Online Marketing: Search Engine Marketing

Guava A/S

OMX/First North: "Guava"

Date of publication:
October 2, 2008

Share price on October 1, 2008:
DKK 1.05

Current Market Cap
DKK 116m

Share price target
DKK 2.76

Integrations proven a costly affair

Guava posts disappointing results for their 2007/08 accounts, with much weaker results than anticipated, causing us to lower our growth expectations and hence our share price target considerably, from a previous target of 7.60 to 2.76. The results can partly be attributed to a slower 4th quarter, stemming from a slow-down in the economy and online advertising spend, and partly to large costs with integrating acquired companies, as well as significant one-time write-offs on integration issues, goodwill, and customer-contracts.

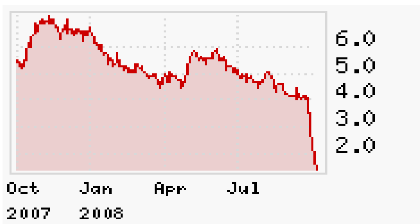
Guava will focus on integration and consolidation, putting acquisitions on hold for 2008/09, why we base our current share price target on an organic growth scenario without acquisitions based on Guava's announcement.

We remain optimistic for Q1+Q2 of 2008/09. Although Guava posts much lower results than expected, a large part of the write-offs and costs are temporary, and to be expected, by acquiring 9 companies within 12 months. With focus on cross-selling and completing an extensive integration process, we already expect synergies to materialise in the semi-annual year of 2008/09.

Share price disproportionately low from excess sell-offs. The lowered financial expectations resulted in a justified share price drop, but the share price has suffered excessively from a weak shareholder structure and share illiquidity.

We reiterate our share price target of 7.60 (May 29, 2008) to a **conservative share price target of DKK 2.76,** which corresponds to a market cap. of **MDKK 304** indicating an upside potential of **162.1%,** from the current share price.

ISIN:	DK006003664-8
Region Country:	Europe/Denmark
Price (September 30, 2008):	DKK 1.05
Outstanding shares:	110,125,372



— Price - 08 (OMX-Copenhagen Stock Exchange)

TDKK

Year	**2006/07**	**2007/08**	**2008/09e**
Turnover	81,445	269,929	344,500
EBITDA	10,833	13,028	27,500
Profit	8,267	-37,768	7,155
P/E	36.6	n/a	16.2
EV/S	3.6	0.4	0.3
EV/EBITDA	27.0	9.0	4.2
EPS-Basic	0.21	-0.43	0.06
EPS-Diluted	0.05	-0.16	0.06

The table contains the forecasted key figures for Guava A/S. The numbers have not been audited by Guava A/S, but reflect the opinion of Korral Partners.

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Guava will not prioritise acquistions in 2008/09, but will participate in the European consolidation if attractive opportunities should arise.

Our view

Guava has undergone several challenges and changes with the massive integration of 9 companies within the financial year of 2007/08. Our view on the positive and negative developments in this period can be summarized as follows:

Positive developments

Expecting to gain from synergies and economies of scale in 2008/09. Guava has allocated significant resources to the integration of different companies and by having centralised the IT-functions, integrated the technical platforms, adjusted the number of staff, optimised the purchasing arrangements, introduced a legal risk management program and streamlined the organisation.

Financial control. Guava has initiated several steps to deal with the current company and market situation such as strengthening the company's financial control. There has not been enough focus on controlling the financial situation in Guava following the wake of 9 acquisitions in Denmark, Sweden and UK in 2007/08. Guava has strengthened its financial expertise by hiring a new Group CFO and a senior financial controller, to keep tighter track of monitoring the financial situation in the Guava Group, as well as the effects of the external market environment.

Cutting personnel costs. Guava has reduced their personnel costs by reducing the number of employees from 214 to 180. The personnel reduction is essentially also a move towards streamlining and building an effective organisation with no "excess fat".

Guava has become a well-established player in the Scandinavian and UK market. An industry leader in Scandinavia, Guava has today achieved a solid platform for future growth in terms of geographic reach, a comprehensive range of products including Search (SEM, SEO and PPC), Affiliate Marketing, Usability, Online Advertising etc. as well as an extensive client base.

Accruing a larger amount for 2008/09 - benefitting the accounts for the current financial year.

