Zacks Small-Cap Research

July 30, 2015

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Inuvo Inc. (INUV-NYSE)

INUV: Don't Extrapolate Q2's Growth…but New SearchLinks Product Could Increase Valuation

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	02/25/2015
Current Price (07/29/15)	$3.16
12-Month Target Price	**3.35**

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. Its new native ad product "SearchLinks" could accelerate growth and increase valuation. Management's goal is to reach a revenue run rate of $100 million by the end of 2017.

SUMMARY DATA

52-Week High	**$3.45**
52-Week Low	**$0.84**
One-Year Return (%)	**218.6**
Beta	**0.20**
Average Daily Volume (sh)	**169,013**
Shares Outstanding (mil)	**24**
Market Capitalization ($mil)	**$77**
Short Interest Ratio (days)	**0.81**
Institutional Ownership (%)	**23**
Insider Ownership (%)	**17**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**3.3**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**31.6**
P/E using 2015 Estimate	**14.3**
P/E using 2016 Estimate	**13.4**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Internet-Services**
Zacks Rank in Industry	**26 of 43**

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	55.0 A
2014	10.1 A	10.9 A	13.0 A	15.5 A	49.6 A
2015	13.4 A	16.7 A	15.5 E	17.0 E	62.7 E
2016					75.0 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	$0.03 A	$0.03 E	$0.04 E	$0.10 E
2016					$0.12 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 third quarter in a row of over 30% growth. Inuvo should be able continue to grow revenues year-over-year while maintaining profitability and positive cash flow albeit perhaps not at over 30%.

- The company has stated its goal is to reach a $100 million in revenue run rate by the end of 2017. 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 strategically adding content through the acquisition of content-based web sites.

- The company just introduced a new advertising product, “SearchLinks”, that is finding success with its ad network partners and create more customer retention. It 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.

- Since launching coverage of the company, the stock has moved up from $1.34 in February to reach our target price of $3.00. If the company is valued on enterprise value to sales (since many competitors operate at a loss), the stock is priced near its peers who trade at an average of 1.2 times sales. Given the company’s progress since then, we are raising our 12-month target price to $3.35 to reflect expected growth in the next year. 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 which would reflect a valuation more than double that.

WHAT’S NEW

Company Reports Exceptional Q2 Due to Unusual Short-Term Demand

Inuvo reported extraordinary revenue growth of 53% in Q2 coming in at $16.7 million and exceeding our estimate of $13.9 by $2.8 million. The company attributed this sale beat due to exceptionally strong demand in one particular vertical that was reflected both in the partner sales and owned and operated. Here volumes and ad prices were higher than normal. After this quarter, expectations are for business to return to more normal sales levels and the company has already seen business from this vertical tapering off. As a result, we are only tweaking revenue forecasts slightly higher for Q3 or Q4 at this time.

Non-GAAP EPS came in at $0.03 as the company reinvested the windfall in marketing to continue to grow sales and was in-line with our expectations. Investors should expect the company to maintain this low level of profitability as excess cash is used to both grow sales and pay down debt. We do however expect the company to report increasingly better profits and cash flow from the business.

