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YouGov

Polling for a profit

21.3.2005

YouGov, the pioneer of internet-based opinion research in the UK, plans to float on London's AIM market in May this year. Since its establishment in May 2000 YouGov has built up an impressive blue-chip client base. The company is now the official pollster to the *Daily Telegraph* and *the Sunday Times* while other clients include Alliance & Leicester, KPMG, HSBC, Asda and Channel 4.

Although media polling is YouGov's most high profile activity the company derives the majority of its revenue from internet-based market research. In common with most in the advertising sector we believe this market is likely to grow strongly in the UK. In order to capitalise on this growth YouGov plans to launch a number of new internet-based market research tools.

In a very short space of time YouGov has become an established brand name in the UK with an internet panel numbering 89,000 people and 120 clients. Internet-based opinion research is far cheaper to conduct than rival methodologies, a factor reflected in the company's EBIT margins of 30-40%. Furthermore capex and working capital requirements are modest. This translates into a highly cash generative business model. This business model is scaleable and we believe formidable growth rates can be achieved without the need for large infusions of capital.

Based on a combination of peer group and discounted cash flow analysis (20% discount rate) we believe the fair value of YouGov's equity to be in the region of £18-19m. This equates to 15.6x calendar year 2006E earnings. YouGov plans to raise £3m-£5m from the upcoming float. In our forecasts we assume it raises £3m post-expenses.

The float is nicely timed to coincide with the UK's upcoming general election, which is widely expected to be held on 5th May.

Shares in Issue: Not yet decided

Share Price: Not yet decided

Valuation : £18-19m

Gearing: Nil (net cash)

Interest Cover: NA

Market: London AIM

NOMAD: Noble & Co Group

Broker: Noble & Co Group

Previous Research Note:
Initiation of coverage

Analyst: James Chapman

Y/E	Sales	Ebitda	PBT	Net Income	P/e ratio	Divi p.	Yield
31 July	**£m**	**£m**	**£m**	**£m**			**%**
2003A	1.89	1.05	1.04	1.00	-	-	-
2004A	1.99	0.68	0.68	0.46	-	-	-
2005E	2.79	0.96	0.99	0.69	-	-	-
2006E	3.80	1.27	1.40	0.98	-	-	-

SWOT analysis

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Strengths

- Established brand name
- Low cost opinion research model (no field force or data entry costs). This translates into high gross and operating margins
- Impressive client list (*Daily Telegraph*, HSBC etc)
- Modest capital spending and working capital requirements
- High accuracy rates in polling to date.YouGov attributes this to the superiority of internet polling (over rival methodologies) and the development in-house of a sophisticated polling model
- Scaleable business model
- Internet polling and market research can be conducted at far greater speed than telephone or face-to-face interviews, and more questions can be asked
- Larger sample size than rivals
- Highly cash generative
- High penetration rates of internet access in important ABC social category
- Diversified revenue base. No-one customer accounts for more than 10% of revenues
- Management team includes experts on polling such as Peter Kellner

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Weaknesses

- Internet-based polling and market research does not have an established track record in the UK
- Modest barriers to entry in some areas of internet polling and market research (though YouGov's establishment of a large panel will be difficult to replicate at low cost)
- Internet penetration in the UK remains low for certain demographic groups (according to the Office of National Statistics only 18% of UK adults aged 65+ have ever used the internet)
- No tangible asset backing
- Accounting functions have been weak in the past (although the recent appointment of a full-time Finance Director has helped to address this problem). YouGov's accounting functions will need to be expanded if the company meets its growth targets
- Little visibility of earnings
- Up to date business information systems not yet in place

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Opportunities

- Development of new internet-based market research tools
- Exploitation of the growing sensitivity of corporations to consumer perception
- UK spending on internet-based market research is expected to total £160m this year and is growing strongly
- Increasing the size of the client list (in part through acquisitions)
- Upcoming UK general election offers opportunity to raise the company's profile
- Strategic tie-up with an established polling or market research company could significantly bolster client list and revenues

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Threats

- Large, established market research companies such as Taylor Nelson Sofres are increasingly focusing on the internet
- US rival Harris Interactive expanding into UK market
- There is a danger that the reputation of internet-based polling and market research could be tarred by the questionable methodologies employed by some rival companies
- YouGov plans to make acquisitions to bolster its client list. Though this appears a sensible strategic move it creates integration risks. The likely use of shares as consideration will also dilute existing shareholders

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Market overview

A brief history of opinion research

The origins of modern opinion research date back to 1930's America and the founding of Gallup. Prior to Gallup's establishment US political polling was dominated by the *Literary Digest*, which mailed out questionnaires to millions of Americans. However the *Literary Digest's* mailing methodology was discredited in 1936 after the magazine confidently predicted that Landon would trounce Roosevelt in the US presidential election (after mailing out 10m surveys and receiving 2.3m replies). In contrast Gallup polled 50,000 people via quota sampling and accurately predicted the result. The modern polling organisation, with its emphasis on representative samples, was born.

