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Research Report – Update

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

Perion Network Ltd.

Speculative Buy

John Nobile
November 6, 2018

PERI $2.88 — (NASDAQ)

	2016A	2017A	2018E	2019E
Revenues (millions)	$312.8	$274.0	$255.1	$267.9
Earnings (loss) per share**	$0.11	$(2.81)*	$0.28	$0.52

52-Week range	$4.05 – $2.13	Fiscal year ends:	December
Common shares out as of 11/1/18	25.9 million	Revenue per share (TTM)	$9.98
Approximate float	15.6 million	Price/Sales (TTM)	0.3X
Market capitalization	$73 million	Price/Sales (FY2019)E	0.3X
Tangible book value/share	$0.08	Price/Earnings (TTM)	NMF
Price/tangible book value	NMF	Price/Earnings (FY2019)E	5.5X

** Includes $85.7 million or $(3.31) per share of impairment charges. **Adjusted for 1-for-3 reverse stock split effective 8/24/18.*

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:

Maintaining Speculative Buy rating on Perion Network but reducing twelve-month price target to $5.50 per share (from $6.75 split adjusted) based on our lowered 2019 EBITDA projection.

Perion operates in the digital advertising industry. In the US, eMarketer projects digital ad spending to grow annually by 13.6%, reaching $170.5 billion by 2022.

Perion has been 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. In its most recent quarter (3Q18), PERI's cash level exceeded its long-term debt level for the first time in four years.

Our forecast through 2019 anticipates strong cash earnings growth that should enable PERI to further strengthen its balance sheet. At the end of 2019, we project Perion to have $21 million cash ($0.79 per share) and a $30 million reduction in debt from 2018 to $7.7 million.

Perion reported (11/1/18) 3Q18 revenues decreasing 12.1% to $57.2 million and EPS of $0.08 compared to $0.10 in the year ago period. We projected 3Q18 revenue of $64 million and EPS of $0.14**.

For 2018, we project a 6.9% decline in revenue to $255.1 million and EPS of $0.28. We previously projected revenue of $264.7 million and EPS of $0.45**. Our reduced forecasts reflect 3Q18 results.

For 2019, we project a 5% increase in revenue to $267.9 million and EPS of $0.52. We previously forecast revenue of $295.5 million and EPS of $1.07**. The reduction in our forecasts are due primarily to an insufficient capacity of publishers to meet the demand for PERI's programmatic ad units.

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

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Recommendation and Valuation

Maintaining coverage of Perion Network Ltd. with a Speculative Buy rating but lowering our twelve-month price target to $5.50 per share (from $6.75 split adjusted) based on our lowered 2019 EBITDA projection.

Perion has been 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. In 3Q18, PERI's cash level exceeded its long-term debt level for the first time in four years. Our forecast through 2019 anticipates strong cash earnings growth that should enable PERI to further strengthen its balance sheet. At the end of 2019, we project Perion to have $21 million cash ($0.79 per share) and a $30 million reduction in debt from 2018 to $7.7 million.

PERI trades at a forward EV/EBITDA multiple of approximately 2.1X (previously (2.7X). Industry peers trade at a 2019 EV/EBITDA multiple of 10.5X (previously 11.9X, source: Thomson Reuters). We anticipate investors according PERI a multiple approaching that of the industry with solid cash earnings forecasted through 2019. Applying an EV/EBITDA multiple of 4.5X (previously 5X) to our 2019 EBITDA/share projection of $1.08 (previously $1.38 adjusted for 1-for-3 reverse stock split), discounted to account for execution risk, suggests a year-ahead value of approximately $5.50 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.

