Zacks Small-Cap Research

February 26, 2015

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Inuvo Inc. (INUV-NYSE)

INUV: Zacks Company Report – Initiating Coverage – Turnaround Completed, Digital Ads Growth Follows

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	02/25/2015
Current Price (02/25/15)	$1.34
Target Price	**2.30**

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. The stock is undervalued versus peer companies and we believe the market should take notice as it continues to report year over year growth. Management's goal is to reach revenues of $100 million in the next three years.

SUMMARY DATA

52-Week High	**$1.70**
52-Week Low	**$0.65**
One-Year Return (%)	**8.94**
Beta	**0.55**
Average Daily Volume (sh)	**92,783**
Shares Outstanding (mil)	**24**
Market Capitalization ($mil)	**$32**
Short Interest Ratio (days)	**5.44**
Institutional Ownership (%)	**23**
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	**10.4**
P/E using 2015 Estimate	**9.0**
P/E using 2016 Estimate	**7.9**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Internet-Services**
Zacks Rank in Industry	**38 of 41**

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 E	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	$0.01 E	$0.04 E	$0.04 E	$0.05 E	$0.14 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 first up year-over-year revenue growth in over six quarters. As the old toolbar business is now virtually zero, Inuvo should be able continue to grow revenues year-over-year while maintaining profitability and positive cash flow.
- The company's valuation is well below its peer group. We believe this is due to its microcap status, and its recent history of declining year over year revenues.
- 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.
- The company is introducing new advertising products that should find success with its ad network partners and create more customer retention. It is also adding more content to its company-owned sites to increase revenue in this business. We believe these efforts should allow the company to grow revenues organically over 18% in 2015.
- The stock trades at a low PE of 10 X 2015 non-GAAP EPS of $0.14. If the company is valued on enterprise value to sales (since many competitors operate at a loss), the stock is priced well below its peers who trade at an average of one times sales. Given this valuation, INVU should trade at $2.30 per share, up 72% from its current price.
- Q1 should be seasonally weak, and we believe the company may report down sequential revenues for the first time despite being up year over year. Additionally we expect earnings to be down year over year as well as sequentially. This could prove to be disappointing to investors after the strong fourth quarter and could be a good entry point for new shareholders. We are **INITIATING coverage with an Outperform**, but given the possibility of this scenario, investors may be presented a more favorable purchase price after Q1 is reported.

OVERVIEW

Inuvo: A Hybrid Digital Ad Network and Publisher

Transitioning Completely out of Toolbars…

Inuvo is an Internet advertising network with a technology platform that serves ads to third parties, as well as its own websites. Its ad network competes with many other networks that serve small and medium publishers including big networks such as Google's AdSense, Apple's iAd and Facebook. Its owned and operated websites compete with all other content providers such as WebMD and IAC. Thus revenues come from two places:

- Revenue from ads it displays on its own websites and apps - in which case it gets paid by Google and Yahoo! for click-throughs of those ads.

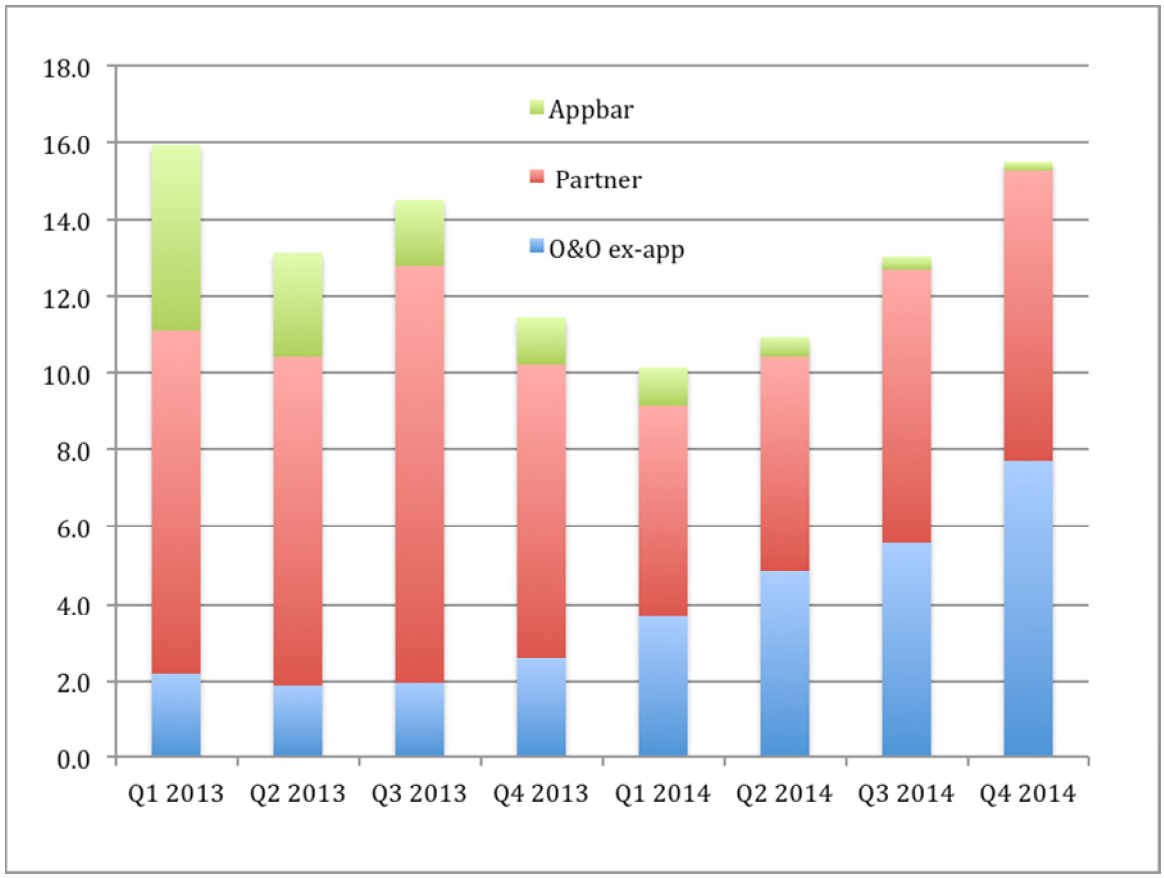
- It also gets revenues from ads it displays on partner's websites and apps, and as readers click on those ads, Inuvo gets paid per click and shares a percentage of that revenue with the partner.

  In 2014, it generated revenues almost equally from each half of the business, but owned and operated contributed 80% of the gross margin. If we were to look at net revenues from the partner network, also known as ex-TAC (traffic acquisition costs), the owned and operated part of the business still contributes 30% more to earnings per dollar of revenue.

…From a complicated past

The company has gone through a variety of business incarnations starting as Gemstar Enterprises in 1987, and through a series of business and name changes became CGI Holdings, then Think Partnership, then money-losing Kowabunga. In 2008, Chairman of the Board of Kowabunga, Mitch Tuchman, hired a new board and new management, including Richard Howe (Inuvo's current CEO), to fix the company. Adding to profitable products, and subtracting unprofitable products, while lowering costs, achieved this. The company again changed its name in 2009, this time to Inuvo and purchased Vertro in 2012. The Vertro CEO then took over, and Richard Howe left to become Chairman. Subsequently however, the board made a strategic decision to exit the money losing toolbar business, the key product of Vertro, and rehired Howe at the end of 2012 to execute this plan. In 2013, the company tapered off its support of the toolbar business and what was $23 million in revenues in 2012 from the toolbar business (or 44% of total revenues), declined to $2 million in 2014. By focusing on the higher margin company-owned websites, the company emerged from losses and is again profitable and growing revenues.

