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Disclosure Insight® Report
June 11, 2018

Ubiquiti Networks Inc. – UBNT
$85.06 Mkt Cap $6.3 Bil

Disclosure Games®

Forget the Buybacks – Run Fast, Run Far.

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Summary and Opinion: With the stock of Ubiquiti Networks, Inc. on something of a tear lately, the shorts are nervous and the longs are gloating. Each side has reasons why the other is wrong. Our view is decidedly negative and is based upon our in-depth analysis of the SEC investigation first disclosed by Ubiquiti in February. Our conclusion is simple, and our conviction table-pounding: Run fast, run far.

Some things to consider –

- Our research shows the SEC was investigating Ubiquiti Networks long before Andrew Left wrote his Citron report in Sep-2017. His report was so damning that it could have easily triggered an investigation on its own. But our first indication of an undisclosed SEC investigation was much earlier, in Dec-2016.

- The SEC subpoenas first disclosed in February are expansive – really, seriously expansive. But for more than a year prior, the company didn't think the SEC investigation sufficiently material to warrant disclosure. Something changed that made the company decide to tell you about it. That makes this especially dangerous. We explain.

- It appears Ubiquiti's SEC investigation-related expenses are being underreported, and by a wide margin. If you can't trust these simple numbers, it opens questions of what else is cooked.

The lack of a CFO is not just "old news", it's also an enduring problem. With the current governance structure, the absence of a permanent CFO leaves the company open to fraud. We are not saying Ubiquiti Networks is a fraudulent company. We are saying we've been doing this kind of research long enough to have our spider senses warning that it just might be.

The mosaic that's formed around Ubiquiti Networks is one of the more negative ones we come across. When we've seen companies announce SEC investigations after having long sat on them, the following year is often a rough one for investors. It's not if the price of Ubiquiti Networks stock falls off a cliff. It's when.

The stock has a relatively small float, and the shares are responding in part to promise of large share buybacks to come. If those pesky shorts get hurt along the way, who's to complain? A small float makes squeezing them easier.

But a note of caution is in order here: From press reports it appears CEO Robert Pera needs to sell – or at least "pledge" some of his shares in Ubiquiti so he can buy out his partners in the Memphis Grizzlies sports franchise. But he wants to maintain majority ownership in the company, so the fewer shares he has to cut loose, the better. Once the Grizzlies deal is done, we think Mr. Pera will care a lot less about the near-term share price of Ubiquiti.

Regardless of buybacks or the Grizzlies, you don't want to be near this company right now. We think SEC pressure has become so bad the current stock price levels are going to soon look aspirational. We'd even tell those involved in any Grizzlies deal that shares connected to Ubiquiti Networks are best avoided. Cash money is the only currency anyone should accept from Ubiquiti founder Robert Pera right now.

Our research shows the SEC was investigating Ubiquiti Networks long before Andrew Left wrote his Citron report in September 2017.

Ubiquiti Networks Inc. was already on our Watch List of companies with undisclosed SEC probes when Andrew Left's Citron Report, published on 18-Sep-2017, asserted that Ubiquiti's financial reports "have every indication of being completely fraudulent."

Our first indication of an SEC investigation was dated 12-Dec-2016. On-going enforcement proceedings were confirmed two times before the company finally disclosed, in Feb-2018, what we recognize as a formal and expansive SEC investigation into a wide array of accounting matters.

The SEC subpoenas disclosed in February are expansive. But something changed that made the company decide to tell you about them.

In this section we analyze a disconnect between the market's current rosy outlook for this company versus what we see as a screaming warning of danger to come. Let's start with the disclosures of the receipt of SEC subpoenas, first made in Feb-2018 –

From the Ubiquiti Networks Inc. 8-K filed on 20-Feb-2018:

> On February 13, 2018, the Securities and Exchange Commission (the "SEC") issued subpoenas to Ubiquiti Networks, Inc. (the "Company") and certain of the Company's officers requesting documents and information relating to a range of topics, including metrics relating to the Ubiquiti Community, accounting practices, financial information, auditors, international trade practices, and relationships with distributors and various other third parties. The Company is in the process of responding to the requests and intends to cooperate fully with the SEC.

From the Ubiquiti Networks Inc. 10-Q filed on 10-May-2018:

> SEC Subpoena – As previously disclosed on the Form 8-K filed by the Company on February 20, 2018, on February 13, 2018, the Securities and Exchange Commission (the "SEC") issued subpoenas to the Company and certain of the Company's officers requesting documents and information relating to a range of topics, including metrics relating to the Ubiquiti Community, accounting practices, financial information, auditors, international trade practices, and relationships with distributors and various other third parties. The Company is in the process of responding to the requests and intends to cooperate fully with the SEC. As the SEC's investigation is ongoing, we cannot currently predict the timing or the outcome of such investigation.