AUTO	CPG	FIN SERVICES	PHARMACEUTICAL	RETAIL	TECH/TELECOM
Chrysler	Coca-Cola	MasterCard	Abbott	The Home Depot	Microsoft
GM	Nestlé	CHASE	AstraZeneca	TARGET	at&t
BMW	General Mills	American Express	Pfizer	STAPLES	Comcast
TOYOTA	DIAGEO	DISCOVER	Shire	Abercrombie & Fitch	SAMSUNG
Ford	L'ORÉAL	SunTrust	Bayer HealthCare	Walgreens	dish
BlaBlaCar	L'OCCITANE en Provence			BIRCHBOX	

Source: Perion Presentation

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.

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 delivers to its brand and agency clients a social marketing platform that enables fast and intelligent decision-making in order to optimize media and creative campaigns based on a variety of key performance indicators (KPIs) on Facebook, Snapchat, Twitter and Google, while efficiently acquiring new users.

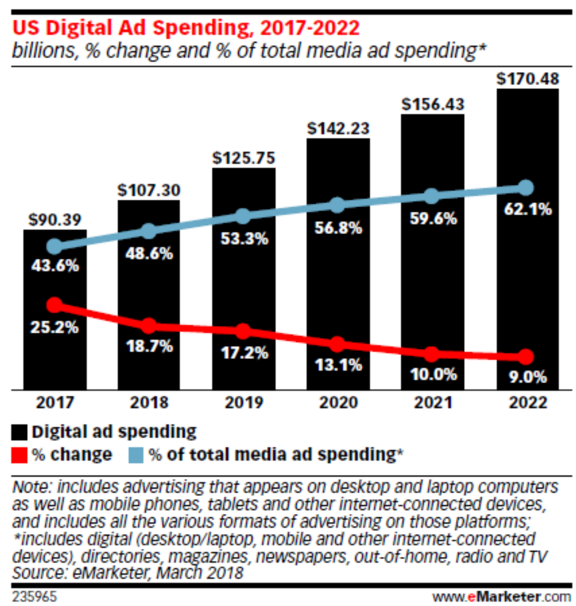
Advertisers can control their marketing expenditures on Perion's social marketing platform. The platform has tools that advertisers can utilize to create operational marketing efficiencies. Perion's customers receive ongoing analysis and optimization of their campaigns with the goal of increasing return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

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%.

US Mobile Ad Spending, 2017-2022

	2017	2018	2019	2020	2021	2022
Mobile ad spending (billions)	**$60.70**	**$74.97**	**$90.34**	**$105.25**	**$118.93**	**$131.41**
—% change	30.0%	23.5%	20.5%	16.5%	13.0%	10.5%
—% of digital ad spending	67.2%	69.9%	71.8%	74.0%	76.0%	77.1%
—% of total media ad spending	29.3%	33.9%	38.3%	42.0%	45.3%	47.9%

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
235966 www.eMarketer.com

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.

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. There are a large number of companies that compete with Perion's advertising solutions. Some of these companies are larger and have more financial resources than Perion including, Google, and Facebook. New entrants and companies that do not currently compete with Perion's advertising technology such as Amazon and AT&T 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 and companies offering consumer search software such as Interactive Corporation 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 solutions.

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 by delivering the right message to the right audience at the right time. 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. With multiple ads being placed for a particular brand, and immediate feedback being received, Perion is able to offer its clients the optimal ad.

"Synchronized Digital Branding" marketed alongside in-house "Pixl 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. The company's Synchronized Digital Branding platform is an example of its high impact ad offering.

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

<u>Creative Ad Units</u> - 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.

<u>Quality Media</u> – 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.

<u>Proprietary Technology</u> – 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, providing brand safety and quality filters to ensure clients' messages are placed in safe and appropriate environments, and using 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.

<u>Service and Support</u> – 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.

<u>Innovation</u> – 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 to $19.5 million in 2019 from $17.8 million in 2017.

Economic Outlook

In October 2018, the IMF lowered its global economic growth estimate to 3.7% for both 2018 and 2019, down 0.2% for both periods from its July 2018 estimate. The downward revision was due to rising trade barriers and a reversal of capital flows to emerging economies.

