

Perion Network Ltd

NASDAQ:PERI

Analyst: Sofian Belhadj

Sector: Technology

BUY

Price Target: \$5.3

Key Statistics as of 3/18/2015

Market Price:	\$3.24
Industry:	Business Software & Services
Market Cap:	\$226.5 M
52-Week Range:	\$3.11-11.86
Beta:	2.36

Thesis Points:

- A shift from desktop advertising to mobile advertising automated
- Expected revenue greater than estimated
- A worldwide presence diversity the risk

Company Description:

Perion Network Ltd., a digital media company, provides products and services to consumers focusing on second wave adopters. The company's products include IncrediMail, a communication client, which is used for managing email messages and Facebook feeds, and offers various graphic and personalizing capabilities, as well as Molto, an email application for the iPhone; Smilebox, a Internet photo sharing and social expression for desktops and smart-phones; and Sweet IM, an instant messaging application. It also offers CodeFuel solution, which provide publishers and developers monetization opportunities through DisplayFuel, a browser extension that offers recommendations, deals, coupons, and relevant content to users as they browse online, as well as through InstallFuel platform, offers developers the ability to incorporate ads into the download and installation process of their software. In addition, the company operates ClientConnect, a cloud-based platform, which allows online publishers to create, implement, and distribute Web browser toolbars and other monetization tools and services to targeted audiences. The company is headquartered in Tel Aviv, Israel.



Thesis

Perion challenge is to be able to fight competitors that are bigger in size and also in market shares.

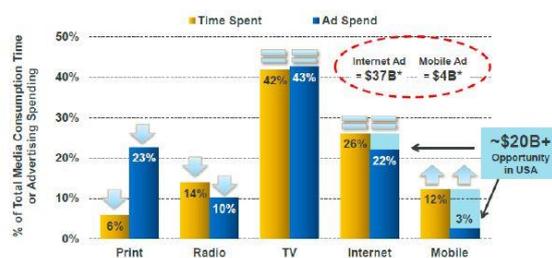


Perion is able to control 2% of the US search market for desktop search, which is lower than google with 67% of the market share and Microsoft with Bing has 18% of the market share. The potential of PERI are enormous considering the changement of business model that would be effective on the next two quarter of 2015. The mobile advertising business automatized to reach customers that is the right user is growing with the growing data possibly and a significant growth opportunity and leverage core competencies that Perion concentrate with acquisition of two companies for the past year. It is an opportunity for investors to enter in a position in a multibillion dollar business when the mobile advertising platform would effective for PERI in the mid-2015 and 2016.

Macro overview Mobile advertising

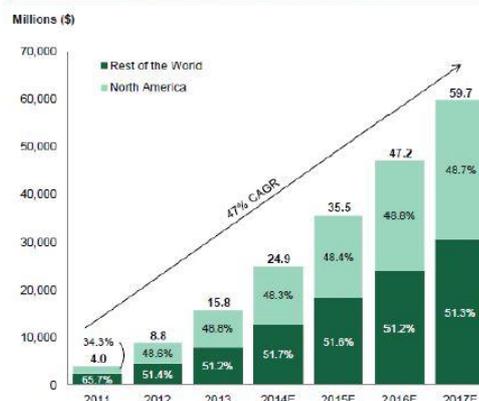
The mobile advertising is an industry that is growing at fast pace since the mutation from desktop to mobile started with the introduction of smartphone. The important input is the times spent on the device versus the money spend on coverage of the media. As an example the TV commercial represent 43% of time spent by household and also 43% on the advertising budget.

% of Time Spent in Media vs. % of Advertising Spending, USA 2012



As a comparison the advertiser spend 3% of the total budget spent on advertising for a 12% of time spent in 2012. The advertising on mobile has the potential just in the US to reach \$20B. The forecast of the mobile ad spending is expected to grow at a 47% per year until 2017 for worldwide spending budget.

Mobile Ad Spending by Region, 2011 - 2017



Source: eMarketer 2013
Note: Rest of World does not include Hong Kong

The specificity on the business is complicated because advertiser to be effective have to match with their client preference, in other world the objectives is to 'Put the right ad in front of the right user at the right user at the right time automatically. The companies on this industry are competing with their algorithm for which has the best conversion rate for seeing the ad to purchasing the item. The advertising on mobile display witch is the automatic marketing had grown at a 20% per year CAGR from 2011-2015.

