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YouGov

Robust maiden results

194p

10.10.2005

These were a robust set of maiden results (as a quoted company) from YouGov, with sales, EBIT and pre-tax profits all modestly ahead of expectations. The cash generative nature of the business was also highlighted with operating profits of £961,000 translating into an operating cash flow of £1.15m. Meanwhile trading appears to be buoyant with the company reporting a "sound start" to its current financial year. Perhaps the most interesting news, though, was the confirmation that YouGov plans to launch its BrandIndex product. This product, which will be based on 0.5m interviews with consumers, will track perceptions of around 1,100 consumer brands on a daily basis. We have not included a contribution from BrandIndex in our forecasts, but the product clearly has the potential to generate a material contribution to sales.

YouGov's shares have performed strongly since May's IPO at 135p a share and now appear fully valued on near-term earnings multiples. However the business is highly scaleable, extremely cash generative (reflected in a free cash flow yield of 3.7%) and the upside from BrandIndex could be significant. YouGov also enjoys a large net cash balance of £3.79m which generates a very low rate of return. In tandem with the high share rating this means that any acquisitions - whether paid for in shares, cash or a combination of both - are likely to be significantly earnings enhancing.

It should also be noted that despite its high profile newspaper polling activities YouGov derives the bulk of its revenue from internet-based market research. This is one of the fastest growing sub-sectors of the market research sector.

Share Price: 194p

12m High: 197p

12m Low: 135p

Market Cap: £25.9m

Shares in issue: 13.3m

NAV/Share: 28p

Gearing: Net cash

Interest Cover: n/a

EV/EBITDA: x17.3 2005/6E

EPIC Code: YOU

ISIN: GB00B0771P53

Sector: Media & Entertainment

Market: London AIM

PR: Financial Dynamics

Website: www.yougov.com

Broker: Noble & Co

Previous Research Note: "Polling for a profit" 21.3.05

Analyst: James Chapman

Y/E 31 July	Sales £m	Ebitda £m	Pre-tax Profit £m	EPS p.	P/e ratio	Divi p.	Yield %
2004A	1.99	0.68	0.68	n/a	n/a	-	-
2005A	2.94	0.98	0.99	5.8	33.4	-	-
2006E	3.80	1.27	1.38	7.2	27.0	-	-
2007E	4.92	1.78	1.93	10.1	19.2	-	-

Full year results

End 31 July £000	*2005A*	*2005 Forecast*	*Variance*
Turnover	2,942	2,789	+5.4%
Gross profit	2,466	2,482	-0.6%
Gross margins	84%	89%	
EBIT	961	950	+1.2%
EBIT margins	32.6%	34%	
PBT	996	950	+1.7%
Operating cash flow	1,149	950	+20%

The full year results were robust with sales, which increased 48% on the previous year, coming in 5.5% ahead of forecasts. Gross margins, though, were marginally below our expectations (84% versus our forecast of 89%) thanks to the inclusion of accrued expenses from incentive payments. These relate to the credits granted on panellists' accounts as they fill out surveys. Prior to the IPO these were not included as expenses until the payment threshold was reached, and although we were unhappy with this policy (see "Polling for a Profit") we assumed it would continue going forward. This is not the case, and the accounting policy change has knocked a few percentage points off our gross margin estimates (it should be noted that this change has no impact on cash flow). This factor, combined with a slightly higher depreciation charge than we expected, was the reason that EBIT only exceeded our forecasts by a modest level. Operating cash flow was extremely strong at £1.15m. This compared to operating profits of £961,000.

YouGov assumed a high profile in the recent General Election, conducting more surveys for the media than any other company. The company won the prestigious contract to provide on-line research to the British Election Study (BES) and was the official election pollster to the "Daily Telegraph", "The Sunday Times" and Sky News. YouGov forecast the final Election result accurately to within one percentage point. Though most pollsters also predicted the final outcome of the election with a high degree of accuracy, YouGov's polls were far less volatile than those of most rivals throughout the campaign.

Although polling remains YouGov's most high profile activity the bulk of the company's work last year (66%) related to commercial market research. Typical of this work was a project for ASDA where YouGov investigated consumer purchasing behaviour and the attitudes of customers to in-store promotions.

Prior to the May's IPO YouGov paid off a £264,000 debenture with Chime Communications and is now free of debt. We forecast YouGov will retain a healthy net cash balance going forward though this will probably diminish as acquisitions are made. It should be noted, however, that management's strong preference is to keep the balance sheet free of debt.