Media driven opinion research took off in the UK during the 1960's. Until 1992 most UK opinion pollsters used similar methodologies - face-to-face interviews - and enjoyed a good track record of accurate predictions (since 1945 the average error in final polls had only twice risen above 2%). Then came the 1992 election. Gallup were the only pollsters to show a Conservative lead, and even then it was only 0.5 percentage points. These polls massively understated the support for the Conservatives, who won the election by 8 percentage points. The 1992 debacle triggered a revolution in opinion research with pollsters through the 1990s moving away from face-to-face street sampling and towards telephone polling. This remains the most common form of opinion research. Telephone polling phone numbers are generated by random selection from directories. The last digit is then randomised to ensure ex-directory numbers are also called. Quota sampling of those households is then employed.

Internet-based market research

Though political polling remains the most high profile activity for the likes of MORI, ICM and YouGov the bulk of these companies' revenues come from market research. This is a huge industry. According to the industry association ESOMAR the global market research industry was worth $18.9bn in 2003. The industry has grown over the past thirty years at an average rate of 7.5% per annum, and its expansion continues to outpace GDP growth in most countries. Taylor Nelson Sofres, which controls around 8% of the global market, anticipates long-term trend growth of 6% per annum.

Internet-based research is one of the fastest growing sub-sectors within market research. Much of this 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.

Around 25% of market research in the US is now conducted on-line compared to 7% in the UK and only 3% in the European Union. Industry insiders are divided about how much research will eventually move on-line (NOP World director Mike Cooke last year predicted that one third of the industry would go on-line), but few doubt that a substantial amount of business will continue to migrate across from other mediums. According to figures from the US group Harris Interactive $796m was spent on internet-based market research in the US alone in 2003. Harris expects this to rise to $971m in 2004. Europe, with its lower internet penetration rates, lags well behind the US, but the growth characteristics are still impressive. 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.

Internet-based opinion research in the US

With 75% of households on-line the internet is already an established polling and market research tool in the US. In contrast to the UK, where the merits of internet-based research are still debated, it is now widely accepted in the US that the internet is a reliable and useful polling and market research tool.

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 over to the internet. Harris's recruitment strategy centred on heavily trafficked sites such as Yahoo which offered e-mail services. Each time a person signed up for e-mail on these sites they were

Novartis experiment on brand recognition					
	Surveys using interviews		Self-completion surveys		
	CATI	Face-to-face	Paper	On-Line (1)	On-line (2)
Brand A	35	34	42	44	55
Brand B	26	23	21	31	30
Brand C	19	18	19	22	29
Brand D (false)	29	22	2	3	3

automatically added to Harris's e-mail database, unless they ticked a box to opt out. A subsequent e-mail would then be sent to confirm whether they wished to participate in polls and market research.

Harris's recruitment strategy has created a huge internet panel in the US, which the company says totals in excess of 6 million people. Less well publicised are the low response rates. The latter are not disclosed but we believe they may run as low as 2-3% on some polls despite inducements such as prize draws and a loyalty programme. Harris's method of building up its internet panel has also been very expensive. We understand that Yahoo, for instance, may charge as much as $3-$4 for every recruited panellist.

Harris has been very acquisitive in recent years, buying businesses in order to increase the size of its panel. A desire to bolster the size of the company's internet panel was the primary motive behind 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 1million people. Based in London, Harris Interactive Europe now publishes data on many UK brands. The company also offers the QuickQueryGB service, a fast response internet-based sample of the UK population.

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 3.4m households worldwide - to market research companies. We believe this is in some respects a commodity business - Greenfield's only real asset is its panel - a factor reflected in EBIT margins of only 16% (though analysts believe these could double to 25-30% as Greenfield outsources operations to India). Greenfield was floated in July 2004 on 26x 2005E EPS.

Internet-based market and opinion research versus other mediums

The merits of Internet-based polls have been heavily debated in recent years. On one side of the argument are companies such as YouGov who argue that the move to internet-based opinion polling and market research is irreversible and similar to the shift from face-to-face interviews to telephone-based polling and research seen in the 1990's. On the opposing side of the argument are the likes of Bob Worcester of MORI. These opponents argue that internet penetration rates in the UK at around 52% of households (or 60% if access at work is included) remain too low and unrepresentative to generate accurate findings. Many other companies are agnostic, conceding that there is a place for the internet in certain areas of market research but worried that the medium is dangerously unrepresentative if broad samples of the entire UK population are required.

Internet-based opinion research

Advantages

- Anonymity. Those surveyed are more inclined to give socially unacceptable responses which would be concealed face-to-face and probably also over phone. Respondents are free to be completely honest without any fear of giving offence or appearing foolish (see Novatris experiment above).
- Direct costs are low. This means samples are larger than telephone and face-to-face polls. YouGov's *Daily Telegraph* polls surveys 2000 people. This is double the size of polls conducted by ICM for *the Guardian* and NOP for *the Independent*.
- Speed. Research can be undertaken and results achieved in a very short time period.
- Convenience. Respondents complete online surveys when and where it is convenient to them, rather than convenient to the polling

company. Respondents can reflect on each question as long as they want. They are under no pressure to give an instant response.