The IMF kept its economic growth estimate for the US at 2.9% for 2018 but lowered its 2019 estimate to 2.5%, down 0.2% from its July 2018 estimate. While the IMF believes that economic momentum is still strong as fiscal stimulus continues to rise, the downward revision for 2019 reflects $200 billion in tariffs on US imports from China.

The advance estimate of US GDP growth (released on October 26, 2018) showed the US economy grew at an annual rate of 3.5% in 3Q18, down from 4.2% in 2Q18. The 3Q18 US GDP growth estimate primarily reflects increases in consumer spending, inventory investment, government spending, and business investment.

Projections

<u>2018 Forecast</u> - We project a 6.9% decline in revenue to $255.1 million and net income of $7.3 million or $0.28 per share. We previously projected revenue of $264.7 million and net income of $12 million or $0.45 per share (adjusted for 1-for-3 reverse stock split effective 8/24/18). Our lowered projections primarily reflect 3Q18 results.

We project gross margins of 90.4%, in line with trailing twelve-month margins. Customer acquisition costs and media buy expenses are projected to decrease 1.8% to $128.5 million as payments to publishers and developers decrease. We anticipate R&D expenses increasing 18.8% to $19.3 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 29.9% to $40.1 million and general and administrative expenses are projected to decline by 15.7% to $18.5 million as the company focuses on cost cutting initiatives.

We project operating income of $12.9 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 $1.4 million in taxes for a 16.4% tax rate.

In 2018, we project $27.3 million cash from operations on cash earnings of $19.8 million and a $7.5 million decrease in working capital primarily due to a decrease in prepaid expenses. Cash from operations should allow for a significant pay down of debt while increasing cash by $3.2 million to $34.8 million at the end of 2018.

<u>*2019 Forecast*</u> **-** We project a 5% increase in revenue to $267.9 million and net income of $13.8 million or $0.52 per share. We previously projected revenue of $295.5 million and net income of $28.3 million or $1.07 per share (adjusted for 1-for-3 reverse stock split effective 8/24/18). Our lowered projections are primarily due to an insufficient capacity of publishers to meet the demand for PERI's programmatic ad units.

We project gross margins of 90%. Customer acquisition costs and media buy expenses are projected to increase 3% to $132.3 million as payments to publishers and developers increase. R&D should be relatively flat at $19.5 million. Selling and marketing expenses should increase by 5% to $42.1 million and general and administrative expenses should increase by 1.5% to $18.8 million in order to support sales growth.

We project operating income increasing 57.4% to $20.3 million due primarily to increased sales. We project the company paying $4.6 million in taxes for a 25% tax rate.

In 2019, we project $21.5 million cash from operations on cash earnings of $24.8 million and a $3.3 million increase in working capital. The increase in working capital reflects an increase in receivables. Cash from operations should not cover capital expenditures and the pay down of debt, decreasing cash by $13.7 million to $21 million at the end of 2019.

3Q and Nine-month Financial Results

<u>3Q18</u> – Total revenues decreased 12.1% to $57.2 million from $65 million. Perion reported net income of $2.2 million or $0.08 per share versus net income of $2.6 million or $0.10 per share. We projected 3Q18 revenue of $64 million and net income of $3.8 million or $0.14 per share.

Advertising revenues decreased 17.4% to $26.2 million. Search and other revenues decreased 7% to $31 million. The decrease in advertising revenue was primarily due to insufficient programmatic inventory to meet demand. The decrease in search and other revenues was primarily due to lower sales of the company's legacy products.

Gross profit decreased 15.9% to $51.7 million from $61.5 million and gross margins decreased to 90.4% from 94.5%. Customer acquisition costs and media buy expenses decreased by 9.8% to $28.8 million from $32 million.

Research and development costs increased by 13.8% to $4.3 million from $4.1 million. Selling and marketing expenses decreased 27.9% to $8.6 million from $14.1million. General and administrative expenses decreased 27.5% to $3.9 million from $5.4 million. Depreciation and amortization expenses decreased by 25.4% to $2.5 million from $3.4 million.