Chart 1: Revenue Segments by Quarter

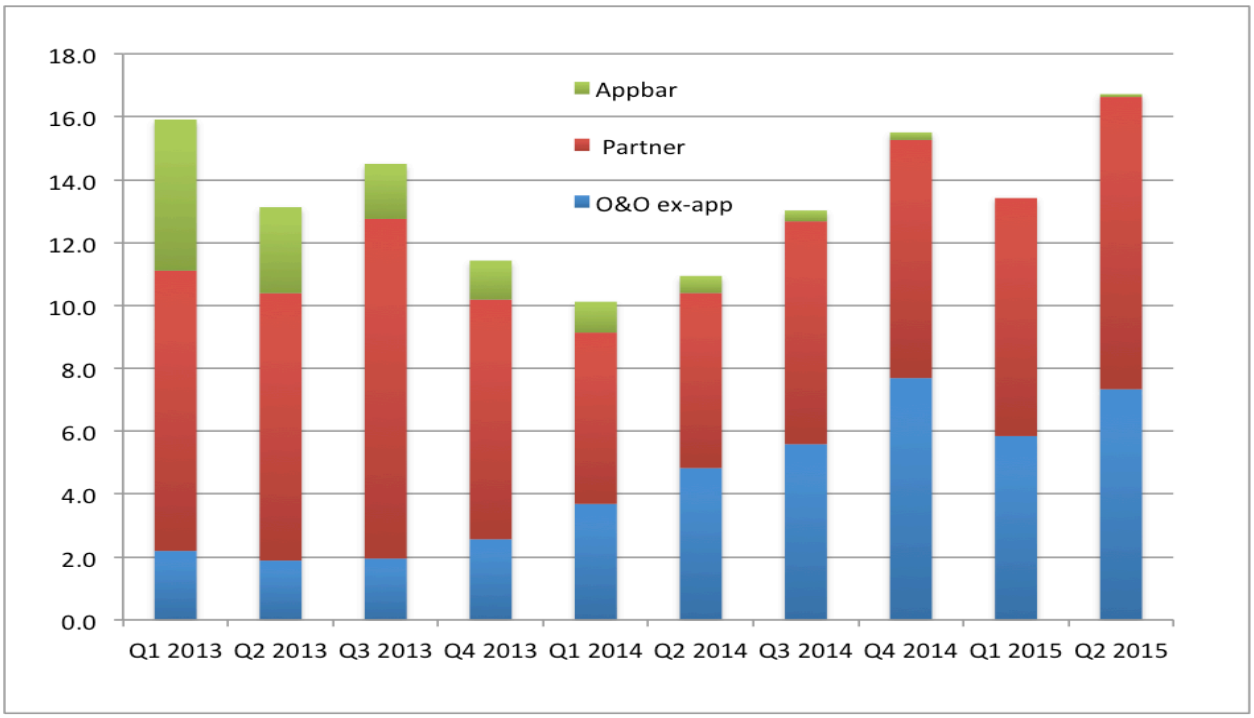
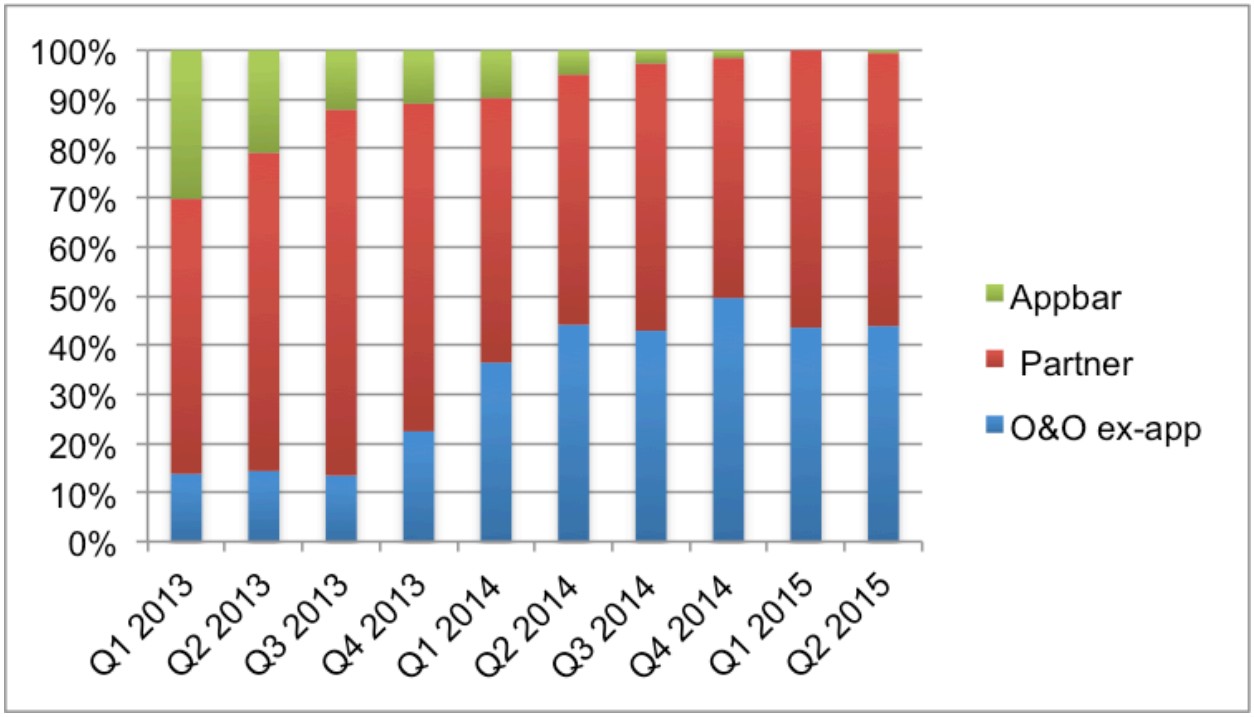


