

## Initial Research Report

*Investors should consider this report as only a single factor in making their investment decision.*

### Perion Network Ltd.

**Speculative Buy**

John Nobile

August 13, 2018

**PERI \$1.05 — (NASDAQ)**

	<u>2016A</u>	<u>2017A</u>	<u>2018E</u>	<u>2019E</u>
Revenues (millions)	\$312.8	\$274.0	\$264.7	\$295.5
Earnings (loss) per share	\$0.04	\$(0.94)*	\$0.15	\$0.36

52-Week range	\$1.35 – \$0.71	Fiscal year ends:	December
Common shares out as of 8/9/18	77.6 million	Revenue per share (TTM)	\$3.38
Approximate float	46.7 million	Price/Sales (TTM)	0.3X
Market capitalization	\$81 million	Price/Sales (FY2019)E	0.3X
Tangible book value/share	\$0.08	Price/Earnings (TTM)	NMF
Price/tangible book value	13.1X	Price/Earnings (FY2019)E	2.9X

\* Includes \$85.7 million or \$(1.10) per share of impairment charges.

Perion Network Ltd., headquartered in Holon, Israel, is a global provider of online advertising and search technology to brands and publishers. The company provides data-driven execution, from high impact ad formats to branded search and a unified social and mobile programmatic platform.

#### Key investment considerations:

*We are initiating coverage of Perion Network Ltd. with a Speculative Buy rating and twelve-month price target of \$2.25 per share.*

*Perion operates in the digital advertising industry. In the US, eMarketer projects digital ad spending to grow 18.7% to \$107.3 billion in 2018. US digital ad spending is projected to grow annually by 13.6%, reaching \$170.5 billion by 2022.*

*Perion exited 2017 and entered 2018 with the goal of optimizing its cost structure through cuts in SG&A spending and focusing on profitability.*

*In 2018, the company is increasing its R&D spending in an effort to accelerate growth in its advertising business.*

*Our forecast through 2019 anticipates strong cash earnings growth that should enable PERI to strengthen its balance sheet. At the end of 2019, we project Perion to have \$37 million cash (\$0.47 per share), a \$43.5 million reduction in debt from 2Q18, and shareholder's equity of \$184.6 million (\$2.33 per share).*

*For 2018, we project a 3.4% decrease in revenue to \$264.7 million and net income of \$12 million or \$0.15 per share. The decline in revenue will be primarily due to lower search sales related to the company's legacy products.*

*For 2019, we project an 11.6% increase in revenue to \$295.5 million and net income of \$28.3 million or \$0.36 per share. The increase in revenue will be primarily due to increased advertising sales stemming from the company's growing investment in its Undertone business.*

***\*Please view our disclosures on pages 14 - 16.***

## Recommendation and Valuation

**We are initiating coverage of Perion Network Ltd. with a Speculative Buy rating and twelve-month price target of \$2.25 per share.**

Perion exited 2017 and entered 2018 with the goal of optimizing its cost structure through cuts in SG&A spending and focusing on profitability while increasing its R&D spending in an effort to accelerate growth in its advertising operations. Our forecast through 2019 anticipates strong cash earnings growth that should enable PERI to strengthen its balance sheet. At the end of 2019, we project Perion to have \$37 million cash (\$0.47 per share), a \$43.5 million reduction in debt from 2Q18, and shareholder's equity of \$184.6 million (\$2.33 per share).

PERI trades at a forward EV/EBITDA multiple of approximately 2.7X our 2019 EBITDA forecast compared to 11.9X for industry peers (source: Thomson Reuters). We anticipate investors according PERI a multiple approaching that of the industry due to our estimated 2019 EBITDA growth in excess of 50%. Applying an EV/EBITDA multiple of 5X to our 2019 EBITDA/share projection of \$0.46, discounted to account for execution risk, suggests a year-ahead value of approximately \$2.25 per share.

## Organizational History


































The company was incorporated in the State of Israel in November 1999 under the name Verticon Ltd. and changed its name to IncrediMail Ltd. in November 2000. In November 2011, the company changed its name to Perion Network Ltd. Since 2011, Perion completed several acquisitions, including the acquisitions of ClientConnect Ltd. in 2014 and Interactive Holding Corp. in 2015, collectively referred to as Undertone.

The company completed its initial public offering of ordinary shares in the US in February 2006. Since November 2007, the company's ordinary shares also trade on the Tel-Aviv Stock Exchange (TASE).

## Business

Perion Network Ltd., headquartered in Holon, Israel, is a global provider of online advertising and search technology to brands and publishers. The company provides data-driven execution, from high impact ad formats to branded search and a unified social and mobile programmatic platform. Programmatic advertising refers to the buying of digital advertising space automatically, with computers using data to decide which ads to buy and how much to pay for them.

The company's Undertone division provides digital advertising across desktop, mobile (Web and App) and social channels. Undertone's customers receive support throughout the full campaign cycle, including planning, creative services, client solutions, campaign management, performance and insights. Some of Perion's advertising customers are shown in the table above.

AUTO	CPG	FIN SERVICES	PHARMACEUTICAL	RETAIL	TECH/TELECOM
					
					
					
					
					
					

Source: Perion Presentation

The company's social marketing platform, MakeMeReach, offers a dashboard for marketers that enables media buying to be more efficient. The MakeMeReach platform is used by more than 4,000 companies worldwide and enables advertisers to increase campaign performance by an average of 30% compared to common social tools.

Perion’s social marketing platform allows for customers to acquire users from top-performing social traffic sources such as Facebook, Twitter, Snapchat and Instagram, as well as access to their performance data and revenue information in one place in order to enable faster, more intelligent marketing decisions.

