ADVFN plc

Into the Black

09 Jan 2008

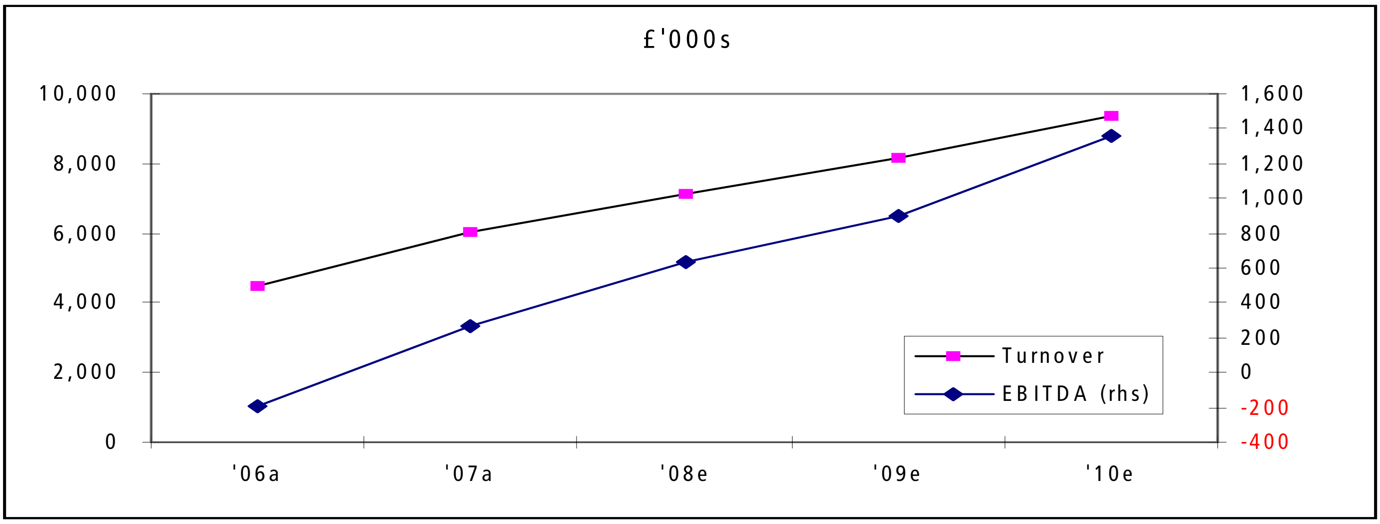
Initiation of Coverage
Recommendation: Buy
Target Price: 3.40p
Current Price: 2.22p
Mkt Cap: £13.8m

We see over 50% upside in ADVFN stock. The business is now executing against plan and facing substantial growth opportunities. ADVFN stands on the brink of profitability after a hard fought struggle to achieve leadership in the delivery of online live financial information to private investors. The business is effectively a Bloomberg/Reuters for the private investor and has developed both advertising and subscription revenue streams. The Group's websites generate traffic volumes akin to that of FT.com (source: Alexa.com) and are now the clear leader in the provision of financial data to UK private investors. The majority of traffic is now developed from the Group's overseas websites and monetising this through higher advertising and subscription revenues is a major opportunity.

In recent months the Management have witnessed both key revenue streams undergoing a 'hockey stick' path, with subscription take-ups rising especially strongly. With the majority of costs insensitive to business volumes ADVFN should begin to demonstrate positive operating 'jaws' as revenues rise. The Group has developed a scaleable business model that can rapidly and easily cross national boundaries. This is now leading to buoyant revenue growth from relatively new territories such as Italy and Brazil at modest additional costs.

The Group turned EBITDA positive in the last financial year and we believe they are now on a clear path to operating profitability and strong, positive cash flow. Previous years have seen significant drag effects in the P&L account from ADVFN's share of associates' operating losses. Management actions to restructure or refocus these Associates should see these drags much diminished going forward, allowing a cleaner P&L to be shown to the market. Our forecasts reflect a degree of financial performance that we regard as very conservative given the recent progress made within the business.

The sector has seen several consolidation moves in recent years, the most recent being the acquisition of OnVista AG by Boursarama late last year. These deals have typically taken place at elevated multiples, highlighting the value within ADVFN should it continue successfully executing on its growth plan. We see substantial upside to the stock which is still rated according to its difficult first few years rather than its future potential. Our target price of 3.40p offers upside of over 50%. Buy.