Brand Index

YouGov has been developing Brand Index during the last 14 months and now plans to launch the product before the end of 2005. BrandIndex will track consumer responses to around 1,100 brands in 32 sectors via the 0.5m interviews over the internet. BrandIndex, which will be launched on 24th October, will include a 7 point profile of products. YouGov believes it will be the first time this sort of data has been supplied on a daily basis, since most tracking studies are only conducted on a monthly or, at best, a weekly basis. The subscription-based BrandIndex service will be marketed to corporates and the investment community. It is difficult to quantify the likely success of BrandIndex at this stage, but given the size of the market place it clearly has the potential to make a material contribution to sales.

Internet Panel

YouGov's internet panel now numbers 98,000 members, compared to 89,000 at the time of the IPO in May. In the last 12 months the churn rate (the number of panellists lost through non participation) ran at 15%, which is low by industry standards. Average response rates run above 50%, which we believe is very high by industry standards (For comparison response rates at Research Now's "Valued Opinions" internet panel run at 25-30%).

Middle East Joint Venture

In July YouGov established a joint venture in Dubai to conduct research and polling across the Middle East. YouGov owns 52% of the joint venture. Local investors have agreed to invest $1m into the venture in return for the remaining 48% stake. YouGov will furnish the venture with its proprietary technology and market research expertise. The 52% stake came at zero cost to YouGov. The venture could start to make a material contribution to sales in YouGov's 2007-8 financial year.

New Finance Director

In late July the chartered accountant Katherine Lee was appointed YouGov's Finance Director. Ms Lee joined from Grant Thornton where she was a Senior Manager in Transaction Services. We believe YouGov's finance department has in the past been understaffed and the new appointment should help redress this problem.

Forecasts

We are making only minor adjustments to our 2005/6 forecasts when we expect pre-tax profits of £1.38m. We now expect slightly lower gross margins (84% v 89%) thanks to the change to accruing credits on panellists' accounts as expenses (as already noted YouGov previously only included these as expenses when the panellist passed the payout threshold). Despite the lower gross margins we expect EBIT margins to still come in at 33% thanks to lower than anticipated SGA expenses. We have also tweaked this forecast since the IPO to take account of the marginally higher depreciation charge and the fact that YouGov secured £2.6m from the IPO, compared to our forecast of £3m (which means slightly lower interest income).

In 2006/7 we have cut £159,000 from our EBIT forecasts to reflect lower than anticipated gross margins (again due to the accounting change). Our 2006/7 forecasts similarly reflect a slightly high depreciation charge and marginally lower interest income.

Future Acquisitions ?

Going forward YouGov does not intend to rely solely on organic growth. One reason for the float was to furnish the company with an appropriate currency - its own paper - to make acquisitions in the market research sector. YouGov plans to focus on acquiring small, successful competitors who employ traditional research techniques. Companies with attractive client bases will be targeted in order to build up YouGov's own client list. Though acquisitions will create integration risk the strategy seems sensible because corporates are notoriously reluctant to switch from one market research company to another (because these market research firms control valuable historical information on these companies).

YouGov is not interested in buying businesses in order to bolster its internet panel, which the company believes is large and diverse enough to service its existing polling needs. The expansion strategy is not dissimilar, albeit on a much smaller scale, to that successfully employed in advertising and marketing services by WPP. Management's goal is to ensure acquired businesses are earnings enhancing in their first full year of ownership. An element of consideration is likely to consist of YouGov's shares.

YouGov could itself become a target for a large market research company seeking to enter the internet-based market.

Sector overview

Internet based market research

Since 1994 global spending on market research has climbed 7.5% a year, compared to 5.3% growth in advertising and global GDP rates of about 5%. This growth has been reasonably consistent, with global spending on market research still climbing 3% in 2001-2003 (source ESOMAR) despite the detrimental impact of the bursting of the TMT bubble. Internet based market research is a fast growing sub-sector within market research. The market research group Inside Research, for example, estimate that over the next 5-10 years internet-based market research will account for around \$3.65bn (or 39%) of the \$9.3bn spent on market research in Europe in 2005.

The UK on-line research market was worth in the region of £160m in 2004 according to a survey in August last year by E-consultancy. This represents around 10% of the total annual spending on market research in the UK. YouGov believes that the UK online research market with grow 25% per annum over the next 3 years.

