

Summary**Why investors should be concerned:**

- Growth rates for contract value, a key measure of future business, are declining. Sales effort revamp has yet to take hold. With 30% of customers in the financial services industry, rising economic headwinds could further weaken sales.
- More troubling: Deferred revenue growth is declining faster than contract value growth. In the most recent third quarter, annual contract value grew at 16%, but deferred revenue grew only 12%. Because CEB normalizes contract value, deferred revenue is a more concrete measure of future business.
- Average value per customer of new contracts is falling, as are cross-sell ratios. Sales force productivity has been blamed, but we wonder if the market is becoming saturated.
- Operating cash flow as a percentage of revenue has declined for two years. Following an aggressive stock repurchase plan and higher dividend, CEB's balance sheet is no longer over-capitalized. Future buyback plans may have to be dialed back, which could affect valuation.

Valuation: CEB shares are down almost 40% over the last year and now sit near a 52-week low. Yet, shares still only trade at a slight discount to peers based on forward earnings. Shares trade at a significant discount based on operating cash flows. This could reflect the Street's belief that the company's cash flow yield may continue to decline. We remain cautious on EXBD shares given the challenges CEB faces.

Corporate Executive Board Corp. (NASDAQ:EXBD)

Share price:	\$53.01
Market cap:	\$1.9 B
Enterprise value:	\$1.8 B
52-week high:	\$96.33
52-week low:	\$50.38
Shares outstanding:	35 M
Float:	34 M
% float short (12/11/07):	11.5 %
Revenue (LTM):	\$516 M
Net income (LTM):	\$81 M
Cash flow from ops (LTM):	\$130 M
Dividend yield (annualized):	3.1%
Debt to equity:	0.0
Debt to capital:	0.0
FYE:	Dec. 31
Auditors:	E&Y

Company description: The Corporate Executive Board Company provides research, decision support tools, and executive education that focus on corporate strategy, operations, and general management issues. Its research services support executive decision making by identifying and analyzing specific management initiatives, processes, and strategies in solving business problems or challenges. The company's services include research studies, executive education seminars, research briefs, and Web-based access to the program's content database and decision support tools. It offers research programs in various areas, such as human resources, strategy and research and development, information technology, sales and marketing, corporate finance, legal and compliance, operations and procurement, financial services, communications, and general management.

Background

Corporate Executive Board (CEB) had a tough 2007 and we don't see 2008 looking much better. Sales productivity fell last year, dragging down growth. Growth rates for contract value, a key measure of future business, are declining. The company's attempts to fix its sales efforts have yet to take hold. As the economy weakens, CEB's sales could be even more challenged.

Based in Washington, D.C., CEB sells research and support programs targeting best-practices in operations, strategy and management to large and mid-sized companies. Customers typically pay upfront for subscriptions to annual programs. As the company has added products and increased its customer base, revenue and contract value growth have averaged 25% annually. The company's sticky and recurring revenue streams historically generated solid margins and lots of cash. As a result, the company's stock has, until recently, traded at a large premium to the market as well as to peers.

Now, growth is declining. Lower efficiency and sales force turn-over have been blamed, and management has worked hard to fix these problems. This report will point to metrics that show conditions may be worse than management has led investors to believe. Additionally, we'll show how the company is no longer generating cash at historic levels, which may limit its ability to return value to shareholders through aggressive stock buybacks.

The current economic environment could make it harder for CEB to sell its programs. Almost 30% of sales are within the hard-hit financial services industry. Also, programs seen as "discretionary" may be more difficult to sell if companies cut budgets. Not helping is the fact that the company has seen turnover in its executive ranks, including the departure of its long-time Chief Research Officer in the beginning of 2007. We believe these trends, added to the company's internal sales challenges, place CEB's shares at risk, even with the stock near its 52-week low.

Analysis

Sales metrics show weakening sales productivity, potential saturation

Recent trends in key metrics show CEB's sales productivity continues to weaken and may indicate that the company's offerings are reaching market saturation. Several analysts are projecting a quick sales turn-around in early 2008 and improving operating metrics. We disagree with this outlook, especially as we enter a slowing economic cycle.