Chart 2: Revenues by Product Line as a Percent of Sales



Q3 2015

We raising our Q2 revenue forecast slightly as the company is seeing continued healthy growth in its base business and is optimistic about the new SearchLinks product. They have signed 40 new customers for this product in addition to the current customers that have been using the product throughout beta. The company did indicate that revenues could be down sequentially, but up year over year for the remaining three quarters of 2015. We are currently looking for revenues of $15.5 million and an EPS of $0.03 versus $13 million a flat EPS with last year. This is a growth rate of 19% that would break its streak of growth over 30%.

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. Should SearchLinks, a native ad tech product be successful, we would look to higher revenue multiples as that business is much more attractive.

We applied average multiples to Inuvo's historical and projected revenues based on the comparable companies in the table below. Based purely on public company comps, the result is a market value of $75.7 million or $3.07 per share. Using this multiple and applying it to 2016 estimated revenues of $75 million, we believe the stock price could move to $3.37, up 7%.

	Ticker	Revenue		TTM	Enterprise Value / Sales		EV/	Included	Enterprise
Company		2015E	LTM	EBITDA	2015E	LTM	EBITDA	Average?	Value
Autobytel	ABTL	$129	$106	$9	1.3x	1.6x	18.8x	y	165
Bluecora	BCOR	$482	$539	$84	1.2x	1.0x	6.6x	y	561
Criteo	CRTO	$462	$938	$56	6.5x	3.2x	54.3x	n	3,020
Demand Media	DMD	$141	$161	$4	0.5x	0.4x	15.7x	y	69
Rocket Fuel	FUEL	$507	$439	-$55	0.6x	0.7x	-5.4x	y	293
Marchex	MCHX	$143	$175	$12	0.7x	0.6x	9.0x	y	106
Millennial Media Inc.	MM	$327	$287	-$42	0.6x	0.7x	-5.0x	y	209
The Rubicon Project	RUBI	$205	$140	-$10	2.8x	4.1x	-57.2x	y	578
MaxPoint Interactive	MXPT	$93	$120	-$12	2.3x	1.8x	-32.0x	y	215
Travelzoo	TZOO	$132	$136	$9	0.6x	0.5x	8.3x	y	72
Average				**0.0**	**1.2x**	**1.3x**	**-4.6x**		**$252**

	Revenue		TTM	Enterprise Value / Sales		Valuation Range	
	2015E	LTM	EBITDA	2015E	LTM	Low	High
Inuvo	**$63**	**$59**	**4.7**	**1.2x**	**1.3x**	**$74**	**$75**
YoY growth							
Conclusion of Enterprise Value			**$74,361,215**				
Market Value			**$76,059,501**				
Shares Outstanding			24,700,000				
Price per Share			**$3.08**				