Source : ADVFN plc, Mirabaud Securities

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HISTORY

ADVFN was established in 1999 and floated on AIM the following year. Unlike many of its peers the business has succeeded in developing a durable revenue base of advertising and subscription streams in multiple markets globally. Initial backing came from On-Line plc, an incubator business established by ADVFN's Chairman, Michael Hodges and the company has subsequently grown both organically and through a small number of acquisitions of complementary businesses, including a sponsored research producer and two US investor websites. An investment into a Japanese associate ultimately proved to be an unsuccessful distraction leading to significant non-cash charges passing through the P&L. This has now been unwound and ADVFN will be running its Japanese site from the UK in future, with a substantial benefit to reported profits as a result.

Whilst ADVFN has covered the US markets for many years, it is fair to say that the US website has not achieved the same degree of leadership as its' UK sibling. This led management to consider acquisition as a route to further US growth and a target company was identified and acquired in September 2006. This brought two sites, InvestorsHub and Silicon Investor into the Group. These sites had significant bulletin board traffic, something that ADVFN has discovered is key to both building user numbers and retaining subscribers.

ADVFN has a 40% stake in All IPO plc, an online business which is seeking to develop a means for private investors to invest into IPO's which would otherwise be available only to institutional funds. This stake is currently valued at £0.6m

The group has two non-core websites, Fotothing.com, which is a file sharing site that allows users to share their photographs, whilst CupidBay.com is an online dating service. Neither has any synergy with the core financial data business of ADVFN nor do they make any significant contribution to the overall performance of the parent and we would not be surprised to see disposals of these businesses if the right terms were to be offered.

MANAGEMENT

The Management Team have been very stable. The Chairman, Michael Hodges and Chief Executive, Clem Chambers are Founders of the company and also Directors of On-Line plc, (still a 20% shareholder in ADVFN) and All IPO plc, in which ADVFN has a 40% stake, worth circa £0.6m. The FD, David Crump is also an On-Line plc Director, whilst the Technical and Sales Directors have been with ADVFN since its early days. There is only one non-Executive Director, Robert Emmet, apart from the Chairman and he is also a Director of All IPO plc.

ASSOCIATES

Recent years have seen large negative sums pass through the P&L representing ADVFN plc's share of the losses incurred by its' Japanese associate company and its investment in All IPO plc. In the last FY these amounted to over £700k. These are non-cash items and distort the underlying performance of ADVFN. We expect to see a resolution of the Japanese issue that will see ADVFN extract the remaining cash in the Japanese business and run the site from the UK hub with only modest ongoing expenses that should be easily covered through advertising sales. We note from All IPO plc's latest results release a commitment to significantly reduce the ongoing rate of losses and accordingly expect non-cash losses passing through the P&L to be much reduced in future periods.

BUSINESS MODEL

The ADVFN model generates both subscription and advertising revenues, with a current bias toward the latter. The site is a natural location for financial service and upscale product advertisers given its investor user-base and ADVFN tends to find that once recruited, advertisers retain a presence on the site for a considerable time.

ADVFN is now the leading UK private investor site for equity prices, news, charting and analytics and it generates a similar volume of traffic to FT.com (source: ADVFN). This suggests that there is considerable further potential to monetise the potential advertising value of the site.

The site has been constructed to be scaleable, allowing ADVFN to create 'clone' sites covering different markets quickly at low cost. This is leading to substantial, and we suspect underappreciated operational leverage in the business. ADVFN now covers the UK and US markets, most Continental markets plus Japan and Brazil. Whilst there are over 3m users across the Group's sites, the number of subscribers is far lower, at circa 13,000. Subscriber numbers have risen almost 50% in the last year. The company believe that they are now seeing a 'hockey stick' curve in both subscriber numbers and advertising volumes.

Subscription options cover a range of service levels. Most subscribers opt for a fairly basic level of live prices costing circa £10 pcm. Currently the Group is writing about 30 new subscriptions each day, with some days generating as much as three times that level of new business. At this stage in the Group's life the observed level of subscription churn has been very low, though it is possible that this could rise to meaningful levels in the future.

