Citron RESEARCH

September 29, 2014

The Fraud at Textura (NASDAQ:TXTR)
Target Price -- 12 Months = $4

In December of 2013, Citron Research introduced readers to Textura Corp. (NASDAQ:TXTR), documenting the CEO's history of fraud and failed businesses, and a shadowy weave of poorly disclosed insider relationships. In its last three quarters, Textura has missed analyst expectations and continues as a wannabe in the SaaS space. Ignoring scant earnings results, the analysts have stood by their unfounded optimistic forecasts.

If you are a Textura shareholder and you are a custodian of someone else's money, you are obligated to read this report. We have done the homework that NONE of the analysts have done, and in this report we spill the truth about this "investment". What you are about to read is not the opinion of Citron, it is FACT. We have hired consultants with genuine expertise and years of experience in construction management to prove that management of Textura is committing FRAUD on the investing public. Yes, we said fraud, and we would love to prove it in a Court of Law.

We already know that Textura has:

- **10 year history of operating losses**
- **Forward P/E: 111**
- **Price/Sales over 12.5**

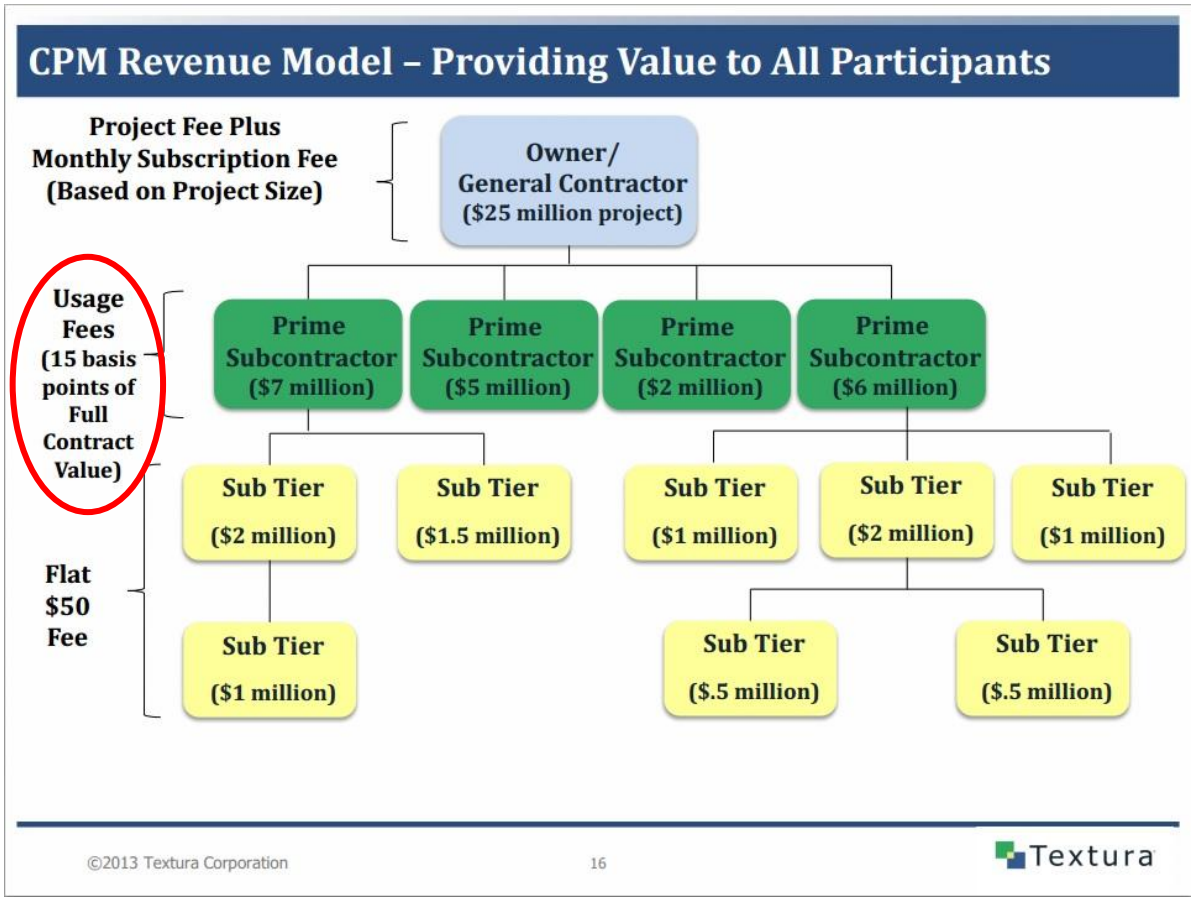
It's taken **over 10 years – and nearly $200 million in retained earnings losses** -- for this company to finally get its annual revenue run rate above the $50 million mark. Nevertheless, the stock has now rebounded, buoyed by the unflinchingly optimistic analysts who know **nothing** about construction management but instead rely on the representation of unscrupulous management.

