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NASDAQ:PERI SNAPSHOT	
All data in USD Millions	
Price	10.98
# of Shares O/S	12.5
Market Cap	137.3
Operational Metrics	
Revenue- LTM (Sep 2013)	94.70
EBITDA- LTM (Sep 2013)	18.30
EBIT- LTM (Sep 2013)	8.80
Net Income- LTM (Sep 2013)	2.70
Debt- 2012	7.10
Cash- 2012	27.30
Ratios	
Gross Margin %	88.80%
EBITDA %	19.32%
Net Income %	2.85%
Valuation Metrics	
Enterprise Value	117.1
BVPS	4.63
EV/Revenue-FY13	1.24
EV/EBIT-FY13	13.30
EV/EBITDA- FY13	6.40
P/E- FY13	50.83
P/BV- FY13	2.37
FCFF Yield	27.91%

DEEP VALUE INVESTMENT IDEA- TRIGGERS

Perion Network presents an exciting deep value investment opportunity. The company is at an inflection point in its trajectory for growth and the following will help achieve it.

1. **Robust Financials:** The Company has strong set of financials and a history of showing profitable growth. It has had a stellar record for beating earnings estimates.
2. **Attractive Valuation:** The Company is available at a deep discount to its intrinsic valuation of around **\$17/share**.
3. **Client Connect Merger:** The merger with Client Connect creates significant synergy and gives scale to the company to enter the big league. Post- merger, Perion Network will be the fifth largest search company in the world.
4. **Potential Acquisition:** Post merger with Client connect, Perion will become significantly attractive as an acquisition candidate to larger players like Google and Yahoo. Moreover, becoming large player will draw attention from broader market.

Nasdaq: PERI - Stock Chart. YTD (Jan 02 2013- Nov 14, 2013) - 22.26%



Background:

Perion Network Ltd., a consumer Internet company, engages in the development of various applications. It designs and markets various consumer products, including IncediMail, a messaging application to manage various email accounts and Facebook messages with graphic and personalizing capabilities; SweetIM, an instant messaging application that enables consumers to personalize their everyday communications with free, fun, and easy to use content; and Smilebox, a photo sharing and social expression product and service that turns life's moments into digital keepsakes for sharing and connecting with friends and family in a fun and personal way for the desktop and smart-phone. The company distributes and sells its products and services to consumers worldwide in approximately 100 countries. The company was formerly known as Incredimail Ltd. and changed its name to Perion Network Ltd. in November 2011. Perion Network Ltd. was incorporated in 1999 and is headquartered in Tel Aviv, Israel.

Perion generates revenue primarily by

- 1) Monetizing the users of its products through search advertising.
- 2) Selling premium and subscription software products.
- 3) Other revenues generating from advertising and collaborations.

Perion started as a mail application company in the form of "IncediMail". It acquired Smilebox in August 2011 and further acquired SweetPacks in Nov 2012. The company's three main products include:

IncediMail: a popular e-mail product offered as free and monetized through advertising and a premium version sold in over 100 countries in 8 different languages.

Smilebox: a photo sharing and social expression product and service, available both on desktop and mobile, that lets customers quickly turn life's moments into digital creations to share and connect with friends and family in a fun and personal way.

SweetPacks: Although SweetPacks currently has a number of useful tools including SweetPCFix, a product that enables users to maximize their PC's proficiency, Video Converter, an application to convert videos from 200 various formats into others, and GamePacks, a collection of 400 games packed into one product, the team's flagship product is SweetIM, its instant messaging product.

Search generated revenues comprise around 70% of total revenues of the firm. However, over the last 2 quarters, the company has been able to reduce its client concentration in the search based segment. Previously, it derived over 80% of its search revenues from Google. However, the company has expanded from 1 search partner to 5, and now works with Google, Bing, Ask.com, Yahoo! and Conduit. No single partner accounts for more than 40% of their search-generated revenues.

The current CEO of the company Joseph Mandelbaum joined the company in August 2010. Under his leadership, the company has been on an aggressive acquisition strategy, having acquired or in process to acquire a total of 3 companies in the last 2.5 years. With each acquisition, the company is adding new products that allow it to not only diversify revenues but also increase reach, thus complementing the search revenue business.

