PEMBROKE

INNOVATION > INSIGHT > GROWTH

SINCE 1968

January 19, 2021

Dear Fellow Collectors Universe Shareholders:

Pembroke continues to oppose the $75.25 tender offer for Collectors Universe shares as we believe it significantly undervalues the company. We outlined our initial rationale for this position in an open letter to shareholders which we press released on December 18, 2020. The disclosure in the company's January 11, 2020 Schedule 14D-9/A filing of management's financial forecasts, which were presented to the company's Board of Directors for strategic planning purposes and used by Houlihan Lokey to render its fairness opinion, has strengthened the conviction behind our stance. We would like to take this opportunity to elaborate upon why this is the case.

[1] Management's own internal 5-year financial projections highlight a very dynamic revenue growth outlook for the company that should be well received by public markets.

	Jun-20 FY 2020	Jun-21 FY 2021E	Jun-22 FY 2022E	Jun-23 FY 2023E	Jun-24 FY 2024E	Jun-25 FY 2025E
Coin revenues	41,599	45,300	48,800	53,000	57,800	63,300
y/y growth	*0.50%*	*9.44%*	*7.73%*	*8.61%*	*9.06%*	*9.52%*
Trading card & autograph revenues	33,673	86,400	121,000	139,200	160,100	184,100
y/y growth	*27.45%*	*227.02%*	*40.05%*	*15.04%*	*15.01%*	*14.99%*
Other revenues	3,619	2,700	2,700	2,700	2,700	2,700
y/y growth	*-21.99%*	*-41.80%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
Total revenues	78,891	134,400	172,500	194,900	220,600	250,100
y/y growth	*8.89%*	*70.36%*	*28.35%*	*12.99%*	*13.19%*	*13.37%*

Management anticipates that massive growth in the business in fiscal year 2021 followed up by substantial growth in the subsequent four years will lead to more than a ***tripling*** of revenues from FY June 2020 to FY June 2025. This growth is underpinned by a booming trading cards and autographs business, which is projected to grow by a multiple of ***5.5 times*** and a compounded annual growth rate of 40.46% over that period.

We had outlined in our initial letter to shareholders the reasons for our optimism regarding the prospects for the PSA card and autograph grading business. As enthusiastic as we were, our internal projections paled relative to the internal forecasts of management. The disclosure of management's revenue growth expectations reinforces our belief that the tender offer bid is wholly inadequate.

[2] Even with management projecting a near quintupling of earnings over the next five years from FY June 2020 levels, we feel the margin assumptions used are overly conservative.

The margin assumptions embedded in management's forecasts show no operating leverage despite significant revenue growth:

	Sep-20	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
	Q1-21	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Revenues	30,785	134,400	172,500	194,900	220,600	250,100
y/y growth	*52.33%*	*70.36%*	*28.35%*	*12.99%*	*13.19%*	*13.37%*
Operating income	7,809	40,200	49,000	55,900	64,100	73,700
Operating margin %	***25.37%***	***29.91%***	***28.41%***	***28.68%***	***29.06%***	***29.47%***
Operating margin % ex-board search + activist defense fees	***32.63%***	***31.57%***	***28.41%***	***28.68%***	***29.06%***	***29.47%***

This is very counterintuitive; one would expect that simple leveraging of fixed costs would lead to some expansion of operating margin percentages. We believe that management's assumptions regarding (i) gross margins and (ii) selling and marketing expenses are unrealistically punitive, thereby depressing the company's projected earnings power.

(i) Gross margins

Despite reaching 62.73% in the latest reported quarter, management's forecasts have gross margin percentages declining to 59.63% for the balance of FY 2021 and continuing to slide every year thereafter through to 2025:

	Sep-20	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
	Q1-21	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Revenues	30,785	134,400	172,500	194,900	220,600	250,100
y/y growth	*52.33%*	*70.36%*	*28.35%*	*12.99%*	*13.19%*	*13.37%*
Gross profit	19,311	81,100	102,500	115,700	130,800	148,200
Gross Margin %	***62.73%***	***60.34%***	***59.42%***	***59.36%***	***59.29%***	***59.26%***

We believe this approach is inaccurate for the following reasons:

• In the last 11.25 years, Collectors Universe has generated $654.8MM in revenues and $394.7M of gross profits, yielding a **60.46%** gross margin percentage. Based on long-term history alone, the gross margin percentage forecasts appear understated.