The UK is far and away the largest source of subscription revenues, but it is also pretty mature. Most growth is coming from recently developed sites, such as Brazil or Italy. In the US the old ADVFN site is also mature, but strong growth is coming out of the newly acquired businesses. Although the UK site is the largest single revenue generator for the Group, it only generates a around 23% of the total traffic across ADVFN Group sites. 30% of traffic now comes from the USA with Brazil and Europe contributing the bulk of the remainder and growing rapidly. Management's challenge is to monetise the international traffic to at least the same degree as the UK flow.

Advertising revenues come from banner ads and targeted e-mail. Group policy is to allocate a small number of (London based) sales execs to a territory and incentivise them to build the business. The acquired businesses in the US were less commercialised than ADVFN and revenues are being increased through lifting the ad-density on the sites, though this must be done gently to avoid antagonising users. It is actually possible to pay a premium to see an ad-free ADVFN. Either way, they get the money.

There are substantial network effects to stock trading websites. Users value the presence of other users and the bulletin board becomes a key loyalty driver. As a result we believe that barriers to entry are emerging which could limit future competitive pressures. Already we have witnessed some weaker players exit, whilst web traffic data suggests that several competitors are losing traction. Scale also creates buying economies. ADVFN have seen favourable movements in data costs, which are one of their major expenses. The gross margin on reselling data can be very high as a result, though scale is everything in terms of converting this through to the bottom line.

The Group has tended to grow users through advertising, principally on Search Engines such as Google. ADVFN buys 'inventory' which is essentially the right to be displayed at the top of the sponsored search results on the right of the screen whenever a user searches for stock price quotes. By setting the keywords on the ADVFN site appropriately, the Group can also try to generate top-ranked entries on the left of the screen. The Engines constantly alter the way their search technology picks out sites to prevent any given site from always being selected for the left hand search result, since this would cut their need to buy inventory slots on the right of the screen.

The vast majority of new users who register with ADVFN initially do so as users of the free-only services. This gives them limited access to live prices, typically for only a few seconds at a time. ADVFN buys a certain number of contended accesses from the Exchanges. When site volumes are low, free users will receive live prices for a meaningful stretch at a time. When the numbers online rise the amount of time each free user is allotted falls to ensure subscribers have their proper access without ADVFN having to buy more contended accesses. In fast markets a free user might get only a couple of seconds before their price quote expires, replaced by a subscription advert. The company find that it takes a year or so to convert a consistent free-service user into taking a subscription, a move most likely prompted by finding that free contended access is not lasting long enough to trade from at a time when market movements could be costing them dearly.

The great conundrum for a business such as ADVFN is how to fully monetise the value of its traffic. As the UK's leading private investor site and with strong positions in markets as large and diverse as the US and Brazil, ADVFN is regularly visited by one of the wealthiest cadres of people in the Western consumer universe. The problem is perhaps though that they visit with a mission to trade stocks, not to browse. As Bloomberg and Reuters users know, advertising is not an obvious bedfellow to sit alongside data that changes second by second and upon which vast profits or losses can rest.

For now the business appears to be focusing more upon bringing the InvestorsHub (iHub) and Silicon Investor (SI) advertising contribution up toward that of the original ADVFN site. We expect that this could quickly double the contribution made by these sites for minimal additional cost. Ultimately though, we would like to see ADVFN explore ways of fully maximising the advertising value of its high net worth client base through introducing additional, less time-critical content that could support a greater degree of advertising value.

By bringing in well populated US chat rooms / bulletin boards Management have significantly increased the medium term growth potential of ADVFN. A far greater private investor ethos in the States means that the business opportunity of success in the USA is greater than the relative population differentials between the UK and US would imply. The acquisition of iHub and SI looks to have been potentially transformational for the Group. Scale in the USA is capable of transforming the fortunes of a business such as ADVFN. Management point out that if SI/iHub were to follow the same growth path as the ADVFN site then this greater scale would lead to a business with over $25m of turnover within five years.

EQUITY DEVELOPMENT

The acquisition of Equity Development appears to have been driven more by financial logic than operating synergy. ED is a leading producer of paid-for equity research. Smaller companies can face difficulties obtaining an appropriate rating for their stock if there is insufficient broker interest in researching them. ED allows managements to commission research notes on their companies which will then be marketed to the investment community.