Contract value and deferred revenue metrics are a good starting point. Contract value reflects CEB's 12 months of forward revenue. Contract value growth has been declining for several

quarters. Interestingly, deferred revenue growth has declined at an even greater rate. In the most recent third quarter, annual contract value grew at 16%; deferred revenue grew only 12%.

Table 1: Quarterly contract value metrics

(\$MM, FYE Dec. 31)	03/2006	06/2006	09/2006	12/2006	03/2007	06/2007	09/2007
Revenue	105.1	111.7	118.4	125.5	124.5	129.7	136.3
Y/Y % growth	28.7%	27.8%	26.7%	25.7%	18.5%	16.2%	15.1%
Contract value (CV)	408.8	426.7	450.3	475.7	492.5	504.8	523.1
Y/Y % growth	29.0%	29.0%	28.0%	25.0%	20.0%	18.0%	16.0%
New bookings	132.5	129.6	142.0	150.9	141.3	142.0	154.6
% revenue	126.1%	116.0%	119.9%	120.2%	113.5%	109.5%	113.4%
Deferred revenue	266.9	254.3	223.9	308.7	315.2	295.3	252.3
Y/Y % growth	30.4%	31.3%	26.2%	18.1%	18.1%	16.1%	12.7%

Source: Company reports, GLC.

Decline in sales growth mirrors contract growth decline.

New bookings decline as percentage of revenue.

Deferred revenue growth below contract growth.

Contract value, however, is not money in the bank. In fact, contract value doesn't represent the future dollar value of signed contracts, but rather annualized contract values for all current subscriptions.¹ Therefore, the figure includes annual amounts for signed contracts that may be up for renewal or contracts without annual terms. Deferred revenue, by contrast, represents signed pre-paid contract value (typically 85% of customer pre-pay subscriptions). The company's collection trends don't indicate a change that would affect deferred revenue trends. Therefore, we see the steeper decline in deferred revenue as a more troubling indicator of the sales challenges CEB faces.

Management says deferred revenue is declining because fewer new contracts have terms greater than 12 months in duration.² This is not a reassuring statistic. While it explains some of the decline, the inability of CEB's sales teams to lock-in clients to longer subscriptions is further evidence of lower sales force effectiveness.

Two other metrics that highlight CEB's deteriorating fundamentals are new contract value per sales team and the cross-sell ratio. Contract values are falling even as the sales force is expanding. Average new contract value per sales team shows the decline in sales force productivity (Table 2). Earlier in 2007, the company placed great emphasis on getting its sales force back on track. It hired more sales people in the second half of 2007 and hopes to end the

¹ "One measure of our business is our annualized Contract Value, which we calculate as the aggregate annualized revenue attributed to all agreements in effect at a given point in time, without regard to the remaining duration of any such agreement." 10-Q filed Nov. 9, 2007, pg. 10.

² "Deferred revenues increased 12.7% to \$252.3 million at September 30, 2007, from \$223.9 million at the end of Q3 2006. In the third quarter, for each of the past few years, we have experienced lower deferred revenue growth versus contract value growth. This is the result of fewer contracts greater than 12 months duration being signed in a quarter. Contracts greater than 365 days in length made up 18% of contract value at the end of Q3 2006, versus 13% at the end of Q3 2007. We expect this pattern to normalize across the balance of the year, and that our year-end deferred revenue growth will be more in line with our year-end CV growth rate." Thomson StreetEvents transcript of CEB conference call, dated Oct. 25, 2007.

year with more than 320 sales teams. Analyst models have adjusted to assume that more sales people will reaccelerate contract value growth in 2008. We aren't so sure.