Advertisers can control their marketing expenditures on Perion’s social marketing platform. The platform has tools that advertisers can utilize to create operational marketing efficiencies. Perion’s customers receive ongoing analysis and optimization of their campaigns with the goal of increasing return on investment and scaling key performance indicators.

Perion’s search related products under its CodeFuel division enables end users to replace their search assets with the company’s. Perion’s search related products allow publishers to track and monitor their business performance. Perion’s relationship with Microsoft’s Bing enables the company to claim that CodeFuel can offer higher search payouts than most competitors on the market using the desktop Chrome extension and mobile launcher, and other browser apps.

Perion’s toolbar platform allows publishers to create, implement and distribute Web browser toolbars. The company’s consumer apps division delivers in-house mobile and desktop apps direct to consumers through its Smilebox and IncrediMail products. Smilebox is a photo sharing and social expression product, and IncrediMail is a unified messaging application that enables consumers to manage multiple email accounts in one place with an easy-to-use interface and extensive personalization features.

**Industry**

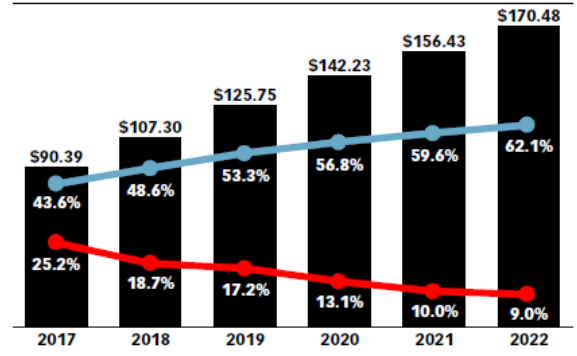
Perion operates in the digital advertising industry. An April 2018 report by the research firm eMarketer projects digital ad spending in the US to grow 18.7% to \$107.3 billion in 2018. Digital ad spending growth is projected to average 13.6% annually, reaching \$170.5 billion by 2022 (see chart at right). Mobile ad spending is anticipated to drive growth powered by innovative formats from top ad sellers. eMarketer projects mobile will account for 77.1% of digital ad spending in 2022, up from 67.2% in 2017.

eMarketer projects mobile ad spending of \$75 billion in 2018, up 23.5% from 2017. Mobile ad spending growth is projected to average 16.8% annually, reaching \$131.4 billion in 2022 (see chart at bottom right). Growth should be driven by increasing mobile commerce activity. eMarketer reports that mobile display ad placements have already surpassed those of desktop.

eMarketer said that while traditional media is expected to account for 51.4% of ad spending in 2018, it is quickly losing ground to digital media (such that Perion provides). Digital advertising is projected to surpass traditional media as a percentage of ad spending in 2019 with a 53.3% share. By 2022, digital’s share is projected to climb to 62.1%.

eMarketer projects that more than 80% of display ad dollars will go through programmatic channels (such as Perion offers) in 2018. Of the \$46.6 billion spent on programmatic advertising in 2018, 42% will be via real-time bidding and 58% will go to direct deals.

**US Digital Ad Spending, 2017-2022**  
billions, % change and % of total media ad spending\*



■ Digital ad spending  
■ % change ■ % of total media ad spending\*

*Note: includes advertising that appears on desktop and laptop computers as well as mobile phones, tablets and other internet-connected devices, and includes all the various formats of advertising on those platforms; \*includes digital (desktop/laptop, mobile and other internet-connected devices), directories, magazines, newspapers, out-of-home, radio and TV*  
Source: eMarketer, March 2018

**US Mobile Ad Spending, 2017-2022**

	2017	2018	2019	2020	2021	2022
<b>Mobile ad spending (billions)</b>	\$60.70	\$74.97	\$90.34	\$105.25	\$118.93	\$131.41
—% change		30.0%	23.5%	20.5%	16.5%	13.0%
—% of digital ad spending		67.2%	69.9%	71.8%	74.0%	76.0%
—% of total media ad spending		29.3%	33.9%	38.3%	42.0%	45.3%

*Note: includes classified, display (banners, rich media, video and other), email, lead generation, messaging-based advertising and search advertising; includes ad spending on tablets*  
Source: eMarketer, March 2018

Search ad spending is projected to reach \$45.8 billion in 2018, representing 42.7% of total digital advertising. eMarketer observed that although search's share is smaller than that of display, it remains a more affordable alternative depending on campaign goals.

## **Competition**

### **Competitive Environment**

The markets in which the company operates in are highly competitive. Perion competes with companies offering solutions for online publishers and developers, including search services and other software in conjunction with changing a user's default search settings.

There are a large number of companies that compete with Perion's advertising technology. Some of these companies are larger and have more financial resources than Perion including, Oath, Google, and Facebook. New entrants and companies that do not currently compete with Perion's advertising technology such as Amazon and Samsung may compete in the future given the relatively low barriers to entry in the industry.

The company competes with search engine providers such as Google, Microsoft, Yahoo, Ask and others. Perion also competes with many other companies offering consumer search software such as Interactive Corporation, Oath, InfoSpace, and others.

Many of the Perion's competitors may have significantly greater financial, research and development, manufacturing, and sales and marketing resources. These competitors could potentially use their greater financial resources to acquire other companies to gain name recognition and market share, as well as to develop new technologies, enhance systems and analytical capabilities and/or products or features that could effectively compete with Perion's technology.