Our message to analysts: Don't publish your predictable denials of this report's conclusions unless you can specifically refute the facts.
Citron presents this story in 3 parts:

1. The utterly fraudulent representation of management about gross margins of their flagship product
2. The fraudulent claims from management when discussing Textura's "Total Addressable Market"
3. The recent lawsuit that Textura hopes its shareholders and customers never read.

Fraudulent Claim #1: 16 to 18 bps Earned on Gross Construction Contracts? Not Even Close!

Textura's main product, CPM, which processes lien waivers and releases payments, accounts for appx 60% - 65% of its total revenues. In its presentations to investors and quarterly conference calls, the company consistently claims that it charges general contractors 4 basis points while collecting an additional 12 basis points from the subcontractors for using its system. This is a complete lie. This graphic is from their recent investor presentation:



http://investors.texturacorp.com/files/doc_presentations/Textura%20Needham%20Conference_Jan2014.pdf

All the analysts coverage initiations repeat this lie. For instance:

JMP Securities: "We estimate the company's current solutions can generate roughly 30 basis points. The company's primary CPM solution represents approximately 10 to 12 basis points of this amount."

Oppenheimer: "We estimate the current TAM at ~$1.2B, which is the total North American commercial construction value of $800B multiplied by Textura's estimated take-rate of ~15bps."

Barrington: "Subs pay a fee of 15 basis points (BPs) for every contract awarded—there is a minimum ($50) and maximum ($1,450). The CPM effective rate (GC plus sub fees) is about 10 BPs of construction value.

Here is Barrington's fiction regarding the revenue Textura will generate from CPM. 10 – 12 BPS and 12 – 15 with the new pricing model? Who are they kidding?

card (10%). The monetization rate varies with project size; it is beneficial to Textura if GCs bid out smaller projects than larger ones. **The CPM effective rate (GC plus sub fees) is about 12-15 bps (up from 10-12 bps) of construction value.**

Project Type	Size	Mix	Duration	Sub BPs	GC BPs	Total BPs
Jumbo	$100m+	30%	28 mo	1-2	2-5	3-5
Large	$50-100m	15%	27 mo	4-5	2-5	6-9
Mid	$2.5-50m	15%	17 mo	8-10	2-5	10-14
Small	$0-1m	50%	7 mo	20-25	2-5	22-27
Overall			18 mo	8	2-5	10-12
*Overall with new pricing beginning 2/1/14				10-12		12-15
*It will take about two years for all projects to be on the new pricing						

Sheer Fiction!
Unsubstantiated by the Numbers.

Here is the Truth About Textura CPM Revenue Rates:

- The company has **never booked even half this level of BPs.**
- It has cut special deals with highly touted licensees whose subcontractors don't pay **any** subcontractor fees at all (e.g. Denver Airport – see below)
- Even their announced revenue increases cannot materially close this gap.

Presenting Textura's Actual CPM Revenue Model, in BPS of Construction Value

This table compares client reported construction billed within the system for the last 8 quarters, comparing to CPM contribution to total revenues. The results are consistent: hi 5's to mid 6's, and not growing. That's a **long, long** way from 16 bps.

	F4Q12	**F1Q13**	**F2Q13**	**F3Q13**	**F4Q13**	**TQ13**	**C1Q14**	**C2Q14**
	Sept.	Dec.	March	June	Sept.	Dec.	March	June
Client-reported construction value added ($ billions)	9.2	7.3	10.6	13.6	23.7	17.9	19.5	17.7
Construction value billed in period ($ billions)	7.1	7.7	8.4	9.1	11.1	13.3	15.1	13.5
Total revenue in quarter ($ thousands)	6,319	6,771	8,548	9,362	10,853	12,003	13,787	14,965
Total revenue as bps of value billed	8.9	8.8	10.2	10.3	9.8	9.0	9.1	11.1
Estimate of CPM Contribution to total revenues (65%)	**5.8**	**5.7**	**6.6**	**6.7**	**6.4**	**5.9**	**5.9**	**6.7**

What software analysts don't understand is that in a typical project **the general contractor performs some of the work itself** and/or charges an override for supervision. Depending on the project, it might also mark up the subs billings. There is a treasure trove of detailed billing data about U.S. based real-world construction projects within the America's Recovery and Reinvestment Act (ARRA) website. In fact, when our professionals surveyed the projects here, focusing on the categories Textura can legitimately claim as addressable market, the subs only account for 64.5% of the project cost. So while the entire project may be "addressable market" revenue from the General Contractor perspective, 75% of Textura's revenue is claimed to be coming from the subcontractors. Yet only 2/3rds of the billed project is subcontractor pass-through. This is the type of work the sell side analysts has NEVER done because there is zero understanding of the construction industry among them. Here is a survey of 75 projects which illustrate the point. [LINK HERE]

Next, Textura caps subcontractor fees at $1,450 per project. These fee caps have a major undisclosed effect on the BPS Textura collects, but nobody has studied it – until now.

