Zacks Small-Cap Research

November 2, 2017

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Inuvo Inc. (INUV-AMEX)

INUV: NetSeer Revenues Have Doubled Since February Acquisition

At an enterprise value of $27.2 million the company is valued well below the industry average of 1.6 times enterprise value to sales. **2017 est. revenue of $79 million yields a $4.40 target stock price.**

Current Price (11/01/17)	$0.88
Valuation	**$4.40**

OUTLOOK

Inuvo, a digital publishing and advertising technology company, purchased NetSeer on Feb 8th, adding an expected $14m to 2017 revenues. NetSeer has brought leading-edge technology and higher gross margins while Inuvo adds management discipline. We expect accelerating revenue and earnings growth and margin improvement going forward as well as continued EBITDA positive results.

SUMMARY DATA

52-Week High	**$1.99**
52-Week Low	**$0.84**
One-Year Return (%)	**-25.4**
Beta	**0.6**
Average Daily Volume (sh)	**128,592**
Shares Outstanding (mil)	**28.5**
Market Capitalization ($mil)	**$25**
Short Interest Ratio (days)	**2.5**
Institutional Ownership (%)	**22**
Insider Ownership (%)	**16**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**9.2**
Earnings Per Share (%)	**8.5**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2017 Estimate	**NM**
P/E using 2018 Estimate	**29.3**
Zacks Rank	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Services**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	13.4 A	16.7 A	19.3 A	21.0 A	70.4 A
2016	18.7 A	15.6 A	17.5 A	19.7 A	71.5 A
2017	17.2 A	18.3 A	20.3 A	23.0 E	78.8 E
2018					100.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	$0.03 A	$0.03 A	$0.03 A	$0.04 A	$0.13 A
2016	$0.03 A	-$0.01 A	-$0.00 A	-$0.00 A	$0.01 A
2017	-$0.04 A	-$0.02 A	-$0.02 A	$0.00 E	-$0.09 E
2018					$0.03 E

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

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WHAT'S NEW

Q3 Focuses on Margins Not Revenues

Inuvo reported revenues of $20.3 million as its had preannounced, up 16% from last year. The key improvement however was in margin. The company is now focused on profit after marketing expense as it deemphasizes its owned and operated websites. This quarter the margin was 17.2%, flat sequentially but up significantly from last year's 13.9%. So on a 16% increase in revenues, the company made 154% more in profit dollars. Marketing spending was reduced to $7.2 million versus $9.9 million last year as the company deemphasized low margin digital publishing. The company expects margins to be sequentially flat for the rest of the year, but to eventually tick up as NetSeer's higher margin contribution to total revenues increases. This was the second full quarter the company has reported with NetSeer revenues. To date, the NetSeer acquisition has been dilutive, but the company expects it to begin to be accretive in Q4 2017. Mobile was 66% of sales in the quarter, higher than the 2016 average of 52%.

Compensation expense increased to $2.4 million versus $1.7 million a year ago as the number of employees grew to 90 from 70 a year ago due to the purchase of NetSeer. The company had 90 employees as of the end of September versus 70 a year ago.

SG&A was versus $2.0 million versus $1.2 million a year ago. This level was flat sequentially if you remove $441,000 in one-time expenses in Q2 2017. The reduction of locations and data center consolidation is still not finished, and its full effect will not be in force until December. This will reduce expenses even further, improving operating margins.

Operating income was a loss $889,000 versus a loss of $452,000 in 2016.

Loss for the quarter was $986,000 versus a loss of $435,000. Taking out stock-based compensation, **adjusted EBITDA was $253,000** versus $167,000 in Q2 2017 and $420,000 last year.

The company reported a loss of $0.03 versus a loss of $0.02 last year, but on an adjusted non-GAAP basis, taking out stock-based compensation, the EPS loss was $0.02 versus breakeven.

The company continues to be optimistic especially for 2018 as it now has capabilities beyond much of its competition. It has an engine, *IntentKey*, which is automated and can discern the intent of the end user by looking at what is read. It can better match ads with content and can further filter that with knowledge about the demographics of the reader. This allows Inuvo to finely target ads at the most desirable viewers. So knowing what you are reading or searching for, combined with who in the house is using the device allows the optimal ad to be served. This capability combined with additional information across users' devices provided by Acxiom's *LiveRamp*, should further increase sales next year. The company is now adding more salespeople and customer service employees to position it for 2018.