Table 2: Quarterly sales metrics

(\$MM, FYE Dec. 31)	03/2006	06/2006	09/2006	12/2006	03/2007	06/2007	09/2007
Sales teams	243.0	242.0	247.0	270.0	255.0	290.0	293.0
Avg. ann. new CV per sales team (\$K)*	462.6	308.5	386.1	393.0	256.0	180.6	251.1
Y/Y % growth	-9.7%	-7.7%	-8.0%	-36.1%	-44.7%	-41.5%	-35.0%
# programs	39.0	40.0	41.0	43.0	44.0	46.0	47.0
Cross-sell ratio	3.78	3.83	3.80	3.80	3.78	3.56	3.53

Source: Company reports, GLC. *= GLC estimate.

New bookings per sales team on decline.

Cross-sell ratio contracts.

The company's cross-sell ratio – the average number of programs per customer – has been falling for two quarters, another indicator of weak sales force productivity. It may also be the greatest evidence of market saturation. CEB added six new programs over the last year, yet the cross-sell ratio declined. With a large customer base and an increasing portfolio of programs to sell, the decline in cross-sell would indicate new programs are not resonating with clients or clients are not renewing existing programs at the same rate. Or, a mixture of both trends may be at play.

This may be a sales force issue, but it could also be a product/customer issue. CEB's large pool of customers has long been viewed as a captive base that could generate more sales as new programs are rolled out. CEO Tom Monahan reminds investors during every earnings call that the company faces a "\$5 billion organic growth opportunity." This projection assumes CEB's larger customers will subscribe to 20-25 out of 60 programs (the number of programs now total 47). The current cross-sell ratio for large customers is four. That's a long way from 25 – and even that number is declining. We suspect there may be more at play here than simply sales force efficiency.

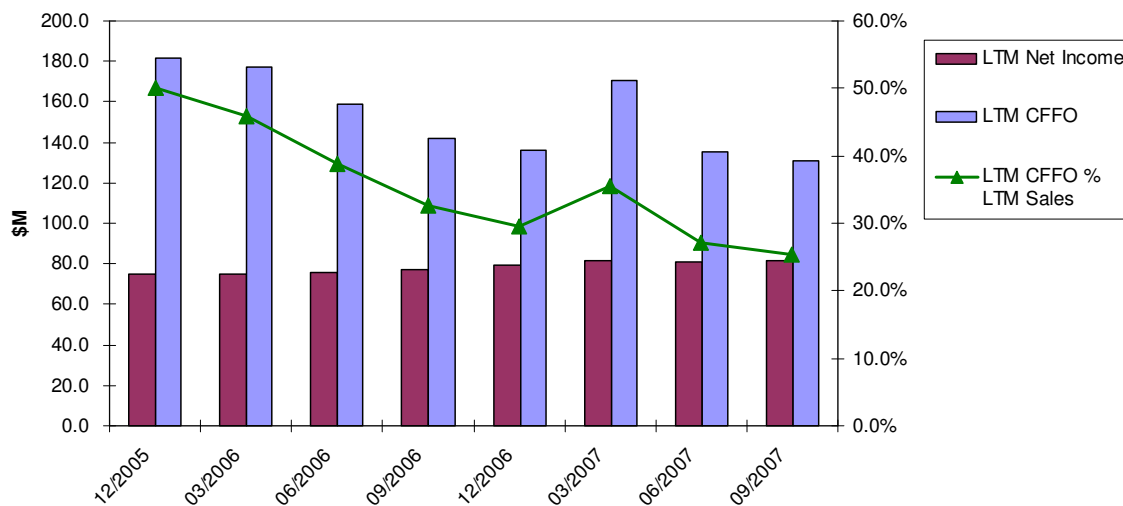
You can see why we're skeptical about a quick CEB rebound in 2008. In 1Q '07, the company revamped its sales strategy by focusing on better training, management and higher compensation for new sales hires. With more sales people, the company is hoping contract value growth will return to previous levels. Yet, in 3Q '07, management confessed newer hires were not ramping as quickly as they had forecasted. If these new sales efforts do not yield improved results shortly, a quick sales rebound is unlikely.

