

**Yelp Inc.**  
NYSE:YELP

**Analyst:** Benjamin Linaud  
**Sector:** Internet Services

**BUY**

**Price Target: \$62**

### Key Statistics as of 04/15/2015

Market Price: \$49.57  
Industry: Internet Software and Services  
Market Cap: \$ 3,699.8 M  
52-Week Range: \$42.10-86.88  
Beta: 2.55

### Thesis Points:

- Oversold on last earnings, less risk than expected
- Underestimate revenue from new services and international market
- Acquisitions will allow Yelp to have a more constant revenue stream
- Margin will increase faster than expected from lower SG&A expenses

### Company Description:

Yelp Inc. operates a platform that connects people with local businesses in the United States. Its platform covers various local business categories, including restaurants, shopping, beauty and fitness, arts, entertainment and events, home and local services, health, nightlife, travel and hotel, auto, and others categories. The company provides local advertising services, including free and paid business listing services to businesses of various sizes, as well as enable businesses to deliver targeted search advertising to large local audiences through its Website and mobile app. It also offers brand advertising services comprising advertising solutions for national brands in the food and restaurant, automobile, financial services, logistics, consumer goods, and health and fitness industries that want to improve their local presence in the form of display advertisements and brand sponsorships. In addition, the company provides other services, including Yelp platform, which allows consumers to transact directly on Yelp; Yelp deals that allows local business owners to create promotional discounted deals for their products and services; and gift certificates products for local business owners to sell full-price gift certificates directly to customers. It serves customers in Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, the Czech Republic, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. It has a strategic partnership with YP to display YP business owner profile data on company's platform. The company was founded in 2004 and is headquartered in San Francisco, California.



## Thesis

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Yelp has been oversold in the recent quarter based on investor concerns about future growth, risk coming from the Google algorithm dependency, and operating leverage. Growth is underestimated and should be faster than estimates. Recent acquisitions allowed the company to reduce its costs and allowed Yelp to introduce new services to enhance consumer experience, drive daily engagement in key restaurants vertical which means an increase of loyalty from customers and a more consistent revenue stream. Sales and Marketing expenses represent the major costs for the company. However, these expenses already are decreasing significantly as a percentage of revenue and will decrease in the future, increasing considerably EBITDA margins and creating value for shareholders. The recommendation is a buy with a target price of \$62 based on the proforma presented on the last page of this report, a potential increase of 25.13%.

## Porter's Five Forces

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Bargaining power of suppliers for YELP is low as inputs have no impact on costs. Low costs positively impact YELP. As a result the company has a lot of room to decrease its operating costs as most of them are selling and administrative expenses.

Bargaining power of consumers is high even if there are a large number of customers. Consumers have low dependency on the product and are able to use Google to make similar researches. YELP is highly dependent on visitors and reviews from customers who have no switching costs on the product.

Threat of substitutes is medium for YELP. Some bigger players such as Google, Facebook, or Yahoo can propose similar services. Switching costs are low but substitute products are inferior in quality and have lower performances.

Threat of new entry is low even if entry barriers are low. YELP disposes of a high learning curve coming from its experience. Customers are loyal to the company and new services available on the platform have recently increased the relationship between the company and its users. Costs of marketing are high for this business and represent the highest percentages of total costs. As a consequence, new competitors would have to spend too much money to build a brand name without necessarily having the expected return on investment. YELP has

strong brand recognition and has already a strong distribution network, reducing the possibility of new entrants.

The intensity of exiting rivalry is high. Competitors have bigger names (Trip Advisors, Google, Yahoo, and Facebook) and the industry is one of the largest in size. There are low storage costs and a fast industry growth rate, making it difficult for companies to follow the trend.