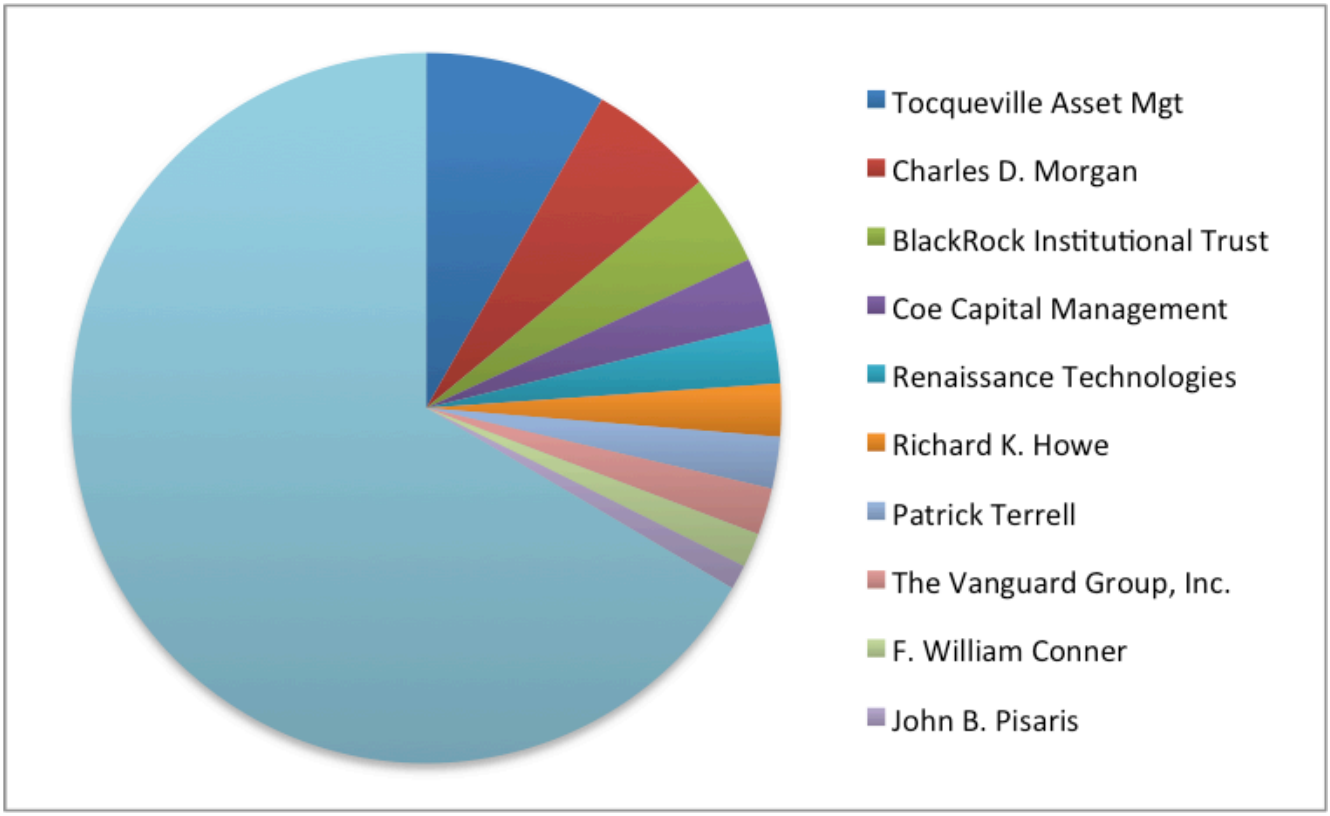
	Revenue		2015E	Enterprise Value / Sales		Valuation Range	
	2016E	2015E	EBITDA	2016E	2015E	Low	High
Inuvo	**$75**	**$63**	**0.0**	**1.2x**	**1.3x**	**$80**	**$88**
YoY growth							
Conclusion of Enterprise Value			**$84,079,732**				
Market Value			**$85,778,018**				
Shares Outstanding			25,428,412				
Price per Share			**$3.37**				

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.
- Some of the company's growth is dependent on the success of a new product that is virtually untested in the market and may not be adopted by new customers.
- 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

As of July 30, 2015



Tocqueville Asset Management is a family office for Charles Morgan.