Much of the growth is being driven by cost savings. Internet surveys are usually 50% cheaper to conduct than telephone surveys, and the savings over face-to-face interviews are even greater. Given that data collection costs usually amount to around 40% of the costs of a market research project this 50% saving on data collection translates into a 20% saving for the entire project. Besides its edge in costs internet-based market research also has other advantages over rival methodologies. Internet surveys can be completed far faster than telephone surveys and multiple languages can be used. The Internet also makes it feasible to display video and images, which can be used for testing potential advertisements. This type of research is not possible in surveys conducted via telephone or mail.

US Internet-based opinion research – problems at Greenfield

The US internet-based opinion research market appears to be about 5 years ahead of Europe. With 75% of households on-line the internet is already an established polling and market research tool in the US. Harris Interactive, which produces the eponymous Harris Poll, pioneered the use of internet-based research in the US. Since the company began building an internet panel in 1997 Harris has been steadily migrating its polling and market research activities across to the internet. Harris's panel recruitment strategy centres on heavily trafficked sites such as Yahoo which offer e-mail services (each time a person signed up for e-mail on these sites they were automatically added to Harris's e-mail database, unless they ticked a box to opt out). This has created a huge internet panel in the US, which the company says now totals in excess of 6 million people. Less well publicised are the low response rates, which we believe may run as low as 2-3% on some polls.

Harris has an established presence in Europe which was enormously bolstered by the acquisition of the French internet-based market research company Novatris for $4.8m (1.6x sales) in March 2004. Novatris came with a European panel numbering over 1 million people. Harris has recently expanded into the UK and now offers the QuickQueryGB service, a fast response internet-based sample of the UK population. Based in London, Harris Interactive Europe now publishes data on many UK brands.

Greenfield Online is the other major US quoted internet polling and market research company. Greenfield was founded in 1994 as a full service market research company but in January 2002 the company spun off its custom research business to focus solely on Internet surveys. In contrast to Harris Interactive Greenfield concentrates solely on selling access to its panels - which total 5.7m households worldwide (or 14.8m consumers) - to market research companies. We believe this is in some respects a commodity business, as Greenfield's only real asset is its panel. Greenfield was floated in July 2004 on 26x 2005E EPS.

Greenfield has endured a torrid recent history, with a profit warning in September (Q3 sales will be $22-23m versus previous guidance of $26-27m) sending the shares to an all-time low. The latest warning came after a string of bad news and the shares had already been sliding after the company substantially lowered guidance (though unfortunately not enough) only six weeks earlier. In the wake of the profit warning Dean Wiltse, the president and CEO, left the company to be replaced by Albert Angrisani, a former president of Harris Interactive. Greenfield's management blamed the Q3 profit warning on lower than expected "wins" in the North American market and an inability to sell on "quality" rather than "price". The shares, which were floated at $13, now trade at $5.57.

Two internet-based market research IPOs

Since YouGov floated in May two other internet-based opinion research companies have been floated on London's AIM market. In July Research Now, an independent provider of fieldwork services to European market research houses, floated at 130p a share. Research Now's business model is almost identical to that of Greenfield On-line in the US, with the company granting access to its internet panel in return for a fee (the company in effect acts as an outsourcing partner to market research groups).
As of June 2005 Research Now's internet panel – branded "Valued Opinions" - totalled 615,349 (270,000 in the UK). Panellists typically receive £1-2 for completing a survey and can cash in when the account reaches £5 in the UK, or €10 in the Eurozone. Research Now says response rates at Valued Opinions run at 25-30 while the churn rate runs at 1% a month.

Since the IPO the Research Now's shares have climbed to 151.5p, placing the company on x19.3 2006E earnings (October year-end). Growth forecasts for Research Now are ambitious, with the company's broker forecasting revenue grow of 57% per annum and earnings growth of 69% per annum over the next five years.

Since Research Now does not compete directly with the market research agencies it could arguably grow faster than companies such as YouGov (which does compete with other market research agencies) if the large agencies outsource their internet-based work to the company. However if the company's only real asset is its internet panel it is in danger of becoming a commodity business and encountering the same sort of pricing difficulties now experienced by Greenfield in the US. Furthermore it should be noted that many market research agencies are already developing their own in-house internet panels. WPP, for instance, has set up Lightspeed Research as an in-house internet-based market research arm. These could prove a threat to both YouGov and Research Now. While Research Now's business model is similar to Greenfield Online in the US, YouGov's is more akin to that of Harris Interactive.