The strategy for Inuvo investors and management has always been to grow the business large enough to be attractive as an acquisition. Once the company reaches over $100 million in sales, which we expect it to reach in 2018, we believe it could be large enough to be an attractive acquisition to a larger company.

KEY POINTS

- Inuvo is an emerging player in the digital advertising space. But according to IHS, native advertising, INUV's newer market, will grow much faster than that. For example it predicts mobile native advertising will increase an average of 70.7% per year to reach $8.9 billion in 2020.

- The company had its goal is to reach a $100 million in revenue run rate by the end of 2017 but is now expected to fall short as it focuses on higher profitability rather than just revenue growth. Revenues from its February NetSeer acquisition are currently at a $15 million run rate.

- Charles D. Morgan, Director and former founder and Chairman of Acxiom, has a 7% stake in the company (through Tocqueville Asset Management.) We believe that this stake will help keep the company's objectives in line with that of shareholders. We believe that ultimately the company will be sold when it proves it has traction and reaches a size of interest to larger corporations.

- We believe the company is valued way below its peers. If we use enterprise value to sales (since many competitors operate at a loss), the stock is still priced well below its peers who trade at an average of 1.6 times enterprise value to sales. **At a multiple of 1.6xs estimated $79 million in 2017 revenue, the stock should be worth $4.40.**

VALUATION

Inuvo is hybrid adtech company and digital publisher, but is moving to a higher percentage of adtech and deemphasizing the lower margin publishing business. In Q1 2017 quarter the revenue the company's revenues were 42% from the digital publisher. The company said that going forward it would no longer break out revenues into segments, but we believe the percent is now much lower than that.

We applied average multiples of sales to Inuvo's historical and projected revenues based on the comparable companies in the table below. Using this multiple and applying it to 2017 estimated revenues of $79 million the stock should be worth $4.41.

		Ticker	Revenue		TTM	Enterprise Value / Sales		EV/	Included	Enterprise
Company			2017E	LTM	EBITDA	2017E	LTM	EBITDA	Average?	Value
Autobytel	-8%	ABTL	$144	$156	$15	0.4x	0.4x	4.2x	y	63
Blucora	2%	BCOR	$503	$492	$92	2.5x	2.5x	13.5x	y	1,250
Criteo	1%	CRTO	$932	$924	$94	2.4x	2.5x	24.3x	y	2,280
Leaf Group	7%	LFGR	$126	$118	-$21	0.9x	1.0x	-5.4x	y	113
Rocket Fuel	-55%	FUEL	$188	$420	-$17	0.8x	0.3x	-8.6x	y	143
Marchex	-16%	MCHX	$89	$106	-$12	0.4x	0.3x	-2.5x	y	31
The Rubicon Project	-22%	RUBI	$177	$227	$7	-0.1x	-0.1x	-3.4x	n	(24)
MaxPoint Interactive	-29%	MXPT	$103	$144	-$9	1.0x	0.7x	-11.4x	y	101
SITO Mobile	24%	SITO	$41	$33	-$3	4.2x	5.2x	-62.1x	y	175
Travelzoo	-15%	TZOO	$105	$123	$10	0.6x	0.5x	6.2x	y	63
IAC	3%	IAC	$3,180	$3,100	$449	3.2x	3.3x	22.7x	y	10,180
Average					**59.8**	**1.6x**	**1.7x**	**-1.9x**		**$1,440**

	Revenue		TTM	Enterprise Value / Sales		Valuation Range	
	2017E	LTM	EBITDA	2017E	LTM	Low	High
Inuvo	**$79**	**$73**	**0.7**	**1.6x**	**1.7x**	**$122**	**$129**

