Zacks Small-Cap Research

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Inuvo Inc. (INUV-NYSE)

INUV: Raising Price Target As Comps Move Up, and Business Grows

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	02/25/2015
Current Price (04/29/15)	$2.28
Target Price	**3.00**

OUTLOOK

Inuvo is digital publishing and advertising technology company. The business is composed of a network of website and app partners and a network of owned and operated websites and apps. Revenue is earned from ads served by the company's proprietary technologies into those websites and apps. In the past two years it shed a money-losing toolbar business and is now poised to grow going forward. Its new native ad product "SearchLinks" could accelerate growth and increase valuation. Management's goal is to reach revenues of $100 million in the next three years.

SUMMARY DATA

52-Week High	**$3.06**
52-Week Low	**$0.65**
One-Year Return (%)	**205.13**
Beta	**0.61**
Average Daily Volume (sh)	**775,357**
Shares Outstanding (mil)	**24**
Market Capitalization ($mil)	**$55**
Short Interest Ratio (days)	**2.03**
Institutional Ownership (%)	**22**
Insider Ownership (%)	**16**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**2.7**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**17.5**
P/E using 2015 Estimate	**14.3**
P/E using 2016 Estimate	**13.4**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Internet-Services**
Zacks Rank in Industry	**7 of 44**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	16 A	13 A	15 A	11 A	55 A
2014	10 A	11 A	13 A	16 A	50 A
2015	13 A	14 E	16 E	17 E	59 E
2016					70 E

Earnings per Share
(Non-GAAP EPS from continuing operations)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.01 A	$0.01 A	$0.04 A	-$0.02 A	$0.03 A
2014	$0.03 A	$0.03 A	$0.03 A	$0.04 A	$0.13 A
2015	$0.03 A	$0.04 E	$0.04 E	$0.05 E	$0.16 E
2016					$0.17 E

Zacks Projected EPS Growth Rate - Next 5 Years % **20**

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KEY POINTS

- Inuvo is an emerging player in the digital advertising space a market that is growing over 16% per year and should benefit from this market growth.

- After transitioning out of a money-losing toolbar business, the company just reported its second quarter in a row of over 30% growth, and reports that April revenues were also up 30%. Inuvo should be able continue to grow revenues year-over-year while maintaining profitability and positive cash flow.

- The company has stated its goal is to reach $100 million in revenues in the next three years. This could happen even faster were the company to grow through acquisition as well as organically. It is adding more content to its company-owned sites, as well as considering adding content through the acquisition of content-based web sites.

- Later this year, the company is introducing a new advertising product, “SearchLinks”, that should find success with its ad network partners and create more customer retention. It also should create a barrier to entry for its ad business, as it is complex and possibly unique in the industry. This native advertising product is in a very high growth space and companies in that space have higher valuations.

- If the company is valued on enterprise value to sales (since many competitors operate at a loss), the stock is priced below its peers who trade at an average of 1.3 times sales. Given this valuation, INVU should trade at $3.00 per share, up 26% from its current price. However, if SearchLinks is successful, investors should look to others in the native advertising space that are currently valued at closer to 3.5x revenues.

WHAT’S NEW

Second Quarter of Revenue Growth Over 33%

Despite a sequentially down quarter, Inuvo reported revenue growth of 32.6% in Q1 coming in at $13.4 million versus $10.1 million, $400,000 ahead of our estimate. The company reported EPS of $0.03 versus our estimate of $0.01, but this difference was due entirely to the reversal of an accrual of taxes that the company had reserved in a dispute with the State of New Jersey. Having been settled the company was able to reverse the accrual.

Having gotten through this seasonally weak quarter we are optimistic the company should be able to continue to grow albeit possibly at a slower rate. The company announced that sales in April were up over 30% year over year and it expected to be able to grow revenues for the 2015 quarters both sequentially and year over year.

Given that this quarter’s beat was due to taxes, we are raising our number for the year only by the two cents to $0.16. Adjusted EBITDA was $672,000 and the company expects to grow that throughout the year.