Our first observation is that the disclosures tell us this is a formal SEC investigation, even though the company never says as much. The vast majority of SEC investigations don't start out formally. When combined with SEC data cited above, it appears Ubiquiti's SEC investigation has been going on for far longer than the company disclosed.

Another thing to consider is that it is also possible that you have only been told about the latest round of subpoenas sent to the company. To give you a sense of how big and protracted SEC investigations can become, we offer the following excerpt from a report we recently published on Tech Data Corp (TECD), on 13-Dec-2017 –

> "March 2018 will mark five years since Tech Data first announced a multi-year restatement and the SEC having started an investigation. In Tech Data's own words, court records show the company's SEC probe started the day after a multi-year restatement was announced in Mar-2013 and rapidly became formal. In the first year alone three subpoenas were sent to the company and an array of company executives submitted to SEC interviews and/or provided testimony to investigators. None of these details have ever been disclosed in official company filings."

Ubiquiti's SEC investigation too is expansive, and in ways we don't often see. Nearly every aspect of the company's operation is under the SEC microscope. Give a cop enough areas to search, and they are bound to find something.

As if the scale and scope of the SEC investigation were not enough to rethink the merits of holding the shares of a controversial company – with shares trading at all-time highs, no less – what makes this especially dangerous for investors is this:

For over a year Ubiquiti Networks did not judge its SEC investigation was serious enough to require disclosure. Not even after the Citron report. Now it does. Something changed. We'll now show you why this is not good.

Years ago, when Dell was a public company, it disclosed an SEC investigation after having stayed silent about it for a year. The following is an excerpt from the press release issued by Dell on 17-Aug-2006 –

> In August 2005, Dell received notice from the U.S. Securities and Exchange Commission that it was conducting an informal investigation of the company.
>
> The notice stated that the investigation is not an indication that any violations of law have occurred. The SEC has requested information relating to revenue recognition and other accounting and financial reporting matters …"

Did you catch the dates? The press release issued in August 2006 told you about an SEC investigation the company first learned about a year earlier, in August 2005.

It took investors more than another year to learn why Dell decided to tell you about a probe it had been sitting on for a year. The following is from a 10-K Dell filed on 30-Oct-2007, "The SEC expanded that inquiry in June 2006 …"

To review, Dell says it first learned about the investigation in Aug-2005. Something changed to cause Dell to finally disclose it in Aug-2006. Until then the company did not feel the exposure sufficiently material to require disclosure. What changed was the SEC expanded its inquiry in Jun-2006.

In a mistake we see often, investors wrongly assume that just because something bad has been disclosed, it has also been fully discounted into the securities of a public company. We say if you cannot independently assess what changed to bring about the disclosure of an SEC investigation a company has been sitting on for more than a year, then it's not fully discounted. It's that simple.

It appears Ubiquiti's SEC investigation-related expenses are being underreported, and by a wide margin.

A line item called "SEC Related Matters" showed up for the first time in the 8-K filed 10-May-2018. For the three months ending 31-Mar-2018, SEC Related Matters were reported as $317,000. A search of company filings found no similar expenses were reported in the past two years.

Using an analytical short-cut we came up with years ago that we call the "Attorney's Equivalent Analysis", we can help you put context to this expense item as follows –

- Our counsel charges us $400 per hour. Not all lawyers, accountants, or other experts bill at the rate. Some are higher, many lower. But it's a place to start.

- Let's then assume an average attorney, working full time, will consistently bill for 50 hours per week. At $400 per hour, they are racking up $20,000 a week in fees. Over a 13-week quarter, one attorney in this scenario will have recorded $260,000 in fees.

Again, Ubiquiti reported it incurred $317,000 in SEC related expenses for the quarter ended 31-Mar-2018. That's the Attorney's Equivalent of only 1.4 attorneys working full time on what is clearly a complex and expansive formal SEC investigation.

Let's now compare this to the legal and advisory fees reported by two other companies in the past. They are Herbalife (HLF – Market cap is larger than UBNT, at $9.1 B) and Tech Data Corp (TECD – Market cap is about half of UBNT, at $3.4 B). Below we present data from our archives to examine each company's SEC costs.

From Q1-2013 through the end of Q2-2015, Herbalife incurred $65.6 million in total expenses, or 1.45% of SG&A, related to joint SEC/FTC investigations at the time. Of the total expenses reported, $56.5 million, or 1.25% of SG&A over the same period, was said to be assigned to "legal, advisory and other professional service fees."