The nature of the service means that ED is essentially catering for a small/micro-cap client base and the audience is principally small cap fund managers and private client brokers. ED will also organise investor roadshows and presentations/conferences for client companies. In a sense, ED is an outsourced IR function. Their staff of analysts will also undertake bespoke research projects for investors on a fee basis.

The business has grown nicely and is now turning over around £1.1m p.a. The sensitivity to market levels is unproven and we must have some concerns that the commissioning of research could prove rather sensitive to a downturn in the market. We also note that the coverage universe has a degree of bias toward small specialty financial stocks which may be vulnerable to credit market tightening. Notwithstanding these concerns, the business is highly profitable and plays a valuable role in offsetting ADVFN's start-up losses as the wider financial information business moves toward breakeven.

COMPETITORS AND TRANSACTION VALUES

There have been transactions at higher multiples of turnover than ADVFN's current market capitalisation implies. For instance Onvista AG, a leading German financial data website has recently been acquired by France's Boursorama for €138m, approximately 5.3x projected sales (source: Onvista AG). Onvista has only a third of the number of site users of ADVFN, though it does seem to have been somewhat better at converting that traffic into revenues.

Direct competitors are typically part of larger groups, especially following the acquisition of Onvista. Quote.com for instance was bought by eSignal, itself acquired by Interactive Data Corp, part of Pearson. Boursarama contains a banking business and has a whole different set of factors affecting it currently as a result. Another competitor, Market Watch is part of Dow Jones, which recently changed hands for an exceptional premium, though we doubt that Market Watch was the reason for the trophy price.

With the exception of Boursarama which has been derated since it moved into banking services, stocks exposed to the online market quotes business have tended to trade at high multiples, though it is hard to say how much of this has been due to this aspect of the broader groups activities. IDC for instance is currently valued at $3bn or 26x consensus earnings and 4.4x sales. In a recent Investor Day the management talked very positively of prospects and stressed the 'positive jaws' nature of the business model, with margins rising rapidly.

FORECASTS

ADVFN's current rate of subscriber sign-up is, we believe adding the equivalent of circa £650k of revenue p.a. in year one and twice that in year two. We expect new signings to deliver an EBIT margin of circa 85% so current growth rates will go a long way toward taking ADVFN through to profitability. Any further rise in subscription rates would be highly positive for future profitability.

As currently configured, the site is pretty intensively covered with advertising and we would expect advertising revenues to grow more steadily, driven by gradual creep in the cost per thousand (CPM) that ADVFN is able to obtain from advertisers.

In the current year revenues at the core ADVFN brand will be driven by new subscriptions, primarily in the European and Latin American markets. InvestorsHub and Silicon Investor will initially see a surge in advertising revenue from the greater commercialisation of the sites under ADVFN's ownership. This looks likely to at least double revenues in the first full year since the new site design went live in October.

We have assumed that growth tails off at Equity Development toward the end of the year, reflecting concerns about the health of stock markets generally. A strong start to the year means that reported full year growth will still be strong for this division, but we currently pencil in flat to low growth for periods beyond FY June '08.

We have not assumed any meaningful contribution from Fotothing or CupidBay in any forecast year.

Sales & Cost Progression

	Jun '07a	Jun '08e	Jun '09e	Jun '10e
ADVFN	4,574	5,260	6,049	6,956
iHub/SI	389	778	973	1,216
Equity Development	969	1,066	1,066	1,119
Other	91	50	50	50
Total Turnover	**6,022**	**7,154**	**8,138**	**9,341**
Cash Costs	**(6,752)**	**(6,925)**	**(7,525)**	**(8,234)**
Non-Cash Costs	**(1,081)**	**(775)**	**(575)**	**(475)**
- Option Expensing	(169)	(175)	(175)	(175)
- Amortisation	(174)	(250)	(250)	(250)
- Associates	(738)	(350	(150)	(50)
Net Interest	35	(10)	(15)	20
PBT	**-1,776**	**-1,156**	**-686**	**-91**

Mindful of success in the field to date, we have assumed that Exchange Fees paid lag growth in subscribers; given the use of contended accesses we believe that growth in the business will lead to more efficient use of exchange access points, which combined with greater bargaining power should keep this important cost line well controlled.