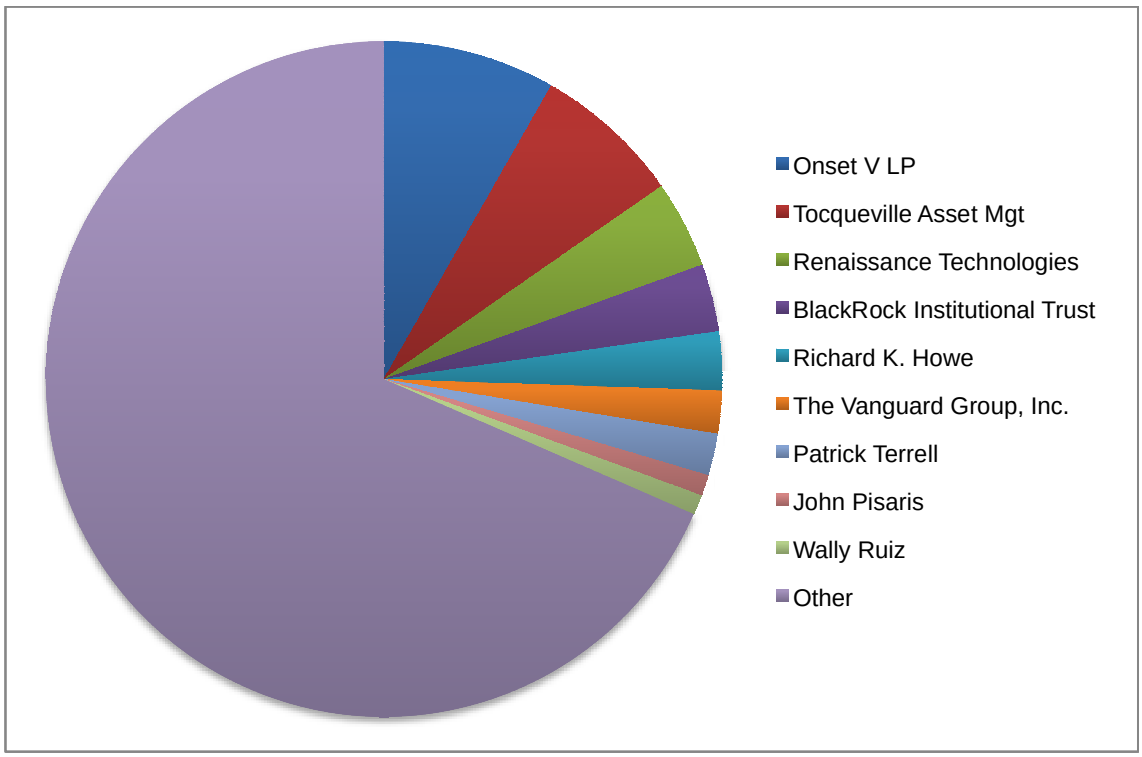
Conclusion of Enterprise Value	**$125,319,791**
Market Value	**$125,666,595**
Shares Outstanding	28,480,000
Price per Share	**$4.41**

RISKS

- There are few barriers to entry in the advertising network business and it typically operates with slim margins with competition mainly on price.
- 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 as well as its abilities to acquire companies.

CURRENT OWNERSHIP

Charles D. Morgan owns 2 million of the shares of the Tocqueville Asset Management position.
Onset V was the venture capitalist owner of NetSeer and now owns 2.6 million shares of Inuvo.