### **Competitive Advantages**

The company aims to exploit the capabilities that differentiates its Undertone division's technology offering from competing technologies.

*"Synchronized Digital Branding" platform* - Enables a brand to tell a complete story; for example, a coffee brand could reach the same user with a "wake-up" message in the morning; a "keep you going" message in the afternoon; and a "decaf espresso for a good night's sleep" message in the evening.

*"Synchronized Digital Branding" marketed alongside in-house "Pixel Studio"* – Taking an advertiser's conventional advertising – for example, a thirty-second television commercial – and translating it into effective digital ads. Perion can create innovative ads and deliver them through its "Synchronized Digital Branding" to offer increased user relevance and performance.

*Network of premium, vetted publishers* – Perion's Synchronized Digital Branding is delivered to these publishers, as well as on Facebook and other social media channels.

## **Strategy**

Perion aims to be the leader in high-quality advertising solutions by delivering messages that stand out through innovative and engaging ad units. The company offers "high impact" ad units (advertising that captures the attention of consumers) as well as standard and non-standard ad formats in desktop, mobile (Web and App), and social media channels.

Perion strives to offer effective advertising solutions through creative ad units, quality media, proprietary technology, service and support, and innovation.

*Creative Ad Units* - The company aims to offer clients creative ads that capture a consumer's attention, as well as functionality that drives consumer engagement. Perion has an in-house, full-service team that works with clients to design, build and execute custom ad campaigns. The company's formats can be deployed across desktop, mobile and tablets and through Web, app and social media channels, depending on the specific needs of the customer.

*Quality Media* – Perion hand-picks a broad portfolio of premium media properties. Qualified publishers are put through a certification process to ensure the proper delivery of the company's formats. Approved publishers are continuously monitored for inappropriate content and suspicious traffic.

*Proprietary Technology* – Some of the key features of Perion's proprietary technology platform include an HTML5-based ad creation platform and production tools that allow for the rapid creation of high impact creative ads and the development of new ad formats. Other features of this platform include programmatically enabled buying and selling allowing clients to increase efficiency and campaign flexibility, brand safety and quality filters to ensure clients' messages are placed in safe and appropriate environments, and the Undertone Data Management System (UDMS) which enables the company to capture, process and analyze data associated with ad campaigns in order to deliver better results to clients.

*Service and Support* – Perion provides its clients with service and support before, during and after the campaign cycle. The company utilizes a consultative approach to develop the appropriate campaign strategy. Perion then oversees all aspects of a client's campaign to ensure it meets the clients' objectives and provides clients with campaign results, key performance metrics and critical analysis.

*Innovation* – In order to remain competitive, Perion must continue to develop new solutions and services. To accomplish this, the company relies on its in-house research and development team which researches, prototypes and tests emerging technology in order to determine how best to reach and influence consumers. The team also conducts research on consumer interactions with ad formats, features and functionalities to determine preferences and usage behavior. We project R&D spending will increase by over \$2 million in 2019 from 2017 levels.

## ***Economic Outlook***

In July 2018, the IMF kept its global economic growth estimate at 3.9% for both 2018 and 2019, unchanged from April 2018. The growth estimates assume gradually tightening but still favorable financial conditions. Domestic demand growth is expected to continue at a strong pace even as overall output growth slows.

The IMF kept its economic growth estimate for the US at 2.9% in 2018 and 2.7% in 2019, unchanged from its April 2018 forecast. The IMF said that substantial fiscal stimulus together with already robust private demand should lift output and lower the unemployment rate below levels to 50 year lows. Imports are set to pick up with stronger domestic demand.

The advance estimate of US GDP growth (released on July 27, 2018) showed the US economy grew at an annual rate of 4.1% in 2Q18, up from 2.2% in 1Q18. The 2Q18 US GDP growth estimate primarily reflects increases in consumer spending, exports, business investment, and government spending.

## ***Projections***

*2018 Forecast* - We project a 3.4% decline in revenue to \$264.7 million and net income of \$12 million or \$0.15 per share. The decline in revenue will be primarily due to lower search sales related to the company's legacy (toolbar) products.

We project gross margins of 90.9%, in line with trailing twelve-month margins. Customer acquisition costs and media buy expenses are projected to increase 1.1% to \$132.3 million as payments to publishers and developers increase. We anticipate R&D expenses increasing 13.9% to \$20.2 million as the company focuses on developing a more robust infrastructure at its Undertone advertising business. Selling and marketing expenses are projected

to decline by 25.9% to \$42.3 million and general and administrative expenses are projected to decline by 10.5% to \$19.6 million as the company focuses on cost cutting initiatives.

We project operating income of \$15.6 million versus an operating loss of \$75.7 million in 2017. The 2017 operating loss included \$85.7 million of impairment charges related to the assets of the acquired Undertone unit. Excluding the 2017 impairment charges, operating income would have been \$10 million. We project the company paying minimal taxes due to its large amount of tax loss carry forwards (\$6.3 million from its US subsidiaries, \$6 million from its European subsidiaries, and \$14.3 million from Israel as of December 31, 2017).

In 2018, we project \$35.9 million cash from operations on cash earnings of \$22.5 million and a \$13.4 million decrease in working capital primarily due to a decrease in prepaid expenses and an increase in payables. Cash from operations should allow for a significant pay down of debt, decreasing cash by \$3 million to \$28.6 million at the end of 2018.

2019 Forecast - We project an 11.6% increase in revenue to \$295.5 million and net income of \$28.3 million or \$0.36 per share. The increase in revenue will be primarily due to increased advertising sales stemming from the company's growing investment in its Undertone business.