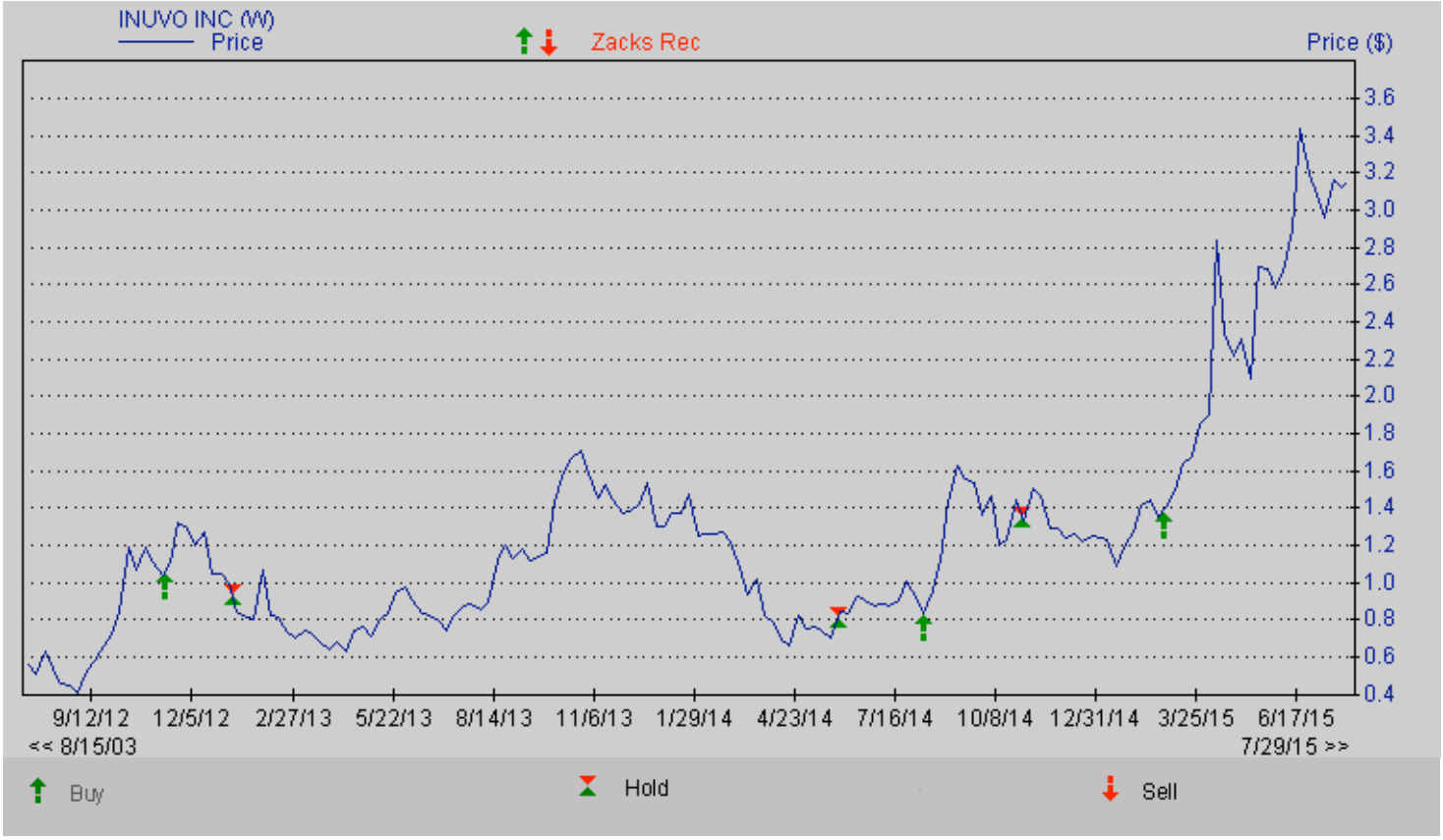
PROJECTED INCOME STATEMENT

Inuvo	Q1 2014 31-Mar	Q2 2014 30-Jun	Q3 2014 30-Sep	Q4 2014 31-Dec	Q1 2015 31-Mar	Q2 2015 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	$9.3	$8.0	$8.4	36.0	25.7	33.3	38.3
Yr-to-yr Growth	-39%	-35%	-34%	-1%	39%	67%	13%	11%	39%	-29%	30%	15%
Owned and operated, excluding Appbar	3.7	4.8	5.6	7.7	5.8	7.3	7.5	8.6	8.5	21.8	29.3	36.6
Yr-to-yr Growth	68%	156%	187%	200%	59%	52%	34%	12%	107%	157%	34%	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%	-83%	-100%	-100%	-55%	-80%	-91%	-100%
Total revenue	**10.1**	**10.9**	**13.0**	**15.5**	**13.4**	**16.7**	**15.5**	**17.0**	**55.0**	**49.6**	**62.7**	**74.9**
Yr-to-yr Growth	-36%	-17%	-10%	36%	32.6%	53%	19%	10%	3.0%	-9.8%	26.5%	19.3%
Cost of services	3.7	4.7	5.9	6.2	6.1	7.1	6.3	6.6	28.8	20.4	26.1	31.0
Partner network gross margin	1.9	1.0	1.2	1.4	1.5	2.2	1.7	1.8	8.0	5.5	7.2	7.3
% GM partner network	34%	17%	17%	19%	20%	24%	21%	21%	22%	21%	22%	19%
Owned and Operated GM	4.6	5.3	5.9	7.9	5.8	7.4	7.5	8.6	18.2	23.7	29.4	36.6
% GM owned and operated	98%	99%	100%	100%	100%	100%	100%	100%	98%	99%	100%	100%
Gross profit	6.4	6.3	7.1	9.3	7.4	9.6	9.2	10.4	26.2	29.2	36.5	43.9
Gross Margin	63.7%	57.4%	54.6%	60.2%	54.8%	57.6%	59.2%	61.0%	47.7%	58.8%	58.2%	58.6%
Operating expenses:					84%	89%						
Marketing	3.7	3.6	4.3	5.9	4.9	6.6	6.0	6.9	14.4	17.5	24.4	30.1
Compensation	1.1	1.1	1.2	1.4	1.2	1.3	1.4	1.5	6.0	4.8	5.4	6.0
SG&A	1.0	1.1	1.2	1.2	1.0	1.2	1.2	1.1	5.8	4.4	4.4	4.9
Total operating expenses	5.8	5.8	6.7	8.4	7.1	9.1	8.6	9.5	26.2	26.7	34.3	41.0
Operating income:	0.7	0.5	0.5	0.9	0.251	0.5	0.6	0.9	0.0	2.5	2.2	2.9
Operating margin	6.6%	4.3%	3.6%	5.8%	1.9%	3.2%	3.9%	5.1%	0.0%	5.0%	3.6%	3.8%
Other income:												