On the other hand YELP has a unique business model and has been able to build a name in this environment thanks to some competitive advantages. Its business model benefit to both customers and the business community, therefore YELP is more a community solver rather than a technology solver. The company competes on the basis of a number of factors. It competes for consumer traffic on the basis of factors including: the reliability of its content; the breadth, depth and timeliness of information; and the strength and recognition of its brand. Yelp competes for local businesses' advertising budgets on the basis of factors including: the size of its consumer audience; the effectiveness of its advertising solutions; its pricing structure; and recognition of its brand. YELP is broader than Trip Advisors and is looking on other businesses than hotels or restaurants, such as haircut, tattoo, bars, and so on. The company's model is unique and the number of reviews on the platform shows their advantages to the competitors. For example, YELP has about six times as many reviews as Google for a given business (studies on a sample of 500 businesses). YELP's ability to build a competitive positioning allowed the company to do better in the past years than its industry.

## Financials vs Industry

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Revenue grew at 62% versus 15.71% for its average industry. ROE is 6.79% compared to a negative 5.75% for the industry showing that Yelp has a better ability to generate profit with the money that has been invested by shareholders. ROIC is 6.73%, again much better than a negative 3.84% compared to its industry average. Most importantly, gross margins are 93.54%, or 30% higher than its competitors. This shows that the company has almost no cost of revenue and will be able to focus on operating costs reduction in the future to increase operating margins. EBITDA margins are 7.59%, 4% higher than 3.26% average for the industry. In addition the company has no debt and has a current ratio of 12.29x, 4 times higher than its competitors. Overall,

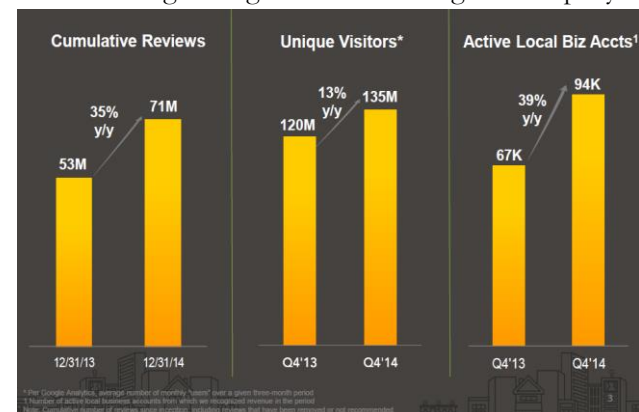
YELP is doing better than its industry in terms of profitability, debt management and liquidity.

## Past Performances

Yelp Metrics Data Sheet	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
<b>Traffic and Engagement Metrics (thousands)</b>								
Total Unique Visitors	102,065	108,058	117,447	120,005	132,460	137,761	139,418	135,399
Desktop Unique Visitors	71,809	73,366	78,179	77,713	82,211	81,884	80,468	77,628
Mobile Unique Visitors	40,168	45,064	50,455	52,905	61,190	67,886	73,440	72,307
International Unique Visitors	15,970	17,120	21,462	25,750	31,124	30,965	30,149	30,837
Cumulative Reviews	39,103	42,526	47,322	52,757	56,905	61,342	66,592	71,232
Cumulative Int'l Reviews	1,989	2,319	3,551	5,802	6,168	6,525	7,013	7,468
Percentage of Searches on Mobile	57%	59%	62%	59%	60%	61%	64%	65%

YELP has been over sold in the recent quarter based on a decrease of total visitors on the platform. However, Q3 to Q4 has been the unique sequentially decline of users for the company. Investors see this decrease as a threat for future growth and do not believe that margins could increase much faster as well. Though, when looking at the previous four quarters, Yelp was often less performant than in other quarters. During Christmas and Thanksgiving, people use Yelp less often as they are spending more time at home with family during those periods of the year. The chart above shows that from 3Q13 to 4Q14 Yelp performed less than in other quarters and desktop unique visitors decreased from 78,179 to 77,713 visitors.

Another concern of investors is the reduction of users coming from desktops unique visitors in recent quarters. This comes from an increase of mobile devices user which is up by 37% year-over-year. This is in fact something positive for the company as it decreases its dependency from Google. About 65% of searches are now on mobile and this percentage should grow in the future years. Less dependency on Google is reducing the risk of a change of algorithm from the giant company.