Figure 1: Global Display Advertising Spend, \$B



Source: Deutsche Bank, Zenith Optimedia

The mobile display advertising is the fastest growing segment on the display Ad market. Despite a research report from the Deutsche Bank It was a \$5B market in 2013 and is expected to reach \$14B in 2016 with a 59% CAGR.

Management

Perion management has proven to be effective in the past years when they decided to stop the dividend distribution that lead them to have a build up in cash that enable to make crucial acquisition because they look forward on the advertising business. The management is focusing on their mutation phase, they started cutting their cost by reducing their staff in a shrinking business with desktop business mostly controled by google and microst. A reduction on 20 % on their staff that accrued a \$4 million one timer expense with the reorganization. The mangement is also drastically reducing their marketing expense for the next 2 years. Despite the management the company is experiency economy of scale with the acquisition of GrowmobileINC San Francisco company and Makemereach SAS a a French company. The CEO bought \$50,000 in 2014 at \$7.40 and in the earnings call says that it would happen again. The management looks confident about the future transformation of their business model and especially because they have a vision to aggressively enter into the mobile advertising business.

Ownership

The director EREZ DROR own 13.79% of the total shares, he is the founder of the largest internet company in Israel. Ronen Shilo who is an Israeli entrepreneur who

is considered as an innovator and software technologist own 13.93% of the total shares. Benchmark Capital is an American venture capital firm responsible for the early stage funding of several successful startups including Twitter, Uber, Snapchat, and Instagram own 13.64% of the company. Rinat Zack and Rinat Jacques who is also an entrepreneur who created Model N (NYSE:MODN) own 9.18% respectively.



The owners of PERI seems very establish investors had worked on software technology or the technology business and did not sell any shares since their acquisition.

A shift from desktop advertising to mobile advertising automated:

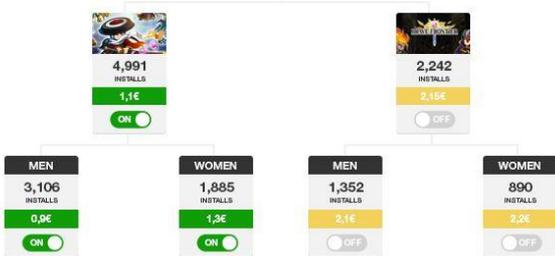
The business model will expand into mobile which is different from the advertising technology used on PC. It would require a different approach of the business, in order to run a campaign a brand need single point's solutions and used around 12 different systems. The results are poor campaign performance and a low ROI. Perion acquired GrowMobile to solve the problem of mobile advertising that provide an end to end solution for running advertising campaign and measure the analytics and technical integration. With GrowMobile, data from all traffic sources and campaigns is compiled in easy-to-understand graphs and tables, enabling immediate analysis and effective action. The objective it to scale the campaign and make it flexible witch mean that advertisers could adapt easily in function of their changing need. The GrowMobile platform enables Perion to retarget high quality users when needed

without using any other external source. The technology is well managed by PERI and is easily visible with graphs table to make intelligent decision for company. The result was a dashboard that brings in 75+ different marketing sources, including ad networks, ad exchanges and more, where app publishers can plan their media campaigns, spend their marketing budgets and then track the results.



The beta version of the 'self-serve advertising platform' had been launched and the final version is expected to be available in the coming months. Peri

The second acquisition is MakeMeReach a French premium social advertising startup that had doubled its revenue year to year in 2014. The company enables PERI to have strong European presence with Facebook, twitter marketing. The objective of MakemeReach is to simplify the creation process to the management of a campaign on the major social media.



The objectives are simplified and have a clear view of what is happening with the advertising campaign. The advantage is that specific data of customers that convert the most which mean most reactive to the campaign that can be converted into a profitable target. The time frames of the campaign are also computed in order for marketer to boost the campaign performance.

The two company acquired already have \$80 million in

managed revenues and are key to the success of the shift from desktop to mobile for Perion.