Financial expenses nearly doubled to $1.2 million from $644,000. Perion paid $84,000 in income tax for a 3.7% tax rate versus a $710,000 tax benefit in 3Q17.

Nine-months 2018 - Total revenues decreased 8% to $180.9 million from $196.7 million. Perion reported net income of $3.2 million or $0.13 per share versus a net loss of $35.5 million or $(1.37) per share. The net loss in 2017 included $43.8 million or $(1.70) per share of impairment charges. Excluding the impairment charges, Perion would have reported net income of $8.4 million or $0.32 per share in the first nine months of 2017.

Advertising revenues decreased 3% to $88.7 million. Search and other revenues decreased 12.4% to $92.2 million.

Gross profit decreased 6.7% to $163.5 million from $178.9 million and gross margins decreased to 90.4% from 90.9%. Customer acquisition costs and media buy expense decreased 4.2% to $91.8 million from $95.8 million.

Research and development costs increased by 13.9% to $14.6 million from $12.8 million. Selling and marketing expenses decreased 26.1% to $28.4 million from $38.4 million. General and administrative expenses decreased 21.1% to $13.1 million from $16.5 million. Depreciation and amortization expenses decreased 46.7% to $7.1 million from $13.3 million.

Financial expenses decreased by 27% to $3 million from $4.2 million. Perion paid $272,000 in income tax for a 7.8% tax rate versus receiving a $10.5 million tax benefit in 2017.

	Nine Months Ended	
	9/18A	9/17A
Search and other	92,158	105,254
Advertising	88,725	91,452
Total revenue	180,883	196,706
Cost of revenue	17,341	17,821
Gross profit	163,542	178,885
Customer acquisition costs and media buy	91,798	95,793
Research and development	14,563	12,783
Selling and marketing	28,417	38,434
General and administrative	13,050	16,541
Depreciation and amortization	7,090	13,297
Impairment	-	43,847
Restructuring charges	2,075	-
Operating income (loss)	6,549	(41,810)
Financial expenses	3,042	4,166
Income (loss) before taxes	3,507	(45,976)
Income tax (benefit)	272	(10,499)
Net income (loss)	3,235	(35,477)
EPS	0.13	(1.37)
Shares Outstanding	26,516	25,850
EBITDA	13,639	(28,513)
Margin Analysis		
Gross margin	90.4%	90.9%
Customer acquisition costs and media buy	50.7%	48.7%
Research and development	8.1%	6.5%
Selling and marketing	15.7%	19.5%
General and administrative	7.2%	8.4%
Operating margin	3.6%	(21.3)%
Year / Year Growth		
Total Revenues	(8.0)%	
Net Income	NMF	
EPS	NMF	

Source: Company filings

Liquidity – As of September 30, 2018, Perion had $40.9 million cash, a current ratio of 1.3X, $39.7 million of total debt ($13.5 million short-term and $26.2 million long-term), and a debt equity ratio of 0.3X.

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 September 30, 2018.

At September 30, 2018, the company had cash earnings of $12.6 million and a $15.8 million decrease in working capital that resulted in $28.5 million cash provided by operations. Cash provided by operations and $1.4 million cash provided by investing activities (primarily from short-term deposits) were partially offset by $20.6 million in debt repayments. Cash increased by $9.3 million to $40.9 million as of September 30, 2018.

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.

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. 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 – Prion’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 15.6 million shares in the float and the average daily volume is approximately 50,000 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.