Investors were also concerned of a decrease in reviews which still grew at 35% from last year and monthly unique visitors grew by 13%. Active local businesses

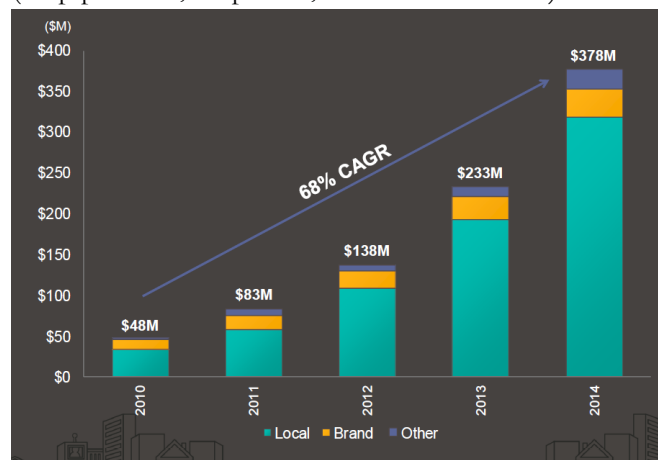
accounts grew fast at 39% (chart above).

YELP has been able to beat analyst estimates in all the major earning departments and have been oversold based on concerns about future growth, future margins, and risks coming from a dependency from Google which is in fact decreasing years-over-years.

## Underestimated Growth

Year Ended December 31,	2014	2013	2012
<b>Percentage of total net revenue by product:</b>			
Local advertising	85%	83%	79%
Brand advertising	9	12	15
Other services	6	5	6
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Yelp generates revenue primarily from the sale of advertising on its website and mobile app to businesses. During the year ended December 31, 2014, it generated net revenue of \$377.5 million, representing 62% growth over 2013, a net profit of \$36.5 million and an adjusted EBITDA of \$70.9 million. Revenue is recognizing from local advertising, brand advertising and other services (Yelp platform, Yelp deals, and Gift certificates).



As shown on the graph above the company has been growing at an impressive 68% CAGR from 2010 to 2014. YELP should be able to sustain growth in the future thanks to its recent acquisitions and international expansion in major countries. The company is already present in 29 countries which represent only 7.4% of its total revenue. Yelp is only monetizing for the moment in about eight countries. In addition, YELP just launched the platform in Japan this year and Brazil, Mexico and other countries in April 2014. YELP estimates that in three years only the company will be able to monetize these countries representing a gigantic opportunity for the company. The company has actually \$377.5 million in revenue, targets \$577.6 million the next year and should reach \$1 billion in 2017 before even starting to

monetize major countries.

Past acquisition will also allow YELP to increase its revenue stream.