• The company has announced price increases for card grading services, adopted lean workflow principles, and is introducing automation through robotics. These initiatives argue for the expansion of gross margin percentages from recent levels, not the opposite.

• In the company's latest quarter, segmented reporting showed that the card and autographs business enjoyed percentage operating margins 1451 basis points higher than coin operations. While gross margin splits were not disclosed, such a wide gap in profitability was most likely driven by differences in segment gross margins, as opposed to differences in sales and marketing or general and administrative expenses. With the cards and autographs business looking like it is emerging as a higher gross margin business compared to the coin business, and with management's forecasts showing the cards and autograph business becoming the dominant revenue driver for the company, we believe that overall corporate gross margin percentages should be driven higher simply as a function of its changing revenue mix.

	Q1-21 A	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Coins - % of revenue	37.2%	33.7%	28.3%	27.2%	26.2%	25.3%
Cards - % of revenue	60.5%	64.3%	70.1%	71.4%	72.6%	73.6%
Other - % of revenue	2.3%	2.0%	1.6%	1.4%	1.2%	1.1%

(ii) Selling and marketing expenses

Management's forecasts of selling and marketing expenses include a significant step-up in spending in FY 2022, followed by more gradual increases thereafter. We feel this is unrealistic, particularly when one considers the historical relationship between card and autograph revenues (the most important driver of future growth and the dominant part of the business) and sales and marketing expenses. For the purposes of this analysis, we will burden the trading cards and autographs business with the selling and marketing expenditures of the entire organization:

	Jun-10	Jun-20	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
	FY 2010	FY 2020	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Trading cards & autograph revenues	9,746	33,673	86,400	121,000	139,200	160,100	184,100
Selling & marketing expenses	5,068	9,436	10,300	15,700	17,500	19,600	22,100

Management's expectations indicate that by the end of FY 2021, card and autograph revenues will be $76.7MM higher than they were in FY 2010. Meanwhile, selling and marketing expenses over the same period will have risen by only $5.2MM if management's FY 2021 forecasts come to fruition. We can also compare FY 2021 forecasts with FY 2020 results to see this same dynamic at play in a more dramatic fashion: a $52.7MM increase in revenues versus an $864,000 increase in sales and marketing expenses.

Clearly, the card and autograph business is not a sales and marketing intensive business. This makes intuitive sense, considering the strength of the PSA brand, the scarcity of trusted competitive alternatives in the grading and authentication arena, and the premium prices PSA-graded cards enjoy in the marketplace. Quite simply, the PSA brand sells itself. Accordingly, we find the projected ramp-up of selling and marketing expenses to be unrealistically punitive and incongruent with the company's history.

[3] Our internal modeling work yields a more compelling earnings picture compared to that provided in management's forecast, and ultimately shows significant upside to CLCT shares.

Our modeling assumptions are as follow:

- Make no changes to management's revenue forecasts.

- Assume gross margin percentages of 61% for the remainder of FY June 2021 and through to FY 2025.

- Use management's selling and marketing figure of $10.3MM for FY 2021, and increase this by $1.5MM per year through to FY 2025.

- Make no changes to management's G&A, interest & other income, effective tax rate, depreciation & amortization, capex, and working capital assumptions.

- Assume a flat share count.

- Assume no dividends are paid out, such that all free cash flow accrues to cash balances.

