Zacks Small-Cap Research

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Inuvo Inc. (INUV-AMEX)

INUV: NetSeer Accretion Happening Even Faster Than Expected

At an enterprise value of $31.5 million the company is valued well below the industry average of 1.3 times enterprise value to sales. **2017 est. revenue of $84 million yields a $3.74 target stock price.**

Current Price (08/08/17)	$1.06
Valuation	**$3.74**

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. Management's goal is to reach a revenue run rate of $100 million by the end of 2017. We expect accelerating revenue and earnings growth going forward as well as EBITDA positive results.

SUMMARY DATA

52-Week High	**$1.99**
52-Week Low	**$0.97**
One-Year Return (%)	**-22.1**
Beta	**0.4**
Average Daily Volume (sh)	**42,902**
Shares Outstanding (mil)	**28.5**
Market Capitalization ($mil)	**$30**
Short Interest Ratio (days)	**8.7**
Institutional Ownership (%)	**24**
Insider Ownership (%)	**16**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**11.0**
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	**35.3**
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	21.0 E	28.0 E	84.5 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	-$0.01 E	$0.02 E	-$0.07 E
2018					$0.03 E

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

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WHAT'S NEW

Q2 Shows Inuvo Moving to a Higher Margin Model

Inuvo reported revenues on target with its pre-announcement but exhibited higher than expected gross margin as it reduces revenue from owned and operated and increases sales of higher margin business in part due to NetSeer sales. However the reduction of locations and data center consolidation is not yet finished, and its full effect will not be in force until December. This will reduce expenses even further improving operating margins. The company had approximately 21 of its 92 employees (as of the end of June) in Sunnyvale. They relocated to new facilities in San Jose as of the end of July.

Revenues totaled $18.3 million for Q2 2017 up 17% from Q2 2016. Q2 last year had a drop off in revenues due to customer confusion caused by the pending acquisition of Yahoo! on July 25th, as well as an internal algorithm problem. This 2017 quarter was with first full quarter with NetSeer revenues. The company no longer breaks out business segments since integrating with NetSeer. Mobile was 58% of sales in the quarter, higher than the 2016 average of 52%.

Gross margin was 58% in the quarter compared with 75% in Q2 2016, but an improvement from 54% in Q1 2017. The company expects gross margin to trend up and expects a few more percentage point of improvement in the second half of 2017.

Marketing spending was reduced to $7.5 million versus $9.4 million last year as the company deemphasizes digital publishing.

Compensation plus SG&A were $4.5 million in the quarter versus $2.9 million in 2016. Adding to compensation were 20 new employees from NetSeer and $441,000 in one-time expenses from the acquisition.

Operating income was a loss $1.3 million versus a loss of $0.6 million in 2016. Without the $441,000 was one-time expense, the loss was $869,000.

The company had $73,000 in interest expense up from $43,000 in Q1 due to higher borrowings for the acquisition. Last year interest expense was $22,000.

Loss for the quarter was $1.4 million versus a loss of $600,000. Taking out one-time expenses for the acquisition and stock-based compensation, **adjusted EBITDA was $167,000** versus $288,000 last year. We had been expecting a loss, so the company is making better progress than expected.

The company reported a loss of $0.05 versus a loss of $0.02 last year, but on a non-GAAP basis, taking out one-time expense and stock-based compensation, the EPS loss was $0.02 versus a loss of $0.01.

The NetSeer acquisition has been initially dilutive, but the company expects it to begin to be accretive by the second half of this year. This is an improvement from its initial expectations of it to be accretive to adjusted EBITDA within 12 months. NetSeer revenues are at much higher gross margins than historical Inuvo revenues and its contribution is expected to increase as a percentage of sales going forward. Its technology is extremely useful to Inuvo and it brings technology expertise while Inuvo provides management discipline making the acquisition highly synergistic.

The company continues to improve its technology and is working on numerous projects such as Campaign Automation and Campaign Analytics. It is also working on identifying users across devices using its IntentKey technology and Acxiom's (ACXM) identity resolution technology, available through their LiveRamp subsidiary. The company signed a deal with Acxiom during Q2. Inuvo's Publisher platform continues to add features that allow publishing clients the ability to optimize against variables like user engagement or latency or viewability, in addition to revenue.