We project gross margins of 91.6%. Customer acquisition costs and media buy expenses are projected to increase 9.6% to \$145.1 million as payments to publishers and developers increase. R&D should be flat at \$20 million. Selling and marketing expenses should increase by 11.7% to \$47.3 million and general and administrative expenses should increase by 11.6% to \$21.9 million in order to support sales growth.

We project operating income increasing 87.4% to \$29.3 million due primarily to increased sales and higher gross margins. We project the company paying no taxes due to its large amount of tax loss carry forwards.

In 2019, we project \$32.3 million cash from operations on cash earnings of \$38.2 million and a \$6 million increase in working capital. The increase in working capital reflects an increase in receivables, offset in part by an increase in payables. Cash from operations should cover capital expenditures and allow for the pay down of debt. We anticipate cash increasing by \$8.6 million to \$37.1 million at the end of 2019.

## ***2Q18 and 1H18 Financial Results***

2Q18 – Total revenues decreased 9.9% to \$62.8 million from \$69.7 million. Perion reported net income of \$986,000 or \$0.01 per share versus a net loss of \$36 million or \$(0.46) per share. The net loss in 2Q17 included \$43.8 million or \$(0.57) per share of impairment charges. Excluding the impairment charges, Perion would have reported 2Q17 net income of \$7.8 million or \$0.10 per share.

Advertising revenues decreased 6% to \$33.2 million. Search and other revenues decreased 13.9% to \$29.6 million. The decrease in advertising revenue was primarily due to insufficient supply to meet existing demand. The decrease in search and other revenues was primarily due to lower sales of the company's legacy products and a 2Q17 network cleanup.

Gross profit decreased 14% to \$57 million from \$66.3 million and gross margins decreased to 90.7% from 95.1%. Customer acquisition costs and media buy expenses decreased by 7.9% to \$31.1 million from \$33.8 million.

Research and development costs increased by 10.6% to \$4.7 million from \$4.2 million. Selling and marketing expenses decreased 36.1% to \$10.1 million from \$15.8 million. General and administrative expenses decreased 18.8% to \$4.9 million from \$6 million. Depreciation and amortization expenses decreased by 50.3% to \$2.5 million from \$5 million.

Financial expenses decreased 10.4% to \$1.2 million from \$1.3 million. Perion paid \$628,000 in income tax for a 38.9% tax rate versus a \$7.7 million tax benefit in 1Q17.

1H18 - Total revenues decreased 6% to \$123.7 million from \$131.7 million. Perion reported net income of \$1 million or \$0.01 per share versus a net loss of \$38.1 million or \$(0.49) per share. The net loss in 1H17 included \$43.8 million or \$(0.57) per share of impairment charges. Excluding the impairment charges, Perion would have reported 1H17 net income of \$5.8 million or \$0.07 per share.

Advertising revenues increased 4.7% to \$62.5 million. Search and other revenues decreased 15% to \$61.2 million.

Gross profit decreased 6.7% to \$111.8 million from \$119.9 million and gross margins decreased to 90.4% from 91%. Customer acquisition costs and media buy expense decreased 1.3% to \$63 million from \$63.8 million.

Research and development costs increased by 14% to \$10.2 million from \$9 million. Selling and marketing expenses decreased 25.3% to \$19.8 million from \$26.5 million. General and administrative expenses decreased 18.1% to \$9.2 million from \$11.2 million. Depreciation and amortization expenses decreased 54% to \$4.6 million from \$9.9 million.

Financial expenses decreased by 48.7% to \$1.8 million from \$3.5 million. Perion paid \$188,000 in income tax for a 15.3% tax rate versus a \$9.8 million tax benefit in 1H17.

Liquidity – As of June 30, 2018, Perion had \$34.7 million cash, a current ratio of 1.2X, \$45.9 million of total debt (\$18.6 million short-term and \$27.3 million long-term), and a debt equity ratio of 0.3X.

	Six Months Ended	
	6/18A	6/17A
Search and other Advertising	61,201	71,967
	<u>62,501</u>	<u>59,697</u>
Total revenue	123,702	131,664
Cost of revenue	<u>11,867</u>	<u>11,807</u>
Gross profit	111,835	119,857
Customer acquisition costs and media buy	62,990	63,838
Research and development	10,222	8,967
Selling and marketing	19,782	26,465
General and administrative	9,167	11,188
Depreciation and amortization	4,562	9,909
Impairment	-	43,847
Restructuring charges	<u>2,075</u>	<u>-</u>
Operating income (loss)	3,037	(44,357)
Financial expenses	<u>1,806</u>	<u>3,522</u>
Income (loss) before taxes	1,231	(47,879)
Income tax (benefit)	<u>188</u>	<u>(9,789)</u>
Net income (loss)	<u>1,043</u>	<u>(38,090)</u>
EPS	<u>0.01</u>	<u>(0.49)</u>
Shares Outstanding	77,556	77,548
EBITDA	7,599	(34,448)
<u>Margin Analysis</u>		
Gross margin	90.4%	91.0%
Customer acquisition costs and media buy	50.9%	48.5%
Research and development	8.3%	6.8%
Selling and marketing	16.0%	20.1%
General and administrative	7.4%	8.5%
Operating margin	2.5%	(33.7)%
<u>Year / Year Growth</u>		
Total Revenues	(6.0)%	
Net Income	NMF	
EPS	NMF	
Source: Company filings		

In November 2015, concurrently with the closing of the Undertone acquisition, the company entered into a secured credit agreement for \$50 million due in quarterly installments from March 2016 to November 2019. The installments started at \$625,000 per quarter, and increased to \$1.25 million per quarter in March 2018, requiring a final payment of \$35 million upon maturity. The outstanding principal bears annual interest at LIBOR plus 5.5% and is secured by substantially all the assets of the companies in the Undertone group.