INVESTMENT THESIS

1. **Robust Financials:** Perion has posted good topline growth over the past few years. Revenues have increased at a rapid CAGR (08-12) of 26.23% from \$21.9 million in Dec 2008 to \$55.6 million at the end of Dec 2012 (fiscal year); the operating income has increased from \$1.4 million in Dec 2008 to \$8.3 million at the end of Apr 2013, posting a CAGR of 55.5%.

However, with the acquisition of SweetPacks, the LTM financials have completely changed the scale of the business. As of Sep 30, 2013, the company posted LTM revenue of \$94.7 million and an EBITDA of \$38 million, implying an EBITDA margin of 19.32%. Further, if the Conduit acquisition is completed, the combined company would be the fifth-largest in the U.S. search market and overtake New York-based AOL, which had a 1.3 percent share in August, according to digital-media data tracker. The management estimates that Perion and Conduit merged entity will be responsible for 2% of searches in the US, beating AOL. I also like the underlying economics of the business. It is a solid free cash flow generating business, with Perion having one of the highest Free Cash Flow yield i.e. 27.91% in the industry. Moreover, the company has consistently beaten the earnings estimates, surprising the market frequently. Following is graph that shows how analysts have revised earnings estimates over last couple of quarters.



2. **Attractive Valuation**

Perion Network on a standalone basis (prior to merger with Client Connect) is available at a substantial discount to its intrinsic value. Based on the current valuation parameters, I believe buying PERI at current levels limits the downside risk and allows the investor to ride the upside. From a risk-reward perspective, I believe Perion is an extremely favorable investment.

To calculate the intrinsic value of Perion Network, I followed two commonly used approaches to valuation: Comparable Company Analysis and DCF. Following is a brief work up on intrinsic valuation calculation.

Comparable Company Analysis:

As per this analysis, the intrinsic value of the company is **\$16.34/share**, representing a **48.82%** upside from current stock price levels.

Perion Network Comparable Company Analysis- Comp Set						
Company Name	Market Cap	EV	Operating Parameters			FCFF Yield
			Revenues	EBITDA	Net Income	
AOL Inc. (NYSE:AOL)	\$ 3,548.80	\$ 3,486.70	\$ 2,240.40	\$ 416.50	\$ 92.10	20.23%
AVG Technologies N.V. (NYSE:AVG)	\$ 947.30	\$ 931.50	\$ 400.40	\$ 132.00	\$ 55.80	13.30%
Blucora, Inc. (NasdaqGS:BCOR)	\$ 1,228.50	\$ 1,225.90	\$ 504.10	\$ 90.10	\$ 29.40	5.12%
IAC (NasdaqGS:IACI)	\$ 4,805.20	\$ 4,703.00	\$ 3,063.80	\$ 538.60	\$ 249.60	14.93%
Perion Network (NasdaqGM:PERI)	\$ 137.00	\$ 116.80	\$ 94.70	\$ 18.30	\$ 2.70	27.91%

Source: Capital IQ, Benchmark Capital & Needham IC reports

Perion Network Implied Valuation From Comparable Company Analysis				
Company Name	Valuation Parameters			
	EV/Revenues	EV/EBIT	EV/EBITDA	Forward P/E
AOL Inc. (NYSE:AOL)	1.6	14.1	8.4	20.58
AVG Technologies N.V. (NYSE:AVG)	2.3	8.6	7.1	9.42
Blucora, Inc. (NasdaqGS:BCOR)	2.4	18.7	13.6	12.88
IAC/InterActiveCorp (NasdaqGS:IACI)	1.5	11.3	8.8	14.68
Mean	1.95	13.175	9.475	14.39
Perion Network Ltd (NasdaqGM:PERI)	1.2	13.3	6.4	7.01
Perion Implied Price per Share	\$ 16.39	\$ 10.89	\$ 15.49	\$ 22.59
Perion Average Implied Price per Share	\$ 16.34			
Perion Current Price per Share	\$ 10.98			
Current discount	48.82%			

DCF Analysis:

Perion Network DCF Valuation							Assumptions- DCF Model	
	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Long Term Growth (g)	2%
FCF	19.28	22.39	22.84	23.30	23.76	24.24	WACC	13.47%
Terminal Value						215.49	Risk Free Rate	5%
							Equity Risk Premium	6%
EV	202.59						Beta	2.59
Debt	7.60						Cost of Equity	20.5%
Cash	27.30						Marginal Cost of Debt	4.6%
Value of Equity	222.29						Tax Rate	37.50%
# of Shares Outstanding	12.50						After Tax Cost of Debt	2.9%
Intrinsic Value/Share	17.78						Target Debt to Cap	40.00%

Perion Network DCF Sensitivity Analysis					
g	WACC				
	11%	12%	13%	16%	18%
1%	20.21	18.54	16.54	14.03	12.55
2%	22.19	20.15	17.78	14.87	13.20
3%	24.67	22.13	19.26	15.83	13.93
4%	27.85	24.60	21.05	16.97	14.77
5%	32.11	27.79	23.27	18.31	15.73

From the above DCF analysis, we see that Perion Network has a standalone DCF Equity value per share of **\$17.78**. Hence, the current stock price represents a discount of **62%**. Further, I did a sensitivity analysis, varying WACC and g, to estimate the range of DCF equity value per share for the company. Even in the extreme cases, we find the DCF equity value to be greater than current price/share of Perion Network.

3. Value Creation due to Client Connect Merger:

On September 16, 2013, Perion's management announced that it has entered into a share purchase agreement with Conduit Ltd. As per the agreement, Conduit decided to split and merge its Client Connect search business with Perion.

Perion held an EOGM on November 18th, 2013 to get shareholder approval for the merger. The votes cast in favor of the merger at the meeting constituted 99% of the aggregate shares voted. The overwhelming majority achieved on the vote is a vindication for the management of Perion and the proposed merger. The management expects the merger to be complete by January 2014, subject to approvals from tax and antitrust authorities. Following is a brief on deal structure, dynamics and value creation.

Client Connect – Perion Merger:

Background on Client Connect: Conduit is a recognized leader in breakthrough engaging solutions for web and mobile publishers and one of Israel's largest internet companies. Conduit's management made a decision to split its business into 2, allowing each part to flourish and grow faster independently thereby maximizing the potential of the overall business. Both companies' management decided to combine 2 powerful and complementary businesses, Perion and the segment of Conduit's business that was highly synergistic with our own, Client Connect. This combination will form one of the largest global digital search distribution and profit companies in the world.

Deal Terms:

As per the terms of share purchase agreement, Conduit will split and spin off its Client Connect business by the end of 2013. This spin-off company will be combined with Perion and upon closing, Perion will issue to Conduit shareholders between \$57 million and \$60 million shares based on Perion's fully diluted share count at closing. As a result, 81% of Perion shares will be owned by existing Conduit share and option holders and 19% by existing Perion share and option holders on a fully diluted basis. This is an all-stock transaction with no payments of cash or debt burden which is accretive for Perion's shareholders as a result of Client Connect's high level of profits. Moreover, post-merger, the current management of Perion will continue to lead the company and founders of Conduit will take board positions.

Deal Dynamics:

The merger of Perion and Client Connect is not only synergistic but also strategic. Following are some of the highlights of the merger.

- a. **Formidable Player in the Industry:** Post the merger, Perion Network will emerge to be the 5th largest player in the US Search market. They will account for over 2% of searches in the US and takeover AOL. It will be the only non US Company in top 5.
- b. **Scale:** Post merger Perion Network, on a pro forma basis had over 17 Billion LTM search queries, 570 Million LTM installs and 461 employees. This puts the company in the big league, enough to be noticed seriously by competitors. With increased reach, Perion will be inherently more attractive for premier software and application publishers and developers. Being a top tier distributor allows the company to optimize revenue at higher levels and better positions them for negotiating distribution relationships.

- c. Accretive: Since the merger is accretive, it brings substantial free cash flow for the merged entity, thereby allowing the firm to accelerate growth organically and inorganically.

Value Creation due to the merger:

I believe that the Perion and Conduit merger creates an entity, which is currently trading at a deep discount to its merged intrinsic value. While we have explained earlier that on a standalone basis, Perion is available cheaply, we feel the recent acquisition of SweetPacks and merger with Client Connect further deepens this discount and hence, makes Perion an exciting investment.