Forecasts

On the call the company reduced its guidance on annual revenues to a range of $84 million to $89 million from a range of $88 million to $93 million. Since the company is now focusing on higher margin revenues rather than low margin digital publishing revenues, guidance for EBITDA was maintained. Most impactful is the guidance to higher gross margins, which will meaningfully increase either profitability or the ability to further invest in the business. The company has no plans for any further acquisitions this year and plans to devote resources to selling. We are reducing annual revenues to $84.5 million and adjusting the quarters. Due to another earnings beat in Q2 we are reducing our non-GAAP EPS estimate to a loss of $0.07 per share versus a positive $0.01 in 2016. We believe that the company will continue to invest cash in marketing to grow revenues.

In 2018, we believe the company may pursue other acquisitions. The current state of its balance sheet may make that difficult, but many opportunities are available. Once the company reaches over $100 million in sales, which we expect it to reach in 2018, we believe it could be an attractive acquisition to a larger company and the management would be willing to entertain discussions.

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 has stated its goal is to reach a $100 million in revenue run rate by the end of 2017 and it is on track to do so particularly with new addition of NetSeer, which should be adding $15 million in revenues by itself.

- 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 1.3 times enterprise value to sales. **At a multiple of 1.3xs estimated $85 million in 2017 revenue, the stock should be worth $3.74.**

VALUATION

Inuvo is hybrid adtech company and digital publisher. 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.

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 $84 million the stock should be worth $3.74.

Company		Ticker	Revenue 2017E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2017E	Enterprise Value / Sales LTM	EV/ EBITDA	Included Average?	Enterprise Value
Autobytel	-7%	ABTL	$147	$158	$16	0.5x	0.5x	4.9x	y	77
Blucora	2%	BCOR	$503	$492	$92	2.6x	2.7x	14.1x	y	1,307
Criteo	14%	CRTO	$947	$832	$81	3.1x	3.5x	36.0x	y	2,914
Leaf Group	13%	LFGR	$128	$114	-$22	0.9x	1.1x	-5.4x	y	122
Rocket Fuel	-54%	FUEL	$203	$447	-$10	0.7x	0.3x	-14.3x	y	144
Marchex	-21%	MCHX	$93	$118	-$16	0.2x	0.2x	-1.5x	y	23
The Rubicon Project	-20%	RUBI	$183	$227	$7	0.0x	0.0x	1.1x	y	8
MaxPoint Interactive	-30%	MXPT	$103	$148	-$11	0.4x	0.3x	-4.0x	y	43
SITO Mobile	36%	SITO	$42	$31	-$2	2.3x	3.1x	-45.6x	y	98
Travelzoo	-14%	TZOO	$106	$123	$10	0.9x	0.8x	9.2x	y	94
IAC	2%	IAC	$3,150	$3,100	$460	2.8x	2.8x	18.9x	y	8,679
Average					**55.0**	**1.3x**	**1.4x**	**1.2x**		**$1,228**

	Revenue 2017E	Revenue LTM	TTM EBITDA	Enterprise Value / Sales 2017E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
Inuvo	**$84**	**$73**	**0.9**	**1.3x**	**1.4x**	**$101**	**$111**

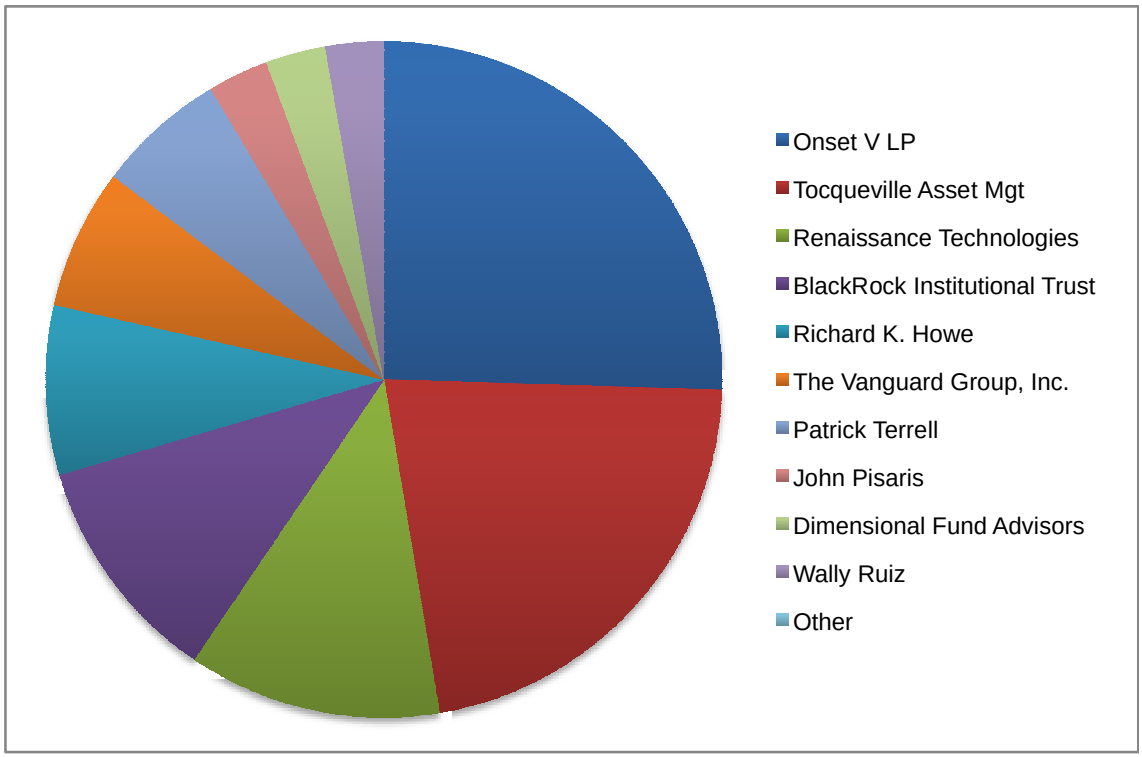
Conclusion of Enterprise Value	**$106,126,643**
Market Value	**$106,473,447**
Shares Outstanding	28,486,809
Price per Share	**$3.74**