Consolidated Balance Sheets
(in thousands $)

	2016A	2017A	9/18A	2018E	2019E
Cash and cash equivalents	23,962	31,567	40,876	34,740	20,995
Short-term bank deposits	8,414	5,913	-	-	-
Receivables	71,346	62,830	43,241	58,507	61,434
Prepaid expenses and other	10,036	13,955	8,602	8,602	8,602
Total current assets	113,758	114,265	92,719	101,849	91,032
Property and equipment	14,205	17,476	16,172	14,649	12,501
Goodwill and intangibles	234,755	136,360	132,747	132,747	132,747
Deferred taxes	4,117	4,798	4,666	4,666	4,666
Other	1,617	1,128	537	537	537
Total assets	**368,452**	**274,027**	**246,841**	**254,448**	**241,483**
Accounts payable	38,293	39,180	36,152	39,641	40,929
Accrued expenses and other	17,466	17,784	13,793	16,560	17,389
Short-term debt	17,944	13,989	13,484	12,984	7,686
Deferred revenues	5,354	5,271	3,935	3,935	3,935
Payment obligation related to acquisitions	7,653	5,146	3,479	1,700	-
Total current liabilities	86,710	81,370	70,843	74,821	69,939
Long-term debt	59,790	46,719	26,202	24,702	-
Deferred taxes	8,087	-	-	-	-
Other	5,721	7,606	6,405	6,405	6,405
Total liabilities	**160,308**	**135,695**	**103,450**	**105,928**	**76,344**
Total stockholders' equity	**208,144**	**138,332**	**143,391**	**148,520**	**165,138**
Total liabilities & stockholders' equity	**368,452**	**274,027**	**246,841**	**254,448**	**241,483**

Source: Company filings and Taglich Brothers' estimates

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

	2016A	2017A	2018E	2019E
Search and other	172,683	139,505	125,158	131,400
Advertising	140,111	134,481	129,975	136,500
Total revenue	312,794	273,986	255,133	267,900
Cost of revenue	25,924	19,698	24,395	26,790
Gross profit	286,870	254,288	230,738	241,110
Customer acquisition costs and media buy	140,210	130,885	128,478	132,343
Research and development	25,221	17,752	19,313	19,500
Selling and marketing	54,559	57,141	40,074	42,060
General and administrative	28,827	21,910	18,470	18,753
Depreciation and amortization	25,977	16,591	9,450	8,186
Impairment	-	85,667	-	-
Restructuring charges	728	-	2,075	-
Operating income (loss)	11,348	(75,658)	12,878	20,268
Financial expenses	8,288	5,922	4,121	1,843
Income (loss) before taxes	3,060	(81,580)	8,757	18,425
Income tax (benefit)	212	(8,826)	1,440	4,607
Net income (loss)	2,848	(72,754)	7,317	13,818
EPS	0.11	(2.81)	0.28	0.52
Shares Outstanding	25,558	25,850	26,278	26,421
EBITDA	37,325	(59,067)	22,328	28,454
Adjusted EBITDA**	45,435	28,917	28,917	31,254
Margin Analysis				
Gross margin	91.7%	92.8%	90.4%	90.0%
Customer acquisition costs and media buy	44.8%	47.8%	49.4%	49.4%
Research and development	8.1%	6.5%	7.6%	7.3%
Selling and marketing	17.4%	20.9%	15.7%	15.7%
General and administrative	9.2%	8.0%	7.2%	7.0%
Operating margin	3.6%	(27.6)%	5.0%	7.6%
Year / Year Growth				
Total Revenues		(12.4)%	(6.9)%	5.0%
Net Income		NMF	NMF	88.8%
EPS		NMF	NMF	87.8%