Referring back to the ARRA database, we survey 20 general non-residential projects, **all of which do** fall into Textura's addressable market categories [LINK HERE] and many of which are built by known Textura customers. We survey the actual amounts they pay to subs, and calculate the fees CPM should earn on the project. This is the work the analysts have NEVER done. The result?

		$50 min / $1,450 max
Project	Total Award	Total Sub Fee (Actual)
1	58,569,656	19,610
2	67,793,284	29,536
3	47,677,778	31,187
4	71,467,904	30,236
5	64,735,873	21,141
6	32,674,210	21,001
7	5,188,089	2,066
8	61,745,319	8,955
9	40,530,205	18,674
10	196,715,345	19,463
11	44,636,984	21,488
12	26,238,815	3,744
13	13,979,213	2,870
14	58,499,203	30,197
15	36,803,561	17,570
16	130,901,718	51,131
17	64,735,873	21,141
18	4,889,168	4,153
19	146,422,474	44,279
20	90,491,518	36,949
	1,264,696,190	435,392
Sub bps of overall construction		**3.4**

Ah, but Textura claims it has just raised prices. New projects will purportedly have a $2,500 minimum per subcontractor, up from $1,450. Recalculating the same 20 projects on that basis, assuming they can actually command this new higher minimum, we still see only 5 BPS coming from the subs. [LINK HERE].

Clearly there's a huge gap between the company's revenue claims and the truth; this goes on quarter after quarter and year after year, and not one analyst has ever acknowledged it.

Fiction vs Reality at Denver Airport

You cannot read about Textura or speak to management without someone mentioning the Denver Airport. The company touted this project to anyone who would listen (here's the PR) and even inserted a prominent rendering of the airport project in their recent investor presentation.

http://investors.texturacorp.com/files/doc_presentations/Textura%20F2Q14%20WB%20Conference%202014_FINAL.PDF (See Page 12)

So what is the reality?

First of all, Textura signed up Denver with a deal that **exempted all subcontractors from making any fee payments at all** … none whatsoever!

Don't believe us? Here's the cost sheet :

Textura®

Construction Collaboration Solutions

texturacorp.com | 1-866-TEXTURA

Textura –

Pricing for Department of Public Works Projects

Prime Contractors will pay a fee based on a percentage of their bid price. Textura will invoice the prime contractor at project start. The fee will cover all project, subscription and usage fees for both the Prime Contractors and Subcontractors. Below is an outline of the fee structure:

PROJECT SIZE	FEE (% OF BID)
< $1,000,000	0.22%
$1,000,001 - $5,000,000	0.17%
$5,000,001 - $20,000,000	0.12%
$20,000,001 - $50,000,000	0.10%
$50,000,001 - $100,000,000	0.08%
$100,000,001 - $500,000,000	0.05%

For details on the company and service on contracts over $500,000,000 contact the Textura® Corporation 866-TEXTURA www.texturacorp.com.

For example:

If the overall bid price is $950,000 the price for the service is $2090.00 ($950,000 x.0022)

If the overall bid price is $2,500,000 the price for the service is $4250.00 ($2,500,000 x .0017)

Note: Please refer to Instructions to Bidder provisions for more information

Additional charges may apply if the Prime Contractor chooses to utilize Textura's integration capabilities. The fees for integration are separate and can be discussed with the Textura representative responsible for managing your project.

© 2013 Textura Corporation. All rights reserved.

https://www.denvergov.org/Portals/743/documents/Textura-CPM%20FAQs%20pricing.pdf

So how much do they make on this huge $544 million project?

> "Prime Contractors will pay a fee based on a percentage of their bid price. Textura will invoice the prime contractor at project start. The fee will cover all project, subscription and usage fees **for both the Prime Contractors and Subcontractors**."

So the reality is, $544 million in construction contract payments nets **Textura 1/20th of 1%** of the contract value, or in this case **$272,000 in gross revenue**. It is highly questionable that this small amount of revenue even covers the costs of implementation. It certainly doesn't cover of even one corporate executive salary pocketed by a Textura honcho.