Chart 1: Revenue Segments by Quarter

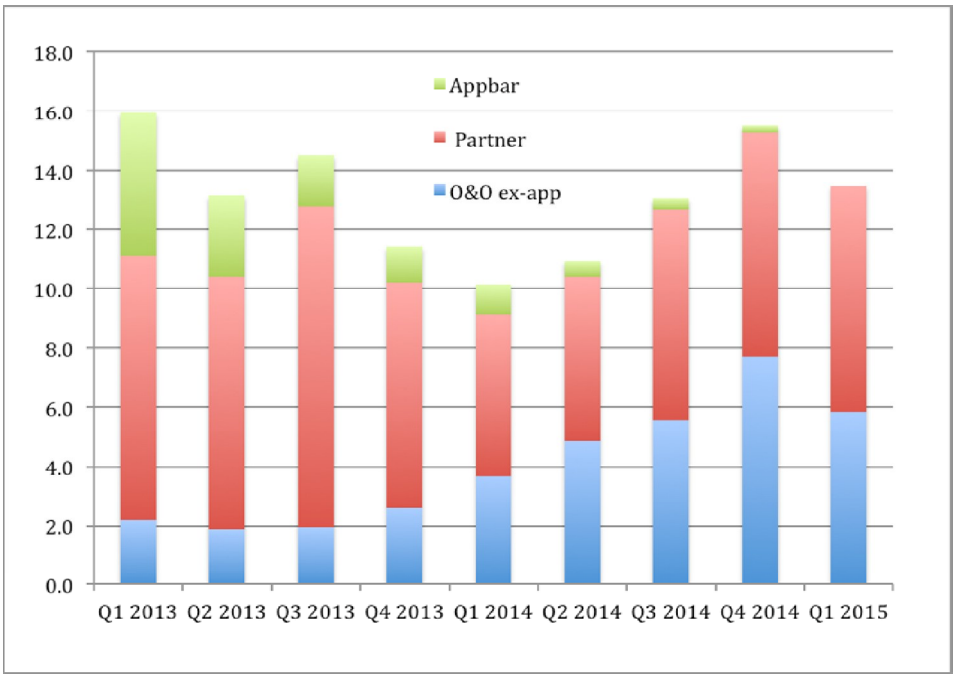
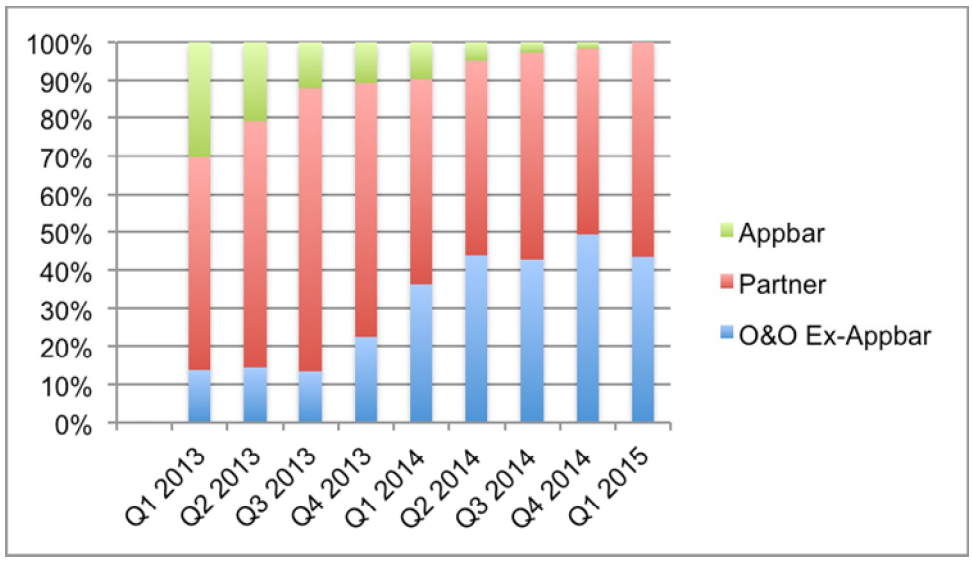


Chart 2: Revenues by Product Line as a Percent of Sales



Q2 2015

We are keeping our Q2 forecast the same although there is the chance that revenues could be higher and gross margins lower. As we have no better handle on the revenue mix now that when we created the forecast, we will leave it alone. The company did indicate that revenues are expected to be up both sequentially and year over year for the remaining three quarters of 2015. We are currently looking for revenues of $13.9 million and an EPS of $0.03 versus $10.9 million and $0.02.

Rollout of SearchLinks In Q3

Key to Inuvo's results in 2015 will be the success of the rollout of its new native advertising product SearchLinks. The company is currently in beta with a half a dozen ad partners and plans are to launch in Q3 with noticeable results in Q4. This product should be unique but similar to products from Taboola and Outbrain. Both companies are private Israeli companies based in NYC. Both use behavioral targeting to recommend content to users as a way of encouraging them to stay on sites. Web publishers then buy and sell traffic to their sites. In contrast, Inuvo will recommend ads, rather than content, to drive purchasing for advertisers.