Negative developments

Lowering financial expectations. Guava maintains a turnover of MDKK 269, an increase of 231% compared to previous year and in the low range of previously announced expectations of MDKK

270-300. Guava reaches an EBITDA of MDKK 13, an increase of 20% compared to previous year, but significantly lower than previous announced expectations of MDKK 30-34, which surprised on the negative side. Higher, than expected, integration costs and costs with rebranding into Guava, including new website, intranet, advertising and campaigns accounts for this development.

Failing to properly anticipate size of integration costs. It is our guess that Guava did not anticipate the extent of the integration costs, but has taken steps to ensure a better financial control by hiring a Group CFO and financial controller.

Write-offs on acquired companies. Guava has conducted significant write-offs of approx. MDKK 26 off on Guava A/S and acquired companies, The Milk, Addvisors, M&P e-marketing, Bubka Systems ApS, and Guava Sweden, due to integration issues (other write-offs include MDKK 18 on customer contracts, MDKK 6 on development projects and miscellaneous for MDKK 9).

Tough market for affiliate marketing segment. The market for affiliate marketing has experienced some challenges with a large mail provider shutting down for the receiving of larger emails. This has affected the earnings for Guava adversely with approx. MDKK 2. The outlook is positive however, for higher growth and results in this segment.

External market factors have affected Guava adversely. Pricing pressure from the UK on the online market has had an impact on earnings.

Pricing pressure on advertising. We see a slowdown in advertising spend and pricing pressures, from previous market expectations of approx. 30% to 22-30%. The source of the slowdown is primarily related to the US and the UK and increasingly disseminating to the European market, adversely affecting Guava's income. Guava has especially experienced the slow down in 4th quarter with in-sale time to new customers increasing from 3 to 3-6 months.

Exposure to UK. The British Pound (GBP) has dropped from DKK 10.90 to 9.47 in the account year for 2007/08. Since 40% of Guava's income is settled in GBP, the accounts in terms of turnover and earnings have been adversely affected.

Other developments

Guava postponing move to the larger stock exchange OMX Nasdaq. Guava has announced that they have postponed the move to OMX and prefers to await a better market climate. We believe the market climate will eventually change for the better, and the move may as well be conducted sooner than later. First North also has recently received a substantial amount of negative publicity and from a shareholder perspective, the larger exchange of OMX Nasdaq would be preferable, in terms of e.g. better

Lower earnings and lower industry averages have caused a lower valuation.

We believe that a substantial part of the disappointing accounts represent one-time costs, not to be overly emphasized.

reputation and a higher share liquidity. On the other hand, Guava runs a risk of not receiving the deserved attention from the current financial climate and it can be argued that it is preferable to await a better timing.

Valutation

We revise our share price target for Guava reaching a share price target of DKK 2.76, indicating an upside potential of 162.1% from the current share price. There could be further upside, but we would need confirmation that Guava has properly consolidated all daughter companies and in a position to extract synergies. We hope to receive confirmation of this already in the semiannual year (Q1 + Q2) of 2008/09.

Lower revised industry averages. Our valuation includes a combination of key ratios from comparable listed companies and the lower industry averages in our peer group are partially responsible for the reiteration of a lower share price target for Guava, from our previous analysis on Guava (May 30, 2008). The industry averages for 2008, from our previous peer group, have dropped from respectively a P/E from 24.6 to 16.5, an EV/S of 2.3 to 1.6, and an EV/EBITDA of 21.0 to 9.8. As the graph below illustrates, the majority of the peer group companies have dropped in value, since the publication of our previous analysis on Guava.