In May 2005 a French on-line fieldwork and panel business ToLuna floated on AIM at 70p a share. ToLuna was floated without any forecasts issued (at least publicly) so we don't know the rating of the shares. However the company generated £344,000 of

Internet-based market research acquisitions

Date	Acquirer	Acquired company	Price	X Sales	X Ebitda	X EBIT
April 2005	Greenfield	CIAO AG	$154m	X6.84(FY 04)	X16.9 (FY04) X10 (2005E)*	X17.9
February 2005	Greenfield	goZing	$30m	X2.56 (FY 04)	na	X 13
March 2004	Harris Interactive	Novatris	$4.8m	x1.6 (FY 03)	na	na

sales and PBT of £80,000 in the two months ended February 2005 but is valued at £32.4m suggesting a fairly heady rating. ToLuna has an on-line European panel numbering 350,000 people. The company licences its panel and proprietary survey technology out to clients. This suggests a business model more akin to that of Greenfield On-line and Research Now to that of YouGov.

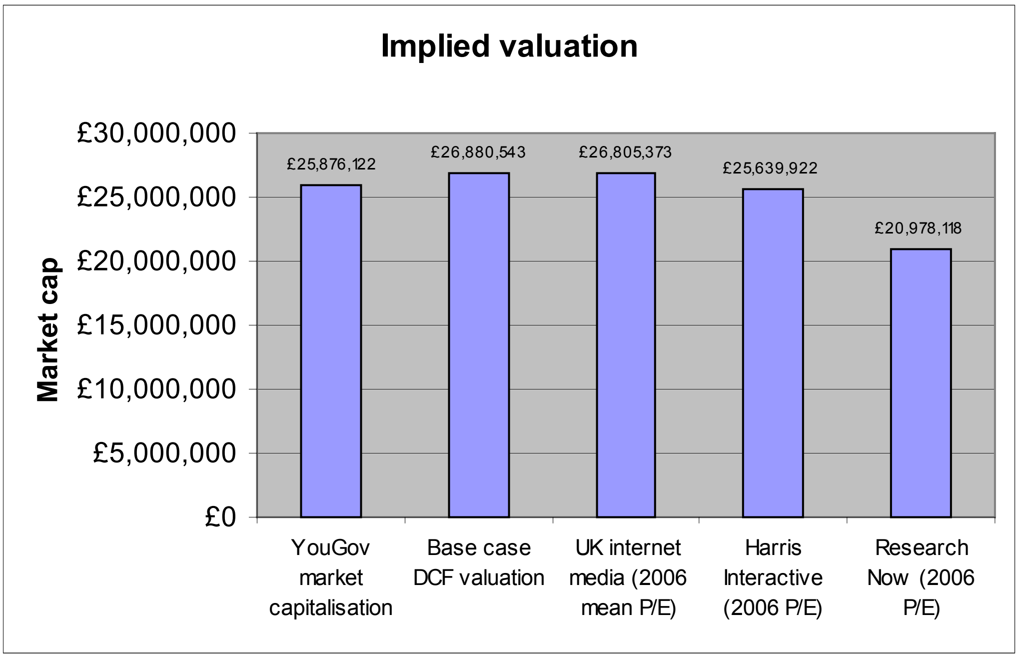
Acquisitions in the sector

The last two years have seen 3 notable acquisitions in the internet-based opinion research sectors. Harris's acquisition of the French group Novatris in 2004, and more recently Greenfield On-line's purchase of German-based Ciao AG (with a panel of 1m) and California-based goZing earlier this year. (These acquisitions are detailed in the table at the top of this page.)

Valuation

We have adopted a variety of methods to value YouGov. The first of these is a "base case" discounted cash flow calculation. This assumes that the company's strong growth rate ceases at the end of the 2007/8 financial year and includes no contribution from BrandIndex. While this may appear excessively cautious we regard it as extremely difficult to accurately forecast cash flows at a fast evolving company such as YouGov beyond a reasonably short time frame. The valuation also makes no assumptions about acquisitions (as these are impossible to predict) which could prove a value enhancing means of deploying the companies cash reserves.

Based on a cost of capital of 10% and a perpetual growth rate of 3% our "base case" dcf model places a value of £26.9m on YouGov's equity, which would appear to underpin the current market valuation. In the model (detailed on page 6) we assume that EBIT margins of 40% are sustainable in the long-term since these are similar to the levels currently achieved by Harris Interactive's internet arm, which is a far more mature operation than YouGov. We have also compared YouGov's valuation with that of a basket of UK internet peers, Harris Interactive, and Research Now (see chart below).



