016, Q4 2015, and Q3 2015, respectively. Again, it is amateur hour for a company of this size to be reporting varying numbers in different periods with no explanations given nor neither footnotes changed.

The question that remains is this: should investors/analysts rely on JCOM's rising ARPU metric as a harbinger for strength at j2 Global? Based on our findings, we believe the answer is a resounding no. It appears that management of JCOM will tend to agree with us as well. In a Corresponding Letter to the SEC discussing this metric[8], management stated, "j2 is continuing to reevaluate the metrics by which it measures the performance of its businesses and **believes that ARPU and the customer cancellation rate have become increasingly immaterial over time**." Then, in its next letter to the SEC, they stated:

> As ARPU varies based on fixed subscription fee and variable usage components, it can serve as a measure by which investors can evaluate trends in the types of services, levels of services and the usage levels of those services across j2's paying DID base. This said, j2 provides an array of Business Cloud services and Digital Media services where revenues are generated without the issuance of a DID.
>
> **This has resulted in ARPU becoming less valuable of a metric to our investors than in the past. While j2 may at some point in the future cease to disclose ARPU as a metric**, as long as it does report it to the public it will continue to include ARPU in its quarterly and annual filings along with the reason why this metric may be useful to investors in j2 [Emphasis added].

[8] Prior CEO Nehemia Zucker and CFO Kathleen Griggs discussed its ARPU metric in two separate Corresponding Letters to the SEC on 06/28/13 and 05/22/13.

Cancellation Rate Formula Changed Without Notice Given:

- Similar to ARPU, JCOM's churn/cancellation rate formula appears to have been altered on numerous occasions with minimal disclosures relayed to the analyst/investing community.

- JCOM's calculation of churn extended its metric to four months out, therefore not counting cancellations in the first four months under its cancellation rate. Because free trials and customers who do not like the product tend to cancel quickly, this only leaves a smaller number of clients in the cancellation calculation.

- Prior to Q2 2014, the company's Cancel Rate footnote stated that it tracked cancellations related to individual customer DIDs with greater than four months of continuous service (05/09/14 10Q).

- Subsequently in the next period, this excerpt was changed to "Cancel Rate is defined as cancels of *small and medium business* and individual Cloud Services customers with greater than four months of continuous service."

- After this change, JCOM curiously enjoyed its lowest cancellation rate in the history of the company, currently residing in the low 2%. However, based on management's statements in the past disregarding this metrics importance and the overall formula change, we remain skeptical of this overall metric.

- Furthermore, with regards to JCOM's arduous cancellation policy, it is well known that cancelling j2's e-fax service is extremely taxing. Many short-sellers have discussed this at length, as the firm does not allow the end user to cancel their subscription online, but only through telephone. We believe these aggressive tactics have also attributed to j2's recent favorable churn trends, in addition to the change in formula.

j2 Global Website Traffic Continues to Dwindle

In the early 2010s, JCOM management understood that in order to keep Wall Street happy, it would need to keep the top line growing to secure its lofty valuation. How would j2 be able to do this though, when its primary product (e-fax services) was in a dying industry? Enter the Ziff Davis acquisition in 2013 and the new Media segment of j2 Global, Inc. With analysts cheering the then booming digital properties industry, j2 was able to secure its top line growth through continued acquisitions. AskMen.com, PCMag.com, IGN, SpeedTest.net, Mashable.com, HumbleBundle.com and blackfriday.com are all significant digital acquisitions dating back to 2013. The firm also acquired several healthcare-related websites such as EverydayHealth, Lifescript.com, and PRIME Education.

Every quarter within its filings, j2 touts relatively meaningless Visits and Page Views figures, in absolute balances. As one could expect from j2 management, these numbers are shown consistently growing by leaps and bounds year after year (see below excerpt from 2017 10K).

Digital Media Segment Performance Metrics

The following table sets forth certain key operating metrics for our Digital Media segment for the years ended December 31, 2017, 2016 and 2015 (in millions):

	Years Ended December 31,		
	2017	2016	2015
Visits	5,720	4,992	4,001
Page views	23,731	18,063	10,276

Sources: Google Analytics and Partner Platforms

- While j2 continues to tout its page views and visits in every period, we find it to be quite disingenuous as the company continues to list them in absolute terms. For example, page views and site visits are both up 31.4% and 14.6%, respectively in 2017. Astonishing.