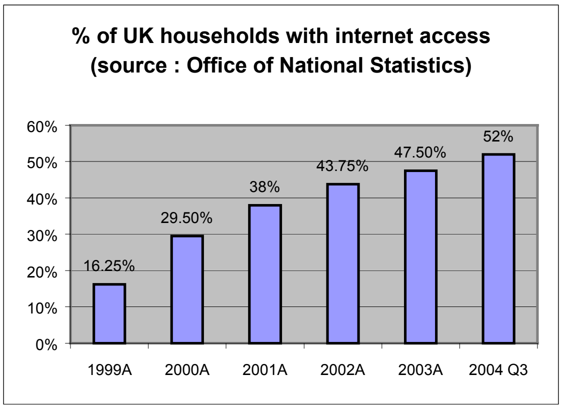
- Telephone and home face-to-face surveys are tilted towards people who are at home at the right time.
- Versatility. Internet research can include motion, sound and still pictures.
- On-line surveys utilise auto-direction on questions. This reduces the likelihood of errors. This is in contrast to paper-based surveys where a respondent may have to wade through a number of pages to move on to the next relevant question after answering a certain identification question (such as whether they are male or female).

Disadvantages

- There is evidence that internet polls have a liberal bias. Even after weighting internet pollsters have struggled to overcome this liberal bias (it is interesting that the only election that YouGov has called wrong to date – the US Presidential election in November 2004 – the poll favoured the liberal candidate).
- 95% of UK households have phones but only around 52% have access to the internet. As a result the population surveyed is in some respects different from the population it is supposed to represent. Internet penetration rates also vary enormously across age groups.

On balance we think the weight of evidence in favour of internet polls is compelling. We also believe that they are likely to become an increasingly critical tool in market research. Here the advantages of self-completion are particularly important. This was illustrated by a Novatris study in 2002. In this study Novatris asked five different national samples to say which of four different brands of bottled water they recognised. Three brands were genuine, one was fake. The table below shows the results (brands A-C were genuine, brand D was false). Very few people doing self-completion surveys recognised the false brand. In contrast in face-to-face and CATI studies 22% and 29% respectively claimed to recognise the false brand (see table on opposite page).

UK internet penetration



Critics of internet polling highlight the fact that only around 50% of UK households have home access to the internet, compared to 75% in the US where the make-up of internet users now broadly mirrors the wider population. Perhaps more importantly internet penetration rates for older age groups in the US are far higher than in the UK. According to a survey by Pewinternet in March 2004, for example, 22% of Americans aged over 65 regularly use the internet. In contrast according to data from the Office of National Statistics between April 2003 and February 2004 only 18% of UK adults aged over 65 *have ever used the internet* (despite the much documented phenomenon of the silver surfers). It is this under representation of the UK's elderly population that provides a formidable challenge for internet-based opinion research companies such as YouGov and ammunition for its critics.

Despite these legitimate concerns we believe that many of the criticisms of internet polling are unjustified. Although low penetration rates amongst the 65+ age group remain a problem in the UK poll weighting methods can help address this problem. Furthermore UK internet penetration is still rising (especially with the increasing use of broadband) across every age group. Many elderly people now recognise the medium's attraction as a method to communicate with their grandchildren. It should also be noted that the low internet penetration rate amongst the elderly population in the UK will inevitably prove to be a finite phenomenon as the current internet savy generation ages.

We also believe that those who disparage the internet as a polling and market research tool all too often ignore the absence of viable alternatives. In particular the future of telephone polling in Western countries now looks very insecure as significant numbers of people move away from landlines towards the mobile phone as their sole form of phone communication. There is no database of mobile users available to pollsters and in some countries, such as the US, the law forbids the cold calling of mobiles. The spread of answerphones and voicemail systems has also allowed people to screen cold callers.

Date	*Event*
May 2000	YouGov founded
June 2001	YouGov's poll is the most accurate in UK election (10% Labour lead forecast v 9.3% achieved).
September 2001	Accurately predicts size of Ian Duncan Smiths' victory (after surveying Conservative Party members) over Kenneth Clark in Conservative Leadership election. Forecasts 61% vote in favour of Smith. Final vote 61% Smith/39% Clarke.
November 2001	Australian General Election outcome accurately predicted
December 2001	Peter Kellner joins YouGov as chairman
February 2002	Pop Idol vote. YouGov predicts 53/47 split in favour of Will Young over Gareth Gates. Will Young wins 53/47 though many in the media and most bookmakers favoured Gareth Gates to win
May 2002	Poll predictions for the London borough elections come within one percentage point of the result
May 2003	1.7% average error on Scottish Parliamentary elections result
November 2004	YouGov US presidential election poll puts Kerry 3 points ahead, gets lead wrong by 6 points.
December 2004	YouGov agrees to buy back Chime Communications 2.4% stake for £170,000
May 2005	Planned float on AIM

In October 2004 61 per cent of adults in Great Britain had used the Internet in the three months prior to being interviewed for the Office of National Statistics' survey. Just over half (55 per cent) of these adults had bought or ordered tickets, goods or services. In October 2004, 34 per cent of UK adults had never used the Internet.