Expected Revenue greater than estimated

Perion has been moving away from its previous business model of working with search engines, especially Google, to distribute software for desktop, and moving towards optimizing mobile campaigns. PERI was very dependent on Google which had changed their policy multiple times and for that reason Perion had been on trouble with google search engine. Chrome made significant change that despite Perion passed the issue with Google but also with Microsoft and are now working together with the search protection mechanism. The company's stock had decreasing since the market was wrong about a thesis: Google search engine change their policy but it was only in Google Chrome. The current environment is positive for Perion in the next coming quarter because the previous news had damaged PERI core business.

The management lowered their expectation on revenue saying that it would be lower by \$7 million to \$10 million with an unchanged EBITDA. Currently the company's EV/EBITDA is trading at 1.5x compared to 16.5x for its peers. The company's P/V is trading at 0.9x compared to 4.7x for its peers. Perion EBITDA Margin is about 26% compared with the peers that have an average of 20%. The EBIT/Interest Expense of PERI is 27.4x compared with only 9.1x for the company peers. The Altman Z score of Perion is 8.45 which are very far from the possibility of bankruptcy compared with 3.16 for the average peers. Most of the multiple that depict Perion are showing that the company is unevaluated compared to its peers.

A global presence to diversify the risk

The company is power to be a leader in the mobile advertising business because Perion has the advantage of having workforce around the world that is targeting clients in France and Spain, Italy, Germany, and a little bit of Scandinavia and UK is probably, from a client basis, 50%-plus of our clients. The Asia-Pacific represents about 10% that has the potential to reach the level of Europe. The US market is representing 30% to

40% of the revenues. The company has the potential to grow domestically in the US with the acquisition of a San Francisco company and also in Europe with the acquisition of a Paris based company. The company is in line with their shift from desktop to mobile by having an allocation of revenue internationally that have a potential to continue growing.

10.7% leading to an Economic Value Added spread of 5.7%.

All these assumptions are considered conservative regarding company's potential and leads to a 1 year target price of \$5.3, representing an upside potential of 62% based on current market price.

Conclusion

Perion is an undervalued company that is in total mutation in term of business model. The company is very strong concerning their fundamental even if for the moment the market is not understanding that the Q1 could potentially see a reduce amount in term of benefit. The potential for investors are very interesting when we know that most of the owner of the stock are people that worked on the technological business and are entrepreneur that know the hidden potential of the company. The management has the capacity to perfectly integrate the company into the mobile market advertising and have dominant market share that clearly indicate confidence.

Valuation

The valuation of Perion has been made using a proforma that is presented on the last page of this report.

Revenue growth for FY2015 has been estimated at -44.8%, FY2016 has been estimated at 10% in line with consensus estimations, and rapidly decremented by 2% year after year to a long term growth of 3% this growth is considered conservative regarding the company's growth potential over next years and according to its business remodeling and Investments in new businesses.

Operating costs over revenues have been increased from 74.1% for FY2014 to 74.5% by 0.5% increments. This increase is also conservative regarding the company's initiatives put in place to gain in productivity and economy of scale made with two acquisitions.

The 10 year median for the company is 74.1% but has been accounted at a long term level of 80%. Return on Invested Capital is expected to be 16.4% during FY 2015 compared to a Weighted Average Cost of Capital of