Declining cash flow yield highlights deteriorating fundamentals

The best indicator of CEB's deteriorating fundamentals is its declining cash flow yield because high cash generation from recurring sources is a key characteristic of this business. Moreover, lower cash yields imperil the company's aggressive share repurchases, and buybacks have been key to recent EPS growth.

Operating cash flow as a percentage of revenue has fallen steadily for two years. There are several reasons why. First, net-income margins have declined, mostly as a result of lower operating margins and other income (a declining cash balance from aggressive share repurchasing has reduced this source of income). Second, contributions from working capital have declined. Declining deferred revenue and payables have reduced operating cash flows and have not offset higher cash inflows from receivables reduction.

Chart 1: LTM cash flow analysis



Source: Company reports, GLC.

Additionally, cash flow yields have benefited from a decline in stock option exercising most likely brought on by the fall in stock price. As of September 2006, the company had cash outflows due to a one time benefit of \$29 million from the adoption of new stock option accounting for the year. For 2007, such payments have totaled only \$2.4 million. Eliminating the impact from these tax payments (which are non-operating in nature) would show the decline in cash flow yield is even more severe than under actual results.

Share repurchase plans may temper if cash flow yields continues its retreat

The decline in cash flow yield, couple with an aggressive stock repurchase plan and higher dividend, means CEB's balance sheet is no longer over-capitalized (bulls have long complained the company had too much cash). This means future buybacks may have to be scaled-back. Bulls have argued that CEB's high earnings multiple was justified by the company's strong cash flow and big cash position, which allowed capital to be returned to shareholders. We're not saying this is no longer the case. Yet, with less cash it's questionable how aggressively the company can continue these activities without challenging operations. And fewer buybacks would have valuation implications.

CEB's buyback activities have yielded positive results. Shares outstanding have been reduced about 10% over the last two years. In the last two quarters, the majority of year-over-year EPS growth was due to a lower share base.

Table 3: Quarterly share analysis

(\$MM, FYE Dec. 31)	03/2006	06/2006	09/2006	12/2006	03/2007	06/2007	09/2007
Shares outstanding - diluted	41.1	41.2	40.5	39.8	39.1	37.5	36.3
Net income	17.1	17.8	21.1	23.2	19.4	17.3	21.4
Y/Y % growth	-0.1%	4.2%	7.7%	8.9%	13.1%	-2.5%	1.3%
EPS - fully diluted	\$0.42	\$0.43	\$0.52	\$0.58	\$0.50	\$0.46	\$0.59
Y/Y % growth	0.00	0.00	0.00	0.00	18.8%	7.2%	12.9%

Source: Company reports, GLC.

This benefit didn't come without a cost, however. CEB spent roughly \$450 million in share buybacks over the last two years. CEB has reduced its largesse in issuing employee options, which made recent buyback efforts more effective than historical programs that simply offset dilution from options. Yet, the company's cash position is now well below levels of two years ago. With all the operating issues we discussed and cash-flow generation below historic levels, we wonder if large-scale buybacks are in CEB's future. A back-of-the-envelope calculation shows the company will be able to allocate only \$75-\$100 million to annual stock buybacks, an amount that would reduce outstanding shares only 4% assuming employee option exercising remains consistent with 2007 activity. This level of capital return to shareholders is not terribly exciting and, in our opinion, doesn't warrant a valuation premium.

Table 4: Annual cash flow/cash position

(\$MM, FYE Dec. 31)	12/2006	12/2007E
Revenue - LTM	460.6	543.6
Y/Y % growth	27.2%	17.0%
Operating cash flow - LTM	136.3	135.9
Y/Y % growth	-24.9%	-0.3%
Capital expenditures	17.7	55.0
Dividend	47.4	55.5
Share repurchase (\$) - LTM	176.0	279.9
Free cash flow - LTM*	71.1	25.4
Cash & equivalents - beginning	544.6	487.3
Cash & equivalents - ending	487.3	148.2
FD shares out - beginning	41.1	40.7
FD shares out - ending	40.7	37.0

Cash way down after aggressive buyback.