YouGov overview

Group history and key events

YouGov was founded in May 2000 as an on-line polling and e-consultation company. The company's founders had worked together on Jeffrey Archers' mayoral bid where they found conventional polling both expensive and slow. They also realised thanks to their experience of local council politics that there was a rising demand for consultation services from local government. As internet penetration rates in the UK increased they believed such consultation was increasingly likely to rely on the internet.

YouGov was set up with the support of Bell Pottinger PR, and shared the PR company's offices when it first began trading. The company built its first panel of respondents through a joint venture with Freeserve (now Wanadoo) in the second half of 2000. YouGov provided a news, comment and interaction site which became a channel on the Freeserve portal. Freeserve also e-mailed some of its membership to invite them to register with YouGov's panel for paid survey work. Under this arrangement YouGov recruited panel members in return for providing research for Freeserve.

YouGov's web site initially sought to combine political news and commentary with on-line questionnaires, which were posted at the end of articles. However the political analysis was soon abandoned and the company decided to focus solely on on-line polls and market research.

YouGov's profile was boosted enormously when it was commissioned to conduct the on-line component of the British Election Study of the 2001 election. The YouGov poll, which was published in *The Business* on the Sunday before the election accurately predicted the result, in contrast to many rivals pollsters who heavily overstated the Labour lead. The poll gained valuable publicity for YouGov and enhanced the reputation of internet polling. The success of the 2001 election poll resulted in a number of important client wins, most notably *the Daily Telegraph* and *the Sunday Times*.

While political polls remained YouGov's most high profile activity it some became clear that the company could leverage its skills in this area into the fast growing market of internet-based commercial market research. YouGov's first commercial client was Lilly Industries, for whom YouGov's surveys formed part of a reputation audit. YouGov's first product-based testing client was Compass. The company carried out a survey in the US, UK and Spain on a new pizza and chicken concept from the FTSE 100 catering group.

In 2004 YouGov started work on project with HSBC Bank Middle East to create the HSBC Middle East Business Confidence Index (MEBCI). This involved surveying business men and women across the region three times a year.

Company strategy

YouGov plans to capitalise on its belief that the internet will supplant the telephone as the dominant methodology in polling and at the same time become an increasingly important tool in market research. As an established brand name in internet surveys the company believes it will enjoy strong organic growth as the shift towards the internet from other mediums gains momentum.

YouGov is currently developing a number of products to take advantage of the move to on-line market research. This includes a subscription-based product which monitors consumer reactions to a wide range of products. YouGov has also developed an interactive tool for monitoring responses to TV adverts and political advertising. This will be used by Sky in its coverage of the 2005 general election.

However YouGov does not intend to rely solely on organic growth. One reason for the upcoming float is to furnish the company with an appropriate currency - its own paper - to make acquisitions in the market research sector. YouGov plans to focus on 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. YouGov believes this strategy is necessary because corporates are notoriously reluctant to switch from one market research company to another. This reluctance is due to market research companies controlling valuable historical information on companies. When a company is acquired a substantial element of the business will be moved on-line immediately, providing an immediate boost to margins. Existing staff will be retained for their sector expertise.

Despite its strong growth profile the market research industry remains fragmented. There are 281 independent privately-owned research agencies with revenues of less than £3m per annum in the UK alone. Management will focus on companies with a strong presence in areas such as fast moving consumer goods, public sector consultation, financial services and health.

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 will seek to acquire businesses on 6-8x net income. An element of consideration is likely to consist of YouGov shares.

The focus will remain on the UK, with no plans to expand abroad at present.

The Management team

Peter Kellner (Chairman) joined YouGov in December 2001. Mr Kellner has been a high profile political commentator and journalist for more than 30 years, regularly appearing on the BBC and writing for *the Sunday Times*, *the Independent* and *the Evening Standard*. He has been an adviser on polls and public opinion to the Bank of England, the Foreign Office, the Corporation of London, NatWest Bank and the Trades Union Congress. Mr Kellner is married to the labour peer Baroness Ashton of Upholland

Stephan Shakespeare (Co-founder and joint chief executive). After graduating from Oxford with an MA Mr Shakespeare worked as a teacher and a headmaster in Los Angeles (where he helped set up a local school) and London during the 1980s. He then became involved in politics, first as a commentator on education policy and then as Jeffrey Archer's policy adviser both during and after the latter's unsuccessful London mayoral campaign. In the 1997 general election, Mr Shakespeare was Conservative candidate for Colchester. Mr Shakespeare, who owns 33% of YouGov, is responsible for the company's commercial development and strategy

Panos Manolopoulos (Managing director) has worked in market research for over 15 years including senior positions at Taylor Nelson Sofres (UK Country Manager for IT accounts), NOP (research manager) and WPP. Mr Manolopoulos is responsible for YouGov's business development strategy and research operations.