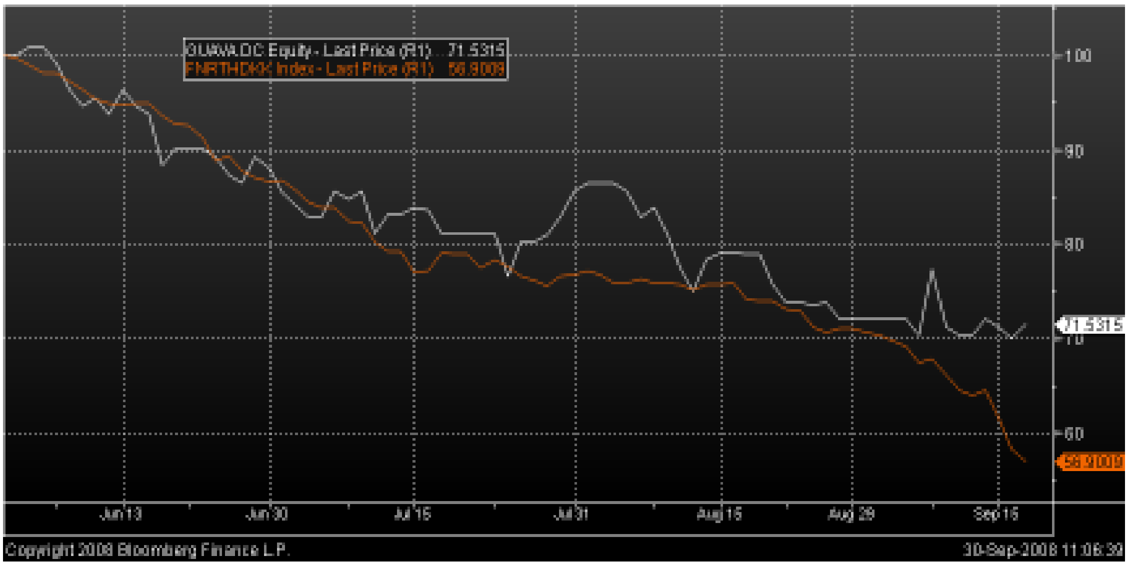
Sell-offs exacerbating drop in share price. Guava's share price clearly shows a dramatic fall, compared to comparable companies, after September 22, 2008. Guava announced their adjustment to their expected annual profits on September 22, 2008, causing a drop in the share price from DKK 3.40 to DKK 2.28 (September 25, 2008), which again has caused a number of sell-offs amongst Guava's shareholders, accounting for an excess drop from DKK 2.28 to DKK 1.05 (September 30, 2008). We believe the drop in share price, has resulted in a currently disproportionately low market valuation of Guava.

Guava

Negative publicity of First North has affected companies.

Share Price Development

As the graph below illustrates, the Guava share has had a positive correlation with the First North index, until primo September 2008, where the First North Index shows a considerable fall (approx. 15%) compared to the Guava share. The First North market has in the last year received negative publicity and the share price development of the First North index has been disappointing.



Guava has obtained an impressive range of services and a leading position within a short time period.

Investment merits

We believe Guava has good fundamentals. Online advertising and media is here to stay and increasingly replacing traditional media. The growth figures in the online marketing sector are expected to continue with annual growth rates of approx. 22-30%[1], down from earlier expected growth rate of approx. 30%.

Guava has built a strong competence in the areas of search engine marketing (SEM), search engine optimisation (SEO), affiliate marketing and online advertising. Furthermore, the company has also diversified into value-adding services within website usability analyses in addition to a wide range of other Internet analyses.

Guava has followed an aggressive growth strategy aiming at becoming the leading online advertising company in Northern Europe and has achieved a very strong growth the last three years through both organic growth and an aggressive acquisition strategy.

Through a leading presence in the Scandinavian market and operating across three countries, Guava is well placed to position itself towards the large markets in Germany, Russia and the Baltic rim.

Investment risks

As Guava has demonstrated in the current financial accounts, the aggressive growth strategy of M&A has a significant risk attached to it. Guava may suffer a risk for its future earning capacity and reputation, if it does not live up to its stated goals of consolidating and structuring the acquired businesses.

There is also a dilution risk which should be considered the next few years from earn-outs on acquired companies.

Guava is fast growing, but may encounter margin erosion as the company invests for growth and encounter various adjustment costs through its new acquisitions. From our analysis in March 5, 2008, we predicted gross profit margins to fall in the 30% range in 2007/08 as a result of additional costs from implementing recent acquisitions, and then gradually climb to the 35-40%-range in the following years. We still maintain these assumptions for the upcoming years.

Guava has recently encountered currency risk with a fall in the GBP, adversely affecting the company's turnover and earnings.

[1] World Advertising Research 2008

Market opportunities

Guava's markets are relatively small in population (total of approx. 90 million UK and Scandinavia), but represent a large share of the European online advertising market due to the extensive Internet usage. Total European online advertising revenues in 2007 amounted to EUR 7.7 billion[2], of which 45% was related to search-advertising, 31% to display, 22% to advertising on classifieds and 2% to email advertising[3]. The UK market alone represented EUR 4.4 billion[4], while the Scandinavian market represented EUR 1.2 billion[5].