*From continuing operations

**Includes stock compensation, restructuring and other costs

Source: Company filings and Taglich Brothers' estimates

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

	3/17A	6/17A	9/17A	12/17A	2017A	3/18A	6/18A	9/18A	12/18E	2018E	3/19E	6/19E	9/19E	12/19E	2019E
Search and other	37,588	34,379	33,287	34,251	139,505	31,610	29,591	30,957	33,000	125,158	32,400	32,700	33,000	33,300	131,400
Advertising	24,388	35,309	31,755	43,029	134,481	29,295	33,206	26,224	41,250	129,975	29,000	34,750	29,500	43,250	136,500
Total revenue	61,976	69,688	65,042	77,280	273,986	60,905	62,797	57,181	74,250	255,133	61,400	67,450	62,500	76,550	267,900
Cost of revenue	5,893	3,406	3,561	6,838	19,698	6,056	5,811	5,474	7,054	24,395	6,140	6,745	6,250	7,655	26,790
Gross profit	56,083	66,282	61,481	70,442	254,288	54,849	56,986	51,707	67,196	230,738	55,260	60,705	56,250	68,895	241,110
Customer acquisition costs and media buy	30,052	33,786	31,955	35,092	130,885	31,885	31,105	28,808	36,680	128,478	30,332	33,320	30,875	37,816	132,343
Research and development	5,020	4,230	4,096	4,406	17,752	5,544	4,678	4,341	4,750	19,313	4,875	4,875	4,875	4,875	19,500
Selling and marketing	12,905	15,785	14,142	14,309	57,141	9,701	10,081	8,635	11,657	40,074	9,640	10,590	9,813	12,018	42,060
General and administrative	5,175	6,013	5,353	5,369	21,910	4,286	4,881	3,883	5,420	18,470	4,298	4,722	4,375	5,359	18,753
Depreciation and amortization	4,901	5,008	3,388	3,294	16,591	2,071	2,491	2,528	2,360	9,450	2,276	2,120	1,970	1,820	8,186
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	3,512	6,329	12,878	3,840	5,079	4,343	7,007	20,268
Financial expenses	2,184	1,338	644	1,756	5,922	607	1,199	1,236	1,079	4,121	823	580	340	100	1,843
Income (loss) before taxes	(4,154)	(43,725)	1,903	(35,604)	(81,580)	(383)	1,614	2,276	5,250	8,757	3,017	4,499	4,003	6,907	18,425
Income tax (benefit)	(2,080)	(7,709)	(710)	1,673	(8,826)	(440)	628	84	1,168	1,440	754	1,125	1,001	1,727	4,607
Net income (loss)	(2,074)	(36,016)	2,613	(37,277)	(72,754)	57	986	2,192	4,082	7,317	2,263	3,374	3,002	5,180	13,818
EPS	(0.08)	(1.39)	0.10	(1.44)	(2.81)	0.00	0.04	0.08	0.15	0.28	0.09	0.13	0.11	0.20	0.52
Shares Outstanding	25,839	25,850	26,794	25,850	25,850	25,850	26,421	26,421	26,421	26,278	26,421	26,421	26,421	26,421	26,421
EBITDA	2,931	(37,379)	5,935	(30,554)	(59,067)	2,295	5,304	6,040	8,689	22,328	6,116	7,199	6,313	8,827	28,454
Adjusted EBITDA**	3,489	7,029	6,482	11,917	28,917	4,286	7,097	6,678	9,793	28,917	6,816	7,899	7,013	9,527	31,254
<u>Margin Analysis</u>															
Gross margin	90.5%	95.1%	94.5%	91.2%	92.8%	90.1%	90.7%	90.4%	90.5%	90.4%	90.0%	90.0%	90.0%	90.0%	90.0%
Customer acquisition costs and media buy	48.5%	48.5%	49.1%	45.4%	47.8%	52.4%	49.5%	50.4%	49.4%	49.4%	49.4%	49.4%	49.4%	49.4%	49.4%
Research and development	8.1%	6.1%	6.3%	5.7%	6.5%	9.1%	7.4%	7.6%	6.4%	7.6%	7.9%	7.2%	7.8%	6.4%	7.3%
Selling and marketing	20.8%	22.7%	21.7%	18.5%	20.9%	15.9%	16.1%	15.1%	15.7%	15.7%	15.7%	15.7%	15.7%	15.7%	15.7%
General and administrative	8.4%	8.6%	8.2%	6.9%	8.0%	7.0%	7.8%	7.4%	7.3%	7.2%	7.0%	7.0%	7.0%	7.0%	7.0%
Operating margin	(3.2)%	(60.8)%	3.9%	(43.8)%	(27.6)%	0.4%	4.5%	6.1%	8.5%	5.0%	6.3%	7.5%	6.9%	9.2%	7.6%
<u>Year / Year Growth</u>															
Total Revenues					(12.4)%	(1.7)%	(9.9)%	(12.1)%	(3.9)%	(6.9)%	0.8%	7.4%	9.3%	3.1%	5.0%
Net Income					NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	36.9%	26.9%	88.8%
EPS					NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	36.9%	26.9%	87.8%