In May 2017, the company secured \$17.5 million under a new credit facility from an Israeli bank which includes a \$12.5 million revolving credit line and a \$5 million term loan, both guaranteed by Perion. The \$5 million long-term loan bears annual interest at LIBOR plus 5%, to be repaid in 36 equal installments starting from June 30, 2017, and the \$12.5 million revolving credit line bears annual interest at LIBOR plus 3.5%.

In September 2014, the company completed a public offering in Israel of its Series L convertible bonds. The bonds were issued at a purchase price equal to 96.5% of their par value and bear annual interest at a rate of 5%, payable semi-annually, subject to an increase up to 6% in the event of a debt rating downgrade. The bonds are convertible into the company's ordinary shares at a conversion price of \$9.69 until March 15, 2020.

The company was in compliance with all financial covenants as of June 30, 2018.

At June 30, 2018, the company had cash earnings of \$6.8 million and a \$10.7 million decrease in working capital that resulted in \$17.5 million cash provided by operations. Cash provided by operations and \$5.9 million cash provided by investing activities (primarily short-term deposits) were partially offset by \$1.2 million of capital expenditures and capitalization of development costs and \$19.1 million in debt repayments. Cash increased by \$3.1 million to \$34.7 million as of June 30, 2018.

### ***Management***

*Doron Gerstel, Chief Executive Officer* - Gerstel has been Chief Executive Officer of the company since April 2017. He previously served as CEO of Panaya Ltd. and also held CEO positions at Nolio Ltd., Syneron Medical Ltd. and Zend Technologies Ltd. BSc. in Economics and Management from the Technion Institute of Technology in Haifa. MBA from Tel Aviv University.

*Maoz Sigron, Chief Financial Officer* – Sigron has been Chief Financial Officer of the company since February 2018. From September 2017 until February 2018, Sigron served as Perion’s VP of Finance. He previously served in various finance leadership and senior accounting positions at Tnuva Dairy Corporation, Allot Communications Ltd. and Stratasys Ltd. as well serving as a CPA with PwC. BA in Accounting and Economics from the College of Management.

*Mike Pallad, President of Undertone* – Pallad is responsible for the day-to-day operations and setting the strategic direction for Undertone. Pallad joined Undertone from Apple, Inc., where he held sales management roles for Apple Music and iAd. He previously held executive-level positions at Cumulus Media and Citadel Broadcasting, overseeing national and network sales. Bachelor’s Degree from Arizona State University.

### ***Risks***

In our view, these are the principal risks underlying the stock.

*Lack of long-term contracts* – Perion generally does not enter into long-term contracts with its advertising customers, and such customers do business on a non-exclusive basis with no minimum spending guarantees. Perion’s advertising customers may reduce or terminate their business relationship with the company at any time which could have a material adverse effect on Perion’s business, results of operations, and financial condition.

*Technological obsolescence* – Google, as an advertising publisher, accounts for most US online search-generated revenues while Microsoft and Yahoo account for substantially all of the rest. A small number of social network companies, such as Facebook, account for a large portion of digital advertising budgets.

These companies, along with other large and established Internet and technology companies, may also leverage their power to make changes to their Web browsers, operating systems, platforms, networks or other products or services in a way that impacts the entire digital advertising marketplace. If Perion is unable to adjust to those changes, the company’s revenues and performance could be adversely impacted.

*Demand for digital advertising* – A substantial portion of the company’s revenues is derived from the sale of digital advertising solutions. If the demand for digital advertising does not continue to grow or customers do not chose Perion’s solutions, it could restrain the company’s operations.

*Competition* - The advertising industry is highly competitive. There are a large number of digital media companies and advertising technology companies that offer services similar to Perion’s that compete for finite advertising budgets and for limited inventory from publishers. Some of the company’s competitors are better established have significantly more financial, technical, sales and marketing resources than Perion. Given that the barriers to entering the digital advertising market are relatively low, the number of competitors may increase. If Perion cannot compete effectively in this market, its revenues are likely to decline.



Search solution sales – The company has experienced a decline in its search solution sales and market perception has not been favorable. As a result, Perion may have difficulty stemming this decline or offsetting it by entering new markets.

Desktop computer search services - The market related to desktop computers has accounted for substantially all of Perion's search revenues. Recently, the number of individuals who access the Internet through devices other than desktop computers, such as mobile phones, tablets, etc., has increased dramatically. While the company has begun developing models and solutions for mobile platforms and acquired MakeMeReach SAS and Interactive Holding Corp. (collectively referred to as Undertone), its search and application services are not yet compatible with these alternative platforms. If this trend towards using the Internet on non-desktop devices accelerates, some of Perion's services will become less relevant and may fail to attract advertisers and Web traffic.

Exchange rates - A significant portion of Perion's costs are incurred in new Israeli shekels (NIS). Exchange rate fluctuations may have an adverse effect on the company's earnings and asset base if it not able to effectively hedge against currency exchange risks.

Regulatory changes – Perion's business is conducted through the Internet and is subject to the laws and regulations that apply to e-commerce and online businesses around the world. These laws and regulations are becoming more prevalent in the US, Europe, Israel, Canada, and elsewhere and may impede the growth of the Internet and consequently the company's services.

Reliance on North American market – Perion's revenues have been concentrated within the North American market, accounting for approximately 78% of 2017 revenues. A significant reduction in the revenues generated in North America could have a material adverse effect on the company's results of operations.