Comparatives			2005E	2006E	2005E	2006E
US internet-based opinion research	*Market cap.*	*EV*	*EV/Sales*	*EV/Sales*	*P/E*	*P/E*
Harris Interactive ($4.2)	£149m	£129.3m	x0.9	x0.99	x70	x22
Greenfield On-line ($5.57)	£78.6m	£68.7m	x1.34	x1.11	x16	x11
European Internet-based market research						
Research Now (152p)*	£19.6m	£17.1m	x4.7	x2.6	x41	x18
ToLuna (90.5p)	£32.4m	£28.3m	n/a	n/a	n/a	n/a
YouGov	**£26m**	**£22m**	**x6.7**	**x5.1**	**x27**	**x22**
UK internet media						
ADVFN (3.9p)	£18m	£18m	x5.8	x4.5	x34.5	x23
Datamonitor (215p)	£152.3m	£139.8m	x2.7	x2.5	x26	x22
Deal Group Media (6.75p)	£25.3m	£22.9m	x1	x0.7	x22.5	x11.3
Hemscott (38.5p)	£22.2m	£33.5m	x1.7	x1.5	na	x55
Interactive Prospect Targeting* (138p)	£49.2m	£43.7m	na	na	x33.4	x17
Themutual.net (31.5p)	£12.7m	£10.5m	x2.9	x2.3	x17	x11
Thomson Intermedia (236p)	£68m	£66.4m	x6	x3.6	x47	x21
Mean			**x3.35**	**x2.5**	**x30**	**x23**
Median			**x2.3**	**x2.4**	**x29.7**	**x21**

All estimates are calendar year-based

Sources Reuters & First Call consensus estimates

**Canaccord Capital estimates*

DCF valuation

Discount rate	***10.00%***			
	1	2	3	4
	2005/6E	***2006/7E***	***2007/8E***	***2008/9E***
Free Cash flow	1,029,121	1,503,678	1,770,766	1,823,889
Discount Factor	0.91	0.83	0.75	
Net cash flow	**935,565**	**1,242,709**	**1,330,403**	
Terminal Value				**26,055,556**
Cash Flows NPV	3,508,676			
Terminal Value NPV	19,575,925			
+ Cash	3,795,942			
Equity Value	**26,880,543**			
No of shares	**13,338,207**			
Share price (p)	**202**			

Assumptions :-	Cost of Capital	
Terminal ROIC of 12.8% v Cost of capital of 10%	UK 10yr gilt	4.27%
Terminal growth rate = 3%	Equity Risk Premium	4%
Terminal Value 2007/8E =	Small Cap risk premium	1%
x3.4 EV/Sales	European media and advertising sector beta	1.14
x8.5 EV/Ebitda	**Cost of capital**	**10%**
x16 Net Income		

Year End 31 July £'000	***2001/2A***	***2002/3A***	***2003/4A***	***2004/5A***	***2005/6E***	***2006/7E***
Turnover	**737,578**	**1,887,446**	**1,992,309**	**2,942,000**	**3,800,000**	**4,925,000**
Gross profit	**676,025**	**1,823,694**	**1,770,766**	**2,466,000**	**3,192,000**	**4,284,750**
Gross margin	92%	97%	89%	84%	84%	87%
SGA	(608,627)	(769,446)	(1,089,467)	(1,488,000)	(1,919,000)	(2,502,007)
Depreciation	(411)	(418)	(11,144)	(17,000)	(19,000)	(21,000)
EBIT (operating profit)	**66,987**	**1,053,830**	**670,155**	**961,000**	**1,254,000**	**1,761,743**
EBIT margin	9%	56%	34%	33%	33%	36%
Interest In/(Out)	(217)	(9,151)	7,601	35,000	129,542	169,678
Pre-tax profit	**66,770**	**1,044,679**	**677,756**	**996,000**	**1,383,542**	**1,931,421**
Tax Charge %	0%	4%	30%	31%	30%	30%
Tax Charge	(5)	(41,500)	(204,000)	(305,000)	(421,640)	(579,426)
After tax profit	**66,765**	**1,003,179**	**473,756**	**691,000**	**961,902**	**1,351,995**
Dividends		(65,000)	(128,837)	(436,058)		
Retained Earnings	66,765	938,179	344,919	254,942	961,902	1,351,995
Shares in issue				**11,998,561**	**13,338,207**	**13,338,207**
Basic EPS (P)				**5.76**	**7.21**	**10.14**
Diluted EPS (p)				**5.60**	**6.87**	**9.66**