But wait, there's more. Or in this case, less.

Let's accept for agrument's sake the strategy that the City of Denver was a loss leader. It brought onto Textura's subscriber database over 3,000 subcontractors, although we see from the Denver link these "new" subcontractors represented zero revenue for Textura.

Denver became a customer because it was attempting to better manage the subcontractor relationships on this large Airport Construction project:

"The contracting community has been asking Denver to offer a payment and invoicing system that provides visibility and accountability for everyone."

https://www.denvergov.org/Portals/743/documents/Textura-CPM%20FAQs%20for%20Denver%20(4).pdf

You get what you pay for! Not only did Textura fail to generate material revenues from the City of Denver, worse they failed to protect the airport project from those very problems they say the software was designed for:

http://www.denverpost.com/news/ci_25734440/big-minority-contract-at-denver-airport-isnt-everything?source=pkg

And in case you don't thing this was Textura's fault just read the key line:

"The mayor's office did not comment about the Burgess contract, but it noted that it recently "launched new tools that will help level the playing field" for businesses owned by minorities and women. (referring to Textura CPM)"

So despite all the glowing PR's and the claim of thousands of new subcontractors entering the CPM system, the results are:

- Nearly all those new subcontractors are non-fee paying
- The fees charged for the system are **deeply discounted below any level Textura has ever disclosed to investors**
- The system utterly **failed to accomplish the principal reason it was installed**; e.g. management of the subcontractor relationships to fulfill Denver's minority-and-women-owned business quotas for the project

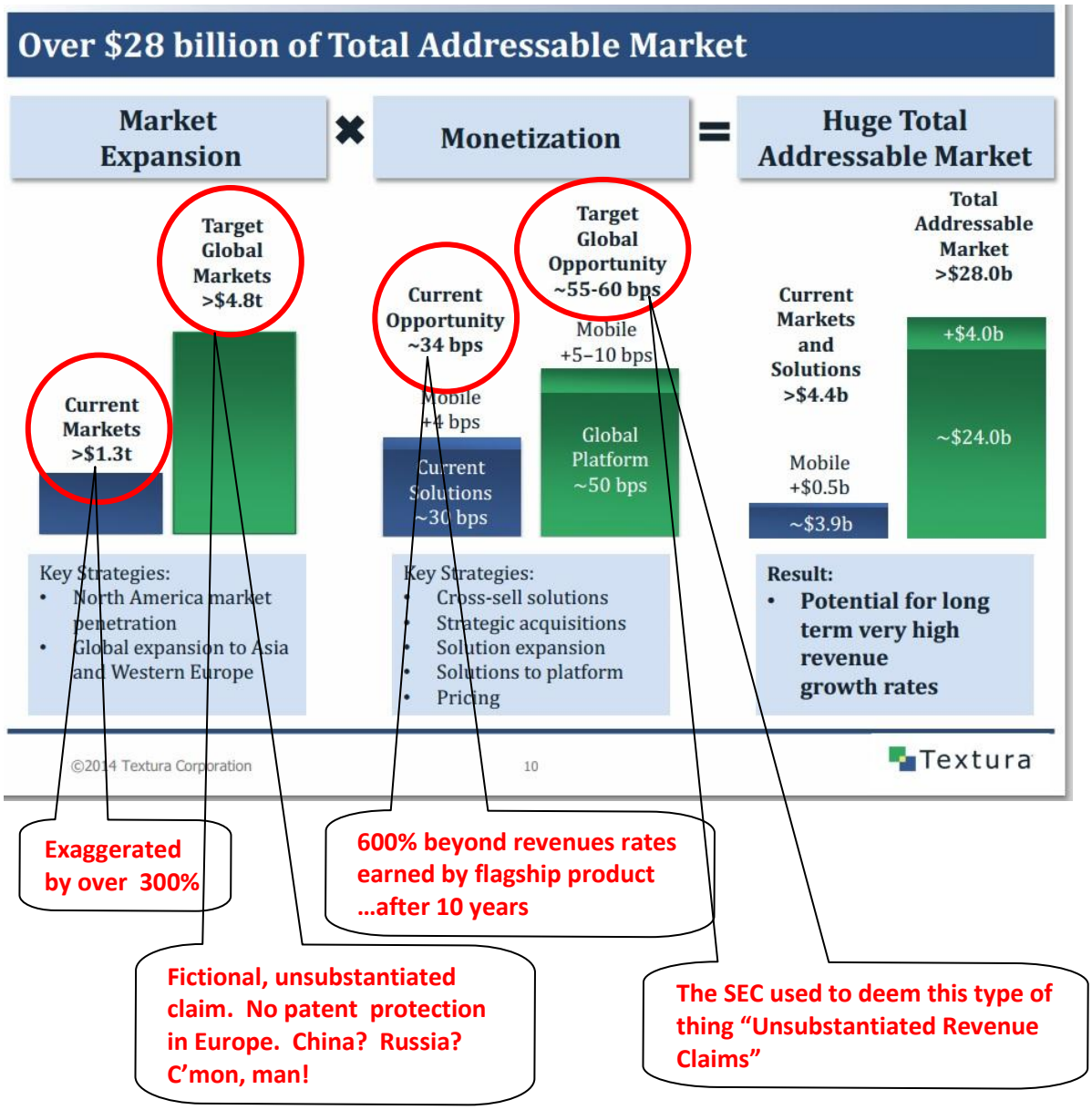
Of course, the preponderance of contracting activity by the City of Denver comes from their major Airport project, so Textura's revenue from Denver is essentially capped at 5 BPS.