Based on the pro-forma LTM financials of merged entity, provided by the management, I did a comparable company analysis to determine the intrinsic value of Perion Network post-merger. Following is the analysis:

Value creation analysis due to merger with Client Connect			
Company Name	Valuation Parameters		
	EV/Revenues	EV/EBITDA	P/E
All data in \$ Millions			
AOL Inc. (NYSE:AOL)	1.6	8.4	42.0
AVG Technologies N.V. (NYSE:AVG)	2.3	7.1	17.0
Blucora, Inc. (NasdaqGS:BCOR)	2.4	13.6	43.1
IAC/InterActiveCorp (NasdaqGS:IACI)	1.5	8.8	20.4
Stake to Perion Shareholders			19.00%
Implied Equity Value Perion Merged Entity - Mean	\$ 738.34	\$ 1,055.46	\$ 2,848.13
Average Implied Equity Value to Perion's current shareholder	\$		293.99
Implied Equity Value Perion Merged Entity - High	\$ 903.49	\$ 1,505.09	\$ 4,008.30
Average Implied Equity Value to Perion's current shareholder	\$		406.40
Implied Equity Value Perion Merged Entity - Low	\$ 573.19	\$ 796.59	\$ 1,581.00
Average Implied Equity Value to Perion's current shareholder	\$		186.88

From the above analysis, we realize that the merged entity will be valued around over \$1 billion. Knowing that Perion's current shareholders will hold around 19% of the merged entity, I estimate post-merger value of Perion's current shares. I believe given the size and scale of the merged entity, the value should reflect premium due to size, liquidity and growth. This premium is reflected in multiples based valuation explained above. We can see that even in worst case scenario, the value to Perion's current shareholder is at a **35%** premium to its current market cap. Furthermore, in the best case scenario the value to Perion's current shareholder is at a **115%** premium to its current market cap. These upside scenarios are purely based on value created due the merger. If we take into account the expected growth in SweetPacks and Client Connect's business then further upside is created in the investment.

4. Potential Acquisition

One of the biggest value drivers in Perion Network is its attractiveness as a potential acquisition candidate by major search firms like Google, Yahoo, and Microsoft etc. Perion will become the fifth largest search based business post-merger with Client Connect, accounting for 2% of searches in US, ahead of AOL. Following are my reasons as to why Perion is an attractive acquisition candidate:

1. Size: While Perion always competed within the search business, being a \$150 million market cap didn't make it a significant player to catch attention of potential acquirers. Post-merger, it will become an over \$1 Billion enterprise with substantial market share. This transformational move will make it an attractive candidate for acquisition.

2. Consolidation in the Industry: The search engine industry is at cross-roads with the top 3 players- Google, Yahoo and Microsoft, all trying to expand their share of the search market. With a strong balance sheet like Perion, any of these players would like to buy Perion and strengthen their position in the market. We also know that these players have been very active in the M&A market lately and have huge cash piles to undertake acquisitions. Following is a brief snapshot of recent transactions:

Buyer	Target	Date
Google Inc.	Flutter Inc.	October-13
Google Inc.	Bump Technologies Inc.	September-13
Google Inc.	SR Tech Group	July-13
Google Inc.	Waze Ltd.	June-13
Google Inc.	LendingClub Corporation	May-13
Google Inc.	Wavii Inc.	April-13
Yahoo! Inc.	LookFlow Inc.	October-13
Yahoo! Inc.	IQ Engines Inc.	August-13
Yahoo! Inc.	Qwiki Inc.	July-13
Yahoo! Inc.	Tumblr Inc.	June-13
Yahoo! Inc.	Milewise Inc.	May-13
Yahoo! Inc.	Summly Limited	March-13
Microsoft Corporation	APIphany Inc.	October-13
Microsoft Corporation	InCycle Software Inc.	June-13
Microsoft Corporation	Pando networks Inc.	February-13
Microsoft Corporation	MetricsHub Inc.	March-13

Hoping the M&A activity remains solid going forward coupled with M&A focus of Perion's management, I feel that Perion can soon be acquired by one of the big search engines. This presents an exciting opportunity to invest in a micro-cap that has the potential to become mid-cap in a relatively short timeframe.

3. Additional Coverage: Becoming a \$1 billion company will make Perion well tracked and traded by the brokerages. This not only provides liquidity to the counter but also attracts institutional players as well as bigger funds focused on technology stocks. Such an event provides further upside to the stock and makes it an attractive investment.