PROJECTED INCOME STATEMENT

Inuvo	Q1 2016 31-Mar	Q2 2016 30-Jun	Q3 2016 30-Sep	Q4 2016 31-Dec	Q1 2017 31-Mar	Q2 2017 30-Jun	Q3 2017 30-Sep	Q4 2017E 31-Dec	2015	2016	2017E	2018E
Ad-Tech	5.3	$4.7	$6.2	$9.8	10.0				30.3	26.0	NA	NA
Yr-to-yr Growth	-30%	-49%	-14%	58%	88%				18%	-14%	NA	NA
Ad-Tech gross margin	1.0	0.8	1.1	1.9	2.1				6.6	4.7	NA	NA
% GM Ad-Tech	19%	17%	17%	19%	21%				22%	19%	NA	NA
Digital Publishing	13.4	10.9	11.3	9.8	7.2				40.0	45.5	NA	NA
Yr-to-yr Growth	129%	49%	-5%	-34%	-46%				83%	14%	NA	NA
Digital Publishing gross margin	13.4	10.9	11.3	9.8	7.2				40.1	45.4	NA	NA
% GM Digital Publishing	100%	100%	100%	100%	100%				99%	100%	100%	100%
Total revenue	**18.7**	**15.6**	**17.5**	**19.7**	**17.2**	**18.3**	**20.3**	**23.0**	**70.4**	**71.5**	**78.8**	**100.0**
Yr-to-yr Growth	40%	-6%	-9%	-7%	-8%	17%	16%	17%	42%	2%	10%	27%
Total Cost of services	4.3	4.0	5.1	8.0	7.9	7.6	9.6	11.0	25.0	21.4	36.2	48.0
Gross profit	14.4	11.7	12.3	11.7	9.3	10.7	10.7	12.0	46.7	50.2	42.6	52.0
Gross Margin %	77%	75%	71%	59%	54%	58%	52%	52%	66%	70%	54%	52%
Operating expenses:												
Marketing	11.1	9.4	9.9	8.8	6.5	7.5	7.2	8.0	34.3	39.2	29.1	33.0
Profit after marketing of Digital Publishing	2.3	1.5	1.4	1.0	2.9	3.2	3.5	4.0	5.7	6.2	13.5	19.0
Margin %	21%	16%	13.9%	11%	16.6%	17.3%	17.2%	17.4%	14%	14%	17%	19%
Compensation	1.7	1.6	1.7	1.9	2.4	2.3	2.4	2.5	5.6	6.8	9.5	11.0
SG&A	1.3	1.3	1.2	1.2	2.1	2.2	2.0	1.9	4.6	5.0	8.2	8.0
Total operating expenses	14.0	12.3	12.8	11.9	11.0	12.0	11.6	12.4	44.6	51.0	46.8	52.0
Operating income:	0.4	(0.6)	(0.5)	(0.2)	(1.6)	(1.3)	(0.9)	(0.4)	2.1	(0.9)	(4.2)	-
Operating margin	2.2%	-3.9%	-2.6%	-1.0%	-9.6%	-7.2%	-4.4%	-1.5%	3.0%	-1.2%	-5.3%	0.0%
Other income:												
Interest expense, net	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.3)	(0.3)
Total other income	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.1)	(0.1)	(0.3)	(0.1)	(0.3)	(0.3)
Income before income taxes	0.4	(0.6)	(0.5)	(0.2)	(1.7)	(1.4)	(1.0)	(0.5)	1.9	(1.0)	(4.5)	(0.3)
Pretax Margin	2.0%	-4.0%	-2.7%	-1.2%	-9.8%	-7.6%	-4.9%	-2.0%	2.7%	-1.3%	-5.7%	-0.3%
Income tax benefit	0.0	(0.1)	(0.0)	0.1	-	-	-	-	(0.4)	(0.0)	-	-
Tax rate	2%	9%	9%	-27%	0%	0%	0%	9%	-18.7%	3.1%	0.0%	5.8%
Net income from continuing operations	0.4	(0.6)	(0.4)	(0.3)	(1.7)	(1.4)	(1.0)	(0.5)	2.2	(0.9)	(4.5)	(0.3)
Net income from discontinued operations	0.0	(0.0)	0.2	(0.0)	(0.0)	-	-	-	0.0	0.2	(0.0)	-
Net income	0.4	(0.6)	(0.3)	(0.3)	(1.7)	(1.4)	(1.0)	(0.5)	2.3	(0.8)	(4.5)	(0.3)
Stk based compensation	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.8	1.3	1.3	1.4
One-time expenses	(0.0)	-	-	-	0.4	0.4	-	-	-	(0.0)	0.7	-
Non-GAAP Income from continuing	0.7	(0.2)	(0.1)	(0.0)	(1.0)	(0.6)	(0.6)	(0.1)	3.0	0.3	(2.6)	1.1
Net income per share:												
Basic from continuing	0.02	(0.02)	(0.02)	(0.01)	(0.06)	(0.05)	(0.03)	(0.02)	0.09	(0.04)	(0.16)	(0.01)
Diluted from continuing	0.02	(0.02)	(0.02)	(0.01)	(0.06)	(0.05)	(0.03)	(0.02)	0.09	(0.04)	(0.16)	(0.01)
Non-GAAP Diluted from continuing	**0.03**	**(0.01)**	**(0.00)**	**(0.00)**	**(0.04)**	**(0.02)**	**(0.02)**	**(0.00)**	**0.11**	**0.01**	**(0.09)**	**0.04**
	182.1%	-137.2%	-113.9%	-103.2%	-233.3%	125.5%	368.9%	229.6%	-16%	-88%	-760%	-140%
Shares												
Basic	24.4	24.6	24.7	24.9	27.0	28.5	28.6	28.5	24.2	24.6	28.1	29.4
Diluted	24.6	24.6	24.7	24.9	27.2	28.7	28.8	28.7	24.5	24.7	28.3	29.7
	1.3%	-0.5%	-0.4%	0.2%	10.8%	16.8%	16.4%	15.1%	1.6%	0.6%	14.8%	4.9%
Adjusted EBITDA	1.30	0.29	0.42	0.61	(0.31)	0.17	0.25	0.79	4.66	2.62	0.42	3.22
	93%	-74%	-69%	-61%	-124%	-42%	-40%	29%	-15%	-44%	-84%	671%