Using this framework results in the following output:

	Jun-20	Sep-20		Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
	FY 2020	Q1-21	Q2-Q4, '21E	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Revenues	78,891	30,785	103,615	134,400	172,500	194,900	220,600	250,100
y/y growth	*8.89%*	*52.33%*		*70.36%*	*28.35%*	*12.99%*	*13.19%*	*13.37%*
Cost of sales	33,655	11,474	40,411	51,885	67,275	76,011	86,034	97,539
% of revenues	*42.66%*	*37.27%*	*39.00%*	*38.61%*	*39.00%*	*39.00%*	*39.00%*	*39.00%*
Gross profit	45,236	19,311	63,204	82,515	105,225	118,889	134,566	152,561
Gross Margin %	***57.34%***	***62.73%***	***61.00%***	***61.40%***	***61.00%***	***61.00%***	***61.00%***	***61.00%***
Selling & marketing expenses	9,436	2,269	8,031	10,300	11,800	13,300	14,800	16,300
% of revenues	*11.96%*	*7.37%*	*7.75%*	*7.66%*	*6.84%*	*6.82%*	*6.71%*	*6.52%*
General & administrative expenses	21,212	6,998	21,367	28,365	37,800	42,300	47,100	52,400
% of revenues	*26.89%*	*22.73%*	*21.10%*	*21.10%*	*21.91%*	*21.70%*	*21.35%*	*20.95%*
Board search & activist defense fees	-	2,235	-	2,235	-	-	-	-
Operating income	14,102	7,809	33,806	41,615	55,625	63,289	72,666	83,861
Operating margin %	***17.88%***	***25.37%***	***32.63%***	***30.96%***	***32.25%***	***32.47%***	***32.94%***	***33.53%***
Operating margin % ex 1-time items	***18.49%***	***32.63%***	***32.63%***	***32.63%***	***32.25%***	***32.47%***	***32.94%***	***33.53%***
Interest income (expense), net	78	18	(18)	-	-	-	-	-
Other income (expense), net	15	-	-	-	-	-	-	-
Income (loss) before income taxes	14,195	7,827	33,788	41,615	55,625	63,289	72,666	83,861
Pre-tax Margin %	***17.99%***	***25.42%***	***32.61%***	***30.96%***	***32.25%***	***32.47%***	***32.94%***	***33.53%***
Income tax expense	3,409	1,865	9,522	11,387	14,531	16,417	18,818	21,733
Effective tax rate	*24.02%*	*23.83%*	*28.18%*	*27.36%*	*26.12%*	*25.94%*	*25.90%*	*25.92%*
Net income	10,786	5,962	24,266	30,228	41,094	46,872	53,848	62,128
Net Margin %	***13.67%***	***19.37%***	***23.42%***	***22.49%***	***23.82%***	***24.05%***	***24.41%***	***24.84%***
Weighted average shares o/s	8,984	9,027	9,027	9,027	9,027	9,027	9,027	9,027
Diluted weighted average shares o/s	9,068	9,120	9,120	9,120	9,120	9,120	9,120	9,120
EPS (basic, ex 1-time items tax-effected)	$ 1.24	$ 0.85	$ 2.69	$ 3.54	$ 4.55	$ 5.19	$ 5.97	$ 6.88
EPS (diluted, ex 1-time items tax-effected)	$ 1.23	$ 0.84	$ 2.66	$ 3.50	$ 4.51	$ 5.14	$ 5.90	$ 6.81
Net income			24,266	30,228	41,094	46,872	53,848	62,128
Total adjustments			-	2,235	-	-	-	-
Depreciation & amortization			2,894	3,700	3,300	3,100	3,200	2,900
Capital expenditures			(3,093)	(4,300)	(1,500)	(1,500)	(1,000)	(1,000)
Change in net working capital			(2,510)	1,400	100	200	200	1,100
Unlevered free cash flow			21,557	33,263	42,994	48,672	56,248	65,128
Unlevered FCF per share			$ 2.39	$ 3.68	$ 4.76	$ 5.39	$ 6.23	$ 7.21
Starting net cash per share			$ 2.64		$ 5.03	$ 9.79	$ 15.18	$ 21.42
Ending net cash per share		$ 2.64	$ 5.03	$ 5.03	$ 9.79	$ 15.18	$ 21.42	$ 28.63

We have high conviction that a 25-30x P/E multiple through the forecast period would be sustainable for Collectors in light of its high growth rates, stellar cash flow dynamics, and thematic drivers. Applying these valuation parameters to our projections yields the following target price framework:

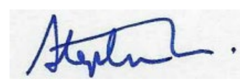
	Target price, excluding cash, as at:			
	Jun-21	Jun-22	Jun-23	Jun-24
Forward P/E multiple				
25x	$ 112.65	$ 128.49	$ 147.61	$ 170.31
30x	$ 135.18	$ 154.19	$ 177.13	$ 204.37

	Target price, including cash, as at:			
	Jun-21	Jun-22	Jun-23	Jun-24
Forward P/E multiple				
25x	$ 117.68	$ 138.28	$ 162.79	$ 191.72
30x	$ 140.21	$ 163.98	$ 192.32	$ 225.78

Clearly, the $75.25 offer price is totally inadequate in light of the potential upside we see in the Collectors Universe franchise over the next four years.

In closing, we remain steadfastly opposed to the tender offer in its current form, as it grossly undercompensates Collectors Universe shareholders for the quality and growth prospects of the business we own.

Sincerely,



Stephen Hui, CFA
Partner
Pembroke Management Ltd.

SPECIAL NOTE REGARDING THIS LETTER:

THIS LETTER CONTAINS OUR CURRENT VIEWS ON THE VALUE OF THE COMPANY'S SECURITIES AND CERTAIN ACTIONS THAT THE COMPANY'S BOARD MAY TAKE TO ENHANCE THE VALUE OF ITS SECURITIES. OUR VIEWS ARE BASED ON OUR OWN ANALYSIS OF PUBLICLY AVAILABLE INFORMATION AND ASSUMPTIONS WE BELIEVE TO BE REASONABLE. THERE CAN BE NO ASSURANCE THAT THE INFORMATION WE CONSIDERED AND ANALYZED IS ACCURATE OR COMPLETE. SIMILARLY, THERE CAN BE NO ASSURANCE THAT OUR ASSUMPTIONS ARE CORRECT. THE COMPANY'S ACTUAL PERFORMANCE AND RESULTS MAY DIFFER MATERIALLY FROM OUR ASSUMPTIONS AND ANALYSIS.

WE HAVE NOT SOUGHT, NOR HAVE WE RECEIVED, PERMISSION FROM ANY THIRD-PARTY TO INCLUDE THEIR INFORMATION IN THIS LETTER. ANY SUCH INFORMATION SHOULD NOT BE VIEWED AS INDICATING THE SUPPORT OF SUCH THIRD PARTY FOR THE VIEWS EXPRESSED HEREIN.

THIS LETTER MAY ALSO REFERENCE THE SIZE OF OUR RESPECTIVE CURRENT HOLDINGS OF THE COMPANY'S SECURITIES RELATIVE TO OTHER HOLDERS OF SUCH SECURITIES. OUR VIEWS AND OUR HOLDINGS COULD CHANGE AT ANY TIME. WE MAY SELL ANY OR ALL OF OUR HOLDINGS OR INCREASE OUR HOLDINGS BY PURCHASING ADDITIONAL SECURITIES. WE MAY TAKE ANY OF THESE OR OTHER ACTIONS REGARDING THE COMPANY WITHOUT UPDATING THIS LETTER OR PROVIDING ANY NOTICE WHATSOEVER OF ANY SUCH CHANGES (EXCEPT AS OTHERWISE REQUIRED BY LAW).

FORWARD-LOOKING STATEMENTS:

Certain statements contained in this letter are forward-looking statements including, but not limited to, statements that are predications of or indicate future events, trends, plans or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties. Forward-looking statements are not guarantees of future performance or activities and are subject to many risks and uncertainties. Due to such risks and uncertainties, actual events or results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Forward-looking statements can be identified by the use of the future tense or other forward-looking words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," "should," "may," "will," "objective," "projection," "forecast," "management believes," "continue," "strategy," "position" or the negative of those terms or other variations of them or by comparable terminology.

Important factors that could cause actual results to differ materially from the expectations set forth in this letter include, among other things, the factors identified in the public filings of the Company. Such forward-looking statements should therefore be construed in light of such factors, and we are under no obligation, and expressly disclaim any intention or obligation, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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