- Again, similar to our organic growth concerns earlier, if the company continues to use leverage to buy more websites, do these numbers really matter in absolute terms? In fact, many of the websites purchased could actually be declining in website traffic, contrasting the worthless rising figures given by management.

- While website traffic has been discussed in prior short-seller reports such as Citron Research, our analysis using Alexa.com and Google trends produce similar results across j2 Global's Digital portfolio.

- When analyzing j2's largest websites[9], we find that many of j2's most notable websites are down substantially in rank YOY; with only the exception of Speedtest.net. In the table below, GHR lists each major j2 website's current rank, previous rank in the prior year and the YOY change.

Table 3: Global Traffic Rankings of j2's Major Websites

Website (Acquisition Date)	Current Global Rank[10]	Previous Year Global Rank	YOY Delta	Estimated Visits[11]
HumbleBundle.com (10/13/17)	624	355	-43.1%	24,302,227
Mashable.com (12/05/17)	1,438	897	-37.6%	32,133,767
Ookla AKA Speedtest.net (12/02/14)	242	259	7.0%	26,474,262
androidcentral.com (05/20/13)	1,920	1,686	-12.2%	12,137,765
MacRumors.com (05/20/13)	1,960	1,403	-28.4%	13,706,806
PCMAG.com (11/12/12)	1,613	1,120	-30.6%	13,535,735
IGN.com (11/12/12)	351	331	-5.7%	61,355,106
AskMen.com (11/12/12)[12]	10,081	6,791	-32.6%	1,867,129
Average			-21.5%	

With these website traffic figures all continuing to fall using verifiable third-party data, we find it highly peculiar that analysts continue to be bullish of this j2 segment. According to JCOM's filings, digital media revenues are earned primarily from the delivery of advertising services and from subscriptions to services and information. It is highly known within the digital media industry that eyeballs will always drive advertising revenue growth. Based off the figures above, GHR cannot believe organic digital media growth performed well for JCOM in 2018.

[9] Defined as having a global rank better than #2000.
[10] All ranking and visit data gathered from Alexa.com as of 12/03/18.
[11] Estimated # of visits to each respective website over the past 30 days.
[12] Although not included in the average table, AskMen.com was added to the table as the company continues to highlight it as a major website for j2 Global in its filings.

JCOM Selects Lesser Known Auditors for its Financials

- JCOM has retained non-Big 4 auditors throughout their acquisition spree dating back to 2011. BDO (2014 to current), a larger accounting firm but not Big 4, and lesser known SingerLewak (2007–2013).

- Our concerns regarding JCOM's choice of SingerLewak relate to 1) its relatively small size (and the relative inexperience with large clients such as JCOM), 2) the complexity SingerLewak would need to handle with the multitude of acquisitions done by JCOM and 3) the nature of deficiencies noted by the PCAOB in its periodic quality control reviews of the firm's audit work.

- Based on our expertise, we consider the issue of auditor size to be quite concerning, as we have found that smaller accounting firms face significant barriers such as lack of sufficient staff and technical expertise when auditing larger firms such as JCOM. In this context, JCOM was by far SingerLewak's largest publicly traded client at the time of audits. As such, we find the choice of SingerLewak as an auditor by JCOM management to be highly suspect at a time when the company's financials were most likely in disarray from the myriad of acquisitions.

- In the most recent PCAOB audit reports on SingerLewak (yes, audits of the auditors), the PCAOB found the following deficiencies regarding the auditor[13]:

    1. the failure, in four audits, to perform sufficient procedures to test the valuation of goodwill and other intangible assets, and
    2. the failure to perform sufficient procedures related to the testing of revenue
    3. the Firm's failure to identify, or to address appropriately, a departure from GAAP that related to a potentially material misstatement in the audited financial statements concerning the classification of certain current liabilities as a reduction of current assets;
    4. the failure to perform sufficient audit procedures related to the Firm's use of the work of a specialist; and
    5. the failure to perform sufficient audit procedures related to the valuation of inventory.