Interest expense, net	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.4)	(0.4)	(0.2)	-
Total other income	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.4)	(0.4)	(0.3)	(0.2)
Income before income taxes	0.6	0.4	0.4	0.8	0.2	0.5	0.6	0.8	(0.3)	2.1	2.0	2.7
Pretax Margin	5.7%	3.3%	2.9%	5.3%	1.5%	3.0%	3.6%	4.9%	-0.6%	4.3%	3.2%	3.6%
Income tax benefit	(0.1)	0.00	0.00	(0.1)	(0.4)	(0.0)	(0.0)	-	(0.3)	(0.2)	-	-
Tax rate	-13%	0%	0%	-9%	-204%	-7%	-6%	0%	92%	-7.1%	0.0%	0.0%
Net income from continuing operations	0.6	0.4	0.4	0.8	0.6	0.5	0.6	0.8	(0.0)	2.3	2.0	2.7
Net income from discontinued operations	0.0	0.0	0.0	(0.1)	0.0	(0.0)	-	-	0.5	(0.0)	-	-
Net income	0.7	0.4	0.4	0.6	0.6	0.5	0.6	0.8	0.5	2.3	2.0	2.7
Foreign currency valuation	-	-	-	-	-	-	-	-	(0.0)	0.0	0.0	0.0
Comprehensive income	0.7	0.4	0.4	0.6	0.6	0.5	0.6	0.8	0.5	2.3	2.0	2.7
Stk based compensation	0.1	0.2	0.3	0.3	0.1	0.1	0.1	0.1	0.7	1.0	0.5	0.5
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	0.7	0.7	1.0	0.7	3.3	2.4	3.2
Yr-over-Yr									-110.9%	393.3%	-24.8%	29.4%
Net income per share:												
Basic from continuing	0.03	0.02	0.02	0.03	0.03	0.02	0.02	0.03	(0.00)	0.10	0.08	0.11
Diluted from continuing	0.03	0.02	0.02	0.03	0.03	0.02	0.02	0.03	(0.00)	0.09	0.08	0.10
Non-GAAP Diluted from continuing	**0.03**	**0.03**	**0.03**	**0.04**	**0.03**	**0.03**	**0.03**	**0.04**	**0.03**	**0.13**	**0.10**	**0.12**
					-18.3%	5.5%	8.3%	-3.4%	-110%	358%	-22%	23%
Shares												
Basic	23.4	23.4	23.4	23.6	24.1	24.3	24.4	24.5	23.3	23.5	23.5	24.7
Diluted	23.5	24.1	24.1	24.5	24.2	24.7	24.8	24.9	23.3	24.0	24.2	25.4
	1.0%	3.1%	3.0%	5.0%	3.2%	2.7%	2.7%	1.8%	10.8%	3.2%	0.8%	5.0%
Adjusted EBITDA	1.34	1.19	1.18	1.78	0.67	1.09	1.17	1.43	3.75	5.48	4.35	5.09
	-2%	39%	-19%	2138%	-50%	-9%	-1%	-20%		46%	-21%	17%

