

Perion Network Ltd.

February 8, 2016

Research Update

'iIA-' Ratings Affirmed And Removed From CreditWatch; Outlook Stable

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Research Update

'iIA-' Ratings Affirmed And Removed From CreditWatch; Outlook Stable

Summary

- In December 2015, Perion Network Ltd. ("Perion") completed the acquisition of the U.S.-based digital advertising company, Undertone, valued at \$180 million. The acquisition of about \$130 million was financed from Perion's internal sources and through debt.
- We estimate that Undertone's acquisition will strengthen Perion's business risk profile, as it will increase Perion's revenue base and EBITDA and decrease its dependence on its traditional field of operation, search engine activity.
- We estimate that Perion's financial risk has increased following the acquisition, due to the increase in debt and the fact that Undertone's activity is characterized by higher working capital investment than the search engine sector. Nevertheless, Perion's leverage remains low compared with similarly rated peers.
- We are affirming our 'iIA-' issuer rating on Perion Networks Ltd., and removing it from CreditWatch where we placed it with developing implications on December 3, 2015.
- The stable outlook reflects our assessment that Perion's business risk profile will remain stable in the medium term and allow the company to report operating performance and coverage ratios which are commensurate with its current rating, i.e. adjusted debt-to-EBITDA below 3.0x.

Rating Action

On February 8, 2016, Standard & Poor's affirmed its 'iIA-' rating on Perion Network Ltd., operating in the fields of online advertising, program development and marketing and advanced services for email developers, distributors and users, and removed it from CreditWatch with developing implications. The outlook is stable.

Rationale

On December 1, 2015, Perion Network Ltd. ("Perion") announced the acquisition of the U.S.-based digital advertising company Undertone valued at \$180 million. Undertone provides advertising solutions for mobile and desktop devices. The acquisition of about \$130 million was financed from Perion's internal sources and through debt. Perion also assumed Undertone's \$50 million long-term debt. As a result of the acquisition, Perion's gross debt increased from \$38 million to about \$102 million.

We believe that Undertone's acquisition will strengthen Perion's business risk profile, as it will increase Perion's revenue base and EBITDA. In addition, the acquisition will decrease Perion's dependence on the volatile search engine field, and is expected to strengthen its position in the digital advertising market, which the company is looking to promote since the acquisition of Growmobile (in July 2014) and MakeMeReach (in February 2015), two mobile advertising companies. The Undertone acquisition is destined to create a one-stop-shop platform in the mobile and desktop advertising technology, while leveraging the company's business connections with brands, advertising agencies and advertisers. We understand that Undertone's added value beyond standard Ad-tech companies focusing on on-line advertising technologies is in

developing unique advertising formats on different platforms (mobile and desktop) and business connections with leading brands and premium websites. These capabilities support its high profit margins compared to other Ad-tech companies. However, this kind of operation is exposed to intense competition and to the volume of on-line advertising, and requires constant investment in R&D in order to maintain technological and competitive differentiation. Undertone's turnover for 2015 is expected to reach about \$ 143 million and its EBITDA – about \$ 21 million. We believe Undertone's operating results for 2016 will be similar or better.

We believe that the acquisition will decrease Perion's dependence on the high-risk search engine field. Following the acquisition, Perion's revenues are expected to be split evenly between searches and product sales and between advertising, compared to before the acquisition when 80%-85% of the company's revenues were derived from searches. However, we believe that in the medium term, the search engine field will account for about 60%-65% of the company's EBITDA, especially in light of the higher profit margin in this field and of the investment in mobile advertising platforms, until the company attains a critical mass of managed campaigns. Therefore, we believe Perion's operating results are still exposed to changes in search engine and browser policies, like the change in Google's policy in 2014 regarding Chrome add-ons, which adversely affected the value for Perion's platform users and decreased Perion's adjusted EBITDA in 2014 (about \$ 118 million) compared to the company's forecast published in May 2014 (\$ 125 million - \$ 130 million). We note that according to the company's estimates, and based on the results of recent quarters, the search engine field will generate stable results in 2016.

We estimate that Perion's financial risk profile was weakened by the acquisition, in light of increased debt and the fact that Undertone's operations requires larger working capital investments compared to the search-engine field. Nevertheless, Perion's leverage remains low relative to similarly rated companies. In addition, the financial risk profile is supported by the company's policy of maintaining large cash balances. According to our base-case scenario, we estimate that Perion will generate about \$ 28 million in adjusted EBITDA in 2016, and that its medium-term adjusted debt to EBITDA ratio will be 2.0x-3.0x, commensurate with the current rating given the business risk profile after the acquisition. We estimate that, in light of the company's business environment, it will continue to make acquisitions, including ones involving both cash and shares. In our base-case scenario we do not assume any leveraged acquisitions, which we believe could lead to a deviation from coverage ratios commensurate with the current rating.

Liquidity: Adequate

According to our criteria, we assess Perion's liquidity profile as "adequate". This assessment is underpinned by existing cash balances, a flat amortization schedule, our forecasted operating cash flow, and our assumption that any M&A activity will be financed mainly through debt and shares.

In our base-case scenario we estimate that the sources at the company's disposal from September 30, 2015, until year end 2016, are:

- About \$ 129 million in cash and cash equivalent;
- About \$ 10 million receipts from equity issuance;
- About \$ 20 million short term loan from Bank Leumi;
- About \$ 10 million in operating cash flow.

Our assumptions regarding the company's uses from September 30, 2015, until year end 2016, are:

- About \$ 12 million in short-term debt maturities;
- About \$ 93 million payment for Undertone's acquisition;
- About \$ 7 million payment for other companies' acquisition;
- About \$ 3 million in capital expenditure.

Outlook

The stable outlook reflects our assessment that Perion's business risk profile after the Undertone acquisition will remain stable in the medium term and allow the company to present operating performance supporting an adjusted debt to EBITDA coverage ratio below 3.0x and positive operating cash flow.

Downside Scenario

We may consider a negative rating action if the company fails to meet the aforementioned coverage ratio or if its operating cash flow is consistently negative. We believe this could be a result of a deterioration in the company's operating performance due to a weakening in market conditions in the search-engine or on-line advertising sectors, to failing to renew the agreement with BING (or to renewing it under less favorable terms), or to making leveraged acquisitions. We may lower the rating if we discover that Undertone's contribution is smaller than our previous estimates.

Upside Scenario

In light of our assessment of a more diversified business risk profile after the Undertone acquisition, we may consider a positive rating action if the company maintains an adjusted debt to EBITDA coverage ratio below 1.5x and stable operating cash flows.

Related Criteria And Research

- [National And Regional Scale Credit Ratings](#), September 22, 2014
- [Corporate Methodology](#), November 19, 2013
- [Criteria For Rating Non-Financial Corporate Issuances On Standard & Poor's Maalot's Local Rating Scale](#), September 22, 2014.
- [Standard & Poor's National And Regional Scale Mapping Tables](#), January 19, 2016
- [Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers](#), December 16, 2014
- [Key Credit Factors For The Technology Software And Services Industry](#), November 19, 2013
- [Standard & Poor's Ratings Definitions](#), February 1, 2016
- [Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings](#), October 24, 2013

Rating Details (As of 8-Feb-2016)**Perion Network Ltd.**

Issuer rating	iIA-/Stable
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Senior Unsecured Debt

Series 12	iIA-/Stable
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Rating history

02-Feb-2016	iIA-/Stable
02-Dec-2014	iIA-/Watch Dev
03-March-2014	iIA-/Stable

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