[13] https://pcaobus.org/Inspections/Reports/Documents/2011_SingerLewak_LLP.pdf

- The long overdue switch of auditors to BDO LLP in 2014 was a better choice than SingerLewak, however BDO has its fair share of deficiencies as well, in addition to not being a Big 4 accounting firm.

- In a report dated 07/12/18, the PCAOB reported most frequently identified audit deficiencies of BDO, which included the following[14]:

  1. Failure to sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing
  2. Failure to sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate
  3. Failure to sufficiently test controls over or sufficiently test the accuracy and completeness of data or reports
  4. Areas of deficiencies include revenue, including accounts receivable, deferred revenue, and allowances, inventories and related reserves, and loans, including allowance for loan losses

- Audit and audit-related fees have exploded since BDO was retained. In the last three years, JCOM's audit fees have increased by 52.2%, 36.9% and 32.4% in 2017, 2016, and 2015, respectively. Currently, JCOM's audit bill resides at approximately $3 million in 2017, according to the company's 2017 proxy statement. This amount of growth over this period of time is highly unusual and leads us to believe that JCOM's financials continue to be more and more complex as time goes on.

- Notwithstanding the 152 acquisitions in the last 10 years that JCOM has completed that these smaller auditors must handle, we also point out the recent complex revenue recognition issues and past changes in estimates that the auditors needed to deal with.

- For example, in the latest period, the firm added an explanation paragraph in its press release (11/06/18) stating, "j2 has commenced a review of the timing and recognition of certain revenues reported by one of its foreign subsidiaries. While the review is on-going, j2 currently believes that the amount of revenue involved is up to $2.4 million, and accordingly, j2 has not recognized such revenue in Q3 2018. j2 has informed its Audit Committee and its auditors and is working diligently to resolve this matter."

[14] https://pcaobus.org/Inspections/Reports/Documents/104-2018-111-BDO-USA-LLP.pdf

- Previously in its Q1 2011 10Q, the company detailed a $10.3 million one-time charge to revenue and offsetting increase in deferred revenue that we believe should have been classified as an error with restated financials.

- In the period in question, JCOM made a change in estimate regarding the remaining service obligations to its annual eFax subscribers. As a result of system upgrades, JCOM then based the estimate on the actual remaining service obligations to these customers. While management and SingerLewak treated this miscalculation as a change in accounting estimate, the description of the underlying circumstances resonates more like a correction of an error in prior period financials based on our experience.

Overall, we bring up the smaller auditors that JCOM has chosen because at the end of the day, GHR does not believe these auditors are truly equipped and staffed to handle JCOM's complex organization. We also believe that a larger auditor such as one of the Big 4 could have uncovered the plethora of accounting issues detailed in this report.

JCOM's CFO and Audit Board Completely Lack Any Accounting Experience

Adopting a Private Equity mentality under the leadership of prior CEO Nehemia (Hemi) Zucker and CFO Scott Turicchi took JCOM from a waning eFax company into what it is today for better or worse. In the early 2010s, these two men decided that in order to combat a dying fax industry, they would lever up their balance sheet and branch into new areas of growth. While our analysis points to very little value creation through these acquisitions, management of JCOM continued to get rich through the use of incentive metrics that have been easily financially engineered (JCOM's Compensation Committee uses "adjusted non-GAAP earnings" to determine its incentive payouts for executives). As the reader will come to understand, GHR believes many of the accounting issues detailed in this report stemmed throughout Mr. Zucker's and Mr. Turicchi's tenure as CEO and CFO of j2 Global.

Long-time standing CEO Nehemia Zucker retired as CEO formally on 12/31/17, although he has stayed on as an advisor to JCOM at this time. He joined the company in 1996 and served in various positions such as CFO, CMO and others before taking the CEO role in 2008.

With regards to Mr. Turicchi, he has also served JCOM in various capacities since joining the company in March 2000. Curiously in 2003, Mr. Turicchi was named Chief Financial Officer in addition to his Executive Corporate Development role, even though Mr. Turicchi does not appear to have a CPA license or any accounting experience. Then for a period of time between 2007-2014, Mr. Turicchi relinquished his CFO post to Kathleen Griggs in order to "devote his energies to mergers and acquisitions".