And of course, you'd never hear about this contracting scandal from the company … not a word that their system failed to manage the single issue that it was implemented to solve.

Fraudulent Claim #2: Grossly and Knowingly Exaggerated "Total Addressable Market" Claim:

Textura's TAM is less than 1/10th What the Company Claims

In one of the most common gambits in the stock promoter's playbook, Textura is fond of touting a huge total addressable market: (Again, from their own investor presentation here:)



The above slide is absolutely riddled with lies and exaggerations.

Even unflaggingly optimistic cheerleader Barrington claims Textura's total addressable market in the US for construction is only $700 billion – little more than half Textura's $1.3 Trillion claim above.

However, what **none** of the analysts know or won't admit is there are several major categories of construction that will **never** be addressable markets for CPM. Again, this is what happens when analysts with no understanding of construction management have no choice but to rely on the representations of management.

Single family residential is one inapplicable category, partially acknowledged by Textura, but others are unacknowledged.

For example, Textura's S-1, filed 4/5/2014, states:

- *In the United States, as of December 2012, the annualized value of commercial construction put in place, which excludes single-family residential construction, was $740 billion, according to the United States Census Bureau*

But the Census Bureau further breaks down the residential category as follows:

Residential Total	**308,153**
New Single Family	144,825
New Multi-Family	25,777
Improvements	137,551

Since the US Census Bureau already provides a total for "Non-residential" value, the appropriate and **honest** way for Textura to have stated their addressable US market would have been to add *New multi-family* of $25 billion to the overall Nonresidential TOTAL of $570 billion and report it accurately at $596 billion. Instead they **overstated** by $144 billion, or more than 24%, by implicitly including residential improvements; this despite the obvious conclusion they will never get any significant revenue from projects such as kitchen, bathroom, and room addition remodels.

What Every Construction Management Professional Knows … But Textura's Analysts Won't Say

Citron's Construction Industry experts were still highly skeptical of the remaining non-residential components of Total Addressable Market, because there are enormous swaths of the Construction industry in which Subcontractors play little or no role. Specifically, projects classified as "Heavy" and "Civil Engineering" Construction, which comprise a material portion of non-residential construction, typically depend very little on subcontractors; typically a specialty contractor self-performs the most of all of the work with its own employees. **Contractors on such projects will never have a reason to utilize CPM at all.**

To study this point, Citron points readers to the 54 projects in our ARRA database analysis which fall into the following groupings: **[LINK HERE]** (See Tabs 3, 4, and 5 for Details)

Category	Projects	Total Prime Awards	Total for Subcontractors	% Utilization of Subcontractors
Highway Street and Bridge	14	32,108,269	2,208,788	**6.9%**
Power Generation & Transmission – Utilities	26	51,459,491	826,769	**1.6%**
Other Heavy and Civil Engineering Construction	13	241,202,168	15,288,191	**6.3%**