Chart 1: Revenue Segments by Quarter



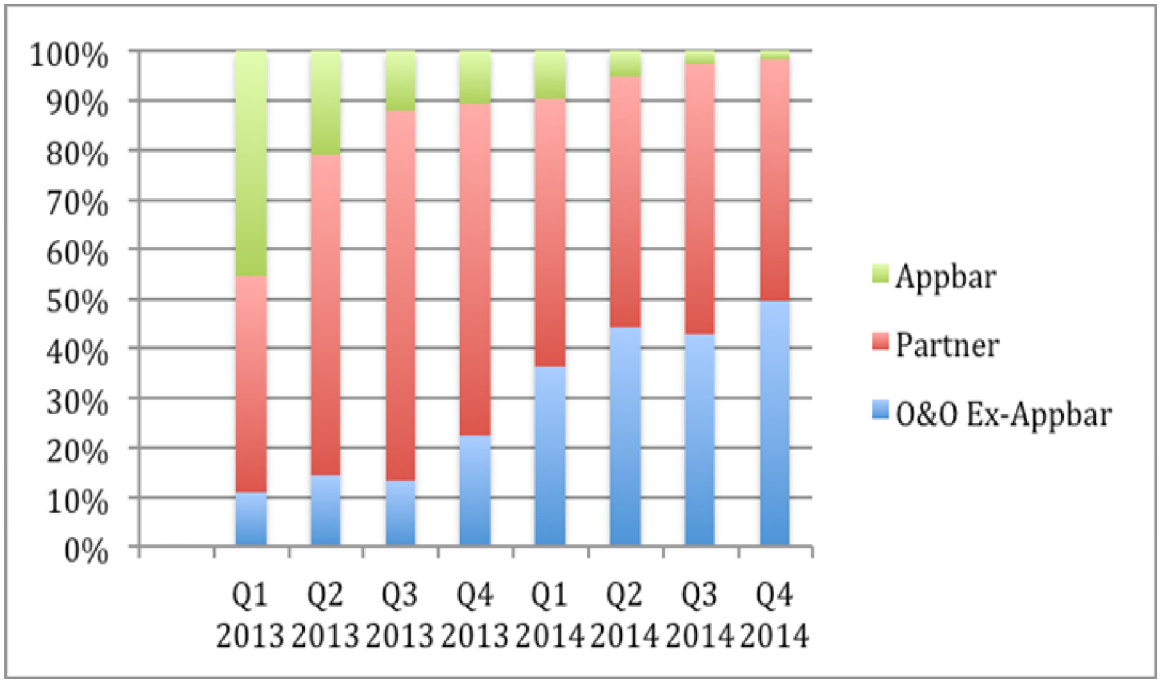
The company now serves approximately 1,000 publishers who own up to 10,000 websites and apps in addition to its own ALOT website properties. Its revenues are split between Google and Yahoo! who contributed 43.8% 53.5% respectively to 2014 revenues. It has relocated to low-cost Arkansas and employs 45 full time equivalent people. It is growing by adding new website topics and improving its ability to deliver the highest quality consumers to advertisers through the best performing ads. It is both cash flow positive and has positive GAAP EPS and we predict this performance should continue.

The competitive difference…

The company believes it has several competitive advantages against others in the same businesses:

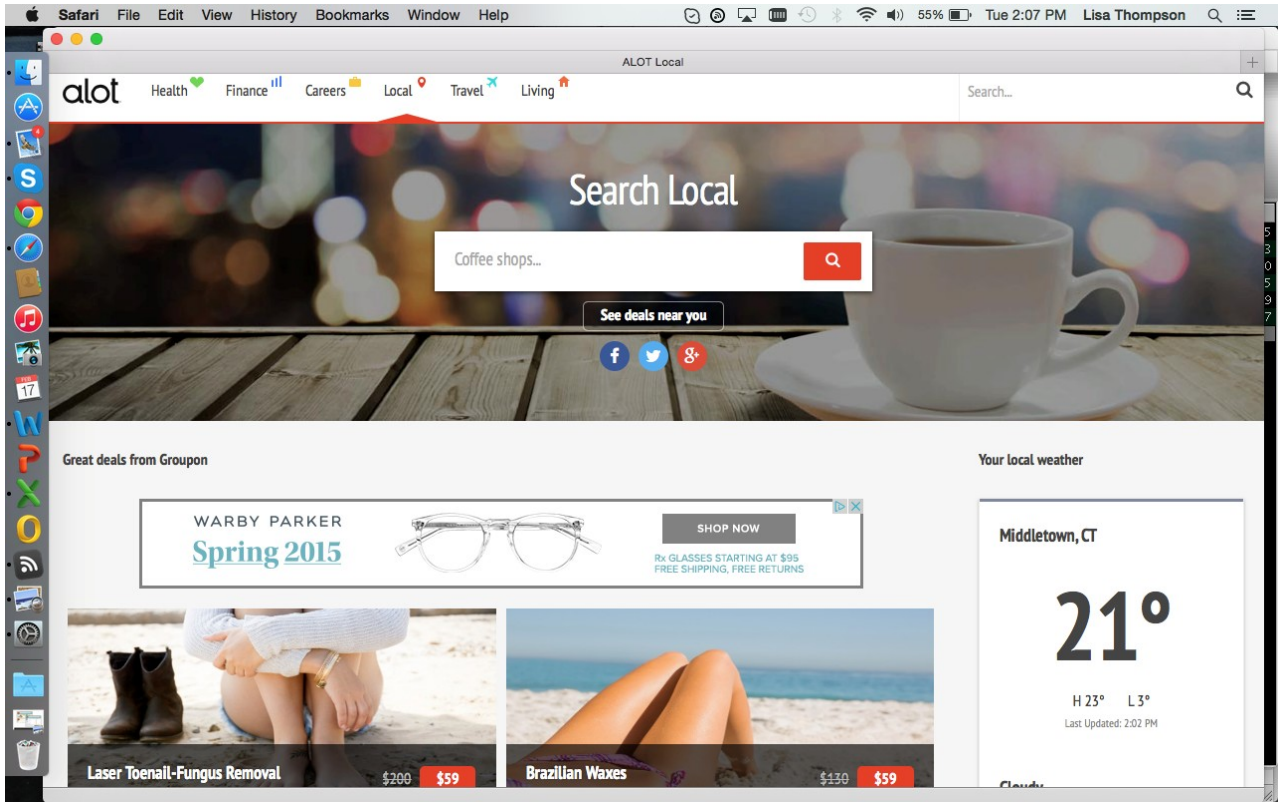
- Owns its content, which can be reused freely.
- Owns its ad-serving technology, which results in better click through results.
- Does its own marketing; it develops and monitors its campaigns in-house.