Outbrain, based in Netanya, Israel, is the older of the two and founded in 2006 and has $99 million in funding. It has approximately 470 employees. In 2013, Outbrain did $130 million in revenues, up 63%. It is rumored to IPO at between $700-800 million. If Outbrain grew 50% in 2014 to $195, that would be a trailing valuation of 3.8 times.

Taboola has raised $157 million and has 250 employees. The latest round was on February 4, 2015. In February management said the company was at a $250 run rate and the last round is rumored to be post money shy of $1 billion. That would probably be 3.5 times the run rate.

These two companies evidence that this type of business could yield a much higher valuation for Inuvo. Outbrain has already filed for a public offering and any interest garnered by this IPO could rub off on Inuvo. If nothing else, it could increase the valuation of the average comps and add to the company's potential target price.

VALUATION

Inuvo is hybrid ad technology platform/ad network and website publisher. Since the company is almost spilt 50/50, we are using a combination of these types of pubic companies to create a blended valuation.

We applied average multiples to Inuvo's historical and projected revenues based on these comparable companies. Based purely on public company comps, the result is a market value of $71.2 million or $2.96 per share.

Comparable Public Companies

Company	Ticker	Revenue 2015E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	EV/ EBITDA	Included Average?	Enterprise Value
Autobytel	ABTL	$117	$106	$8	1.1x	1.3x	16.2x	y	134
Bluecora	BCOR	$480	$581	$90	1.1x	0.9x	6.1x	y	547
Criteo	CRTO	$492	$270	$56	4.8x	8.7x	42.1x	n	2,340
Demand Media	DMD	$157	$172	$14	0.5x	0.5x	5.8x	y	83
Rocket Fuel	FUEL	$533	$409	-$38	0.7x	0.9x	-9.5x	y	357
Local	LOCM	$85	$83	-$2	0.3x	0.3x	-10.9x	n	23
Marchex	MCHX	$136	$183	$9	0.8x	0.6x	12.5x	y	109
Millennial Media Inc.	MM	$323	$296	-$22	0.5x	0.6x	-7.5x	y	163
The Rubicon Project	RUBI	$177	$125	-$10	3.0x	4.2x	-52.2x	y	532
MaxPoint Interactive	MXPT	$90	$107	-$9	2.6x	2.2x	-32.0x	y	233
Travelzoo	TZOO	$133	$138	$22	1.0x	1.0x	6.4x	y	138
Average				**7**	**1.3x**	**1.3x**	**-6.0x**		**$255**

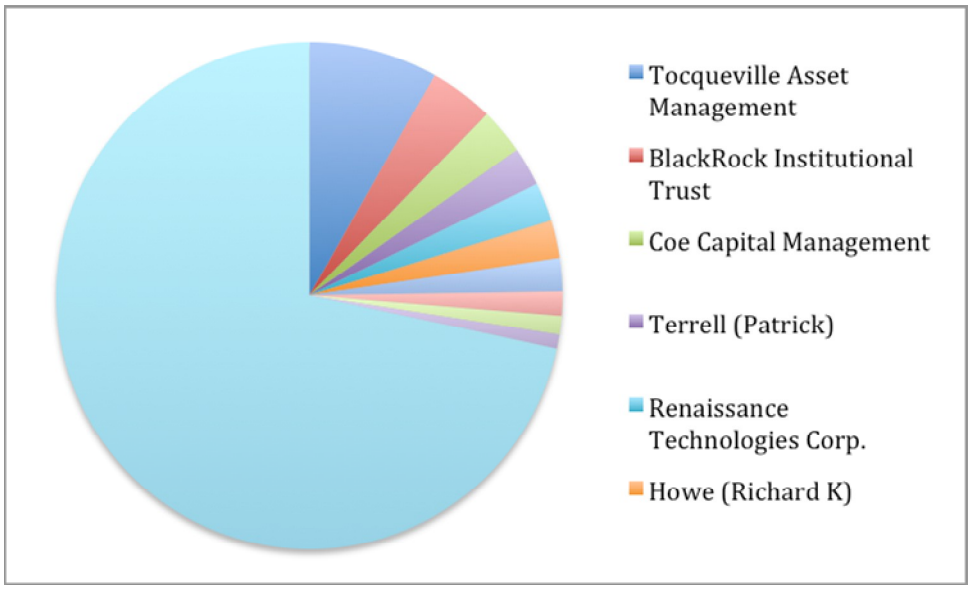
	Revenue 2015E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
Inuvo	**$59**	**$53**	**4.8**	**1.3x**	**1.3x**	**$71**	**$75**
YoY growth							