BALANCE SHEET

	Sept 30, 2017	June 30, 2017	Qtr-Qtr % Change	Dec 31, 2016	Sept-Dec % Change
Current assets					
Cash	$2,901,965	$3,680,711	-21%	$3,946,804	-26%
Accounts receivable, net	9,976,903	7,677,784	30%	7,586,129	32%
Unbilled revenue	0	0	0%	8,644	-100%
Prepaid expenses and other current assets	347,707	439,519	-21%	284,469	22%
Total current assets	13,226,575	11,798,014	12%	11,826,046	12%
Property and equipment, net	2,233,183	1,676,931	33%	1,615,223	38%
Other assets					
Goodwill	9,773,842	9,773,842	0%	5,760,808	70%
Intangible assets, net of accumulated amortization	11,319,044	11,717,661	-3%	8,343,876	36%
Other assets	96,070	107,392	-11%	15,186	533%
Total other assets	21,188,956	21,598,895	-2%	14,119,870	50%
Total assets	36,648,714	35,073,840	4%	27,561,139	33%
Current liabilities					
Accounts payable	11,761,983	9,433,277	25%	9,280,779	27%
Accrued expenses and other current liabilities	2,936,116	3,212,415	-9%	2,689,640	9%
Revolving credit line - current portion	5,000,000	2,500,000	100%	0	NM
Total current liabilities	19,698,099	15,145,692	30%	11,970,419	65%
Long-term liabilities					
Deferred tax liability	3,738,500	3,738,500	0%	3,738,500	0%
Revolving credit line - long term	0	2,500,000	-100%	0	0%
Other long-term liabilities	485,405	193,839	150%	326,428	49%
Total long-term liabilities	4,223,905	6,432,339	-34%	4,064,928	4%
Total Liabilities	23,922,004	21,578,031	11%	16,035,347	49%
Stockholder's equity					
Total stockholders' equity	12,726,710	13,495,809	-6%	11,525,792	10%
Total liabilities and stockholders' equity	$36,648,714	$35,073,840	4%	$27,561,139	33%
Quick Ratio	0.7	0.8	-14%	1.0	-32%
Working Capital	(6,471,524)	(3,347,678)	93%	(144,373)	4383%
Cash as % of assets	8%	10%	-25%	14%	-45%
Cash per share	$0.12	$0.13	-9%	$0.15	-20%
Debt % of assets	15%	14%	5%	0%	NM