Mr. Turicchi then took the position back from Ms. Griggs after her resignation on 08/08/14. From an outside perspective, we see the many hats being worn by both Mr. Zucker and Mr. Turicchi to be a separation of duties and internal control concern. While it appears that Mr. Turicchi's main function lies with M&A activities for JCOM, we would hope someone with much more sufficient accounting experience would be managing j2's books due to its complexity.

JCOM's auditing board currently consists of three members with very little accounting backgrounds: W. Brian Kretzmer (audit chairman), Jonathan Miller, and Stephen Ross. Within the auditing board, we would expect JCOM to have CPAs or prior Big 4 employees serving this committee. However, this could not be further from the truth. Besides the fact that there is not one CPA serving as the CFO or within the audit committee, neither do any of the members have an accounting background.

It is highly unusual for not one member of these positions to hold a CPA license, especially the CFO and/or Audit Chairman. When we look into the Audit Chairman's, Mr. Kretzmer's, background, we find that he graduated with a BA in Asian Studies from Montclair State University and an MBA in Finance from Fairleigh Dickinson. We were not able to find any accounting experience with the audit committees other two members Jonathan Miller or Stephen Ross. Due to JCOM's complexity regarding its financials and accounting concerns listed herein, we believe the board may not be currently equipped to fully comprehend the firm's accounting issues at this time.

<u>JCOM's Share Price is at Risk for Severe Deterioration Due to Misunderstood Bull Thesis</u>

The bull case regarding JCOM's stock price revolves around the following tenants that we believe the sell-side community has misunderstood:

1) The company's disciplined approached to identifying investment opportunities with turnaround acquisitions
2) Free-cash-flow generation that continues to accelerate
3) Adjusted EPS metrics that continue to beat surpass estimates

Regarding these items, we have detailed in this report how management's touted ROIC metric that uses FCF instead of better earnings proxies is a farce. Furthermore, the use of FCF without acquisition costs are entirely misleading as the company *cannot* grow without the use of acquisitions. We believe that obstinate analysts are missing the organic declines the firm is facing within its core business. We also doubt that the sell-side community fully comprehends the magnitude of accounting headwinds that JCOM faces over the next 6-12 months.

We at GHR believe the company's true economic earnings can be better estimated using sincerer metrics such as GAAP earnings and/or free-cash-flow including acquisitions. If analysts <u>do not</u> adjust for the obviously recurring and true expenses such as amortization, stock-based compensation and acquisition-related costs, it is almost laughable that the market is valuing this company with a GAAP P/E multiple of approximately 27x.

Exacerbating the issue, the plethora of accounting irregularities detailed throughout this report make JCOM's current multiples appear to be even more outrageous. Overall, we do not see how a company operating in a dying fax industry contemporaneous with declining traffic on all its main websites could possess a high growth Price-to-Sales and P/E multiples.

Basing our valuation on our sustainable EPS of $2.06,[15] we believe a fair share-price for the firm stands currently at $24.77, which represents a 64.2% downside to the share-price. Based on our organic growth and acquisition accounting analysis, we believe a conservative P/E multiple lies at 12x, which we used in our models.

In light of our concerns regarding the plethora of accounting and fundamental concerns laid out herein, GHR finds the current stock price to be highly egregious. Accordingly, we are initiating coverage on j2 Global, Inc., (JCOM) with a target price of $24.77.

[15] Based on our analysis, we use GAAP EPS as our earnings proxy with a 20% discount due to JCOM's acquisition accounting reserves. We believe this figure creates a fair and conservative sustainable earnings value at this time.