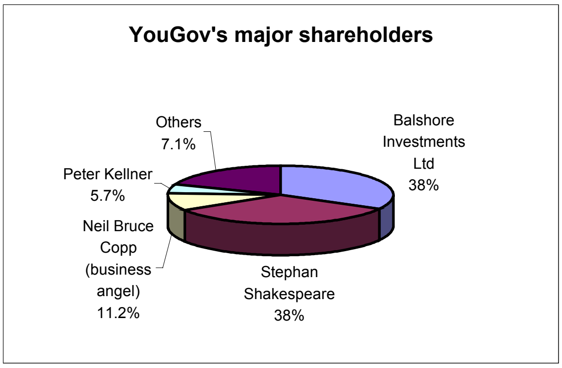
Nadhim Zahawi (Co-founder and joint chief executive) was European marketing director for Smith & Brooks before founding YouGov with Stephan Shakespeare in May 2000. He is responsible for YouGov's corporate direction and acquisition strategy. Mr Zahawi was campaign director for Jeffrey Archer during the latter's unsuccessful bid to become mayor of London in 1999. Mr Zahawi was the sales director and a major shareholder in Allen (Hinkley) Ltd which was owned by the Ray Allen Group. The latter collapsed in November 1998 with debts of £3.2m. Mr Zahawi and Jeffrey Archer (who was also a major shareholder in Allen (Hinkley) Ltd) were subsequently referred to the DTI for investigation but no action was taken against them. Mr Zahawi has been a councillor in Wandsworth since 1994 and stood as a Conservative candidate in the 1997 election for Erith Thamesmead constituency. Mr Zahawi's family trust owns 33% of YouGov.

Jonson Helps (Finance Director) joined YouGov in October 2003 before being promoted to Finance Director this year. Prior to joining YouGov Mr Helps held senior financial positions at the public relations agency Gabrielle Shaw Communications and the ladies fashion wear company Amanda Wakeley.

Anthony Foye (Non-Executive Director) is group Finance Director of T & F Informa. Mr Foye joined Taylor & Francis in 1987 as Group Chief Accountant and Company Secretary after qualifying as a chartered accountant with Haines Watts. He helped oversee the Taylor and Francis's flotation in May 1998 its merger with Informa last year.

Peter Bazalgette (Non-Executive Director) is Chairman of Endemol UK, the British arm of the TV production company behind the Big Brother series. Mr Bazalgette also serves on the Endemol's executive board as Chief Creative Officer.

YouGov's shareholders



Balshore Investments Ltd is a Zahawi family trust (Nadhim Zahawi is not a beneficiary). YouGov's management will be subject to 12 month lock-ins after the float. In December 2004 YouGov agreed to acquire Chime Communications 2.4% stake in the company for £170,000. This deal is still awaiting approval from some of the company's shareholders.

The business model

The key to YouGov's business is the company's internet panel. We explain how this operates below :-

YouGov's internet panel

YouGov recruits its internet panelists via advertisements on the internet. Most adverts are located on non-political web sites such as Wanadoo. The company also uses specialist agencies to recruit difficult to find demographic groups. In some instances clients web sites act as feeders.

When YouGov conducts a survey it selects a specific panel from its total pool of panellists, dependent on the projects requirement using a programme designed in-house. YouGov emails each panel member and invites them to complete a survey by clicking on an internet link. In order to complete the survey they must log in and provide their password. When the internet-based field work is complete the raw data is then rim weighted by age, gender, social class, newspaper readership and (if it is a political poll) past vote.

The number of people emailed in any given survey depends on both the size of the sample that is required and how quickly the results are needed. YouGov says that response rates in the region of 40% are normally achieved within 24 hours and 60% within 72 hours. The company says that little difference has been detected between the results from early and late respondents. The average response rate is 59%.

Respondents are usually given at least 24 hours to reply to a survey, though the time frame is inevitably shorter for daily polls or "snap reaction" polls such as that conducted for the *Daily Telegraph* and carried by the BBC that evening when Prince Charles announced plans to marry Camilla Parker Bowles.

Respondents receive a small inducement to complete surveys, ranging from 50p to £1 per survey. This builds up in a YouGov account and can be cashed in via a cheque when it reaches £50. Payouts currently run at £16,000 per month.

In contrast to some rivals YouGov does not place any advertising alongside its polls or market research. The company's panel now has 89,000 members, which management says is perfectly adequate to cope with the company's current polling and market research needs.

Sources of revenue

The sources of YouGov's revenue can be divided into 3 broad categories - commercial market research, media and political opinion polling, and stakeholder consultation. Commercial market research usually entails studies commissioned by private sector companies which directly target the end-consumer. These companies usually want to discover more details about consumer usage of their products and levels of customer satisfaction. The fastest growing demand for this research is coming from the financial services, fast moving consumer goods (FMCC), healthcare and wireless telecoms sectors. We believe this market is likely to enjoy strong growth amid rising internet penetration rates and a growing acceptance of the medium as an accurate research tool (see "Internet-based market research v other mediums").

YouGov also derives revenue from opinion polls. These are commissioned by a number of different organisations including newspapers, current affairs programmes and political parties. These studies may include questions on how respondents intend to vote in elections or their views on current affairs issues of the day (such as the marriage of Prince Charles to Camilla Parker Bowles). In the past YouGov has also generated revenue in this area from conducting polls on entertainment issues, such as the likely Pop Idol winner, and sporting events.