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 2017E 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**	**21.0**	**28.0**	**70.4**	**71.5**	**84.5**	**100.0**
Yr-to-yr Growth	40%	-6%	-9%	-7%	-8%	17%	20%	42%	42%	2%	18%	18%
	-11%											
Total Cost of services	4.3	4.0	5.1	8.0	7.9	7.6	8.7	11.0	25.0	21.4	35.2	40.0
Gross profit	14.4	11.7	12.3	11.7	9.3	10.7	12.3	17.0	46.7	50.2	49.3	60.0
Gross Margin %	77%	75%	71%	59%	54%	58%	59%	61%	66%	70%	58%	60%
Operating expenses:												
Marketing	11.1	9.4	9.9	8.8	6.5	7.5	8.2	12.3	34.3	39.2	34.5	40.0
Profit after marketing of Digital Publishing	2.3	1.5	1.4	1.0	0.8	NA	NA	NA	5.7	6.2	NA	NA
Margin %	21%	16%	14%	11%	12%	NA	NA	NA	14%	14%	NA	NA
		2.876										
Compensation	1.7	1.6	1.7	1.9	2.4	2.3	2.6	2.5	5.6	6.8	9.7	11.0
SG&A	1.3	1.3	1.2	1.2	2.1	2.2	1.9	1.8	4.6	5.0	8.0	9.0
Total operating expenses	14.0	12.3	12.8	11.9	11.0	12.0	12.7	16.6	44.6	51.0	52.2	60.0
Operating income:	0.4	(0.6)	(0.5)	(0.2)	(1.6)	(1.3)	(0.4)	0.4	2.1	(0.9)	(2.9)	-
Operating margin	2.2%	-3.9%	-2.6%	-1.0%	-9.6%	-7.2%	-2.0%	1.6%	3.0%	-1.2%	-3.5%	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)	(0.5)	0.3	1.9	(1.0)	(3.2)	(0.3)
Pretax Margin	2.0%	-4.0%	-2.7%	-1.2%	-9.8%	-7.6%	-2.4%	1.3%	2.7%	-1.3%	-3.8%	-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)	(0.5)	0.3	2.2	(0.9)	(3.2)	(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)	(0.5)	0.3	2.3	(0.8)	(3.2)	(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	1.2	1.3
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)	(0.2)	0.6	3.0	0.3	(2.0)	1.0
Net income per share:												
Basic from continuing	0.02	(0.02)	(0.02)	(0.01)	(0.06)	(0.05)	(0.02)	0.01	0.09	(0.04)	(0.11)	(0.01)
Diluted from continuing	0.02	(0.02)	(0.02)	(0.01)	(0.06)	(0.05)	(0.02)	0.01	0.09	(0.04)	(0.11)	(0.01)
Non-GAAP Diluted from continuing	**0.03**	**(0.01)**	**(0.00)**	**(0.00)**	**(0.04)**	**(0.02)**	**(0.01)**	**0.02**	**0.11**	**0.01**	**(0.07)**	**0.03**
	182.1%	-137.2%	-113.9%	-103.2%	-233.3%	125.5%	47.0%	-1976.2%	-16%	-88%	-630%	-146%
Shares												
Basic	24.4	24.6	24.7	24.9	27.0	28.5	28.5	28.5	24.2	24.6	28.1	29.4
Diluted	24.6	24.6	24.7	24.9	27.2	28.7	28.7	28.7	24.5	24.7	28.3	29.7
	1.3%	-0.5%	-0.4%	0.2%	10.8%	16.8%	16.1%	15.1%	1.6%	0.6%	14.7%	4.9%
Adjusted EBITDA	1.30	0.29	0.42	0.61	(0.31)	0.167	0.62	1.49	4.66	2.62	1.5	3.13
	93%	-74%	-69%	-61%	-124%	-42%	47%	144%	-15%	-44%	-43%	111%