FDSO reduced 10%.

Source: Company reports, GLC. Notes: 2007 projections based on metrics provided during recent earnings conference calls.

Valuation

CEB's recent business challenges are reflected in its stock, which is down 40% over the last year and now sits near its 52-week low. Yet, shares still trade at only a slight discount to peers based on forward earnings. CEB shares have historically traded at a premium to its closest peer, Advisory Board Company. Shares trade at a significant discount based on operating cash flows. This could reflect the Street's belief that the company's cash flow yield may continue to decline. Despite their current valuation, we're cautious about EXBD shares given the challenges CEB faces.

Table 5: Valuation

	EXBD	Average - Comparables	Premium / (Discount)
Price (current)	\$53.01		
<u>Valuation</u>			
Price / net income - LTM	24.9x	37.1x	-32.8%
Price / net income - 2007E	24.9x	25.5x	-2.2%
Price / net income - 2008E	21.5x	21.4x	0.9%
Enterprise value / sales - last 12 mos.	3.5x	4.4x	-20.3%
Enterprise value / op. cash flow - LTM	13.8x	17.5x	-21.0%
<u>Performance</u>			
52-week high	\$96.33		
52-week low	\$50.38		
52-week % change	-40.5%	-11.4%	

Source: FactSet, Thomppson. Peers include: ABCO, TRAK.

Chart 2: LTM PE vs. stock price



Source: FactSet.

Appendix

1: Selected financial data - annual

Income statement	12/2002	%	12/2003	%	12/2004	%	12/2005	%	12/2006	%
Revenues	162.4	100%	210.2	100%	280.7	100%	362.2	100%	460.6	100%
Gross margin	106.2	65%	139.2	66%	189.3	67%	241.3	67%	296.6	64%
SG & A	58.9	36%	77.0	37%	106.8	38%	134.0	37%	181.8	39%
Other expense/(income) - net	6.4	4%	7.6	4%	9.9	4%	13.6	4%	24.3	5%
Operating income	41.8	26%	56.4	27%	70.4	25%	100.0	28%	104.4	23%
Taxes	18.6	11%	28.3	13%	26.7	10%	38.6	11%	49.6	11%
Net income	29.6	18%	35.7	17%	53.7	19%	75.1	21%	79.2	17%
Diluted earnings per share	\$0.79		\$0.93		\$1.34		\$1.83		\$1.94	
Balance sheet										
Cash and cash equivalents	225.9		293.9		417.0		544.6		487.3	
Accounts receivable	50.4		63.2		97.1		120.2		153.1	
Inventory	0.0		0.0		0.0		0.0		0.0	
PP&E	14.9		15.5		17.4		18.4		27.0	
Goodwill & intangibles	0.0		0.0		0.0		8.4		7.8	
Total assets	359.6		423.5		578.5		727.0		736.1	
Accounts payable	12.5		12.5		17.5		42.4		66.8	
Total debt	0.0		0.0		0.0		0.0		0.0	
Deferred revenues	(121.4)		(154.8)		(205.5)		(261.3)		(308.7)	
Total equity	213.4		242.0		327.5		385.4		317.9	
Cash flow statement										
Operating cash flows	77.9		88.7		118.7		181.5		136.3	
Investing cash flows	(68.3)		(30.9)		(142.4)		159.5		(212.0)	
Financing cash flows	13.5		(10.6)		19.2		(30.7)		(177.2)	

Source: Company reports, GLC.