In theory, the business should be capable of supporting significant top line growth with minimal additional costs apart from exchange fees and performance-linked pay for the advertising sales teams. In practice though we feel it is more conservative to assume that SG&A costs do rise in real terms at a fairly fast clip, albeit behind revenue growth.

In the near term the cash operating performance of the Group will continue to be overshadowed at the reported level by a number of non-cash items. Whilst we forecast a rapid decline in associates' losses, there will continue to be charges of circa £400k p.a. going through the P&L to cover goodwill amortisation and employee share option expensing. For this reason we feel it is best to focus on cash generation, where the underlying trend should be one of steady improvement.

Last year the group generated a small positive EBITDA of £262k. In the current year we anticipate that this will rise to around £630k and then grow steadily.

£'000s	Jun 06a	Jun 07a	Jun 08e	Jun 09e	Jun 10e
Turnover	4463	6022	7154	8138	9341
EBITDA	-188	263	629	904	1364
PBT	-1079	-1777	-1156	-686	-91
EPS (p)	-0.22	-0.27	-0.17	-0.10	-0.01

RISKS

The company faces a number of operating risks, not least the risk that current market weakness could lead to a drop in investor interest in online market data, with knock-on effects on subscription and advertising revenues. The business could also suffer from higher market data costs and IT unit costs, or the lack of key personnel. None of these can be dismissed, however the company has found that falling markets can even stimulate interest as people seek to more actively try to preserve value. Equally, experience to date suggests that greater scale actually allows ADVFN to negotiate better market data terms. The downwards trend in IT equipment costs is well established and we suspect unlikely to reverse at a time of economic uncertainty. Perhaps the most significant risk then is that of personnel change and here we believe that overall staff churn has declined a little in recent years whilst the top team has been stable.

CONCLUSION

ADVFN has successfully moved into the international arena. With a majority of traffic coming from international markets the Group is set to monetise this flow of business in the years ahead. Greater presence in the US through the acquired iHub and Silicon Investor brands offers further upside. Our forecasts look conservative in the light of recent new business rates and we believe that continued success in converting users into subscribers could lead to profitability coming in usefully ahead of our forecasts. With increasing global broadband penetration the number of potential users of live streamed financial data is rising inexorably.

There are relatively few competitors offering live pricing data, sites such as Quote.com are delayed and unattractive to active traders. Others such as e-Signal are more expensive for many users. Of course investors can simply rely on their brokers' online services but these often restrict access to live prices and generally offer a lower level of data than a site such as ADVFN. With larger corporates now owning most of the industry we would not be surprised to see ADVFN taking part in corporate activity in the future. For now the Management are focused on growing the business and improving the stock's rating so that its value more clearly reflects the potential not the past. Should the market fail to reward the business for the rapid progress currently underway then a review of strategy would seem inevitable.

For our target price we have used EV/sales as the key metric. We believe operating profit ratios still understate the value in the business since it is still in the process of moving into sustainable profitability. With other businesses in the space achieving high operating margins at a later stage of maturity we think it is appropriate to value ADVFN at a multiple of 3x Sales (Jun '08F). This equates to a price target of 3.40p per share, upside of over 50%.

RECOMMENDATIONS HISTORY

Stock	ADVFN plc
Market index	FTSE Small Cap

Date	Market Index level	Stock price p	Target price p	Opinion	Qualifier
9th Jan 2008	3310	2.22	3.4	Buy	

Sources: Bloomberg, Mirabaud Securities

RATINGS, CERTIFICATION AND DISCLOSURE

RATINGS SYSTEM

BUY: The stock is expected to generate absolute positive price performance of over 20% during the next 12 months.

OVERWEIGHT: The stock is expected to generate absolute positive price performance of 10-20% during the next 12 months

NEUTRAL: The stock is expected to generate absolute price performance of between 10% positive and 10% negative during the next 12 months.

UNDERWEIGHT: The stock is expected to generate absolute negative price performance of 10-20% during the next 12 months

SELL: The stock is expected to generate absolute negative price performance of over 20% during the next 12 months.

RISK Qualifier: Speculative

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