Appendix

Exhibit #1, excerpt from Q2 2014 10Q filing:

Business Cloud Services Segment Performance Metrics

The following table sets forth certain key operating metrics for our Business Cloud Services segment as of and for the three and six months ended June 30, 2014 and 2013 (in thousands, except for percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Subscriber revenues:				
Fixed	$ 85,507	$ 74,555	$ 165,986	$ 145,829
Variable	19,633	19,196	38,006	37,424
Total subscriber revenues	$ 105,140	$ 93,751	$ 203,992	$ 183,253
Percentage of total subscriber revenues:				
Fixed	81.3%	79.5%	81.4%	79.6%
Variable	18.7%	20.5%	18.6%	20.4%
Average monthly revenue per Cloud Business Customer (1)(2)	$ 13.84	$ 14.07		
Cancel Rate(3)	2.0%	2.2%		

(1) Quarterly ARPU is calculated using our standard convention of applying the average of the quarter's beginning and ending base to the total revenue for the quarter. We believe ARPU provides investors an understanding of the average monthly revenues we recognize associated with each Cloud Business Customer. As ARPU varies based on fixed subscription fee and variable usage components, we believe it can serve as a measure by which investors can evaluate trends in the types of services, levels of services and the usage levels of those services across our Cloud Business Customer base.

(2) Cloud Business Customers is defined as paying DIDs for fax and voice services, and direct and resellers' accounts for other services.

(3) Cancel Rate is defined as cancels of small and medium business ("SMB") and individual Cloud Business Customers with greater than 4 months of continuous service (continuous service includes Cloud Business Customers which are administratively cancelled and reactivated within the same calendar month), and enterprise Cloud Business Customers beginning with their first day of service. Calculated monthly and expressed here as an average over the three months of the quarter.

Exhibit #2, excerpt from Q2 2013 10Q filing:

Business Cloud Services Segment Performance Metrics

The following table sets forth certain key operating metrics for our Business Cloud Services segment as of and for the three and six months ended June 30, 2013 and 2012 (in thousands, except for percentages):

	June 30,	
	2013	2012
Paying telephone numbers	2,189	2,058

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Subscriber revenues:				
Fixed	$ 75,304	$ 72,187	$ 146,691	$ 142,414
Variable	18,447	15,884	36,562	30,482
Total subscriber revenues	$ 93,751	$ 88,071	$ 183,253	$ 172,896
Percentage of total subscriber revenues:				
Fixed	80.3%	82.0%	80.0%	82.4%
Variable	19.7%	18.0%	20.0%	17.6%
Subscriber revenues:				
DID-based	$ 86,182	$ 81,537	$ 168,684	$ 160,024
Non-DID-based	7,569	6,534	14,569	12,872
Total subscriber revenues	$ 93,751	$ 88,071	$ 183,253	$ 172,896
Average revenue per paying telephone number (ARPU) (1)	$ 13.16	$ 13.19	$ 13.06	$ 13.00
Cancel Rate(2)	2.2%	2.3%		

(1) Quarterly ARPU is calculated using our standard convention of applying the average of the quarter's beginning and ending base to the total revenue for the quarter. We believe ARPU provides investors an understanding of the average monthly revenues we recognize associated with each DID deployed to our paying customers. As ARPU varies based on fixed subscription fee and variable usage components, we believe it can serve as a measure by which investors can evaluate trends in the types of services, levels of services and the usage levels of those services across our paying DID base.

(2) Cancel rate is defined as cancels related to individual customer DIDs with greater than four months of continuous service (continuous service includes customer DIDs which are administratively canceled and reactivated within the same calendar month).

Exhibit #3, Presentation Slide from Q3 2016 Earnings Call:

Total Cloud

(in Thousands)

	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Revenue by Type							
Fixed Subscriber Revenues	$96,097	$102,437	$103,957	$112,428	$115,496	$117,199	$117,816
Variable Subscriber Revenues	$19,687	$21,368	$21,364	$21,384	$21,453	$24,156	$24,396
Subscriber Revenues	**$115,784**	**$123,805**	**$125,321**	**$133,812**	**$136,949**	**$141,355**	**$142,212**
Other Licenses Revenues (1)	$2,277	$1,383	$1,115	$1,141	$1,191	$1,105	$1,130
Total Cloud Revenues	**$118,061**	**$125,188**	**$126,436**	**$134,953**	**$138,139**	**$142,460**	**$143,342**
Revenue - DID vs. Non-DID							
DID Based Revenues	$85,777	$88,945	$89,257	$88,676	$89,967	$92,592	$92,396
Non-DID Based Revenues	$32,284	$36,243	$37,179	$46,277	$48,173	$49,868	$50,946
Total Cloud Revenues	**$118,061**	**$125,188**	**$126,436**	**$134,953**	**$138,139**	**$142,460**	**$143,342**
Cloud Services Customers (2)	**2,896**	**2,936**	**3,004**	**3,022**	**3,086**	**3,090**	**3,114**
Average Monthly Revenue/Customers (3)	$13.91	$14.15	$14.06	$14.79	$14.95	$15.26	$15.28
Cancel Rate (4)	2.2%	1.9%	2.0%	2.1%	2.2%	2.2%	2.3%