*From continuing operations
**Includes stock compensation, restructuring and other costs
Source: Company filings and Taglich Brothers' estimates

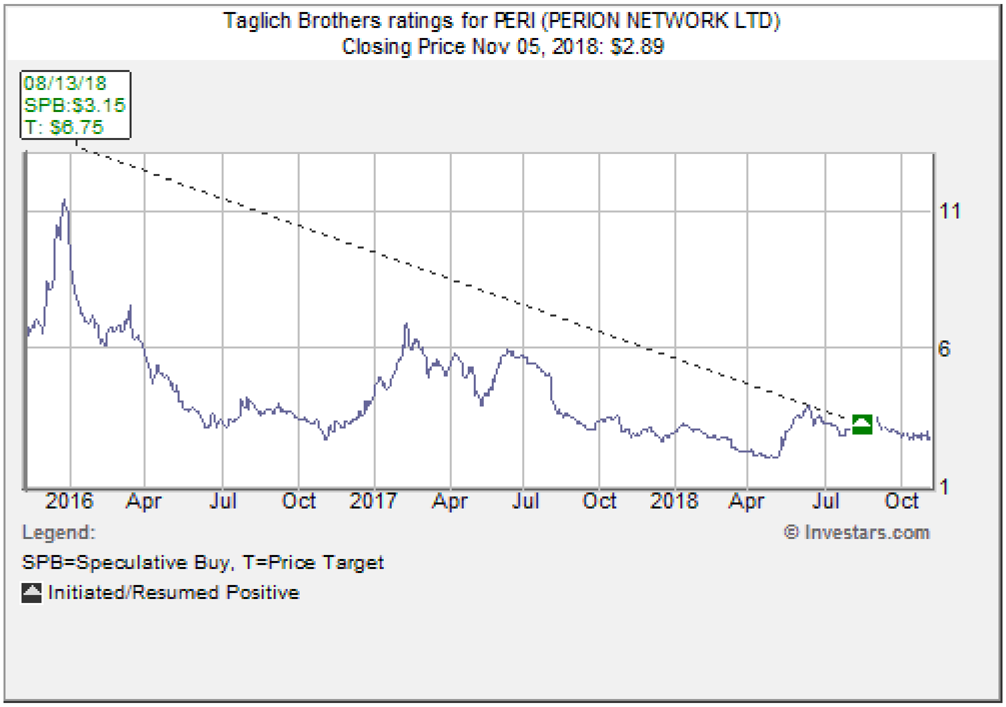
Statement of Cash Flows for the Periods Ended
(in thousands $)