Conclusion of Enterprise Value	**$73,361,290**
Market Value	**$71,726,254**
Shares Outstanding	24,240,000
Price per Share	**$2.96**

RISKS

- There are few barriers to entry in the advertising network business and it typically operates with slim margins with competition mainly on price.
- The company is almost entirely dependent upon Yahoo! And Google for revenues.
- The company pivoted two years ago and its new strategy of focusing on company-owned sites may not provide continued growth or lower its valuation.
- The digital ad business is very competitive and there is far more inventory of ad space than is needed. There could be continued price pressure that would lower click rates going forward. Much of the ad inventory in the US goes unsold; more inventory could exacerbate this supply-demand imbalance. Thus, Inuvo may have to increase volume of ads sold just to maintain revenues.
- Inuvo has limited resources with which to compete against much larger companies and this could hinder its growth.

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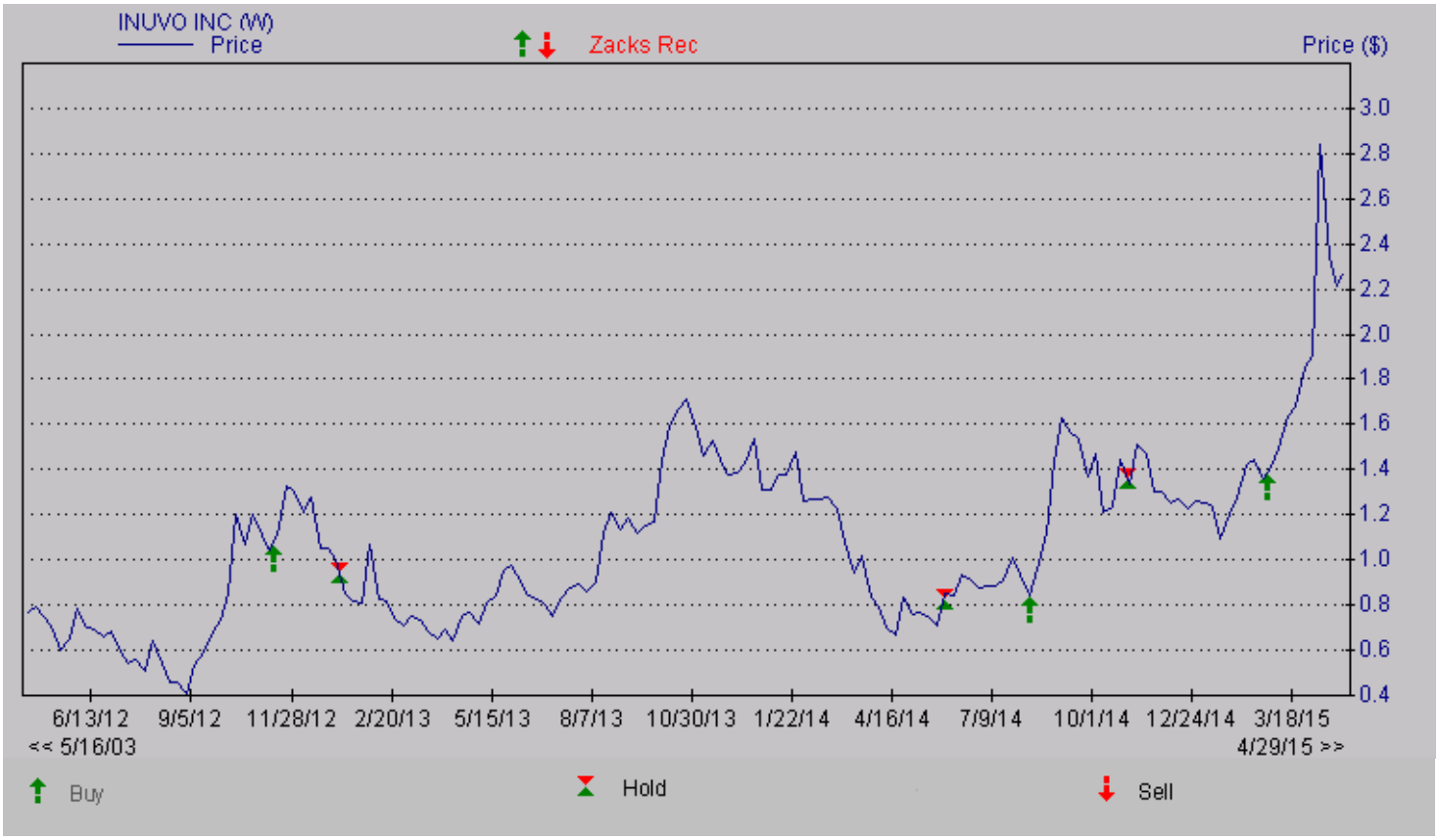
PROJECTED INCOME STATEMENT