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



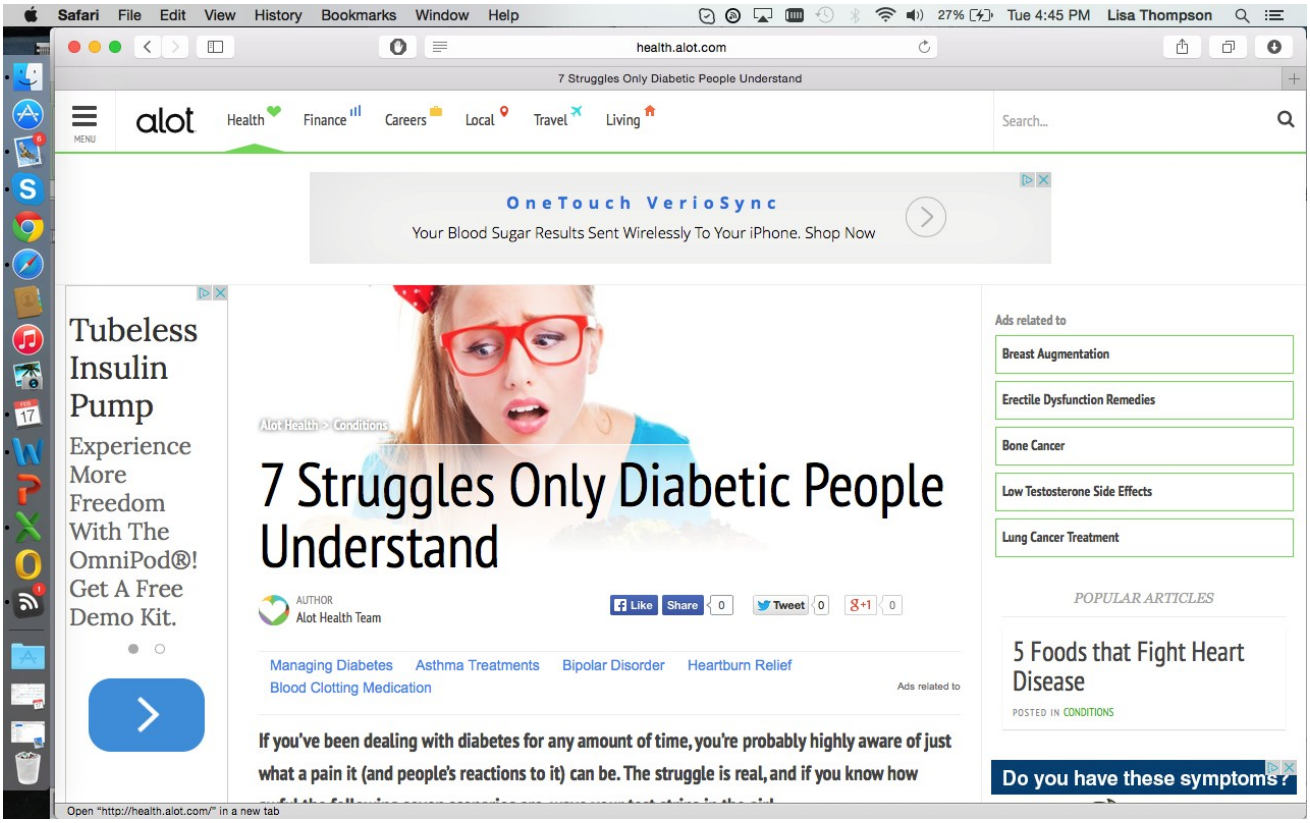
Growth in 2015 driven by new types of content and new ad products

Owned and operated growth should primarily be driven by adding new varied content to the sites. In addition to plain text articles, the company plans to add a variety of graphics, slide shows and interactive content such as polls and quizzes. Also, since the company gets approximately 50% of its revenues in owned an operated from its first two websites, Local and Health, the company should be able to grow this segment as the newer sites mature. Below we show the home page of ALOT Local.

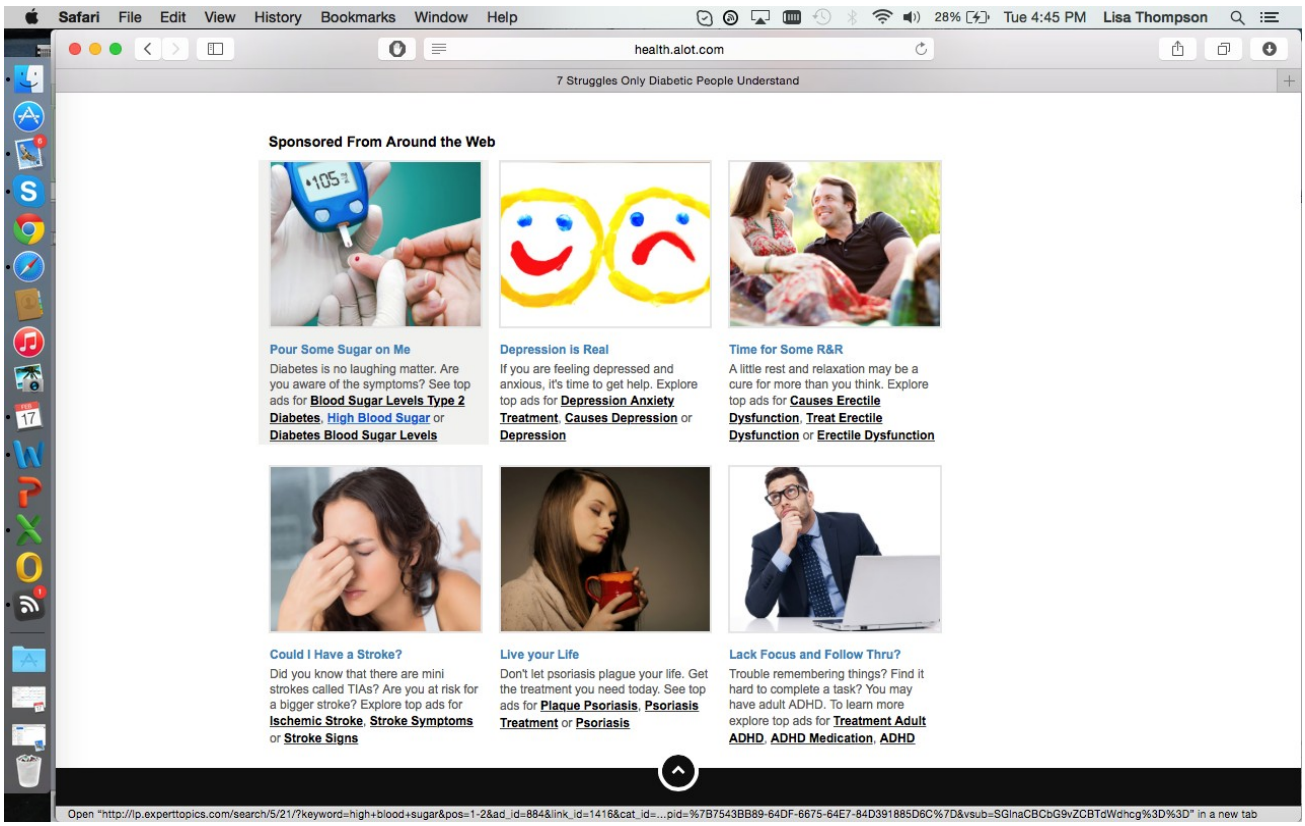


In 2015, the company believes a new product line made up of ad units that will be branded as “Searchlinks,” will drive much of its growth in the partner network. To explain, on a section of a page, there will be an area that will be filled with links to other articles that are relevant to the content on that page. These links, when clicked, will send the reader to an ad relevant to the content. For example, if you are reading about a disease, the box may contain articles about medicines for that disease. This product is expected to be in broad release shortly. In addition to generating more revenue, this product offering should integrate more closely with publishers, making switching to other networks more difficult. An example of this “ad unit” is shown as follows.

