

## **In Focus: Silver Spring Networks (SSNI)**

White Brook entered Silver Spring Networks (SSNI, “Silver Spring” or “The Company”) slightly too early and took an early loss in its position this quarter. White Brook has been adding to its initial position in the Model Portfolio, however, and believes the potential returns to be more than what it conservatively models.

To White Brook, Silver Spring is a perfect tweener. It splits the investment community, as energy analysts do not quite understand the smart/telecom aspects of the business while technology analysts don’t quite understand the municipal/utility aspect of the business. At the same time, while the Company is well led, it is poorly messaged. White Brook believes if the Company can fix their messaging and continue to execute, in time, it will prove to be a tremendous investment opportunity at these levels.

Silver Spring Networks was founded in July 2002, signed its first customer in 2007, and went public in March 2013. The Company’s legacy business is as a provider of technology that enables power utilities to automate the reading of a building’s energy meter. While there are differences between smart meters, the business has become commoditized. The Company, however, has widened its solutions and built on their two-way communication technology to: help electric utilities manage their load and respond to demand fluctuation, help water utilities manage their meters, and help municipalities light their streets. Of these solutions, the first two are basically commoditized industries, while the third is less competitive and Silver Spring’s position is enviable.

White Brook’s excitement is based on the Company’s smart streetlighting products. A leader in the industry, the Company enables intelligence in 30% of intelligent streetlighting with a recent win – share of over 50%. In conjunction with providing communication capability to street lighting, Silver Spring includes a second radio that creates a mesh wireless network that the Company manages, to provide a layer of communication across “smart devices”. The network benefits from classic network effects with each system growing in importance and capability as more devices are connected. The devices extend the network, and the abilities of the devices grow as they work in conjunction with adjacent systems.

The latest version of the network provides throughput of up to 2.4 MB/sec to each device, is redundant by nature of its mesh networking, and is power sipping, secure, and can connect devices within 50 miles. It operates on an open standard that is extensible, backward compatible, and easy to develop for. It is most appropriate for devices that are either stationary or that move and then stop. The Company earns between \$2-\$3 for each connected endpoint and a \$100 fee for the communications chipset used to connect to the network.

By winning streetlight contracts, Silver Spring creates a better propagated network than competitors with an incumbent presence in energy or water meters. This technological capability, depending on how it is defined, is shared with a handful of other companies of which three, like Silver Spring, do not provide major infrastructure. In the utility and municipal space, where entities need to prove to rate and tax payers that they’re getting the best deal, municipalities may seek to avoid locking in to one provider of streetlight infrastructure for fear that they may overpay on big-ticket items like the water meter or streetlight. Instead, being agnostic to the infrastructure provider can be an advantage in subsequent negotiations. Of the agnostic network providers, Silver Spring is the largest, with a backlog equating to over \$1.1 billion. When that backlog turns into cashflow, under conservative assumptions, it represents over 80% of its market capitalization.

White Brook believes the management team is both good and appropriate. While “the largest Internet of Things Company You’ve Never Heard of” is their chosen message, White Brook believes that it is

terrible branding. In White Brook's conversations with experts, no two experts give the same definition of what the "internet of things" ("IOT") encapsulates, and investors don't either. That said, Mike Bell, the CEO, has previous experience that suggests he is the type of leader that is well positioned to lead Silver Spring Networks. He is an engineering visionary that a company with a great technological core that needs to be developed will benefit by having. White Brook believes, however, that his go to market capabilities are limited.

To Mr. Bell's credit, he hired Aysel Ildeniz as COO. A veteran of Intel, Ms. Ildeniz built and managed in-country marketing teams. While her last stop was in the ill-fated New Devices Group, White Brook contributes that failure to a slow developing technology without a purpose rather than to an inability to execute. Ms. Ildeniz's hire suggests a change in go to market strategy from a US centric model to building out longer term in-region sales teams that are also available for support. While this model will result in higher fixed costs, it's the right model for the Silver Spring business and Ms. Ildeniz is well suited to carry it out successfully.

Conservatively, White Brook sees over 60% upside over the investment horizon based on the following:

1. **The international opportunity is just getting started and the US IOT business is nascent:** Both opportunities are in the very early innings with total addressable markets that add multiples to Silver Spring's total addressable market. While it will take time to educate and execute on those sales, the company has 6 years' worth of backlog, and it can continue to grow sales high single digits while adding to the backlog.

Additionally, the deal sizes from both segments are likely to be smaller than the more consolidated US energy utility market and will help stabilize Silver Spring's growth, which has suffered from limited but repeated contract slippage by different customers. Smaller contracts will even out quarters and fill in Silver Spring's installation capacity when a large customer delays, resulting in smoother revenue growth and fewer earnings surprises.

2. **Silver Spring can use its cash balance to build a traditional SAAS business:** While Silver Spring's services should be ratably recognized, some of the Company's municipal and utility customers prefer for their expenditures to be capital expenditures where they can show an IRR rather than a continuous operating expense. Silver Spring accommodates their customers, making their revenue look lumpier than it is. As corporate customers address their connectivity needs, the services will be booked as the more valuable recurring revenue stream that it is.

Additionally, Silver Spring has a significant cash balance that it can use to help corporate customers finance the rollout of the technology. While the Company will use its cash balance, it will be able to outcompete its smaller competitors while building a formidable recurring revenue stream.

3. **Silver Spring can fix its messaging:** The Company's sell-side analyst base does it no favors, with a healthy supply of "new energy" analysts focused on solar companies and a few networking infrastructure analysts – neither of which reflect accurate comparables to either side of its business.

Consider that the Company sells a \$100 communications solution for a product that costs between \$200-\$5,000 and has another company's label on the box along with managing a network for \$2-3 an endpoint. In many ways, Silver Spring Networks is a semiconductor company, whose customers are the energy, water, and streetlight manufacturers that install it, and the municipalities and utilities that



buy the capability rather than a consumer goods, computing, or communications company. The difference in end markets creates a different growth profile, lowers reinvestment costs, and lowers gross profit margins, but results in much higher barriers to entry and similar operating margins when compared to most semiconductor companies. Management should position the Company in line with that reality. As the Company's technology expands to non-municipal customers the more highly valued SAAS component will result in a much higher valuation for the combined company.

Ultimately Silver Spring is a company with a tremendous strategically valuable asset base and good management team, currently depressing earnings by investing in its sales and go to market capability. As the Company has success in the marketplace, White Brook expects the stock price to reflect the sizable backlog and for the stock to appreciate considerably. White Brook believes that its forecasts are conservative, and looks forward to the company executing over the next couple quarters and creating sizeable value over the next several years.

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