BALANCE SHEET

	June 30, 2015	March 31, 2015	
Current assets			
Cash	$3,779,339	$1,923,617	96%
Accounts receivable, net of allowance for doubtful accounts of $87,733 and $62,845, respectively	6,348,993	7,398,031	-14%
Unbilled revenue	29,038	19,629	48%
Prepaid expenses and other current assets	286,577	232,727	23%
Total current assets	10,443,947	9,574,004	9%
Property and equipment, net	1,201,858	999,267	20%
Other assets			
Goodwill	5,760,808	5,760,808	0%
Intangible assets, net of accumulated amortization	9,789,539	9,331,821	5%
Other assets	210,050	200,032	5%
Total other assets	15,760,397	15,292,661	3%
Total assets	27,406,202	25,865,932	6%
Current liabilities			
Accounts payable	8,368,632	7,001,628	20%
Accrued expenses and other current liabilities	4,175,373	3,052,266	37%
Term and credit notes payable - current portion	666,667	959,942	-31%
Total current liabilities	13,210,672	11,013,836	20%
Long-term liabilities			
Deferred tax liability	3,552,500	3,552,500	0%
Term and credit notes payable - long term	833,334	2,500,000	-67%
Other long-term liabilities	581,052	98,711	489%
Total long-term liabilities	4,966,886	6,151,211	-19%
Total Liabilities	18,177,558	17,165,047	6%
Stockholdersâ€™ equity			
Total stockholders' equity	9,228,644	8,700,885	6%
Total liabilities and stockholders' equity	$27,406,202	$25,865,932	6%
Quick Ratio	0.8	0.9	-9%
Working Capital	(2,766,725)	(1,439,832)	92%
Cash as % of assets	14%	7%	85%
Debt % of assets	8%	14%	-45%

HISTORICAL ZACKS RECOMMENDATIONS



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Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
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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