2: Ratios - annual

Ratios	12/2002	12/2003	12/2004	12/2005	12/2006
Quick ratio	1.23	1.33	1.26	1.75	1.20
Current ratio	1.23	1.33	1.26	1.75	1.20
Debt to equity	0.00	0.00	0.00	0.00	0.00
Debt to capital	0.00	0.00	0.00	0.00	0.00
Goodwill & intangibles to equity	0.00	0.00	0.00	0.02	0.02
Return on equity	13.9%	14.7%	16.4%	19.5%	24.9%
Return on assets	8.2%	8.4%	9.3%	10.3%	10.8%
Return on capital	13.9%	7.3%	9.5%	14.0%	24.9%
Revenue growth rate	26.7%	29.5%	33.5%	29.0%	27.2%
Operating cash flow growth rate	47.4%	14.9%	33.5%	52.9%	-24.9%
Accounts receivable growth rate	19.9%	25.4%	53.7%	23.8%	27.3%
Deferred revenue growth rate	28.2%	27.5%	32.7%	27.2%	18.1%

Source: Company reports, GLC.

3: Selected financial data - quarterly

Income statement	12/2006	%	03/2007	%	06/2007	%	09/2007	%
Revenues	125.5	100%	124.5	100%	129.7	100%	136.3	100%
Gross margin	84.6	67%	79.8	64%	82.4	64%	90.7	67%
SG & A	45.2	36%	51.4	41%	56.4	43%	55.0	40%
Other expense/(income) - net	6.0	5%	5.9	5%	5.3	4%	3.2	2%
Operating income	31.7	25%	25.6	21%	22.9	18%	31.6	23%
Taxes	14.5	12%	12.1	10%	10.8	8%	13.4	10%
Net income	23.2	18%	19.4	16%	17.3	13%	21.4	16%
Diluted earnings per share	\$0.58		\$0.50		\$0.46		\$0.59	
Balance sheet								
Cash and cash equivalents	487.3		428.6		294.5		172.8	
Accounts receivable	153.1		84.1		89.0		84.5	
Inventory	0.0		0.0		0.0		0.0	
PP&E	26.99		29.36		47.17		73.00	
Goodwill & intangibles	7.83		7.66		7.50		62.81	
Total assets	736.1		613.4		509.8		463.2	
Accounts payable	66.8		46.2		36.5		51.0	
Total debt	0.0		0.0		0.0		0.0	
Deferred revenues	(308.7)		(315.2)		(295.3)		(252.3)	
Total equity	317.9		204.7		123.5		85.8	
Cash flow statement								
2007/2006								
Operating cash flows	59.0		84.2		(20.5)		8.3	
Investing cash flows	(4.0)		(3.9)		99.1		45.4	
Financing cash flows	(8.0)		(140.0)		(104.0)		(65.9)	
2006/2005								
Operating cash flows	64.4		50.2		14.7		12.5	
Investing cash flows	41.7		(199.9)		(3.0)		(5.1)	
Financing cash flows	(7.5)		(36.0)		(24.6)		(108.5)	

Source: Company reports, GLC.

4: Ratios - quarterly

Ratios	12/2006	03/2007	06/2007	09/2007
Quick ratio	1.20	1.17	0.94	0.66
Current ratio	1.20	1.17	0.94	0.66
Debt to equity	0.00	0.00	0.00	0.00
Debt to capital	0.00	0.00	0.00	0.00
Goodwill & intangibles to equity	0.02	0.04	0.06	0.73
Return on equity	7.3%	9.5%	14.0%	24.9%
Return on assets	3.1%	9.5%	3.4%	4.6%
Return on capital	7.3%	9.5%	14.0%	24.9%
Revenue growth rate (quarter over quarter)	6.0%	-0.8%	4.2%	5.1%
Revenue growth rate (year over year)	25.7%	18.5%	16.2%	15.1%
Operating cash flow growth rate (quarter over quarter)	373.7%	42.7%	-124.4%	-140.3%
Operating cash flow growth rate (year over year)	-8.4%	67.7%	-240.1%	-33.6%
Accounts receivable growth rate (quarter over quarter)	107.4%	-45.1%	5.9%	-5.1%
Accounts receivable growth rate (year over year)	27.3%	13.4%	15.9%	14.5%
Deferred revenue growth rate (quarter over quarter)	37.9%	2.1%	-6.3%	-14.5%
Deferred revenue growth rate (year over year)	18.1%	18.1%	16.1%	12.7%

Source: Company reports, GLC.

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