The following table on Herbalife's legal and advisory fees was first published by us in Sep-2015 --

Period	Legal and Advisory Fees $mm	Legal and Advisory Fees as a % of SG&A
Q1-2013	8.40	**2.30%**
Q2-2013	7.10	**1.77%**
Q3-2013	5.70	**1.39%**
Q4-2013	4.50	**0.99%**
FY 2013	**$ 25.70 mm**	**1.58%**
Q1-2014	4.00	**0.80%**
Q2-2014	7.20	**1.56%**
Q3-2014	3.70	**0.61%**
Q4-2014	5.50	**1.32%**
FY 2014	**$ 20.40 mm**	**1.02%**
Q1-2015	3.90	**0.90%**
Q2-2015	6.50	**1.38%**
Totals	**$ 56.50 mm**	**1.25%**

As you can see in the table above, Herbalife was routinely spending millions of dollars, quarter-after-quarter, to deal with their regulatory problems at the time. The lowest the company incurred was $3.7 million, and the highest quarterly expense was $8.4 million. This is as compared to Ubiquiti's claim that it incurred just $317,000 for the three months ending 31-Mar-2018.

In running Herbalife's numbers through our Attorney's Equivalent Analysis, at the time we had concluded an estimated 22-27 outside professionals could have been working full time, week-after-week, for 2½ years on Herbalife's regulatory exposure. This included an SEC and FTC investigation, which is not the case for Ubiquiti. Still, you could fill a small office building with all those people! Using this same analysis, it appears Ubiquiti wants you to believe less than 2 full-time equivalent personnel is all it takes to deal with its expansive SEC investigation.

For reference, from Herbalife 10-Q filed 05-Aug-2015 –

> "In late 2012, a hedge fund manager publicly raised allegations regarding the legality of our network marketing program and announced that the hedge fund manager had taken a significant short position regarding our common shares, leading to intense public scrutiny and significant stock price volatility. We have engaged legal and advisory services firms to assist with responding to the allegations and to perform other related services in connection to these events …"

Recall Herbalife also spent an additional $10 mm in related expenses not assigned to professional fees at the time. Now let's see what we can learn from Tech Data's SEC investigation.

Last December, we learned Tech Data was suing its insurers over failure to reimburse the company for "millions of dollars" spent responding to an SEC probe into accounting errors. Court records show Tech Data's SEC investigation involved multiple rounds of subpoenas and expanded over time.

As of last December, 2017, Tech Data reported it had spent $76.6 million on restatement-related expenses as part of an SEC investigation running more than five years at the time. Apparently, these costs were having impact. In Dec-2016, Tech Data filed a lawsuit against Travelers Casualty and Surety Company of America, and Zurich American Insurance Company. Each insurance company provided $10 million of Director's & Officer's coverage to Tech Data, with each policy covering the period 01-Feb-2013 to 01-Feb-2014, or one year each.

Tech Data brought the suit asserting, per the complaint, "the Insurers refuse to reimburse Tech Data for attorneys' fees Tech Data and its officers, directors and employees have incurred and are continuing to incur in connection with an investigation conducted by the U.S. Securities and Exchange Commission ("SEC")."

- Those with an interest may wish to ask Ubiquiti if they filed similar claims with their own insurance carriers, when such claims were first filed, and whether they have been paid.

We think Ubiquiti did not tell you about SEC related expenses earlier to keep hidden an SEC investigation. Now disclosed, we know this SEC investigation involves at least one round of multiple subpoenas, covering an expansive range of matters. Even if $317,000 is a good number, which the data suggests may not be the case, the experience of others warns this expense item will rise significantly. But if you can't trust even these simple numbers, it makes one wonder what else is cooked?

The lack of a CFO is not just "old news". It's also an enduring problem. The absence of a permanent CFO where the founder is also the Chairman/CEO, leaves a company open to fraud.

The fact that Ubiquiti has gone through two CFO's since going public, and hasn't had a permanent CFO since the second one left in 2015, is easy to dismiss as old news. The headline may be old, but we're not sure the enduring problem is fully appreciated by investors.

As the founder, especially one who's started a rapidly growing company, you become used to calling the shots. Accountability is not nearly what it would be if you had a traditional, shareholder-friendly governance structure which separates the roles of chairman from CEO, and installs competent, seasoned professionals in the ranks of senior C-suite positions. We argue that companies become vulnerable to fraud when they have a hard time retaining a qualified CFO, and the founder CEO also serves as chairman. But finding a CFO who can also stand up to a founder is hard, and that may be part of Ubiquiti's problem right now.

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If we alert you to existence of an undisclosed SEC probe, that means we filed a Freedom of Information Act (FOIA) request with the SEC on the company in question and have a response, in black-and-white, on government letterhead that supports our statement. The only thing we know at this time is that the probe(s) somehow pertains to the conduct, transactions, and/or disclosures of the companies referenced.

New SEC investigative activity could theoretically begin or end after the date covered by the latest information in this report which would not be reflected here. The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced above. Companies with undisclosed SEC investigations are maintained on our Watch List of companies with undisclosed SEC probes.
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