BALANCE SHEET

	June 30, 2017	Mar 31, 2017	Qtr-Qtr % Change	June 30, 2016	Yr-Yr % Change
Current assets					
Cash	$3,680,711	$3,923,517	-6%	$3,974,793	-7%
Accounts receivable, net	7,677,784	7,138,288	8%	5,316,043	44%
Unbilled revenue	0	0	0%	8,385	-100%
Prepaid expenses and other current assets	439,519	341,978	29%	412,749	6%
Total current assets	11,798,014	11,403,783	3%	9,711,970	21%
Property and equipment, net	1,676,931	1,554,099	8%	1,846,632	-9%
Other assets					
Goodwill	9,773,842	9,773,842	0%	5,760,808	70%
Intangible assets, net of accumulated amortization	11,717,661	12,116,278	-3%	8,805,996	33%
Other assets	107,392	86,507	24%	29,229	267%
Total other assets	21,598,895	21,976,627	-2%	14,596,033	48%
Total assets	35,073,840	34,934,509	0%	26,154,635	34%
Current liabilities					
Accounts payable	9,433,277	10,016,747	-6%	7,416,600	27%
Accrued expenses and other current liabilities	3,212,415	2,633,628	22%	2,853,143	13%
Revolving credit line - current portion	2,500,000	1,100,000	127%	0	NM
Total current liabilities	15,145,692	13,750,375	10%	10,269,743	47%
Long-term liabilities					
Deferred tax liability	3,738,500	3,738,500	0%	3,799,600	-2%
Revolving credit line - long term	2,500,000	2,500,000	0%	0	NM
Other long-term liabilities	193,839	361,317	-46%	701,957	-72%
Total long-term liabilities	6,432,339	6,599,817	-3%	4,501,557	43%
Total Liabilities	21,578,031	20,350,192	6%	14,771,300	46%
Stockholder's equity					
Total stockholders' equity	13,495,809	14,584,317	-7%	11,682,104	16%
Total liabilities and stockholders' equity	$35,073,840	$34,934,509	0%	$26,453,404	33%
Quick Ratio	0.8	0.8	-6%	0.9	-18%
Working Capital	(3,347,678)	(2,346,592)	43%	(557,773)	500%
Cash as % of assets	10%	11%	-7%	15%	-31%
Cash per share	$0.13	$0.15	-11%	$0.16	-20%
Debt % of assets	14%	10%	38%	3%	431%

CASH FLOWS

	Year	3 Months Ended	3 Months Ended	3 Months Ended	3 Months Ended	Year	3 Months Ended	3 Months Ended
	2015	3/31/16	6/31/16	9/30/16	12/31/16	2016	3/31/17	6/30/17
Operating activities:								
Net income	2,339,774	374,274	(574,828)	(263,073)	(229,308)	(772,584)	(1,693,054)	(1,382,371)
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
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
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
Stock based compensation	707,544	359,338	327,110	315,596	262,222	1,264,266	292,334	293,825
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)
Prepaid expenses and other assets	(19,370)	64,747	50,986	22,597	81,326	219,656	109,577	(124,826)
Accounts payable	4,545,906	(2,411,075)	(247,496)	628,475	1,407,548	(622,548)	(2,844,928)	(583,470)
Accrued expenses and other liabilities	(1,054,363)	(299,033)	4,105	(54,941)	(71,006)	(420,875)	(989,738)	434,059
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)
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)
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)
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)	-	-
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)
Treasury stock repurchase						(22,499)		
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
Effect of exchange rate changes	-	-	-	-	-	-	-	-
Net change - cash	542,679	176,333	(458,744)	(336,682)	500,405	(310,400)	(23,287)	(242,806)
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
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
Supplemental information:								
Interest paid	122,136	18,063	16,466	20,556	17,666	72,751	25,317	79,745
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	-	-	-	-	-	-	-

STOCK PRICE CHART

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