Key growth drivers include increase in internet usage, improved efficiency of online marketing, ability to achieve higher prices and by the increased use of internet by marketers. These forces have led online advertising industry to show explosive growth rates over the last 5 years, with online advertising European revenues increasing 47% pr. year[6].

Growth can generally be expected to continue, with an estimated 2007-09 increase in online advertising spending on 22-30% in Europe[7]. The main growth engine is expected to be located in Southern Europe, as the internet usage and internet adaptation by marketers is already relatively extensive in the Northern Europe.

Our valuation derives a target price of DKK 2.76 – a potential upside of 162.1%.

Calculating a fair value of Guava has been carried out using an NPV model and key ratios from comparable listed companies.

When calculating the net present value of earnings from Guava, a Weighted Average Cost of Capital (WACC) has been constructed. The market premium has been fixed at 5.0%, which corresponds with the consensus on the Danish stock market. A beta of 0.91 has been used in order to reflect the systematic risk of the industry in which the company operates.

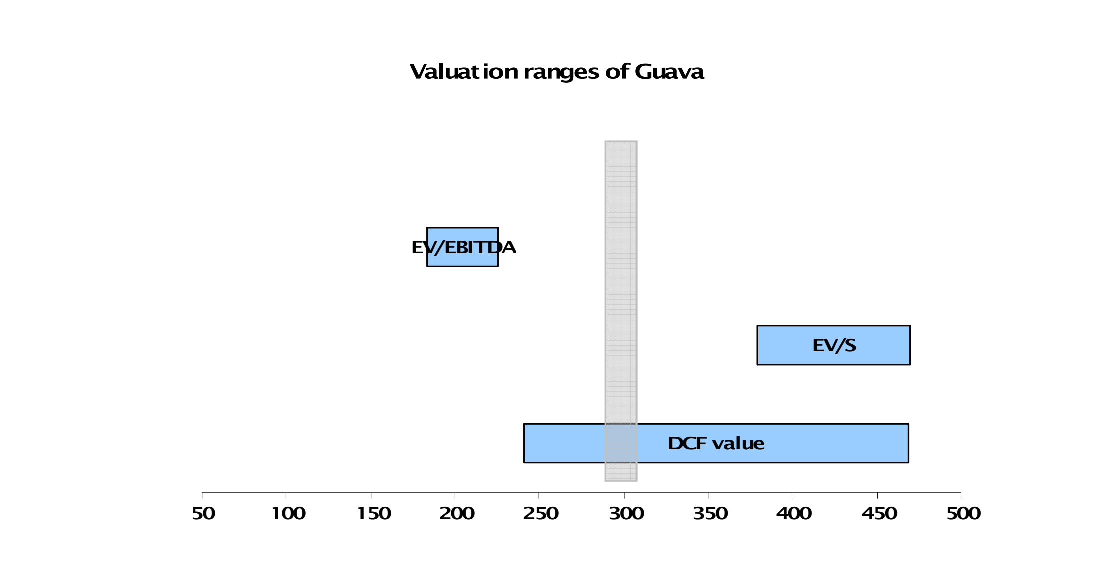
The target capital structure of Guava is based on the industry average. The combined WACC is calculated to be 15.54%. The growth in earnings (g) in the terminal period is estimated to 2.50%.

2 World Advertising Research, April 2008
3 IAB 2008
4 Tradedoubler, pg. 18, WARC 2008
5 World Advertising Research 2008, Euromonitor 2008
6 World Advertising Research 2008
7 World Advertising Research 2008

Guava

Korral estimates a fair value of MDKK 304, corresponding to a share price of DKK 2.76 showing an conservative share rating, based on an organic growth scenario. Our company model has not taken an acquisition scenario into account.

A relative valuation of Guava based on the ratios P/E, EV/S and EV/EBIT indicates a value of the company in the range 183 MDKK to 470 MDKK. The grey shaded area in the below chart illustrates the combined suggested value range of Guava from 275 MDKK to 295 to 310 MDKK.



Significant upside potential in earnings prospect.

We believe with the current profitability and growth prospects Guava represents an attractive investment opportunity. Guava is geared to cope with the significant growth in the online marketing space, by having acquired several companies and also through its cross-border acquisitions, thereby benefitting from both external and internal growth. DCF prospect also shows a significant upside, but we will need confirmation that Guava can emerge through the current financial crisis, and pricing pressure in the online marketing industry, with synergies from acquired companies, contributing positively to EPS.