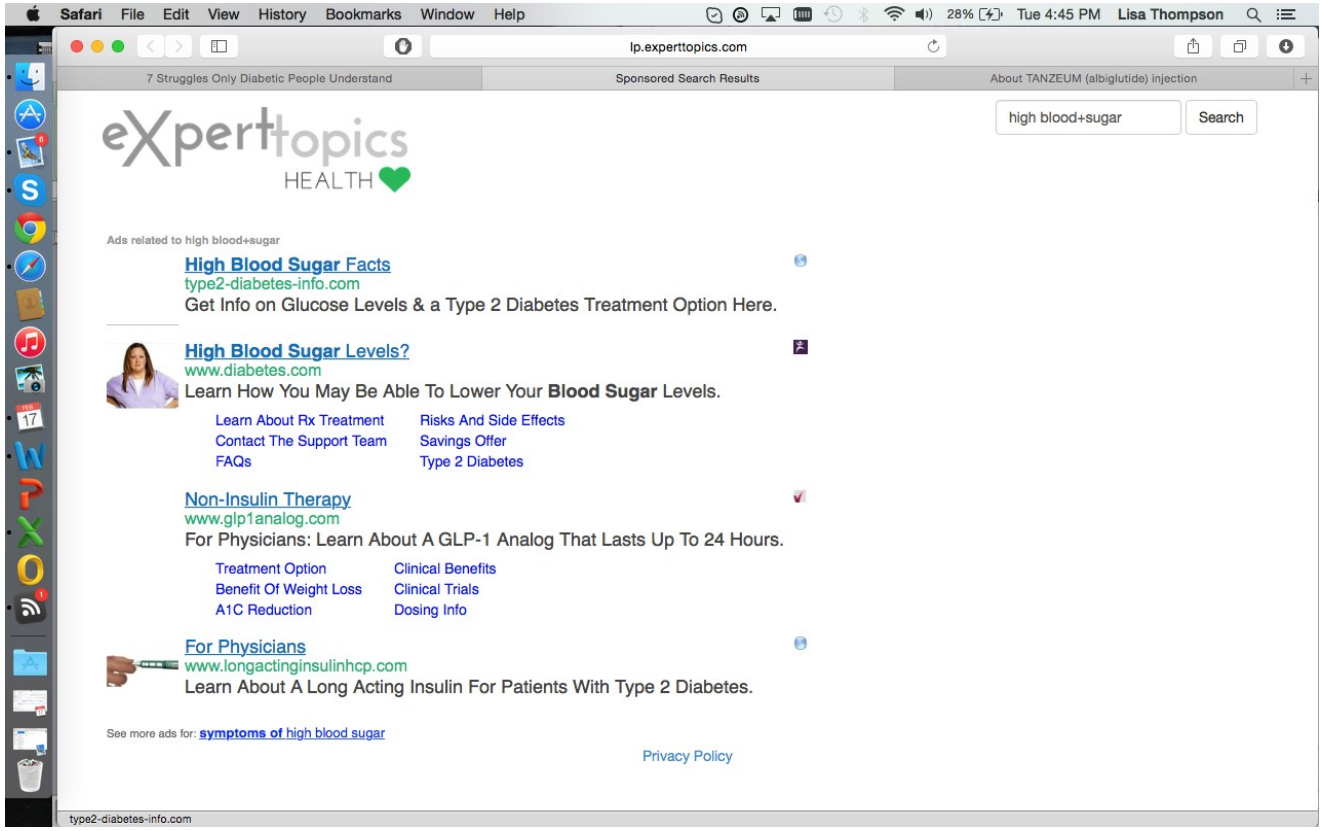
This example shows an article on the health.alot page about diabetes. This screen shot shows the top of the web page.



Scrolling down the page takes you to the ad unit below with six articles …



If you click any of the links you are taken to the following landing age with ads.



When a reader clicks on any of the above links, per click ad revenue is generated.

We believe Inuvo is worth $2.30 a share…

At the mid-point of its range, Inuvo would price at an enterprise valuation of $59 million or $2.30 per share, versus its current price of $1.34, 72% higher. This is based on an average price to sales ratio of 1.0x sales for its peer group and our estimate of 2015 gross revenues of $59 million. We believe this valuation is conservative given many of its peers are unprofitable.

We have assumed the company will grow revenues 19%--slightly faster than the digital advertising market in 2015. The company was profitable in 2014 and generated non-GAAP EPS of $0.13 per share, up from $0.03 in 2013. Its adjusted EBITDA was $5.5 million, or 21% of sales versus $3.8 million in 2013 or 10% of sales and up 46%. In 2015, we expect earnings to grow to a non-GAAP EPS of $0.14 and revenues to reach $59 million, up 19%, as it expands its company owned websites.

…And a Weak Q1 Could Provide An Attractive Entry Point.

Coming off an exceptionally strong Q4, we believe investors may not be please with the seasonally weak Q1 the company should report ending March 31, 2015, despite what is likely to be a strong year-over-year revenue growth. The Christmas quarter is traditionally strong for advertising, particularly digital advertising, which can be deployed rapidly and used to fill in when print and TV advertising do not get desired results. Both the company owned and network business should be down sequentially and EPS is also to

US Digital Ad Spending Should Grow 16% This Year

The market for digital advertising is huge and is expected to be $32 billion in the US alone according to eMarketer. With $50 million in revenues last year, Inuvo does not need to worry about market growth to itself grow but the market continues to increase and this year is expected to be up 16%. Desktop ads should decline 3% while mobile, still on a tear, should grow 50%. Inuvo's revenues in December were split 54% desktop and 46% mobile, so if that split continues, it could be able to grow 21% this year by just maintaining market share.

Exhibit 1. Total US Digital Ad Spending

US Digital Ad Spending, by Channel, 2012-2018
billions and % change

	2012	2013	2014	2015	2016	2017	2018
Desktop*	**$32.43**	**$33.40**	**$32.99**	**$32.01**	**$29.00**	**$26.68**	**$23.90**
—% change	6.6%	3.0%	-1.2%	-3.0%	-9.4%	-8.0%	-10.4%
Mobile**	**$4.36**	**$9.69**	**$17.73**	**$26.59**	**$37.49**	**$47.43**	**$58.33**
—% change	178.3%	122.0%	83.0%	50.0%	41.0%	26.5%	23.0%
Total	**$36.80**	**$43.08**	**$50.71**	**$58.60**	**$66.49**	**$74.11**	**$82.24**
—% change	15.0%	17.1%	17.7%	15.6%	13.5%	11.5%	11.0%

*Note: *includes spending primarily on desktop- and laptop-based ads; **includes classified, display (banners and other, rich media and video), email, lead generation, messaging-based and search advertising; ad spending on tablets is included*
Source: eMarketer, June 2014

174313 www.eMarketer.com

Google is still the major ad network in the US by a wide margin

While Inuvo has agreements with both Google and Yahoo!, Google is the largest player in the market for digital advertising with 10% of the market as shown in the chart below. Facebook is a distant second but gaining market share as it hones its offerings. Yahoo is still number three with a small 1.5% of the market. The industry is still fragmented and other than Google, the other players have small pieces and the top eight companies only sum to 28% of the industry.

Exhibit 2. US Market Share of Digital Ad Revenues

Net US Digital Ad Revenue Share, by Company, 2012-2016

% of total media ad spending

	2012	2013	2014	2015	2016
Google	9.1%	10.0%	10.6%	11.1%	11.3%
Facebook	1.3%	1.9%	2.7%	3.2%	3.7%
Yahoo	1.5%	1.5%	1.5%	1.5%	1.5%
Microsoft	1.1%	1.3%	1.4%	1.7%	2.0%
AOL	0.6%	0.6%	0.6%	0.7%	0.7%
Amazon	0.3%	0.4%	0.5%	0.6%	0.7%
IAC	0.6%	0.6%	0.5%	0.5%	0.5%
Twitter	0.1%	0.3%	0.4%	0.6%	0.8%
Total digital*	**22.3%**	**25.2%**	**28.2%**	**30.9%**	**33.2%**

*Note: includes advertising that appears on desktop and laptop computers as well as mobile phones and tablets, and includes all the various formats of advertising on those platforms; net ad revenues after companies pay traffic acquisition costs (TAC) to partner sites; *data through 2013 is derived from IAB/PwC data*

Source: company reports; eMarketer, June 2014

174217 www.eMarketer.com

Inuvo competes with many others in the ad tech space in trying to persuade publishers to use them to source ads for their websites. Inuvo believes its completive strength is that is uses its technology on its own web site and by doing so is particularly adept at tweaking the system to get the results desired for the customer. It develops campaigns, executes them on its own properties and gets feedback with which to get better product sell through. As shown on the chart below by Cheifmartec, there are numerous companies in this space, though few are public. Public companies shown below are Rocket Fuel (FUEL), Criteo (CRTO), TubeMogul (TUBE), Conversant, which is now, own by Alliance Data (ADS), and DoubleClick, owned by Google.