A final important source of revenue is stakeholder consultation. This area of the business entails studies commissioned by organisations such as local government or health authorities to examine the attitudes of consumers of their services. Employers also engage in stakeholder consultation studies to canvas their employees' views. Stakeholder consultation is a growth market. Much of this growth is due to new UK government legislation which requires institutions and corporates to engage in a consultation with those persons who will be effected by their policies.

YouGov's market research and opinion research studies can be categorised into two areas - bespoke studies and omnibus studies. Bespokes studies are quite complex and tend to require a specific respondent panel, which must be targeted by YouGov. In contrast Omnibus studies are simpler and tend to employ far less questions. Here around 3 – 5 clients submit a set of questions which are incorporated in a general survey. This survey is then issued to a nationally representative sample of the population. Omnibus surveys tend to generate higher margins due to the syndication of the work across a number of clients.

Financial Commentary

Margins

YouGov's use of the internet rather than expensive field forces means the company has a much lower cost base than most rival pollsters and market research groups. This is reflected in very high margins. Gross margins run at approximately 90%, while EBIT margins are around 30-40%. That compares to EBIT margins of 10-15% at traditional polling groups such as MORI. YouGov's management has in the past taken dividends as a form of compensation for tax reasons. This policy, which will cease when the company is quoted, flatters YouGov's historic margins.

Marketing & Sales

There has been little focus on sales and marketing to date. Advertising for new clients is in practice free thanks to the high profile of YouGov's polls in the national press. By management's own admission most business in the past has "come in through the door". The amount spent on marketing and advertising could rise substantially if the company launches new internet-based market research tools.

Financial controls and business systems

Until recently YouGov has operated without a Finance Director and the company's finance function was run by a part-time financial controller. The company's auditors, Butterworth Jones (now replaced by Grant Thornton), processed the payroll. Clearly this is completely unsatisfactory for a public company. The recent appointment of Jonson Helps as full time Finance Director should help address this issue.

YouGov concedes that its current business information systems are inadequate for providing detailed information on many areas of the business. Fortunately this problem is being addressed by the development of an in-house system which will monitor projects and client workload. The new system is scheduled to come on-line this spring.

Use of float proceeds

YouGov plans to use the float proceeds to develop a new subscription-based market research product; promote its brand in the market place; develop new on-line research tools; and help fund its acquisition programme. One of the motivations behind the float is also to furnish the company with the appropriate currency - its own shares - to make acquisitions.

Accounting policies

Revenue recognition and payment terms for trade creditors and trade debtors are in-line with industry best practice. YouGov makes provisions for credits on customers accounts as soon as these reach £50, which is the level at which a panelist is entitled to a pay-out. The company currently makes no provision for credits in its polling members' accounts below this level. Though YouGov has no obligation to pay any accrued amounts until the £50 level is achieved we believe as a potential liability a provision should be made for these sums in the balance sheet. However it should be noted that this sum is not large (less than £100,000) and the omission of this potential liability does not significantly flatter the balance sheet.

Historical performance and forecasts

The increase in sales between 2003 and 2004 is misleading if taken out of context. Late in 2003 YouGov was awarded a large, very profitable one-off contract (worth in the region of £640,000). This resulted in a one-off leap in sales and a large working capital outflow in 2003 (as the contract's customer became a trade debtor at the year-end). If this contract is stripped out turnover was in the region of £1,247,000 in 2003, and on that basis year-on-year sales growth as 60%. This would tend to support our growth expectations going forward.

Going forward YouGov plans to acquire market research companies with attractive client bases. We believe these deals are likely to be earnings accretive given management's target of buying businesses on 6-8x net income and the likely rating of YouGov's shares. We believe that EBIT margins of around 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.

YouGov recently 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.
Fairly modest capital spending levels are envisaged though these could rise substantially if the company decides to put more resources into developing products to take advantage of the move to on-line market research. YouGov says that its current computer systems have plenty of capacity to deal with the company's projected growth.

Competition

YouGov faces competition from fellow opinion research companies such as MORI, ICM, NOP and Populus most of whom are also engaged in market research. The largest of these is MORI, which was valued at £55m when ISIS took a 50% stake in March 2004. In its last filed accounts (for the year ending 31 December 2003) MORI generated operating profits of £4.84m (2002 : £3.9m) on sales of £41.5m (2002 : £37.7m).

Competition in market research also comes from the larger media groups such as Taylor Nelson Sofres and WPP. These companies already utilise the internet as a market research tool. WPP, for instance, has set up Lightspeed Research as an in-house internet-based market research arm. Though these companies are at present a competitive threat there is the possibility that they may ultimately view internet-based research as "non-core" and outsource these activities to companies such as YouGov.

On a smaller scale YouGov also faces competition in internet-based market research from operations such as Tickbox.net, the internet research arm of the PR agency markettiers4DC. In contrast to YouGov, which carries no advertising on its polls, Tickbox.net generates revenue from direct marketing to its internet panels.
YouGov also faces potential competition from Harris Interactive. Harris has recently expanded into the UK and now offers the QuickQueryGB service, a fast response internet-based sample of the UK population.