Inuvo	Q1 2014 31-Mar	Q2 2014 30-Jun	Q3 2014 30-Sep	Q4 2014 31-Dec	Q1 2015 31-Mar	Q2 2015E 30-Jun	Q3 2015E 30-Sep	Q4 2015E 31-Dec	2013	2014	2015E	2016E
Partner Network Revenue	5.5	5.6	7.1	7.6	7.6	$6.8	$7.6	$8.2	36.0	25.7	30.2	34.7
Yr-to-yr Growth	-39%	-35%	-34%	-1%	39%	22%	7%	8%	39%	-29%	17%	15%
Owned and operated, excluding Appbar	3.7	4.8	5.6	7.7	5.8	7.0	7.5	8.6	8.5	21.8	28.9	36.2
Yr-to-yr Growth	68%	156%	187%	200%	59%	45%	34%	12%	107%	157%	33%	25%
Appbar	1.0	0.5	0.3	0.2	$0.1	$0.1	$0.0	$0.0	10.5	2.1	0.2	0.0
	-80%	-80%	-80%	-81%	-90%	-82%	-100%	-100%	-55%	-80%	-91%	-100%
Total revenue	**10.1**	**10.9**	**13.0**	**15.5**	**13.4**	**13.9**	**15.1**	**16.8**	**55.0**	**49.6**	**59.3**	**70.9**
Yr-to-yr Growth	-36%	-17%	-10%	36%	32.6%	27%	16%	8%	3.0%	-9.8%	19.6%	19.5%
Cost of services	3.7	4.7	5.9	6.2	6.1	5.7	6.4	6.8	28.8	20.4	25.0	18.9
Partner network gross margin	1.9	1.0	1.2	1.4	1.5	1.2	1.4	1.6	8.0	5.5	5.7	6.6
% GM partner network	34%	17%	17%	19%	20%	18%	18%	19%	22%	21%	17%	19%
Owned and Operated GM	4.6	5.3	5.9	7.9	5.8	7.0	7.4	8.4	18.2	23.7	28.6	35.5
% GM owned and operated	98%	99%	100%	100%	100%	98%	98%	98%	98%	99%	98%	98%
Gross profit	6.4	6.3	7.1	9.3	7.4	8.2	8.7	10.0	26.2	29.2	34.2	42.1
Gross Margin	63.7%	57.4%	54.6%	60.2%	54.8%	58.9%	57.7%	59.4%	47.7%	58.8%	57.7%	59.3%
Operating expenses:												
Marketing	3.7	3.6	4.3	5.9	4.9	5.0	5.3	6.3	14.4	17.5	21.5	26.9
Compensation	1.1	1.1	1.2	1.4	1.2	1.3	1.4	1.5	6.0	4.8	5.4	6.7
SG&A	1.0	1.1	1.2	1.2	1.0	1.1	1.2	1.2	5.8	4.4	4.4	5.3
Total operating expenses	5.8	5.8	6.7	8.4	7.1	7.4	7.9	9.0	26.2	26.7	31.4	39.0
Operating income:	0.7	0.5	0.5	0.9	0.251	0.8	0.9	1.0	0.0	2.5	2.9	3.1
Operating margin	6.6%	4.3%	3.6%	5.8%	1.9%	5.6%	5.7%	5.9%	0.0%	5.0%	4.9%	4.4%
Other income:												
Interest expense, net	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.4)	(0.4)	(0.2)	(0.2)
Total other income	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.4)	(0.4)	(0.3)	(0.2)
Income before income taxes	0.6	0.4	0.4	0.8	0.2	0.7	0.8	0.9	(0.3)	2.1	2.6	2.9
Pretax Margin	5.7%	3.3%	2.9%	5.3%	1.5%	5.3%	5.4%	5.6%	-0.6%	4.3%	4.4%	4.1%
Income tax benefit	(0.1)	0.00	0.00	(0.1)	(0.4)	0.0	0.0	0.0	(0.3)	(0.2)	-	-
Tax rate	-13%	0%	0%	-9%	-204%	0%	0%	0%	92%	-7.1%	0.0%	0.0%
Net income from continuing operations	0.6	0.4	0.4	0.8	0.6	0.7	0.8	0.9	(0.0)	2.3	2.6	2.9
Net income from discontinued operations	0.0	0.0	0.0	(0.1)	0.0	-	-	-	0.5	(0.0)	-	-
Net income	0.7	0.4	0.4	0.6	0.6	0.7	0.8	0.9	0.5	2.3	2.6	2.9
Foreign currency valuation	-	-	-	-	-	-	-	-	(0.0)	0.0	0.0	0.0
Comprehensive income	0.7	0.4	0.4	0.6	0.6	0.7	0.8	0.9	0.5	2.3	2.6	2.9
Stk based compensation	0.1	0.2	0.3	0.3	0.1	0.1	0.1	0.1	0.7	1.0	0.2	0.2
One-time expenses	-	-	-	0.1	-	-	-	-	-	0.1	0.0	0.0
Non-GAAP Income from continuing	0.8	0.6	0.7	1.2	0.7	0.8	0.9	1.0	0.7	3.3	2.8	3.1
Yr-over-Yr									-110.9%	393.3%	-12.9%	9.6%
Net income per share:												
Basic from continuing	0.03	0.02	0.02	0.03	0.03	0.03	0.03	0.04	(0.00)	0.10	0.11	0.12
Diluted from continuing	0.03	0.02	0.02	0.03	0.03	0.03	0.03	0.04	(0.00)	0.09	0.11	0.11
Non-GAAP Diluted from continuing	0.03	0.03	0.03	0.04	0.03	0.03	0.04	0.04	0.03	0.13	0.12	0.12
					-18.3%	24.7%	28.6%	-0.6%	-110%	358%	-10%	4%
Shares												
Basic	23.4	23.4	23.4	23.6	24.1	23.7	23.8	23.9	23.3	23.5	23.5	24.7
Diluted	23.5	24.1	24.1	24.5	24.2	24.6	24.7	24.8	23.3	24.0	24.2	25.4
	1.0%	3.1%	3.0%	5.0%	3.2%	2.3%	2.3%	1.4%	10.8%	3.2%	0.8%	5.0%
Adjusted EBITDA	1.34	1.19	1.18	1.78	0.67	1.26	1.35	1.47	3.75	5.48	4.75	5.03
	-2%	39%	-19%	2138%	-50%	6%	15%	-17%		46%	-13%	6%