Peer group

Guava primarily offers consultancy services within the areas of Search Engine Optimisation and Search Engine Marketing. Guava also provides solutions within web design, sites analysis, affiliate, viral and affiliate/e-mail marketing, pay-per-click campaigns, usability, and online advertising. To value Guava using a peer group valuation, we have selected a number of different companies within the same or similar areas of online companies as Guava. The companies Tradedoubler, Marchex, or Onvista are companies within performance marketing and affiliation and are primarily peer companies to Guava's affiliate marketing segment, while Valueclick Inc., Adlink Internet Media, and Hi Media are peer companies to Guava's SEM/SEO, and e-marketing activities.

Total Industry

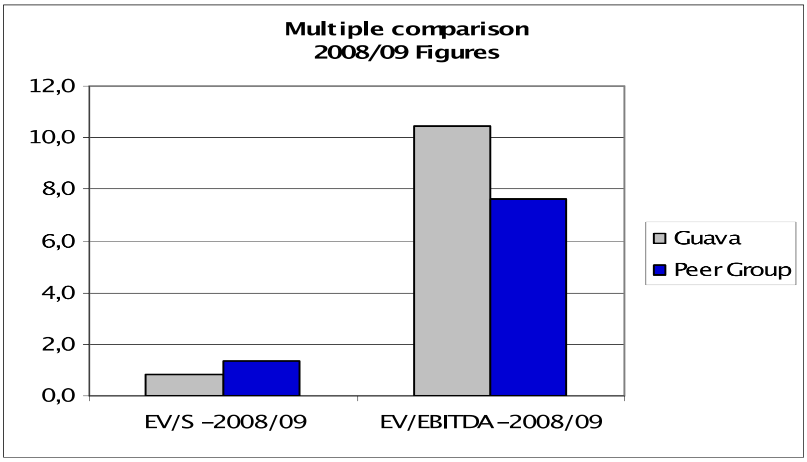
Company	P/E-08	P/E-09	EV/S-08	EV/S-09	EV/EBITDA-08	EV/EBITDA-09	Beta
Guava	**n/a**	**n/a**	**1,1**	**0,8**	**22,1**	**10,5**	
Onvista	n/a	28,1	3,5	2,2	16,7	10,4	0,6
Marchex	31,2	26,5	2,8	2,6	12,4	10,9	1,0
Valueclick Inc.	10,7	10,1	1,5	1,4	5,0	4,7	1,56
Tradedoubler	12,7	9,2	0,4	0,4	8,6	6,9	1,06
Adlink Internet Media	14,0	10,8	0,7	0,6	9,3	7,7	0,50
HI Media	14,0	9,7	0,9	0,7	6,9	5,0	0,72
Industry average	**16,5**	**15,7**	**1,6**	**1,3**	**9,8**	**7,6**	**0,91**

Source: Bloomberg

Comparisons with peers

We expect negative net profit figures for 2008/09 and the P/E values for 2008 and 2009 are subsequently not applicable (n/a). The fair value of MDKK 304 for Guava corresponds to an EV/S of 0.8, and an EV/EBITDA of 10.5 for 2008/09, which correspond well to the peer group average for 2009. For 2008/09, Guava is trading on respectively; a discount on its EV/S multiple of 38.5%; and a premium of 38.2% on its EV/EBITDA multiple, which we believe to be justified given Guava's growth perspectives in earnings.

Premium on EV/EBITDA is justified by high growth prospect in earnings.



Organic growth assumptions for Guava

The table below contains the forecast income statement used in the valuation of Guava, and only assuming organic growth. The budget numbers for the income statement do *not* include Guava's expected growth from future acquisitions, but are solely based on Guava's organic growth and expected revenue from its existing operations. Guava will focus on integration and consolidation, putting acquisitions on hold for 2008/09, why we base our current on an organic growth scenario only. The income statement reveals a steady increase in turnover, as well as gross profit, over the next four years. The significant increase in earnings FY2009/2010 from the previous year can mainly be attributed to previous acquisitions and the materialisation of synergy effects.