Valuation

Relative valuation

There are no companies directly comparable to YouGov quoted in the UK. Most of the smaller market research and polling groups such as MORI, ICM and Populus are privately owned. Of the quoted market research agencies only EQ Group is of comparable size. However EQ Group does not utilise the internet for its research, which is reflected in its 14% EBIT margins. Given this important structural difference we are wary is using EQ as a comparative. In the UK we view research companies such as Datamonitor, Hemscott, ADVFN, and Thomson Intermedia, all of which heavily utilise the internet, as the best comparatives. We see limited value in comparisons with the larger market research agencies such as Taylor Nelson Sofres since these dwarf YouGov in terms of sales and profits.

There are far better comparatives in the US. In particular Harris Interactive, though substantially larger than YouGov (its sales totalled $146m in the year to June 2004), has a business model in place which is very similar to YouGov's (see "Internet-based opinion research in the US"). Harris generates gross margins of 60-65% and EBIT margins of around 44% at its fast growing internet operations where revenues totalled $86.5m in the year to June 2004, compared to $60.1m the previous year. Though Greenfield employs a slightly different business model than YouGov (see "Internet-based opinion research in the US") we view this as another interesting comparative.

Comparatives	Market Cap	EV/Ebitda 2005E	EV/ebitda 2006E	P/E 2005E	P/E 2006E
UK small cap					
Thomson Intermedia (198p)	£57m	28	16.7	34.0	18.7
ADVFN (4.95p)	£22.8m	10	6.2	19.0	9.5
Hemscott (49p)	£28.3m	17	11.7	-	70.0
Datamonitor (161p)	£114m	15	11.0	24.0	19.0
Mean		***17.4***	***11.4***	***25.7***	***15.7****
					*Exc Hemscott
US internet based opinion research					
Harris Interactive ($5)	£160m			24.0	19.0
Greenfield on-line ($16.9)	£185m			31.0	21.0
Mean				***27.5***	***20***
Market Research					
Taylor Nelson Sofres (234p)	£1044m	10	8.5	16.1	14.3
GfK (€32)	£689m	8.3	7.8	19.0	16.2
IPSOS (€82.5)	£405m	9	7.8	15.4	13.7
Acxiom ($22.04)	£985m	7.5	6.7	25.0	20.0
Mean		***8.7***	***7.7***	***18.9***	***16.1***

All estimates are calendar year-based

We forecast YouGov will achieve calendar year earnings of £814,682 in 2005 and £1,184,164 in 2006. A mean p/e multiple for 2006 based on UK small cap peers would put a value of £18.6m on the company's equity.

Discounted cash flow analysis

Given YouGov's strong growth profile we have also used discounted cash flow analysis to judge the appropriate value of the company's equity. We have explicitly forecast free cash flow to the firm (FCFF) out to 2007/8. After that period we have assumed a terminal growth rate of 3% (which in our view is very conservative given that the market research industry is growing at GDP + rates) and a weighed average cost of capital of 9% in our calculation of an appropriate terminal value, which we believe is not too dissimilar to the average for a small cap UK company. We have assumed that long-term EBIT margins of 40% are sustainable.

Since YouGov is likely to use its cash pile to buy businesses which generate a return in excess of the company's capital, rather than have this cash sit in the balance sheet destroying value, we regard this discounted cash flow analysis as a base case scenario.

	2005/6E	**2006/7E**	**2007/8E**	
Sales	3,800,000	4,925,000	5,663,735	
EBIT	1,259,613	1,920,836	2,286,658	
EBIT x (1-tax rate)	881,729	1,344,585	1,600,661	
Depreciation	14,586	9,655	9,700	
Net Capex	(10,000)	(10,000)	(14,000)	
Working Capital	19	87,897	57,767	
FCFF	**886,334**	**1,432,137**	**1,654,128**	Terminal cash flow = 1,703,752
Terminal Value			**28,395,864**	Terminal Value =
Terminal growth rate = 3%				2007/8E
Terminal WACC assumption = 9%				x5 sales
	Discount rate	**PV of equity**		x12.4 EBIT
	10%	24,566,346		x16.2 Net Income
	15%	21,611,984		
	20%	**19,123,192**		
	25%	17,011,230		
	30%	15,206,952		