Political, economic and military risks – Perion's principal executive offices are located in Israel. Accordingly, political, economic and military conditions in the Middle East may directly affect the company's business.

Liquidity risk - Shares of Perion have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. There are 46.7 million shares in the float and the average daily volume is approximately 207,000 shares.

Miscellaneous risk - The company's financial results and equity values are subject to other risks and uncertainties including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Perion Network Ltd.

Consolidated Balance Sheets  
(in thousands \$)

	<u>2016A</u>	<u>2017A</u>	<u>6/18A</u>	<u>2018E</u>	<u>2019E</u>
Cash and cash equivalents	23,962	31,567	34,662	28,585	37,138
Short-term bank deposits	8,414	5,913	-	-	-
Receivables	71,346	62,830	50,240	60,701	67,764
Prepaid expenses and other	<u>10,036</u>	<u>13,955</u>	<u>7,936</u>	<u>7,936</u>	<u>7,936</u>
Total current assets	113,758	114,265	92,838	97,222	112,837
Property and equipment	14,205	17,476	15,938	15,427	13,717
Goodwill and intangibles	234,755	136,360	134,026	134,026	134,026
Deferred taxes	4,117	4,798	4,752	4,752	4,752
Other	<u>1,617</u>	<u>1,128</u>	<u>699</u>	<u>699</u>	<u>699</u>
<b>Total assets</b>	<b><u>368,452</u></b>	<b><u>274,027</u></b>	<b><u>248,253</u></b>	<b><u>252,126</u></b>	<b><u>266,031</u></b>
Accounts payable	38,293	39,180	35,150	47,798	49,372
Accrued expenses and other	17,466	17,784	16,172	17,181	19,180
Short-term debt	17,944	13,989	13,472	13,472	2,472
Deferred revenues	5,354	5,271	4,432	4,432	4,432
Payment obligation related to acquisitions	<u>7,653</u>	<u>5,146</u>	<u>5,146</u>	<u>2,646</u>	<u>-</u>
Total current liabilities	86,710	81,370	74,372	85,530	75,456
Long-term debt	59,790	46,719	27,319	7,319	-
Deferred taxes	8,087	-	-	-	-
Other	<u>5,721</u>	<u>7,606</u>	<u>5,992</u>	<u>5,992</u>	<u>5,992</u>
<b>Total liabilities</b>	<b>160,308</b>	<b>135,695</b>	<b>107,683</b>	<b>98,841</b>	<b>81,448</b>
<b>Total stockholders' equity</b>	<b><u>208,144</u></b>	<b><u>138,332</u></b>	<b><u>140,570</u></b>	<b><u>153,286</u></b>	<b><u>184,583</u></b>
<b>Total liabilities &amp; stockholders' equity</b>	<b><u>368,452</u></b>	<b><u>274,027</u></b>	<b><u>248,253</u></b>	<b><u>252,126</u></b>	<b><u>266,031</u></b>

Source: Company filings and Taglich Brothers' estimates

Perion Network Ltd.

Income Statements for the Fiscal Years Ended  
(in thousands \$)

	<u>2016A</u>	<u>2017A</u>	<u>2018E</u>	<u>2019E</u>
Search and other Advertising	172,683	139,505	124,201	130,000
Total revenue	312,794	273,986	264,702	295,500
Cost of revenue	25,924	19,698	24,031	24,822
Gross profit	286,870	254,288	240,671	270,678
Customer acquisition costs and media buy	140,210	130,885	132,349	145,091
Research and development	25,221	17,752	20,222	20,000
Selling and marketing	54,559	57,141	42,342	47,280
General and administrative	28,827	21,910	19,601	21,867
Depreciation and amortization	25,977	16,591	8,444	7,130
Impairment	-	85,667	-	-
Restructuring charges	728	-	2,075	-
Operating income (loss)	11,348	(75,658)	15,638	29,311
Financial expenses	8,288	5,922	3,496	1,014
Income (loss) before taxes	3,060	(81,580)	12,142	28,297
Income tax (benefit)	212	(8,826)	188	-
Net income (loss)	2,848	(72,754)	11,954	28,297
EPS	0.04	(0.94)	0.15	0.36
Shares Outstanding	76,674	77,549	78,834	79,262
EBITDA	37,325	(59,067)	24,082	36,441
<u>Margin Analysis</u>				
Gross margin	91.7%	92.8%	90.9%	91.6%
Customer acquisition costs and media buy	44.8%	47.8%	50.0%	49.1%
Research and development	8.1%	6.5%	7.6%	6.8%
Selling and marketing	17.4%	20.9%	16.0%	16.0%
General and administrative	9.2%	8.0%	7.4%	7.4%
Operating margin	3.6%	(27.6)%	5.9%	9.9%
<u>Year / Year Growth</u>				
Total Revenues		(12.4)%	(3.4)%	11.6%
Net Income		NMF	NMF	136.7%
EPS		NMF	NMF	135.4%

\*From continuing operations

Source: Company filings and Taglich Brothers' estimates

Perion Network Ltd.