Year End 31 July £'000	***2001/2A***	***2002/3A***	***2003/4A***	***2004/5A***	***2005/6E***	***2006/7E***
Cashflow						
Operating profit	**66,987**	**1,053,830**	**670,155**	**961,000**	**1,254,000**	**1,761,743**
Amortisation	17,793					
Depreciation	411	418	11,144	17,000	19,000	21,000
Working Capital	(113,196)	(682,876)	85,000	171,000	(38,421)	7,897
Other (Provisions etc)			86,000			
Operating cash flow	**(28,005)**	**371,372**	**852,299**	**1,149,000**	**1,234,579**	**1,790,640**
Interest	(217)	(9,151)	7,601	35,000	129,542	169,678
Tax		(5)	(44,000)	(202,000)	(305,000)	(421,640)
Net Capex	(11,916)	0	(60,000)	(28,000)	(30,000)	(35,000)
Free cash flow	**(40,138)**	**362,216**	**755,900**	**954,000**	**1,029,121**	**1,503,678**
Acquisitions and disposals						
Dividends			(194,000)	(436,058)		
Other			7,083	(167,000)		
Share issue			35,000	2,732,000		
Increase/decrease in net debt	(40,138)	362,216	603,983	3,082,942	1,029,121	1,503,678
Opening net cash (net debt)		**(253,199)**	**109,017**	**713,000**	**3,795,942**	**4,825,063**
Closing net cash (net debt)	**(253,199)**	**109,017**	**713,000**	**3,795,942**	**4,825,063**	**6,328,741**

Year End 31 July £'000	***2001/2A***	***2002/3A***	***2003/4A***	***2004/5A***	***2005/6E***	***2006/7E***
Balance Sheet						
Fixed Assets						
Intangible Assets	160,137	87,165				
Tangible Assets	1,673	1,255	51,244	63,000	74,000	88,000
Investments		1,700	1,700			
Current Assets						
Trade Debtors	217,743	636,792	465,093	495,000	561,797	728,254
Other Debtors	6,412		40,907	204,703	31,873	31,873
Cash	10,801	380,600	977,000	3,795,942	4,825,063	6,328,741
Others (prepayments, accrued income)	21,393	4,362		69,297	19,000	24,625
Total assets less current liabilities	**969,232**	**1,409,739**	**1,877,944**	**5,508,942**	**6,299,576**	**8,158,065**
Liabilities						
Trade creditors	(215,657)	(26,549)	(9,859)	(84,497)	(88,977)	(97,903)
Other creditors (taxes, accruals)	(77,728)	(4,113)	(329,141)	(785,503)	(686,866)	(846,669)
Provisions	(257,688)	(267,203)	(3,000)	(11,000)	(12,000)	(12,000)
ST debt		(264,000)	(264,000)			
LT creditors						
LT debt	(264,000)					
Shareholders' Funds	**(396,914)**	**550,009**	**929,944**	**3,746,942**	**4,723,890**	**6,244,921**

Year End 31 July £'000	**2001/2A**	**2002/3A**	**2003/4A**	**2004/5A**	**2005/6E**	**2006/7E**
Debtor days	108	123	85	61	54	54
Creditor days	1279	152	16	65	53	56
Working capital/sales	-41.4%	18.2%	8.2%	-3.8%	-4.6%	-3.5%
COGS	61,553	63,752	221,543	476,000	608,000	640,250
Gearing	na	net cash	net cash	net cash	net cash	net cash
ROCE	6.9%	74.8%	35.7%	17.4%	19.9%	21.6%
ROE	na	182.4%	50.9%	18.4%	20.4%	21.6%
ROIC	6.9%	74.8%	33.3%	13.8%	15.1%	16.4%
Cash conversion	-42%	35%	127%	120%	98%	102%
Market Cap. (share price 194p)				25,876,122	25,876,122	25,876,122
P/E				33.7	26.9	19.1
EV				22,080,180	21,051,059	19,547,381
EV/Sales				7.51	5.54	3.97
EV/Ebitda				23	17	11
Free cash flow yield				3.69%	3.98%	5.81%

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