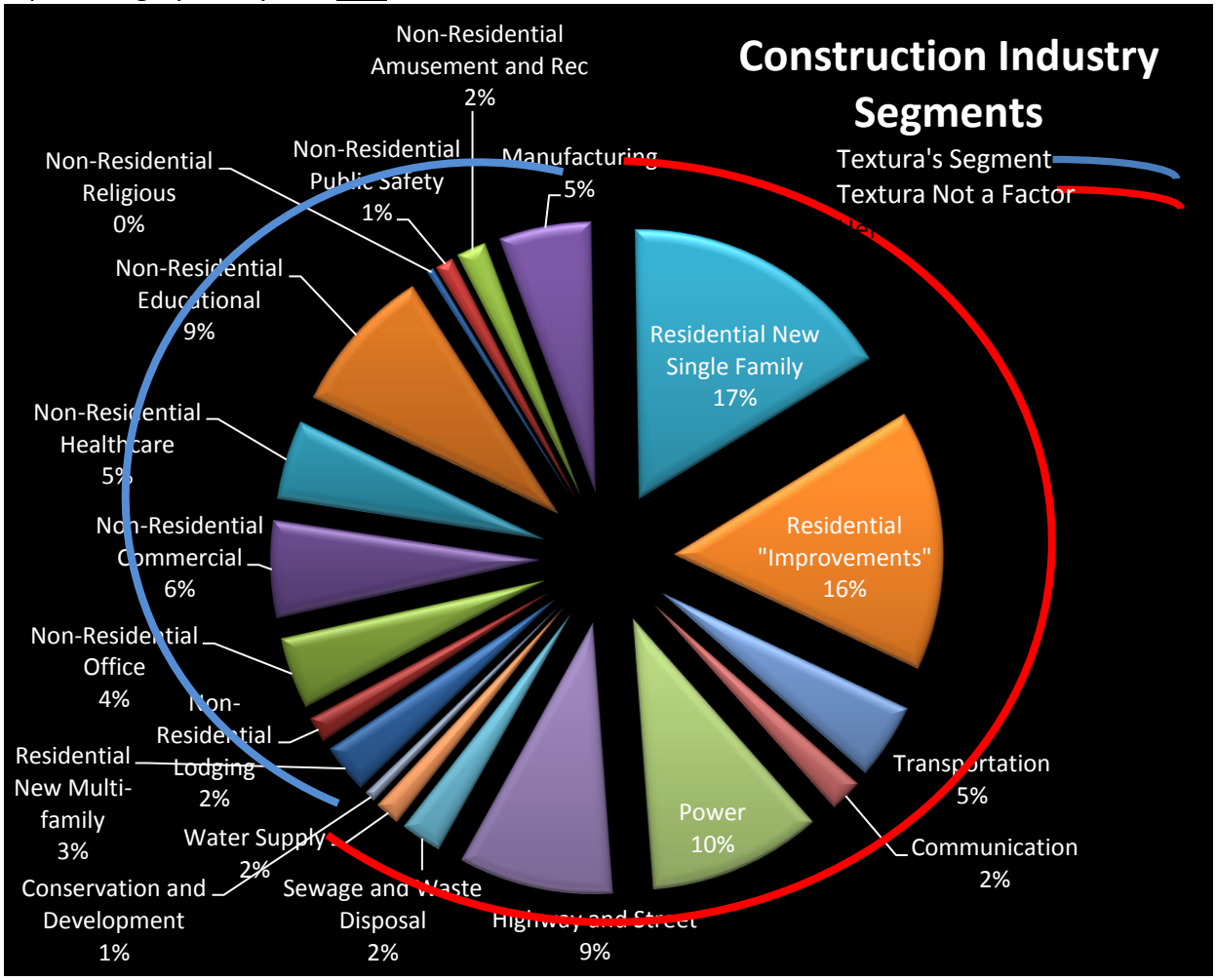
The utilization of subcontractors in these types of construction projects is **so marginal** that the entire category can effectively be excluded from Textura's addressable market for CPM.

The Census Bureau's construction statistics for 2012 gives us good measurements of the proportions of these segments within non-residential construction. Clearly, Textura can compete for barely more than half the dollar volume in the "Non-Residential Construction" sector.

Non-Residential Construction		Building Construction	Heavy and Civil Engineering Construction
Total	**568,560**	**298,465**	**270,095**
		52.49%	**47.51%**
	Lodging	13,585	
	Office	37,620	
	Commercial	50,992	
	Health Care	41,484	
	Educational	77,996	
	Religious	3,678	
	Public Safety	9,652	
	Amusement and Recreation	15,513	
	Transportation		39,731
	Communication		17,294
	Power		90,639
	Highway and Street		81,212
	Sewage and Waste Disposal		21,676
	Water Supply		13,515
	Conservation and Development		6,028
	Manufacturing	47,945	

Removing the non-residential construction from categories for which almost no work trickles down to subcontractors, Textura's addressable market is now closer to $326 billion than $700 billion … less than half of what the analysts claim.