Quarterly Income Statements 2017A - 2019E\*  
(in thousands \$)

	3/17A	6/17A	9/17A	12/17A	2017A	3/18A	6/18A	9/18E	12/18E	2018E	3/19E	6/19E	9/19E	12/19E	2019E
Search and other Advertising	37,588	34,379	33,287	34,251	139,505	31,610	29,591	30,000	33,000	124,201	31,000	32,000	33,000	34,000	130,000
Total revenue	61,976	69,688	65,042	77,280	273,986	60,905	62,797	64,000	77,000	264,702	65,350	69,750	75,050	85,350	295,500
Cost of revenue	5,893	3,406	3,561	6,838	19,698	6,056	5,811	5,696	6,468	24,031	5,489	5,859	6,304	7,169	24,822
Gross profit	56,083	66,282	61,481	70,442	254,288	54,849	56,986	58,304	70,532	240,671	59,861	63,891	68,746	78,181	270,678
Customer acquisition costs and media buy	30,052	33,786	31,955	35,092	130,885	31,885	31,105	31,552	37,807	132,349	32,087	34,247	36,850	41,907	145,091
Research and development	5,020	4,230	4,096	4,406	17,752	5,544	4,678	5,000	5,000	20,222	5,000	5,000	5,000	5,000	20,000
Selling and marketing	12,905	15,785	14,142	14,309	57,141	9,701	10,081	10,240	12,320	42,342	10,456	11,160	12,008	13,656	47,280
General and administrative	5,175	6,013	5,353	5,369	21,910	4,286	4,881	4,736	5,698	19,601	4,836	5,162	5,554	6,316	21,867
Depreciation and amortization	4,901	5,008	3,388	3,294	16,591	2,071	2,491	1,967	1,915	8,444	1,882	1,816	1,749	1,683	7,130
Impairment	-	43,847	-	41,820	85,667	-	-	-	-	-	-	-	-	-	-
Restructuring charges	-	-	-	-	-	1,138	937	-	-	2,075	-	-	-	-	-
Operating income (loss)	(1,970)	(42,387)	2,547	(33,848)	(75,658)	224	2,813	4,809	7,792	15,638	5,600	6,506	7,586	9,619	29,311
Financial expenses	2,184	1,338	644	1,756	5,922	607	1,199	990	700	3,496	400	300	200	114	1,014
Income (loss) before taxes	(4,154)	(43,725)	1,903	(35,604)	(81,580)	(383)	1,614	3,819	7,092	12,142	5,200	6,206	7,386	9,505	28,297
Income tax (benefit)	(2,080)	(7,709)	(710)	1,673	(8,826)	(440)	628	-	-	188	-	-	-	-	-
Net income (loss)	(2,074)	(36,016)	2,613	(37,277)	(72,754)	57	986	3,819	7,092	11,954	5,200	6,206	7,386	9,505	28,297
EPS	(0.03)	(0.46)	0.03	(0.48)	(0.94)	0.00	0.01	0.05	0.09	0.15	0.07	0.08	0.09	0.12	0.36
Shares Outstanding	77,487	77,550	80,381	77,550	77,549	77,550	79,262	79,262	79,262	78,834	79,262	79,262	79,262	79,262	79,262
EBITDA	2,931	(37,379)	5,935	(30,554)	(59,067)	2,295	5,304	6,776	9,707	24,082	7,482	8,322	9,335	11,302	36,441
<u>Margin Analysis</u>															
Gross margin	90.5%	95.1%	94.5%	91.2%	92.8%	90.1%	90.7%	91.1%	91.6%	90.9%	91.6%	91.6%	91.6%	91.6%	91.6%
Customer acquisition costs and media buy	48.5%	48.5%	49.1%	45.4%	47.8%	52.4%	49.5%	49.3%	49.1%	50.0%	49.1%	49.1%	49.1%	49.1%	49.1%
Research and development	8.1%	6.1%	6.3%	5.7%	6.5%	9.1%	7.4%	7.8%	6.5%	7.6%	7.7%	7.2%	6.7%	5.9%	6.8%
Selling and marketing	20.8%	22.7%	21.7%	18.5%	20.9%	15.9%	16.1%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%
General and administrative	8.4%	8.6%	8.2%	6.9%	8.0%	7.0%	7.8%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%
Operating margin	(3.2)%	(60.8)%	3.9%	(43.8)%	(27.6)%	0.4%	4.5%	7.5%	10.1%	5.9%	8.6%	9.3%	10.1%	11.3%	9.9%
<u>Year / Year Growth</u>															
Total Revenues					(12.4)%	(1.7)%	(9.9)%	(1.6)%	(0.4)%	(3.4)%	7.3%	11.1%	17.3%	10.8%	11.6%
Net Income					NMF	NMF	NMF	NMF	NMF	NMF	9022.5%	529.4%	93.4%	34.0%	136.7%
EPS					NMF	NMF	NMF	NMF	NMF	NMF	8825.5%	529.4%	93.4%	34.0%	135.4%

\*From continuing operations

Source: Company filings and Taglich Brothers' estimates

Perion Network Ltd.

Statement of Cash Flows for the Periods Ended  
(in thousands \$)