Exhibit 3. Ad Technology Platform Competition



Source: Cheifmartec.com

Interestingly, Gartner just initiated a magic quadrant for a category called “Digital Marketing Hubs” under the belief that a variety of ad tech, marketing tech and CRM platforms will converge in the future. Adobe (ADBE), Oracle (ORCL) and Salesforce (CRM) are in the upper left meaning they are both able to execute and have a complete vision, while newcomers Rocket Fuel, TURN and Ignition One are creeping up to the execution level. We see Conversant and DataXU are considered niche players. All of the companies on the quadrant have at least $50 million in revenues. What this shows is that in the future there should be consolidation, and successful niche players could be acquisition candidates as companies round out the completeness of their offerings. While Inuvo is much too small to be on the radar now, it might be of interest to larger players later on.

Exhibit 4:



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. The result is an equity value of $59 million or $2.32 per share.

Exhibit 5. Comparable Public Companies

Company	Ticker	Revenue 2015E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	EV/ EBITDA	Included Average?
Autobytel	ABTL	$121	$101	$7	0.7x	0.8x	12.5x	y
Bluecora	BCOR	$493	$640	$108	1.1x	0.9x	5.2x	y
Criteo	CRTO	$400	$262	$56	5.4x	8.2x	38.8x	n
Demand Media	DMD	$153	$366	$29	0.4x	0.2x	2.0x	y
Digital River	DRIV	$400	$375	$36	1.3x	1.4x	14.6x	y
Rocket Fuel	FUEL	$631	$355	-$30	0.9x	1.5x	-18.6x	y
Local	LOCM	$85	$94	-$3	0.2x	0.2x	-7.3x	n
Marchex	MCHX	$135	$183	$10	0.7x	0.5x	10.0x	y
Millennial Media Inc.	MM	$321	$306	-$22	0.3x	0.3x	-4.8x	y
The Rubicon Project	RUBI	$159	$112	-$10	3.0x	4.2x	-46.3x	y
Travelzoo	TZOO	$145	$148	$22	0.6x	0.6x	4.2x	y
Average				**17**	**1.0x**	**1.2x**	**-2.4x**	

	Revenue 2015E	Revenue LTM*	TTM EBITDA	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM*	Valuation Range Low	Valuation Range High
Inuvo	**$59**	**$50**	**3.4**	**1.0x**	**1.2x**	**$58**	**$59**
YoY growth							

Conclusion of Enterprise Value	**$58,640,563**
Market Value	**$56,831,835**
Shares Outstanding	24,500,000
Price per Share	**$2.32**

Recent M&A Transactions

One competitor of Inuvo's that was recently acquired was Conversant, which was formerly called ValueClick, and owned Greystripe (market leader in mobile ads). Alliance Data Systems (NYSE:ADS) purchased Conversant on December 10, 2014 for $2.3 billion or 4.2 times its revenue run rate at the time. Right before its acquisition, the company divested its owned and operated website business for a price of 1.4 times the revenue run rate. If we separate the two components of Inuvo and apply those valuations, we get $47 million for owned and operated and $128 for the ad tech network, or $175 million enterprise value or $7 per share. Other high profile acquisitions have been Yahoo's acquisition of BrightRoll for $640 million, and Facebook's purchase of LiveRail for an estimated $400 million.

MANAGEMENT AND BOARD OF DIRECTORS

Richard K. Howe

Chairman and CEO

Mr. Howe has been a member of the Board of Directors since 2009. Up until its merger with Vertro 2012, Richard was the CEO of Inuvo. Prior to his involvement with Inuvo, he was Chief Marketing/Business Strategy and M &A Officer at the Acxiom Corporation. While at Acxiom, he had been responsible for building the company's Asia Pacific business, consulting business, targeted display advertising business and for managing the information products and analytics business. He was brought back to Inuvo in 2012 to help turn around the business which was faltering. Before Acxiom, he was a general manager of the $110 million Global Marketing Services unit of Fair Isaac & Company. He was also instrumental in Fair Isaac's purchase of HNC, a software company at which he worked from 1997 to 1999. Before joining Fair Isaac, he founded and was chairman and CEO of ieWild Inc., a marketing applications SaaS company. He earned a BS in structural engineering from Concordia University, Canada in 1988 and a MS in engineering from McGill University, Canada in 1991.

Wally Ruiz

CFO

Wally serves as Inuvo's Chief Financial Officer and is responsible for the company's financial functions, budgeting, human resources, legal affairs and investor relations. Prior to joining Inuvo in June 2010, he was the CFO of SRI Surgical Express. Wally started his career in the New York offices of Ernst & Young and has led the finance function of companies in the consumer products, oil and gas, retail, fashion and high tech industries. Wally has helped start ups through successful IPOs and growing enterprises with bank and private placement financings. He has been an adjunct professor of International Finance at the University of Miami and a director on the board of the Florida Institute of CFOs. Wally earned an MBA in Accounting and Finance from Columbia University in 1975 and a BS in Computer Science from St. John's University in 1973. He is a CPA and a Certified Information Technology Professional.

Trey Barrett

COO

Trey joined Inuvo in February 2010 from Acxiom Corporation' where he was Director of Interactive Media Products overseeing the innovation and development of Acxiom’s interactive consumer targeting product line. With over 25 years of data-driven direct marketing experience, he has been involved in several successful business start-ups in the direct and interactive marketing industries. Trey earned bachelor’s degrees in Marketing and Economics from the University of Arkansas at Fayetteville in 1986.

Rick Anderson

CTO

Rick has been with Inuvo since February of 2005, when his company Ozona Online Network (an ISP/ASP), was purchased by Inuvo. Before Ozona he also founded and successfully sold another company, AIS, to MSC Industrial Supply. He earned a BS in Computer Science and Systems Design from St. Petersburg College in 1995.

John Pisaris

General Counsel

John has served as the General Counsel and Secretary of Inuvo since the acquisition of Vertro in March 2012. John joined Vertro in 2004 and served as Vertro's General Counsel and Secretary. Prior to Vertro, John was a partner in the law firm of Porter, Wright, Morris & Arthur LLP. At Porter Wright, John practiced in the corporate and securities group and advised clients on business transactions, M&A, financings, securities offerings and securities compliance. John earned his JD at Case Western Reserve University School of Law in 1993 and a BLS in Marketing from Hillsdale College in 1988.

BOARD OF DIRECTORS

Richard K. Howe

Chairman and a Director since 2008.

F. William Conner

Mr. Conner, joined the board of Inuvo in June 2014, and was most recently President and CEO of Entrust Inc. that he sold to the Datacard Group in December 2013. He was also a board member there, as was Charles Morgan. He is currently CEO of Silent Circle and is also on the board of Blackphone both involved in highly secure communications. Mr. Conner held executive positions at Nortel Networks from 1992 to 2001 including chief marketing officer and President of Nortel's $5 billion dollar revenue Enterprise Data Networks and e-Business Solutions divisions. Mr. Conner earned a BS from Princeton University in mechanical engineering in 1981 and an MBA from the Wharton School of the University of Pennsylvania in 1987.

Joseph P. Durrett

Joe became a board member of Inuvo in 2012 and before that a director of Vertro. He is currently President of Jocobos Brands and a partner at PrimeGenesis. He is also on the board of 7Summits and Landaal Packaging Systems. From 1999 to 2004 he was Chairman and CEO of Information Resources the leading supplier of analytics and market research to the worldwide consumer goods industry. For three years before that he was CEO of Broderbund. He also had positions with Advo, Kraft and Proctor & Gamble. He earned and AB in Economics from Duke in 1967 and an MBA from Wharton.