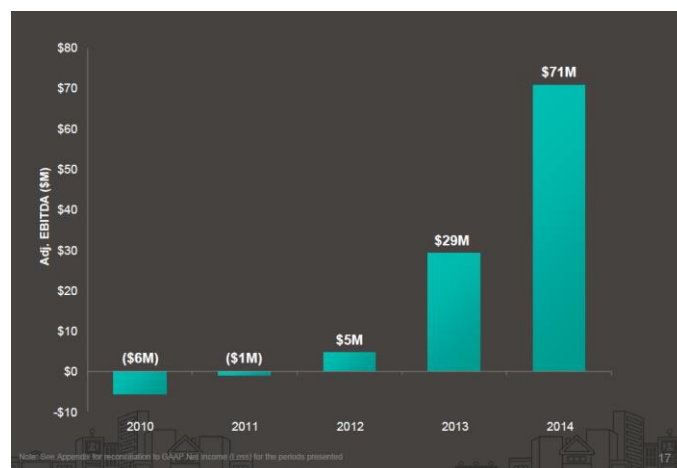
## Acquisitions

YELP acquired SeatMe the 24th of July 2013 and recently acquired Eat24 (02/09/2015). These two acquisitions already helped the company to reduce its cost and will help it to increase its revenue stream in the future by increasing consumer engagement and relationship. SeatMe was a company with a reservation system that allowed YELP to also increase its customer by 200. Almost 18 month later, SeatMe had 8,000 paid and unpaid customers, free product called Yelp reservation and \$19 million seated dinner in 2014. This is the proof that Yelp is able to ally a good product and technology with its important traffic and see that kind of impressive growth. OnTable is also on Yelp and now customers do not have to leave the app to make reservations, which increases customer engagement and relationship with the company. This is driving more transaction and is increasing consumer loyalty. The recent acquisition of Eat24 (at 3.7x 2015 revenue, a discount to GrubHub's multiple of 8.5x), shows that YELP continues to focus on closing the loop with its SMB customers by providing consumers, data, and transactions. This should help Yelp in the future to enhance daily engagement in the restaurant vertical by giving consumers the ability to execute on reviews' driven impulses. The number of advertisers grew by 54% on the platform in the last quarter and the acquisition of Eat24 will improve interactions with local businesses and build longer relationship with customers. It will enhance consumer experience, drive daily engagement in key restaurant vertical and expand offerings to one million listed U.S restaurants.

The market reacted positively but prudently to this acquisition with an increase of the stock price of 11% from 02/09/2015 to today, from \$44.66 to \$49.57. With those acquisitions, Yelp is still debt free; still have 58.1% of its total asset in cash. The company has been able to reduce its costs and will be able to have a constant revenue stream in the future thanks to a higher consumer loyalty.

As a result, margins have increased and will increase faster in future years, allowing the company to generate free cash flows and value.

## Higher Margins



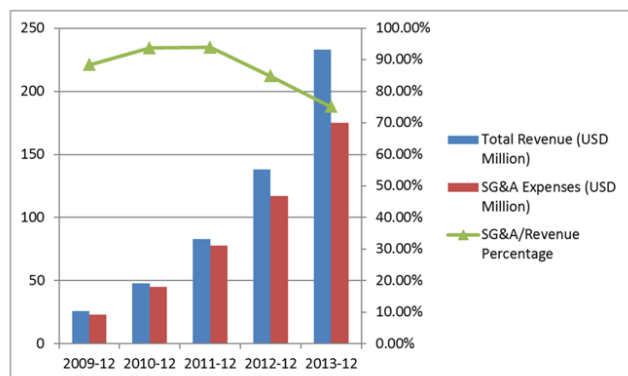
Investors are concerned about future margins and do not believe that there is possible leverage for YELP. They had the same concern a year ago and the company was able to more than double its EBITDA margins from 7.6% to 18.5% in 2014. The graph above proves that there is actually significant leverage in this company with a growth in adjusted EBITDA of 145% from 2013 to 2014. EBITDA Margins are expected to increase slightly to 19% in 2015 due to an important increase in marketing expenses. Yelp spent about \$10 million last year and is expecting an incremental \$20 million in 2015. On the other hand future margins will increase much faster and should increase in the longer term to 35% and to 40%

Costs and expenses:	2014	2013	2012
<b>Cost of revenue (exclusive of depreciation and amortization shown separately below)</b>	<b>7%</b>	<b>7%</b>	<b>7%</b>
<b>Sales and marketing</b>	<b>53</b>	<b>57</b>	<b>62</b>
<b>Product development</b>	<b>17</b>	<b>16</b>	<b>15</b>
<b>General and administrative</b>	<b>15</b>	<b>18</b>	<b>23</b>
<b>Depreciation and amortization</b>	<b>5</b>	<b>5</b>	<b>5</b>
<b>Restructuring and integration</b>	<b>—</b>	<b>—</b>	<b>1</b>
<b>Total costs and expenses</b>	<b>97</b>	<b>104</b>	<b>113</b>

When looking at the cost structure (table above), it is clear that most of the costs are coming from sale and marketing expenses, representing 53% of net revenue in 2014. Those expenses are also long term investment and will generate more revenue in the future allowing revenue to grow faster than expenses. Yelp started to generate positive free cash flows only in 2013 and it is understandable as total costs became less than 100% of revenue in 2014. This shows that there is a lot of room for the company to decrease its costs as it is coming mainly from marketing.