	2016A	2017A	6m18A	2018E	2019E
Net income (loss)	2,848	(72,754)	1,043	11,954	28,297
Depreciation & amortization	25,977	16,591	4,562	7,872	6,948
Impairment	-	85,667	-	-	-
Restructuring costs	254	-	462	462	-
Stock-based compensation	6,844	2,112	1,483	3,000	3,000
Foreign currency translation	980	83	12	12	-
Accretion of payment obligation related to acquisition	320	43	-	-	-
Accrued interest	406	475	223	223	-
Deferred taxes	(3,268)	(8,877)	(9)	(9)	-
Accrued severance pay	214	801	-	-	-
Change in payment obligation related to acquisitions	983	-	-	-	-
Fair value revaluation - convertible debt	1,350	3,785	(992)	(992)	-
Loss from sale of property and equipment	149	-	-	-	-
Cash earnings (loss)	37,057	27,926	6,784	22,522	38,245
<i>Changes in assets and liabilities</i>					
Receivables	(5,333)	8,888	-	2,129	(7,063)
Prepaid expenses and other	8,613	(3,241)	-	6,019	-
Accounts payable	(1,702)	1,106	-	8,618	1,573
Accrued expenses and other	(2,486)	1,429	-	(2,537)	(476)
Deferred revenue	(2,365)	(95)	-	(839)	-
(Increase) decrease in working capital	(3,273)	8,087	10,670	13,390	(5,965)
<b>Net cash provided by (used in) operations*</b>	<b>33,784</b>	<b>36,013</b>	<b>17,454</b>	<b>35,912</b>	<b>32,279</b>
Purchase of property and equipment	(1,504)	(1,606)	(48)	(1,000)	(1,000)
Proceeds from sale of property and equipment	151	10	-	-	-
Capitalization of development costs	(4,591)	(5,756)	(1,119)	(2,202)	(1,762)
Change in restricted cash	647	-	-	-	-
Short-term deposits	34,028	2,501	5,913	5,913	-
<b>Net cash provided by (used in) investing</b>	<b>28,731</b>	<b>(4,851)</b>	<b>4,746</b>	<b>2,711</b>	<b>(2,762)</b>
Exercise of options and restricted shares	2	1	-	-	-
Payments made in connection with acquisition	(29,537)	(2,551)	-	(2,500)	(2,646)
Proceeds from debt	40,000	5,000	-	-	-
Repayment of debt	(63,072)	(26,290)	(19,149)	(39,149)	(18,319)
<b>Net cash provided by (used in) financing</b>	<b>(52,607)</b>	<b>(23,840)</b>	<b>(19,149)</b>	<b>(41,649)</b>	<b>(20,965)</b>
Effect of currency exchange rates	(136)	283	44	44	-
Effect from discontinued operations on cash	(3,329)	-	-	-	-
<b>Net change in cash</b>	<b>6,443</b>	<b>7,605</b>	<b>3,095</b>	<b>(2,982)</b>	<b>8,552</b>
<b>Cash - beginning of period</b>	<b>17,519</b>	<b>23,962</b>	<b>31,567</b>	<b>31,567</b>	<b>28,585</b>
<b>Cash - end of period</b>	<b>23,962</b>	<b>31,567</b>	<b>34,662</b>	<b>28,585</b>	<b>37,138</b>

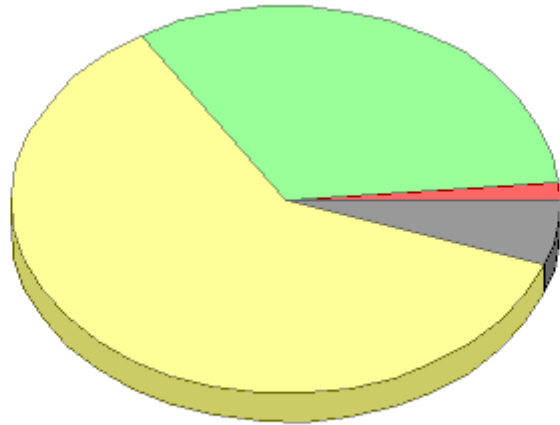
\*From continuing operations

Source: Company filings and Taglich Brothers' estimates

**Price Chart**



**Taglich Brothers' Current Ratings Distribution**



32.43 % Buy 60.81 % Hold 5.41 % Not Rated 1.35 % Sell

<b>Investment Banking Services for Companies Covered in the Past 12 Months</b>		
Rating	#	%
Buy	3	12
Hold		
Sell		
Not Rated	1	50

### **Important Disclosures**

As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families do not have a position in the stock of the company mentioned in this report. Taglich Brothers, Inc. does not currently have an Investment Banking relationship with the company mentioned in this report and was not a manager or co-manager of any offering for the company within the last three years.

All research issued by Taglich Brothers, Inc. is based on public information. The company paid a monetary fee of \$6,000 (USD) in July 2018 for the creation and dissemination of research reports for the first three months. After the first three months from initial publication, the company will pay a monthly monetary fee of \$2,000 (USD) to Taglich Brothers, Inc., for a minimum of six months for the creation and dissemination of research reports.

### **General Disclosures**

The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to changes in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is fully disclosed with its clearing firm, Pershing, LLC, is not a market maker and does not sell to or buy from customers on a principal basis. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. There may be instances when fundamental, technical and quantitative opinions contained in this report are not in concert. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. Analysts and members of the Research Department are prohibited from buying or selling securities issued by the companies that Taglich Brothers, Inc. has a research relationship with, except if ownership of such securities was prior to the start of such relationship, then an Analyst or member of the Research Department may sell such securities after obtaining expressed written permission from Compliance.

### **Analyst Certification**

**I, John Nobile, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be, directly, or indirectly, related to the specific recommendations or views contained in this report.**

#### **Public companies mentioned in this report:**

Allot Communications (NASDAQ: ALLT)  
Facebook (NASDAQ: FB)  
Google (NASDAQ: GOOG)  
Microsoft (NASDAQ: MSFT)  
Stratasys (NASDAQ: SSYS)  
Twitter (NYSE: TWTR)  
Yahoo (NASDAQ: ABAA)

### **Meaning of Ratings**

**Buy** – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

**Speculative Buy** – Long term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

**Neutral** – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

**Sell** – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

**Dropping Coverage** – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

### **Some notable Risks within the Microcap Market**

**Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.**

---

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.