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Perion Network Ltd.		PERI	Analyst Sofian Belhadi	Current Price \$3.25	Intrinsic Value \$5.15	Target Value \$5.26	Dividend Yield 0%	Target Return 61.97%	BULLISH				
General Info		Peers		Market Cap.		Management							
Sector	Information Technology	Blucora, Inc.		\$591.85	Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014				
Industry	Internet Software and Services	Rocket Fuel Inc.		\$413.41	Horowitz, Corey	Chairman and Chief Executive C	\$ 1,026,000.00	\$ 1,128,500.00	\$ 1,370,400.00				
Last Guidance	Feb-25-2015				Kahn, David	Chief Financial Officer, Secretary :	\$ 193,000.00	\$ 185,000.00	\$ 212,830.00				
Next earnings date	NM				Greene, Jonathan	Executive Vice President and Me	\$ 294,000.00	\$ 253,000.00	\$ 254,160.00				
					Olsen, Robert	0	\$ -	\$ -	\$ -				
					Ranum, Marus	Other Professional	\$ -	\$ -	\$ -				
Market Data						Historical Performance							
Enterprise value	\$152.75					PERI	Peers	Industry	All U.S. firms				
Market Capitalization	\$228.93					Growth	21.7%	12.4%	6.0%				
Daily volume	0.08					Retention Ratio	0.0%	462.2%	61.6%				
Shares outstanding	70.66					ROIC		16.0%	11.8%				
Diluted shares outstanding	70.33					EBITDA Margin	0.0%	10.6%	14.1%				
% shares held by institutions	10.98%					Revenues/Invested capital	149.3%	81.9%	132.0%				
% shares held by insiders	36.90%					Excess Cash/Revenue	#DIV/0!	96.5%	54.8%				
Short interest	0.21%					Unlevered Beta	1.30	1.14	0.95				
Days to cover short interest	1.29					TEV/REV	0.6x	7.8x	3.9x				
52 week high	\$11.77					TEV/EBITDA	2.5x	101.0x	16.7x				
52-week low	\$3.11					TEV/EBITDA	3.1x	110.2x	19.9x				
5y Beta	0.00					TEV/UFCF		201.0x	30.5x				
6-month volatility	54.36%					Non GAAP Adjustments							
						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	0%	N/A	N/A				
						Forecasted Profitability							
						Revenue	NOPLAT	Invested capital	UFCF				
						\$388.73	\$88.09	\$260.43	\$88.09				
						\$214.58	\$42.62	\$305.52	-\$2.47				
						\$236.04	\$40.57	\$337.60	\$8.49				
						\$254.92	\$39.12	\$366.68	\$10.03				
						\$270.22	\$37.77	\$392.56	\$11.89				
						\$281.02	\$36.23	\$415.08	\$13.71				
						\$289.46	\$34.82	\$434.03	\$15.87				
						\$298.14	\$33.96	\$449.16	\$18.82				
						\$307.08	\$33.39	\$462.20	\$20.35				
						\$316.30	\$33.12	\$472.87	\$22.45				
						Proforma Assumptions							
						Period	Rev. Growth	Adj. Op. Cost/Rev					
						LTM	0%	61%					
						LTM+1Y	-45%	55%					
						LTM+2Y	10%	57%					
						LTM+3Y	8%	59%					
						LTM+4Y	6%	61%					
						LTM+5Y	4%	62%					
						LTM+6Y	3%	63%					
						LTM+7Y	3%	64%					
						LTM+8Y	3%	65%					
						LTM+9Y	3%	65%					
						Valuation							
						ROIC	WACC	EVA	Enterprise Value	Total Debt	Other claims	Equity	Adjusted Price
						33.8%	10.4%	\$60.91	\$341.89	\$40.00	-\$116.18	\$418.07	\$5.90
						16.4%	10.7%	\$17.27	\$325.83	\$40.00	-\$128.01	\$413.84	\$6.01
						13.3%	10.8%	\$8.24	\$340.08	\$40.00	-\$160.41	\$460.49	\$6.69
						11.6%	11.0%	\$2.31	\$359.58	\$40.00	-\$199.03	\$518.61	\$7.53
						10.3%	11.1%	-\$3.05	\$381.36	\$40.00	-\$241.29	\$582.65	\$8.45
						9.2%	11.2%	-\$8.15	\$405.24	\$40.00	-\$285.26	\$650.50	\$9.44
						8.4%	11.3%	-\$12.65	\$431.32	\$40.00	-\$330.10	\$721.42	\$10.43
						7.8%	11.4%	-\$16.12	\$460.22	\$40.00	-\$375.77	\$795.99	\$11.49
						7.4%	11.5%	-\$18.91	\$491.32	\$40.00	-\$422.22	\$873.54	\$12.60
						7.2%	11.6%	-\$21.10	\$524.45	\$40.00	-\$469.45	\$953.90	\$13.50
						Monte Carlo Simulation Assumptions				Monte Carlo Simulation Results			
						Base	Stdev	Min	Max	Distribution	Intrinsic Value		1y-Target
						0	10%	N/A	N/A	Normal	Mean est.	\$5.90	\$6.01
						0	10%	N/A	N/A	Normal	σ(ε)	\$0.25	\$0.25
						6%	N/A	5%	7%	Triangular	3 σ(ε) adjusted price	\$5.15	\$5.26
						3%	N/A	3%	22%	Triangular	Current Price	\$3.25	
						0	0.1	N/A	N/A	Normal	Analysts' median est.		\$6.50