Charles Morgan

Mr. Morgan has been a director at the company since 2009 and is the largest shareholder with 1.9 million shares or 10% of the company shown under the title Tocqueville Asset Management. He is an investor in Bridgehampton Arbitrage LLC and an equity owner of Bridgehampton Capital Management LLC. Currently, he is Chairman of the Advisory Board of Bridgehampton Capital Management LLC and co-manager of investments. Mr. Morgan was Chairman and CEO of Acxiom Corporation, an interactive marketing services company, from 1975-2008. He took the company from start-up to over $1.4 billion in revenues. He holds a mechanical engineering degree from the University of Arkansas. In addition, Mr. Morgan has served on the board and in various leadership roles with the Direct Marketing Association and serves as a member and is the past chairman of the board of trustees of Hendrix College.

Charlie Pope

Mr. Pope has been a director since 2008 and brings more than 30 years of experience in executive management, finance and accounting to his position. He was CFO of public companies, Aerosonic Corporation, Reptron Manufacturing, SRI/Surgical, and UTEK Corporation. He is also on the board of Oragenics. Previously, Mr. Pope was a partner at PricewaterhouseCoopers. He earned a B.S. in economics and accounting from Auburn University in 1978, and is a CPA in Florida.

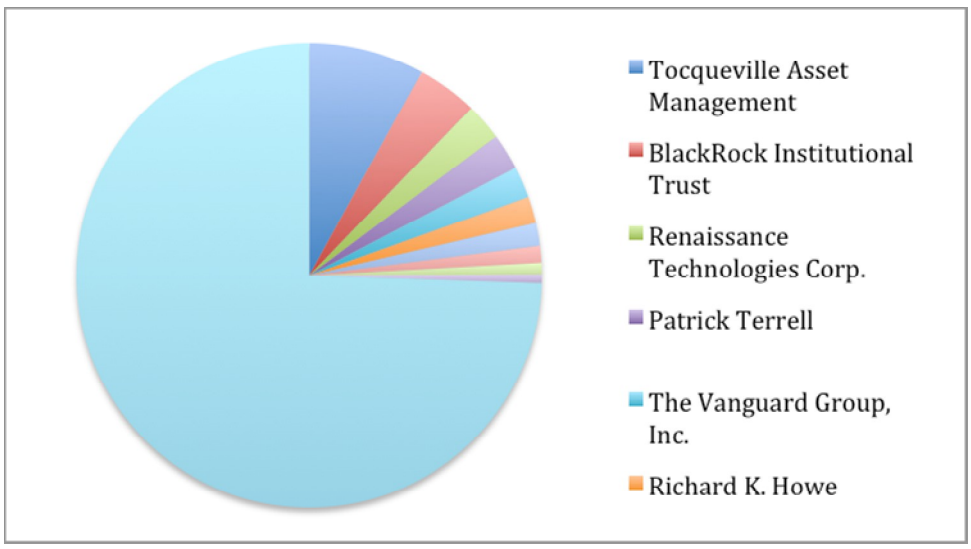
Patrick Terrell

Mr. Terrell had been a director since January 2013. He is currently the managing member of both Terrell Group Management, and PatRick Investments, LLC, private equity and real estate investment companies. He also serves on the boards of RS Medical, Routeware Inc, Skagit Garden and Aequitas Capital. Mr. Terrell served as founder and CEO of Leading Technology, a $300 million per year manufacturer of personal computers. Additionally, he founded Byte Shops Northwest, which serviced personal computers, and grew to $50 million in annual revenue.

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.

OWNERSHIP



Tocqueville Asset Management is a family office for Charles Morgan.

Balance Sheet

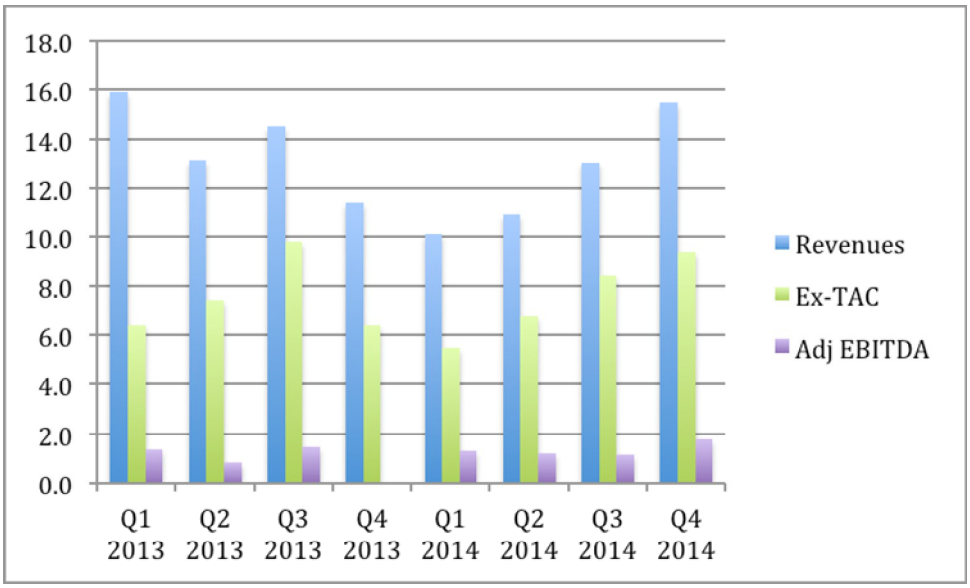
The company had $3.7 million in cash at the end of 2014 and $2.7 million in long-term debt. The debt is down 26% since last year as the company slowly pays it off through positive cash flow. The company has no pans to immediately pay off the debt and would rather plow back the cash into investing in the business to produce growth. Working capital was a negative $1.2 million, a number that the company is working to get positive. The company typically gets paid by Google and Yahoo! weeks before they have to pay the two for SEO advertising contributing to the negative number**.**

Income Statement

2014

For 2014, Inuvo's revenues declined 9.8% to $49.6 million due to the winding down of the money-losing toolbar business as well as the elimination of low quality partners using the partner network. Toolbar was deemed to be losing money and the company let it slowly drift away while the partner network revenues were winnowed in late 2013 to get rid of low quality traffic. As a result, earnings from continuing operations went from a loss of $24,000 to a gain of $2.6 million. Non-GAAP net income from continuing operations went from $660,000 to $3.3 million. The decline in revenues was caused by a decrease of 29% in partner revenues (from $36 to $26 million), and a decline in toolbar revenues of 80% (from $11 million to $2 million) offset by an increase in company owned and operated website revenue increase of 157% from $9 million to $22 million.

Chart 3. Quarterly Financial Performance 2013-14



Gross margin is quite different for the two lines of business. The partner revenues are just the share of revenues that are paid to Inuvo, not the gross advertising revenues that was paid by Google or Yahoo!. In

2014, this part of the business generated margins of 21%. On the other hand, the owned and operated business reports gross revenues before the SEO advertising that was paid to the search engines to generate the traffic. The gross margin for this part of the business was 98% in 2014. Taking the gross margin number and subtracting “marketing” on the income statement will give the ex-TAC number or revenues excluding Traffic Acquisition Costs. The ex-TAC gross margin was 26% in 2014 versus 20% in 2013.

Operating expenses other than marketing were $9.2 million versus $11.8 million in 2013, a reduction of 22% mostly due to lower compensation expense and the move to Arkansas. The company pays no taxes and ended the year with a $34.2million tax loss carry forward.