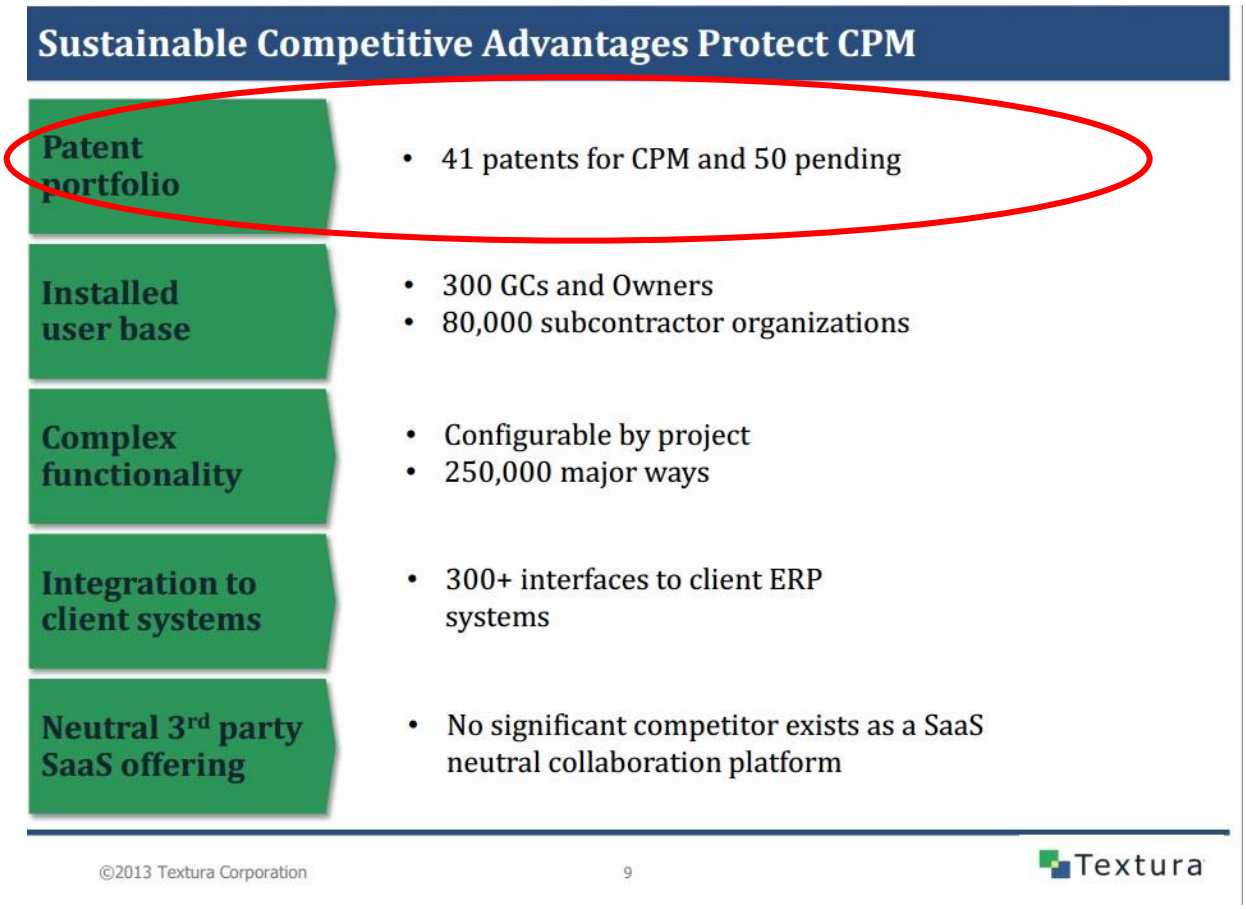
Expressed graphically, the **real** construction addressable market looks like this:



No Meaningful Entry into Foreign Construction Markets

First of all, Textura has zero basis to claim future revenues from foreign markets. Their lien waiver system responsible for the bulk of Textura's revenue applies **specifically** to the management of construction payments in the US. Despite a partner trying to find a niche market in Australia, the reality is that difference in contract law, construction practice and liabilities management make CPM's core functionality inapplicable outside the U.S. Further, the European Patent Office saw right through Textura's patent claims for a standard business process.

The Undisclosed Truth about Textura's Patent Portfolio in Europe



While the company claims overwhelming patent protection, they have **never disclosed** that the core of their **entire patent portfolio was rejected by European Patent Office**, who characterized it as "notoriously well known business processes" implemented on a computer without the need of any "inventive" technical solutions.'
https://register.epo.org/application?number=EP05711504&lng=en&tab=doclist

https://register.epo.org/application?documentId=EP0YGMI92198764&number=EP05711504&lng=en&npl=false

Any investor should find this explanation of their rejection especially chilling:

> "In particular, the Division is still of the opinion that the claims, although not completely devoid of technical character, **merely specify commonplace features relating to a technological implementation of subject matter excluded from patentability** under Art. 52(2) and (3) EPC, **without involving an inventive step** (Article 56 EPC) No technical solution defined in response to a problem could be identified within the content of the application as originally filed. Any problems which are addressed to not appear to require a technical, but rather an administrative or organizational, i.e. business, solution. Whilst the implementation of such solutions may include the use of generic technical features, these merely serve their well known functions as would be recognized by the skilled person in the technical field under consideration."

https://register.epo.org/application?documentId=EPN2YZJZ1421FI4&number=EP05711504&lng=en&npl=false

(Had the U.S. patent office been a little more sophisticated about software patents during the years 2005 to 2008, it very likely would have ruled similarly on the bulk of Textura's patents.)

This sheds a lot of light why Textura has not yet pursued a single legal defense of its patent portfolio, despite the emergence of numerous competitors. The patent landscape for software is now much less likely to uphold broad protection for business methods than it was a decade ago. Patents for software that automates well-understood business processes now offer just a shadow of the protection they once promised.

The Lawsuit That Textura Does Not Want It's Customers or Investors to See…Ever!

Last month, the N.Y. Superior Court ruled that a lawsuit against a General Contractor by a Subcontractor who billed through Textura's CPM can proceed, even though it was paid using CPM's lien waiver system**. The subcontractor's ability to sue for $10.7 in overcharges which had been signed away using Textura's lien waiver, which didn't allow the entry of exceptions allowed on the backside of the form, is the root of the dispute**. While Textura isn't a party to the suit so far, the general contractor may get stuck for millions in charges.

Lawsuits between Subcontractors and General Contractors over payment is the very thing … the only thing … that Textura's lien waiver software is intended to prevent! If it doesn't prevent this outcome, why would any General Contractor pay for it, or trust it enough to ever risk implementing it?

http://constructlaw.com/2014/08/11/new-york-court-rules-that-excavators-suit-against-gc-may-proceed-despite-releases-it-provided-with-progress-billings/

http://constructlawph.files.wordpress.com/2014/08/2014_n_y__misc__lexis_2824.pdf

Plaintiff, in opposition, alleges that, [12] despite the Subcontract's requirement of written approval of all change order work, plaintiff and defendant established a routine, due to the expedited nature of the project, whereby plaintiff would perform modified work while the change orders for such work were still pending. It also contends that defendant required it to submit monthly payment applications through its electronic "Textura Payment Management System" and that applying for payment required plaintiff to submit form SF-320, which stated that no other payments were due, "except as listed on the reverse side hereof." Plaintiff then explains that the electronic payment system did not allow for claims to be written on the reverse side of the form. It argues that the payment application form "became simply an acknowledgment by [plaintiff] of its payment receipt for the amount of the Project Subcontract work and for the amount of the change order that had, up to the date of the [application], been approved by [defendant]."**

How long before a dispute like this one names Textura as a defendant? The sums at risk here dwarf the fees collected for use of CPM by 500-fold or more.

Conclusion: Did you Expect Anything Different??

The last time Patrick Allin was CEO of a publicly traded company, it made unsubstantiated revenue expectations and eventually filed bankruptcy. (read previous Citron reports)….what did you really think was going to happen this time?

Textura and its management mislead the investing public in so many ways that it can only be considered a complete investment FRAUD.

Textura purports to be a mainstream solution to the construction industry, when it provides neither general accounting nor project management functionality. Aside from CPM, the company's products are a collection of relatively disparate and poorly integrated utilities with only niche appeal.

Now that CPM itself has demonstrated its vulnerabilities to major litigation risk for adopters, the company will face major headwinds in bringing on new customers to CPM. The analysts

who will minimize the impact of the above Subcontractor vs. General Contractor Lawsuit demonstrate their utter lack of understanding of the construction industry. Word of this suit will undoubtedly circulate among the decision-makers who are responsible for committing to and implementing CPM. It's a small community, and they do know each others' business.

The road downhill is inevitable, but Wall Street loves companies like this. As it burns through its cash, (one half of the cash it had one year ago is gone) Textura will return to Wall Street for more … and as long as there are fees to be earned, Wall Street will be complicit in deals like this, that should never ever have been brought public in the first place.

Textura: Please Sue Me!

Jjust over one year ago, insiders sold over $100 million in stock while lying to the investing public. Meanwhile its bankers (William Blair and Barrington) had principals who owned IPO stock away from their firms while ignoring all conflicts of interest. We are sure the lawyers of one of your firms will want to sue Citron. Lets go to court so I can subpoena your emails and forget about short selling and collect some real whistleblower money.

This story is over, buy or sell, either way this stock goes to $4.00.