EBITDA margins will increase significantly as the firm will require lower SG&A expenses

future years, increasing free cash flows and creating value for shareholders. In addition, the company is debt free and has 58.1% of its total assets in cash. The company relies on Google, competes with Yahoo, TripAdvisor and Facebook, making it also a possible target for an acquisition. The recommendation is a buy.



The graph above shows that SG&A as a percentage of revenue is decreasing consequently over the years. There should be lower costs coming from advertising in the future as the company already has a strong name and is well known around the world. A slight decrease in advertising expenses should substantially increase margins in the future.

## Valuation

A valuation has been done on the next page of this report. The valuation has been done based on the return on capital rather than in ROIC. The beta has been chosen on the Sub-Industry historical median of 1.12. It has been increased to 1.2 considering the risk associated with the dependency on Google's algorithm. Operating expenses as a percentage of revenue have decreased from 82.3% to 80% based on fewer expenses in marketing in the future. Long term revenue growth has been fixed at 5% considering the faster growth of this industry. R&D and SG&A expenses have been capitalized has those expenses represent the major costs of the company and are its main long term investment. The target price is \$62, representing a potential increase of 25.13%.

## Conclusion

YELP has significant room for revenue growth coming from growth in users, international expansion, and higher loyalty coming from new services. Recent acquisitions brought more customers for yelp but also helped the company to reduce its costs. Significant operating leverage is possible as most of the costs are coming from marketing expenses which are decreasing considerably as a percentage of revenue over the years. EBITDA margin will increase faster than expected in the