	2016A	2017A	9m18A	2018E	2019E
Net income (loss)	2,848	(72,754)	3,235	7,317	13,818
Depreciation & amortization	25,977	16,591	7,090	9,450	8,186
Impairment	-	85,667	-	-	-
Restructuring costs	254	-	462	462	-
Stock-based compensation	6,844	2,112	2,121	2,871	2,800
Foreign currency translation	980	83	12	12	-
Accretion of payment obligation related to acquisition	320	43	-	-	-
Accrued interest	406	475	357	357	-
Deferred taxes	(3,268)	(8,877)	91	91	-
Accrued severance pay	214	801	-	-	-
Change in payment obligation related to acquisitions	983	-	-	-	-
Fair value revaluation - convertible debt	1,350	3,785	(741)	(741)	-
Loss from sale of property and equipment	149	-	-	-	-
Cash earnings (loss)	37,057	27,926	12,627	19,819	24,804
Changes in assets and liabilities					
Receivables	(5,333)	8,888	-	4,323	(2,928)
Prepaid expenses and other	8,613	(3,241)	-	5,353	-
Accounts payable	(1,702)	1,106	-	461	1,288
Accrued expenses and other	(2,486)	1,429	-	(1,317)	(1,647)
Deferred revenue	(2,365)	(95)	-	(1,336)	-
(Increase) decrease in working capital	(3,273)	8,087	15,831	7,485	(3,287)
Net cash provided by (used in) operations*	**33,784**	**36,013**	**28,458**	**27,304**	**21,517**
Purchase of property and equipment	(1,504)	(1,606)	(1,350)	(1,800)	(1,800)
Proceeds from sale of property and equipment	151	10	-	-	-
Capitalization of development costs	(4,591)	(5,756)	(1,449)	(2,202)	(1,762)
Change in restricted cash	647	-	-	-	-
Cash paid in connection with acquisitions	-	-	(1,667)	(3,446)	(1,700)
Short-term deposits	34,028	2,501	5,913	5,913	-
Net cash provided by (used in) investing	**28,731**	**(4,851)**	**1,447**	**(1,535)**	**(5,262)**
Exercise of options and restricted shares	2	1	-	-	-
Payments made in connection with acquisition	(29,537)	(2,551)	-	-	-
Proceeds from debt	40,000	5,000	-	-	-
Repayment of debt	(63,072)	(26,290)	(20,640)	(22,640)	(30,000)
Net cash provided by (used in) financing	**(52,607)**	**(23,840)**	**(20,640)**	**(22,640)**	**(30,000)**
Effect of currency exchange rates	(136)	283	44	44	-
Effect from discontinued operations on cash	(3,329)	-	-	-	-
Net change in cash	**6,443**	**7,605**	**9,309**	**3,173**	**(13,745)**
Cash - beginning of period	**17,519**	**23,962**	**31,567**	**31,567**	**34,740**
Cash - end of period	**23,962**	**31,567**	**40,876**	**34,740**	**20,995**

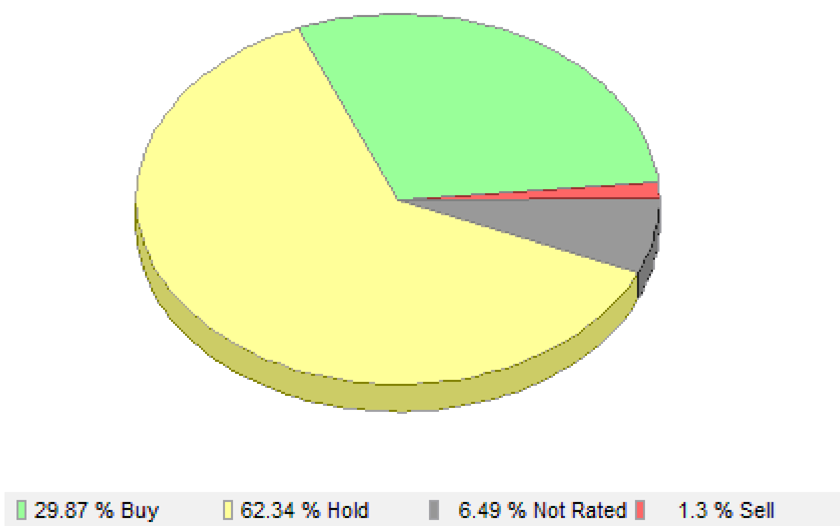
*From continuing operations

Source: Company filings and Taglich Brothers' estimates

Price Chart



Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	**3**	**11**
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.

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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.