BALANCE SHEET

	March 31, 2015	Dec. 31, 2014	
Current assets			
Cash	$1,923,617	$3,714,525	-48%
Accounts receivable, net of allowance for doubtful accounts of $87,733 and $62,845, respectively	7,398,031	5,106,300	45%
Unbilled revenue	19,629	23,541	-17%
Prepaid expenses and other current assets	232,727	299,873	-22%
Total current assets	9,574,004	9,144,239	5%
Property and equipment, net	999,267	959,475	4%
Other assets			
Goodwill	5,760,808	5,760,808	0%
Intangible assets, net of accumulated amortization	9,331,821	9,530,322	-2%
Other assets	200,032	211,833	-6%
Total other assets	15,292,661	15,502,963	-1%
Total assets	25,865,932	25,606,677	1%
Current liabilities			
Accounts payable	7,001,628	5,714,158	23%
Accrued expenses and other current liabilities	3,052,266	3,704,464	-18%
Term and credit notes payable - current portion	959,942	959,942	0%
Total current liabilities	11,013,836	10,378,564	6%
Long-term liabilities			
Deferred tax liability	3,552,500	3,552,500	0%
Term and credit notes payable - long term	2,500,000	2,666,667	-6%
Other long-term liabilities	98,711	735,211	-87%
Total long-term liabilities	6,151,211	6,954,378	-12%
Total Liabilities	17,165,047	17,332,942	-1%
Stockholdersâ€™ equity			
Total stockholders' equity	8,700,885	8,273,735	5%
Total liabilities and stockholders' equity	$25,865,932	$25,606,677	1%
Quick Ratio	0.9	0.9	-1%
Working Capital	(1,439,832)	(1,234,325)	17%
Cash as % of assets	7%	15%	-49%
Debt % of assets	14%	17%	-19%

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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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