PROJECTED INCOME STATEMENT

Inuvo	Q1 2014 31-Mar	Q2 2014 30-Jun	Q3 2014 30-Sep	Q4 2014 31-Dec	Q1 2015E 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	6.3	$6.8	$7.6	$8.2	36.0	25.7	28.9	33.2
Yr-to-yr Growth	-39%	-35%	-34%	-1%	16%	22%	7%	8%	39%	-29%	13%	15%
Owned and operated, excluding Appbar	3.7	4.8	5.6	7.7	6.6	7.0	7.5	8.6	8.5	21.8	29.7	37.1
Yr-to-yr Growth	68%	156%	187%	200%	79%	45%	34%	12%	107%	157%	36%	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
	-89%	-80%	-80%	-81%	-90%	-82%	-100%	-100%	-55%	-80%	-91%	-100%
Total revenue	**10.1**	**10.9**	**13.0**	**15.5**	**13.0**	**13.9**	**15.1**	**16.8**	**55.0**	**49.6**	**58.8**	**70.4**
Yr-to-yr Growth	-36%	-17%	-10%	36%	28%	27%	16%	8%	3.0%	-9.8%	18.5%	19.7%
Cost of services	3.7	4.7	5.9	6.2	5.4	5.7	6.4	6.8	28.8	20.4	24.3	18.9
Partner network gross margin	1.9	1.0	1.2	1.4	1.0	1.2	1.4	1.6	8.0	5.5	5.2	6.3
% GM partner network	34%	17%	17%	19%	16%	18%	18%	19%	22%	21%	17%	19%
Owned and Operated GM	4.6	5.3	5.9	7.9	6.6	7.0	7.4	8.4	18.2	23.7	29.3	36.4
% GM owned and operated	98%	99%	100%	100%	98%	98%	98%	98%	98%	99%	98%	98%
Gross profit	6.4	6.3	7.1	9.3	7.6	8.2	8.7	10.0	26.2	29.2	34.5	42.7
Gross Margin	63.7%	57.4%	54.6%	60.2%	58.3%	58.9%	57.7%	59.4%	47.7%	58.8%	58.6%	60.7%
Gross margin minus marketing	2.8	2.7	2.8	3.4	2.5	3.2	3.4	3.7	11.8	11.7	12.8	15.6
% of sales	**27%**	**24%**	**22%**	**22%**	**19%**	**23%**	**23%**	**22%**	**21%**	**24%**	**22%**	**22%**
Operating expenses:												
Marketing	3.7	3.6	4.3	5.9	5.1	5.0	5.3	6.3	14.4	17.5	21.7	27.1
Compensation	1.1	1.1	1.2	1.4	1.3	1.3	1.4	1.5	6.0	4.8	5.5	6.9
SG&A	1.0	1.1	1.2	1.2	1.0	1.1	1.2	1.2	5.8	4.4	4.5	5.3
Total operating expenses	5.8	5.8	6.7	8.4	7.4	7.4	7.9	9.0	26.2	26.7	31.6	39.3
Operating income:	0.7	0.5	0.5	0.9	0.2	0.8	0.9	1.0	0.0	2.5	2.9	3.4
Operating margin	6.6%	4.3%	3.6%	5.8%	1.7%	5.6%	5.7%	5.9%	0.0%	5.0%	4.9%	4.9%
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)	(0.3)	(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	3.2
Pretax Margin	5.7%	3.3%	2.9%	5.3%	1.2%	5.2%	5.3%	5.5%	-0.6%	4.3%	4.4%	4.6%
Income tax benefit	(0.1)	0.00	0.00	(0.1)	0.00	0.00	0.00	0.00	(0.3)	(0.2)	-	-
Tax rate	-13%	0%	0%	-9%	0%	0%	0%	0%	92%	-7.1%	0.0%	0.0%
Net income from continuing operations	0.6	0.4	0.4	0.8	0.2	0.7	0.8	0.9	(0.0264)	2.3	2.6	3.2
Net income from discontinued operations	0.0	0.0	0.0	(0.1)	-	-	-	-	0.5	(0.0)	-	-
Net income	0.7	0.4	0.4	0.6	0.2	0.7	0.8	0.9	0.5	2.3	2.6	3.2
Foreign currency valuation	-	-	-	-	-	-	-	-	(0.0)	0.0	0.0	0.0
Comprehensive income	0.7	0.4	0.4	0.6	0.2	0.7	0.8	0.9	0.5	2.3	2.6	3.2
Stk based compensation	0.1	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.7	1.0	1.0	1.1
One-time expenses	-	-	-	0.1	-	-	-	-	-	0.1	0.0	0.0
Non-GAAP Income from continuing	0.8	0.6	0.7	1.2	0.4	1.0	1.1	1.2	0.660	3.258	3.6	4.3
Yr-over-Yr									-110.9%	393.3%	10.5%	19.4%
Net income per share:												
Basic from continuing	0.03	0.02	0.02	0.03	0.01	0.03	0.03	0.04	(0.00)	0.10	0.11	0.13
Diluted from continuing	0.03	0.02	0.02	0.03	0.01	0.03	0.03	0.04	(0.00)	0.09	0.11	0.13
Non-GAAP Diluted from continuing	0.03	0.03	0.03	0.04	0.02	0.04	0.04	0.05	0.03	0.13	0.15	0.17
					-49.9%	53.9%	55.7%	17.8%	-110%	358%	14%	14%
Shares												
Basic	23.4	23.4	23.4	23.6	23.6	23.7	23.8	23.9	23.3	23.5	23.5	24.7
Diluted	23.5	24.1	24.1	24.5	24.5	24.6	24.7	24.8	23.3	24.0	24.2	25.4
	1.0%	3.1%	3.0%	5.0%	4.2%	2.3%	2.3%	1.4%	10.8%	3.2%	0.8%	5.0%
Adjusted EBITDA	1.34	1.19	1.18	1.78	0.90	1.46	1.54	1.66	3.75	5.48	5.57	6.23
	-2%	39%	-19%	2138%	-33%	22%	31%	-6%		46%	2%	12%