CASH FLOWS

	Year 2015	3 Months Ended 3/31/16	3 Months Ended 6/31/16	3 Months Ended 9/30/16	3 Months Ended 12/31/16	Year 2016	3 Months Ended 3/31/17	3 Months Ended 6/30/17	3 Months Ended 9/30/17
Operating activities:									
Net income	2,339,774	374,274	(574,828)	(263,073)	(229,308)	(772,584)	(1,693,054)	(1,382,371)	(986,170)
Adjustments to reconcile net income to net cash provided by operating activities:									
Settlement of tax liability	(406,453)	-	-	-	-	-	-	-	-
Depreciation and amortization	1,807,350	540,562	561,494	556,296	551,386	2,209,738	693,175	741,692	804,631
Deferred income taxes	233,480	-	-	-	(61,100)	(61,100)	-	-	-
Amortization of financing fees	19,804	6,400	6,400	6,400	-	25,600	6,400	6,400	6,400
Adjustment of European liabilities related to discontinued operations	(59,751)	(5,144)	-	(171,844)	-	(176,988)	1,109	-	-
Provision of doubtful accounts	(6,036)	(464)	(293)	6,557	-	5,800	-	141,000	(2,211)
Stock based compensation	707,544	359,338	327,110	315,596	262,222	1,264,266	292,334	293,825	336,913
Other, net	0	-	-	-	-	0	-	-	-
Change in operating assets and liabilities:									
Accounts receivable and unbilled revenue	(2,001,613)	1,944,137	(250,317)	(1,008,384)	(1,268,518)	(583,082)	2,740,326	(680,496)	(2,296,908)
Prepaid expenses and other assets	(19,370)	64,747	50,986	22,597	81,326	219,656	109,577	(124,826)	96,734
Accounts payable	4,545,906	(2,411,075)	(247,496)	628,475	1,407,548	(622,548)	(2,844,928)	(583,470)	2,328,706
Accrued expenses and other liabilities	(1,054,363)	(299,033)	4,105	(54,941)	(71,006)	(420,875)	(989,738)	434,059	(411,874)
Other, net	-	-	-	-	(34,864)	(34,864)	-	-	-
Net cash provided by operating activities	6,106,272	573,742	(122,839)	37,679	733,650	1,053,019	(1,684,799)	(1,154,187)	(123,779)
Investing activities:									
Purchases of equipment and capitalized development costs	(1,525,888)	(372,598)	(322,886)	(233,896)	(186,991)	(1,116,371)	(151,424)	(469,274)	(442,113)
Grant funds received for equipment and office construction	-	-	-	-	-	-	-	-	-
Net cash from NetSeer Asset Acquisition						-	235,763	-	-
Net cash used in investing activities	(1,525,888)	(372,598)	(322,886)	(233,896)	(186,991)	(1,116,371)	84,339	(469,274)	(442,113)
Financing activities:									
Payoff of NetSeer debt acquired					-	-	(2,015,577)	-	-
Deposit to collateralize letter of credit		-	-	-	-	-	-	-	-
Prepaid financing fees and other	25,600	-	-	-	25,600	25,600	-	-	-
Net taxes paid on RSU grants exercised	(360,608)	(11,952)	-	(128,790)	(63,094)	(203,836)	-	-	(97,376)
Proceeds from revolving line of credit	4,000,000	-	3,750,000	(3,750,000)	7,950,000	7,950,000	3,600,000	1,400,000	-
Payments on revolving line of credit	(5,793,275)	-	(3,750,000)	3,750,000	(7,950,000)	(7,950,000)	-	-	-
Proceeds from term note payable	-	-	-	-	-	-	-	-	-
Payments on term note payable and capital leases	(1,909,422)	(12,859)	(13,019)	(11,675)	(8,760)	(46,313)	(7,250)	(19,345)	(70,705)
Treasury stock repurchase						(22,499)			(44,772)
Net cash used in financing activities	(4,037,705)	(24,811)	(13,019)	(140,465)	(46,254)	(247,048)	1,577,173	1,380,655	(212,853)
Effect of exchange rate changes	-	-	-	-	-	-	-	-	-
Net change - cash	542,679	176,333	(458,744)	(336,682)	500,405	(310,400)	(23,287)	(242,806)	(778,745)
Cash, beginning of quarter		4,257,204	4,433,537	3,974,793	3,974,793	3,974,793	3,946,804	3,923,517	3,680,711
Cash, end of period	4,257,204	4,433,537	3,974,793	3,638,111	3,946,804	3,664,393	3,923,517	3,680,711	2,901,966
Supplemental information:									
Interest paid	122,136	18,063	16,466	20,556	17,666	72,751	25,317	79,745	75,734
NetSeer stock issuance						-	4,459,244	-	-
Writedown of domain names and cont. liab.						-	222,477	-	-
Income taxes paid	280,453	-	10,000	16,000	-	26,000	-	-	-
Cash received from construction allowance	200,000	-	-	-	-	-	-	-	-
Purchase of property and equipment under capital lease	103,609	-	-	-	-	-	-	-	523,518

STOCK PRICE CHART



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