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<b>Yelp Inc.</b>	<b>YELP</b>	Analyst <b>TYPE YOUR NAME HERE</b>	Current Price <b>\$49.57</b>	Intrinsic Value <b>\$67.06</b>	Target Value <b>\$62.05</b>	Divident Yield <b>0%</b>	Target Return <b>1-y Return: 25.17%</b>	<b>NEUTRAL</b>															
<b>General Info</b>		<b>Peers</b>		<b>Market Cap.</b>		<b>Management</b>																	
Sector	Information Technology					<b>Professional</b>	<b>Title</b>	<b>Comp. FY2012</b>	<b>Comp. FY2013</b>	<b>Comp. FY2014</b>													
Industry	Internet Software and Services					Stoppelman, Jeremy	Co-Founder, Chief Executive Offi	\$340,657	\$8,097,964	\$66,913													
Last Guidance	Feb-10-2015					Krolik, Robert	Chief Financial Officer	\$311,409	\$3,007,548	\$338,533													
Next earnings date	4/29/2015					Donaker, Geoff	Chief Operating Officer and Direct	\$311,371	\$6,243,727	\$23,232													
<b>Market Data</b>						Wilson, Laurence	Senior Vice President of Legal & U	\$305,983	\$3,003,245	\$333,233													
Enterprise value	\$3,333.96					Nadman, Joseph	Senior Vice President of Revenue	\$487,919	\$3,162,205	\$619,481													
Market Capitalization	\$3,699.77					Sollitto, Vince	Vice President of Corporate Comm	\$0	\$0	\$0													
Daily volume	5.40					<b>Historical Median Performance</b>																	
Shares outstanding	74.64					<b>YELP</b>		<b>Peers</b>		<b>Industry</b>		<b>All U.S. firms</b>											
Diluted shares outstanding	76.71					Growth	55.5%	0.0%	13.8%	7.4%													
% shares held by institutions	82.78%					ROC	8.5%		11.3%	11.8%													
% shares held by insiders	13.71%					NOPLAT Margin	36.0%		10.7%	10.4%													
Short interest	11.63%					Revenue/Total Capital	0.24		1.06	1.13													
Days to cover short interest	2.73					Excess Cash/Rev.	N/A	#DIV/0!	13.5%	12.9%													
52 week high	\$86.88					Total Cash /Rev.	96.9%	#DIV/0!	12.3%	15.2%													
52-week low	\$42.10					Unlevered Beta	3.04		1.12	0.95													
5y Beta	2.55					TEV/REV	9.5x		3.9x	2.5x													
6-month volatility	59.99%					TEV/EBITA	16.1x		17.5x	13.1x													
						PE (normalized and diluted EPS)	29.1x		33.9x	23.5x													
						P/BV	1.8x		2.5x	2.2x													
						<b>Non-GAAP Adjustments in estimates computations</b>																	
						Operating Leases Capitalization	100%	Straightline		10 years													
						R&D Exp. Capitalization	100%	Straightline		10 years													
						Expl./Drilling Exp. Capitalization	0%	N/A		N/A													
						SG&A Capitalization	100%	Straightline		10 years													
						<b>Forecast</b>																	
						<b>Period</b>		<b>Rev. Growth</b>		<b>Adj. Op. Cost/Rev</b>		<b>Capital</b>		<b>NOPLAT Margin</b>		<b>ROC</b>		<b>WACC</b>					
						LTM	62.0%	82.3%	\$2,347.98	37%	6.0%	9.1%											
						NTM	56.3%	82.0%	\$1,326.77	22%	5.5%	9.1%											
						NTM+1	50.6%	81.8%	\$1,662.93	21%	14.4%	9.0%											
						NTM+2	44.9%	81.6%	\$2,073.00	21%	16.4%	9.0%											
						NTM+3	39.2%	81.4%	\$2,538.49	21%	18.2%	9.0%											
						NTM+4	33.5%	81.1%	\$3,107.24	21%	19.7%	9.0%											
						NTM+5	27.8%	80.9%	\$3,775.16	21%	20.5%	9.0%											
						NTM+6	22.1%	80.7%	\$4,525.51	21%	20.6%	9.0%											
						NTM+7	16.4%	80.5%	\$5,329.05	21%	20.1%	9.0%											
						NTM+8	13.0%	80.2%	\$6,181.75	21%	19.4%	9.1%											
						Continuing Period	9.0%	80.0%	\$17,906.70	12%	12.0%	9.2%											
						<b>Valuation</b>					<b>Pricing Model</b>												
						<b>Period</b>		<b>Capital x (ROC-WACC)</b>		<b>Total Debt</b>		<b>Other non-interest bearing claims</b>		<b>Shares Outstanding</b>		<b>DCF (Weight = 100%)</b>		<b>Relative (Weight = 0%)</b>		<b>Distress (Weight = 0%)</b>		<b>Weighted Average Price Per Share</b>	
						LTM	\$0.00	\$0.00	\$434.66	74.64	\$68.02	\$47.79	\$72.04	\$68.02									
						NTM	-\$84.98	\$0.00	\$509.71	74.64	\$62.80	\$46.32	\$60.85	\$62.80									
						NTM+1	\$70.96	\$0.00	\$617.07	74.64	\$71.13	\$68.45	\$69.82	\$71.13									
						NTM+2	\$122.54	\$0.00	\$762.20	74.64	\$78.65	\$97.73	\$77.52	\$78.65									
						NTM+3	\$189.33	\$0.00	\$947.08	74.64	\$86.11	\$134.39	\$85.04	\$86.11									
						NTM+4	\$271.13	\$0.00	\$1,160.64	74.64	\$94.48	\$178.74	\$92.94	\$94.48									
						NTM+5	\$357.69	\$0.00	\$1,293.75	74.64	\$102.92	\$230.33	\$102.04	\$102.92									
						NTM+6	\$438.53	\$0.00	\$1,542.55	74.64	\$110.71	\$282.85	\$109.61	\$110.71									
						NTM+7	\$500.34	\$0.00	\$1,710.74	74.64	\$118.92	\$333.67	\$117.62	\$118.92									
						NTM+8	\$548.45	\$0.00	\$1,865.57	74.64	\$124.73	\$382.80	\$125.36	\$124.73									
						Continuing Value	\$3,970.89																