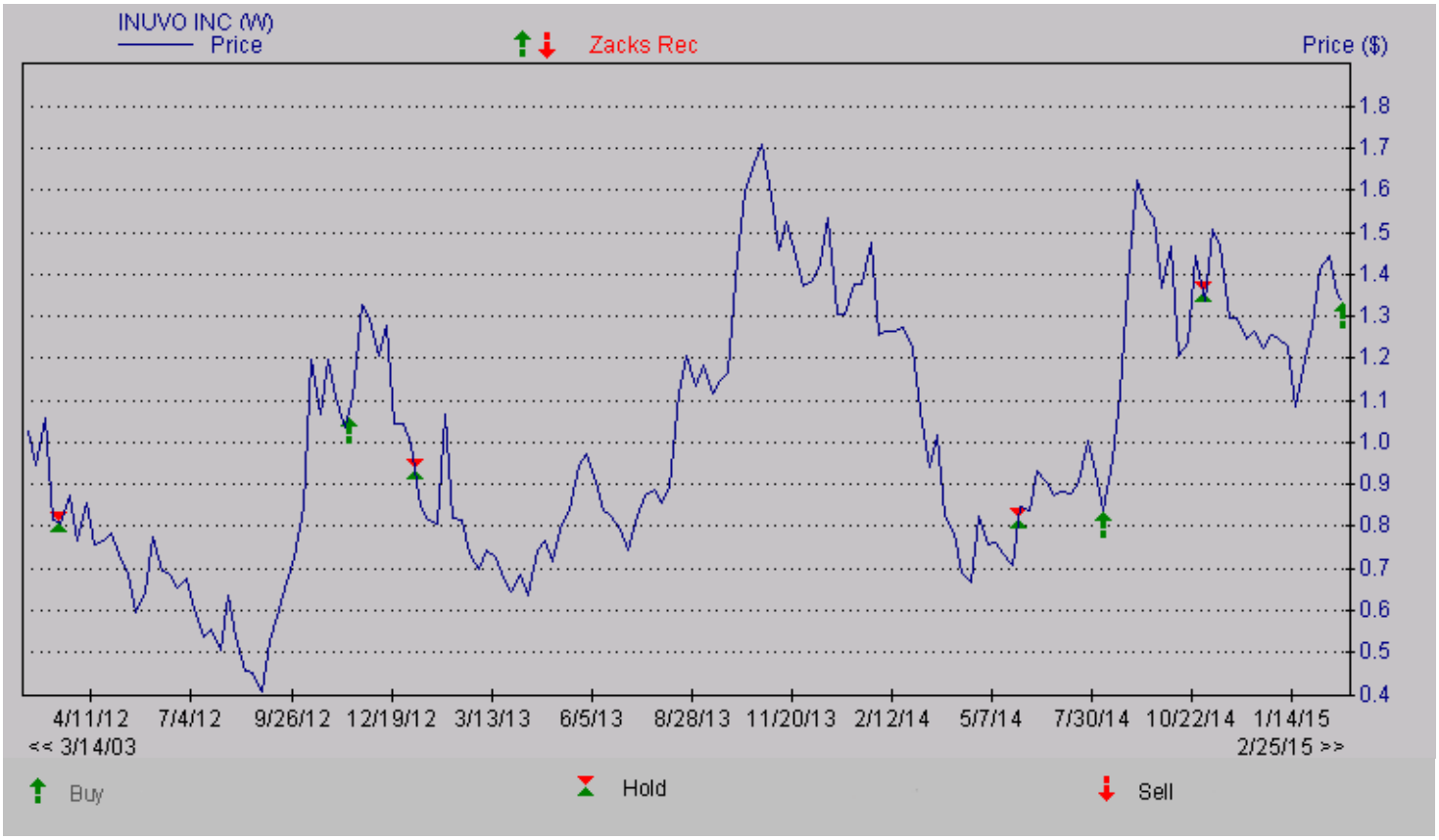
BALANCE SHEET

	Dec. 31, 2014	Sep. 30, 2014	Dec. 31, 2013	Dec-Dec
Current assets				
Cash	$3,714,525	$3,459,946	$3,137,153	18%
Accounts receivable, net of allowance for doubtful accounts of $87,733 and $62,845, respectively	5,106,300	5,105,414	3,609,825	41%
Unbilled revenue	23,541	19,013	24,472	-4%
Prepaid expenses and other current assets	299,873	426,189	510,968	-41%
Total current assets	9,144,239	9,010,562	7,282,418	26%
Property and equipment, net	959,475	1,031,956	1,188,566	-19%
Other assets				
Goodwill	5,760,808	5,760,808	5,760,808	0%
Intangible assets, net of accumulated amortization	9,530,322	9,728,823	10,324,326	-8%
Other assets	211,833	229,247	379,513	-44%
Total other assets	15,502,963	15,718,878	16,464,647	-6%
Total assets	25,606,677	25,761,396	24,935,631	3%
Current liabilities				
Accounts payable	5,714,158	6,642,228	6,235,533	-8%
Accrued expenses and other current liabilities	3,704,464	2,772,990	2,386,226	55%
Term and credit notes payable - current portion	959,942	1,659,942	2,548,333	-62%
Total current liabilities	10,378,564	11,075,160	11,170,092	-7%
Long-term liabilities				
Deferred tax liability	3,552,500	3,713,205	3,788,903	-6%
Term and credit notes payable - long term	2,666,667	2,833,333	3,595,300	-26%
Other long-term liabilities	735,211	775,399	1,039,470	-29%
Total long-term liabilities	6,954,378	7,321,937	8,423,673	-17%
Total Liabilities	17,332,942	18,397,097	19,593,765	-12%
Stockholdersâ€™ equity				
Preferred stock, $.001 par value: Authorized shares 500,000, none issued and outstanding	0	0	0	
Common stock, $.001 par value: Authorized shares 40,000,000; issued shares 23,940,325 and 23,763,307, respectively; outstanding shares **23,563,798** and 23,386,780, respectively	23,939	23,939	23,763	1%
Additional paid-in capital	128,470,661	128,470,661	127,908,328	0%
Accumulated deficit	(118,824,306)	(119,733,742)	(121,193,666)	-2%
Treasury stock, at cost - 376,527 shares	(1,396,559)	(1,396,559)	(1,396,559)	0%
Total stockholders' equity	8,273,735	7,364,299	5,341,866	55%
Total liabilities and stockholders' equity	$25,606,677	$25,761,396	$24,935,631	3%
Quick Ratio	0.9	0.8	0.7	35%
Working Capital	(1,234,325)	(2,064,598)	(3,887,674)	-68%
Cash as % of assets	15%	13%	13%	15%
Debt % of assets	17%	20%	29%	-41%

CASH FLOW

CONSOLIDATED STATEMENTS OF CASH FLOWS (USD $)	3 Months Ended March 31, 2014	3 Months Ended June 30, 2014	3 Months Ended Sep. 30, 2014	3 Months Ended Dec. 31, 2014
Operating activities:				
Net income	674,759	382,291	402,874	645,190
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	454,473	441,836	424,425	428,804
Deferred income taxes	(75,698)	-	-	75,698
Amortization of financing fees	4,167	8,813	6,350	9,533
Adjustment of European liabilities related to discontinued operations	30,871	(89,934)	(33,950)	90,519
Provision of doubtful accounts	17,000	(1,968)	9,856	(1,011)
Stock based compensation	130,448	248,382	279,970	333,148
Other, net	(96,289)	-	(2)	96,291
Cash Flow	1,259,680	1,072,509	1,107,269	1,407,142
Free cash flow	1,081,257	875,647	826,113	1,223,716
Change in operating assets and liabilities:				
Accounts receivable and unbilled revenue	(327,790)	166,350	(1,353,578)	(4,403)
Prepaid expenses and other assets	98,940	(55,854)	128,733	134,198
Accounts payable	(541,985)	(186,242)	1,227,935	(1,018,589)
Accrued expenses and other liabilities	11,173	206,471	37,982	688,799
Other, net	-		-	(165,193)
Net cash provided by operating activities	380,069	1,120,145	1,130,595	1,312,984
Investing activities:				
Purchases of equipment and capitalized development costs	(178,423)	(196,862)	(281,156)	(183,426)
Grant funds received for equipment and office construction	-	-	-	-
Net cash used in investing activities	(178,423)	(196,862)	(281,156)	(183,426)
Financing activities:				
Deposit to collateralize letter of credit	-			
Prepaid financing fees and other	0	-	43,896	(1)
Proceeds from revolving line of credit	750,000	600,000	350,000	850,000
Payments on revolving line of credit	(761,469)	(500,000)	(1,672,533)	(1,077,467)
Proceeds from term note payable	-	-	2,000,000	-
Payments on term note payable and capital leases	(604,349)	(345,227)	(1,511,893)	(647,511)
Net cash used in financing activities	(615,818)	(245,227)	(790,530)	(874,979)
Effect of exchange rate changes	-	-	-	-
Net change - cash	(414,172)	678,056	58,909	(3,205,367)
Cash, beginning of quarter	3,137,153	2,722,981	3,401,037	3,459,946
Cash, end of period	2,722,981	3,401,037	3,459,946	254,579
				-
Supplemental information:				
Interest paid	74,667	86,897	75,801	52,879
Cash Flow	1,259,680	1,072,509	1,107,269	1,407,142
EBITDA	1,293,687	1,078,285	1,155,470	1,635,771

HISTORICAL ZACKS RECOMMENDATIONS



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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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