We expect Guava to reach an EBITDA margin of 8% FY2008/09 as synergies from cross-selling, economies of scale, staff reductions, etc. gradually are expected to break through. We still maintain relatively high depreciation costs FY2008/09 and FY2009/10, but expect these to level out to approx. MDKK 7 FY2010/11 and onwards, as depreciations on customer contracts (currently depreciated by MDKK 18) are diminished. Depreciations on development projects and acquired companies e.g. brand and technical platforms are also one-time write-offs, for the added acquisitions in 2007/08.

Guava
Budget resume 2008/09-

Income statement for Guava								
MDKK	Realised 2004/05	Realised 2005/06	Realised 2006/07	Realised 2007/08	Budget 2008/09e	Budget 2009/10e	Budget 2010/11e	Budget 2011/12e
Turn over	**17,326**	**26,069**	**81,445**	**269,929**	**344,500**	**420,300**	**497,700**	**573,600**
Cost on goods and other fixed costs	9,006	15,436	48,470	181,506	225,000	262,000	301,000	340,000
Gross Profit	**8,320**	**10,632**	**32,975**	**88,423**	**119,500**	**158,300**	**196,700**	**233,600**
Gross Profit-Margin	*48%*	*41%*	*40%*	*33%*	*35%*	*38%*	*40%*	*41%*
Personel costs	5,838	7,766	22,142	75,395	92,000	110,000	130,000	150,000
EBITDA	**2,482**	**2,866**	**10,833**	**13,028**	**27,500**	**48,300**	**66,700**	**83,600**
EBITDA-Margin	*14%*	*11%*	*13%*	*5%*	*8%*	*11%*	*13%*	*15%*
Depreciation	0,593	0,653	2,162	58,766	28,000	18,000	7,000	7,000
EBIT	**1,888**	**2,214**	**8,671**	**-45,738**	**-0,500**	**30,300**	**59,700**	**76,600**
EBIT-Margin	*11%*	*8%*	*11%*	*-17%*	*0%*	*7%*	*12%*	*13%*
Result from non-consolidated affiliate	*-0,105*	*-0,337*	*0,000*	*0,000*	*0,000*	*0,000*	*0,000*	*0,000*
Net financial income	-0,076	0,477	0,994	-1,823	-2,500	-2,500	-2,500	-2,500
EBT	**1,707**	**2,354**	**9,664**	**-47,561**	**-3,000**	**27,800**	**57,200**	**74,100**
Tax	**0,645**	**0,670**	**1,398**	**-9,793**	**-0,854**	**7,910**	**16,275**	**21,084**
Net income	**1,062**	**1,684**	**8,267**	**-37,768**	**-2,146**	**19,890**	**40,925**	**53,016**
Employees (Avg.)	23	32	77	193	n/a	n/a	n/a	n/a

Growth assumptions (%) for Guava							
	Realised 2005/06	Realised 2006/07	Realised 2007/08	Budget 2008/09e	Budget 2009/10e	Budget 2010/11e	Budget 2011/12e
Turnover growth	**50,46%**	**212,42%**	**231,42%**	**27,63%**	**22,00%**	**18,42%**	**15,25%**
Cost on goods and other fixed costs	71,41%	214,00%	274,47%	23,96%	16,44%	14,89%	12,96%
Gross Profit	**27,79%**	**210,14%**	**168,15%**	**35,15%**	**32,47%**	**24,26%**	**18,76%**
Personel cost	33,01%	185,12%	240,50%	22,02%	19,57%	18,18%	15,38%
EBITDA	15,51%	277,92%	20,26%	111,09%	75,64%	38,10%	25,34%
EBITDA-Margin	11,00%	13,30%	4,83%	7,98%	11,49%	13,40%	14,57%
Depreciation	9,98%	231,37%	2617,75%	-52,35%	-35,71%	-61,11%	0,00%
EBIT growth	**17,25%**	**291,64%**	**-627,51%**	**98,91%**	**-6160,00%**	**97,03%**	**28,31%**
EBIT margin	8,49%	10,65%	-16,94%	-0,15%	7,21%	12,00%	13,35%
Net financial income	-727,64%	108,57%	-283,41%	37,15%	0,00%	0,00%	0,00%
Net income	**58,58%**	**390,91%**	**-556,87%**	**-94,32%**	**-1026,67%**	**105,76%**	**29,55%**

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The principals and employees of Korral are also current investors into Guava A/S. The research has been carried out using traditional analysis methods and publicly available information sources.

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