Year End 31 July £'000	**2001/2A**	**2002/3A**	**2003/4A**	**2004/5E**	**2005/6E**	**2006/7E**	**2007/8E**
Turnover	**737,578**	**1,887,446**	**1,992,309**	**2,789,000**	**3,800,000**	**4,925,000**	**5,663,735**
Gross profit	**676,025**	**1,823,694**	**1,770,766**	**2,482,210**	**3,383,860**	**4,432,498**	**5,097,362**
Gross margin	92%	97%	89%	89%	89%	90%	90%
SGA	(608,627)	(769,446)	(1,089,467)	(1,519,760)	(2,109,661)	(2,502,007)	(2,801,004)
Depreciation	(411)	(418)	(11,144)	(12,600)	(14,586)	(9,655)	(9,700)
EBIT (operating profit)	**66,987**	**1,053,830**	**670,155**	**949,850**	**1,259,613**	**1,920,836**	**2,286,658**
EBIT margin	9%	56%	34%	34%	33%	39%	40%
Interest In/(Out)	(217)	(9,151)	7,601	43,836	143,452	177,589	231,101
Pre-tax profit	**66,770**	**1,044,679**	**677,756**	**993,686**	**1,403,065**	**2,098,425**	**2,517,759**
Tax Charge %	0%	4%	32%	30%	30%	30%	30%
Tax Charge	(5)	(41,500)	(215,145)	(298,106)	(421,640)	(630,427)	(755,328)
After tax profit	**66,765**	**1,003,179**	**462,611**	**695,580**	**981,425**	**1,467,998**	**1,762,431**
Dividends		(65,000)	(128,837)	(436,058)			
Retained Earnings	66,765	938,179	333,774	259,522	981,425	1,467,998	1,762,431

Year End 31 July £'000	**2001/2A**	**2002/3A**	**2003/4A**	**2004/5E**	**2005/6E**	**2006/7E**	**2007/8E**
Cashflow							
Operating profit	**66,987**	**1,053,830**	**670,155**	**949,850**	**1,259,613**	**1,920,836**	**2,286,658**
Amortisation	17,793						
Depreciation	411	418	11,144	12,600	14,586	9,655	9,700
Working Capital	(113,196)	(682,876)	199,350	236,369	19	87,897	57,767
Other (Provisions etc)							
Operating cash flow	**(28,005)**	**371,372**	**880,649**	**1,198,819**	**1,274,218**	**2,018,388**	**2,354,125**
Interest	(217)	(9,151)	7,601	43,836	143,452	177,589	231,101
Tax		(5)	(41,500)	(298,106)	(421,640)	(630,427)	(755,328)
Net Capex	(11,916)	0	(61,133)		(10,000)	(10,000)	(14,000)
Free cash flow	**(40,138)**	**362,216**	**785,617**	**944,549**	**986,030**	**1,555,550**	**1,815,898**
Acquisitions and disposals							
Dividends			(193,837)	(436,058)			
Other							
Share issue				3,000,000			
Increase/decrease in net debt	(40,138)	362,216	591,780	3,508,491	986,030	1,555,550	1,815,898
Opening net cash (net debt)		**(253,199)**	**109,017**	**700,797**	**4,209,288**	**5,195,318**	**6,750,868**
Closing net cash (net debt)	**(253,199)**	**109,017**	**700,797**	**4,209,288**	**5,195,318**	**6,750,868**	**8,566,766**

Year End 31 July £'000	**2001/2A**	**2002/3A**	**2003/4A**	**2004/5E**	**2005/6E**	**2006/7E**	**2007/8E**
Balance Sheet							
Fixed Assets							
Intangible Assets	160,137	87,165					
Tangible Assets	1,673	1,255	51,244	38,644	34,058	34,403	38,703
Investments		1,700	1,700				
Current Assets							
Trade Debtors	217,743	636,792	465,093	435,070	561,797	728,254	849,560
Other Debtors	6,412		31,873	31,873	31,873	31,873	31,873
Cash	10,801	380,600	977,287	4,209,288	5,195,318	6,750,868	8,566,766
Others (prepayments, accrued income)	21,393	4,362	8,759	15,163	19,000	24,625	28,318
Total assets less current liabilities	**969,232**	**1,409,739**	**1,888,948**	**5,282,972**	**6,517,889**	**8,494,595**	**10,615,172**
Liabilities							
Trade creditors	(215,657)	(26,549)	(9,859)	(84,497)	(88,977)	(97,903)	(130,268)
Other creditors	(77,728)	(4,113)		(109,681)	(151,214)	(201,291)	(250,390)
Provisions, taxes, accrued expenses	(257,688)	(267,203)	(343,133)	(358,756)	(435,652)	(625,378)	(719,294)
ST debt		(264,000)	(264,000)				
LT creditors							
LT debt	(264,000)						
Shareholders' Funds inc. Intangibles	**(396,914)**	**550,009**	**918,964**	**4,177,104**	**5,166,203**	**6,645,451**	**8,415,268**

Year End 31 July £'000	**2001/2A**	**2002/3A**	**2003/4A**	**2004/5E**	**2005/6E**	**2006/7E**	**2007/8E**
Debtor days	108	123	85	57	54	54	55
Creditor days	1279	152	16	101	78	73	84
Working capital/sales	-41.4%	18.2%	7.7%	-2.5%	-1.7%	-2.8%	-3.4%
COGS	61,553	63,752	221,543	306,790	416,140	492,502	566,373
Gearing	na	net cash	net cash	net cash	net cash	net cash	net cash
ROCE	6.9%	74.8%	35.5%	18.0%	19.3%	22.6%	21.5%
ROE	na	182.4%	50.3%	16.7%	19.0%	22.1%	20.9%
Cash conversion	-42%	35%	131%	126%	101%	105%	103%

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