Media

	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Digital Media Traffic (5)							
Visits	955,687	931,769	1,022,275	1,091,510	1,096,332	1,159,925	1,448,339
Views	2,391,570	2,226,210	2,569,875	3,087,971	3,637,100	4,215,216	5,405,305

(1) Cloud Services revenue includes IP Licensing revenue
(2) Cloud Services Customers are defined as paying DIDs for Fax & Voice services and direct and resellers' accounts for other services
(3) Quarterly ARPU is calculated using our standard convention of applying the average of the quarter's beginning and ending customer base to the total revenue of the quarter
(4) User cancel rate, also called user churn, is defined as cancellation of service by Cloud Business customers with greater than 4 months of continuous service (continuous service includes Cloud Business customers that are administratively cancelled and reactivated within the same calendar month). User cancel rate is calculated monthly and expressed here as an average over the three months of the quarter.
(5) Digital Media Traffic figures based on Google Analytics & Partner Platforms

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Exhibit #4, Presentation Slide from Q4 2016 Earnings Call:

Total Cloud (in 000's)

	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4
Revenue by Type								
Fixed Subscriber Revenues	$96,097	$102,437	$103,957	$112,428	$115,496	$117,199	$117,816	$117,885
Variable Subscriber Revenues	$19,687	$21,368	$21,364	$21,384	$21,453	$24,156	$24,396	$23,944
Subscriber Revenues	**$115,784**	**$123,805**	**$125,321**	**$133,812**	**$136,949**	**$141,355**	**$142,212**	**$141,830**
Other Licenses Revenues (1)	$2,277	$1,383	$1,115	$1,141	$1,191	$1,105	$1,130	$1,168
Total Cloud Revenues	**$118,061**	**$125,188**	**$126,436**	**$134,953**	**$138,139**	**$142,460**	**$143,342**	**$142,998**
Revenue - DID vs. Non-DID								
DID Based Revenues	$85,777	$88,945	$89,257	$88,676	$89,967	$92,592	$92,396	$92,787
Non-DID Based Revenues	$32,284	$36,243	$37,179	$46,277	$48,173	$49,868	$50,946	$50,211
Total Cloud Revenues	**$118,061**	**$125,188**	**$126,436**	**$134,953**	**$138,139**	**$142,460**	**$143,342**	**$142,998**
Cloud Services Customers (2)	**2,896**	**2,936**	**2,994**	**3,011**	**3,074**	**3,081**	**3,108**	**3,109**
Average Monthly Revenue/Customers (3)	$13.91	$14.15	$14.09	$14.84	$15.00	$15.31	$15.32	$15.21
Cancel Rate (4)	2.2%	1.9%	2.0%	2.1%	2.2%	2.2%	2.3%	2.1%

Media (in '000s)

	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4
Digital Media Traffic (5)								
Visits	955,687	931,769	1,022,275	1,091,510	1,096,332	1,159,925	1,448,339	1,287,501
Views	2,391,570	2,226,210	2,569,875	3,087,971	3,637,100	4,215,216	5,405,305	4,805,816

(1) Cloud Services revenue includes IP Licensing revenue
(2) Cloud Services Customers are defined as paying DIDs for Fax & Voice services and direct and resellers' accounts for other services
(3) Quarterly ARPU is calculated using our standard convention of applying the average of the quarter's beginning and ending customer base to the total revenue of the quarter
(4) User cancel rate, also called user churn, is defined as cancellation of service by Cloud Business customers with greater than 4 months of continuous service (continuous service includes Cloud Business customers that are administratively cancelled and reactivated within the same calendar month). User cancel rate is calculated monthly and expressed here as an average over the three months of the quarter.
(5) Digital Media Traffic figures based on Google Analytics & Partner Platforms

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