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Bazaarvoice's Valuation Is Utterly Bizarre

June 14, 2012

Situation Overview

On February 23rd, Bazaarvoice (Nasdaq: BV) raised $114 million at its initial public offering by selling 9.5 million shares at $12 per share. The expected pricing range was $8.00 - $10.00 per share, and the shares ultimately closed at $16.50 on the first day of trading. At today's price of $17.00, the company's fully diluted enterprise value is approximately $1.1 billion.

So what does this billion dollar company do? Bazaarvoice is a provider of social commerce solutions that help clients capture, display and analyze online word-of-mouth, including consumer-generated ratings and reviews, questions and answers, stories, recommendations, photographs, videos and other content about their clients' brands, products or services. The company's solutions are provided via a SaaS platform to clients in a range of industries including retail, consumer products, travel and leisure, technology, financial services, healthcare and automotive industries.

Call me anti-social or just an extreme skeptic, but I struggle to justify BV's $1.1 billion enterprise value. Since being founded in May 2005, the company has been unable to reach an EBITDA or cash flow positive break-point, and is not projected to do so any time soon. When you strip-out the Wall Street buzz words du jour of "social" and "SaaS" from BV's business description, you're left with what appears to be a pedestrian marketing analytics company that may forever be challenged to achieve commercial success. Even the most bullish Wall Street estimates have BV bleeding cash until 2014, which would mark a total of 9 years of consecutive losses.

Of course, there's no guarantee that the company will ever achieve a profit, or a proven business model. A major sticking point for potential customers appears to be their unwillingness to embrace BV's solution such as Ratings & Reviews, due to the discomfort with displaying negative reviews about products or services offered on their websites. Furthermore, policing fraudulent or inaccurate reviews presents a major challenge.

In the table below I've illustrated BV's historical and projected financial model. The company will be investing heavily in sales, marketing, research and development expenses in the next few years. This will keep adjusted EBITDA and free cash flow strongly negative. The analysts are expecting this investment to continue driving revenue growth, but at a sharply lower growth rate from recent history. The revenue growth rate is expected to decline to 24.0% in calendar year 2013, from 67.7% in 2011.

Bazaarvoice Historical and Projected Financials
Fiscal Yr. Ended April 30,
$ in millions

	2009	2010	2011	2012	Wall St. Projections 2013E	2014E
Sales	$22.5	$38.6	$64.8	$106.1	$131.6	$167.0
growth	--	*72.0%*	*67.7%*	*63.7%*	*24.0%*	*26.9%*
Cost of Sales	$8.3	$15.2	$25.6	$36.4	$43.5	$54.2
% of sales	*36.9%*	*39.3%*	*39.5%*	*34.3%*	*33.0%*	*32.5%*
Sales/Marketing Expense	$10.7	$16.9	$33.4	$49.7	$62.4	$67.1
% of sales	*47.8%*	*43.7%*	*51.6%*	*46.9%*	*47.4%*	*40.1%*
R&D Expense	$3.2	$5.4	$10.1	$20.8	$28.9	$30.4
% of sales	*14.2%*	*13.8%*	*15.6%*	*19.6%*	*21.9%*	*18.2%*
General/Admin. Expense	$4.2	$7.0	$11.3	$21.9	$23.4	$25.2
% of sales	*18.5%*	*18.1%*	*17.4%*	*20.6%*	*17.8%*	*15.1%*
Total Operating Expenses	**$18.1**	**$29.2**	**$54.8**	**$92.4**	**$114.7**	**$122.6**
% of sales	*80.4%*	*75.7%*	*84.6%*	*87.1%*	*87.1%*	*73.4%*
Adjusted EBITDA	**($3.3)**	**($4.2)**	**($13.3)**	**($12.9)**	**($27.0)**	**($10.0)**
% of sales	*-14.9%*	*-10.9%*	*-20.5%*	*-12.2%*	*-20.5%*	*-6.0%*
Cash from Operations	$0.2	$5.2	($0.6)	($0.3)	($18.8)	($3.6)
Capex	($1.0)	($6.8)	($2.8)	($5.1)	($10.0)	($13.1)
Free Cash Flow	**($0.8)**	**($1.6)**	**($3.5)**	**($5.4)**	**($28.8)**	**($16.7)**
% of sales	*-3.7%*	*-4.2%*	*-5.3%*	*-5.1%*	*-21.9%*	*-10.0%*

Source: Company filings, Wall St. Research

There may be a glimmer of hope for BV's financial future if you believe the company's cohort analysis provided in the prospectus. Since the company makes significant upfront investments in acquiring new clients, it does take time to achieve a return on the investment, especially since revenue is recognized ratably over the contract life when the customer starts using the solution. The 2008 client cohort analysis is illustrated in the table below. The historical evidence is limited to just one cohort so far, so there is not enough current evidence to say for sure if their model will succeed.

$ in millions

	2008 Cohort	2011 Result of 2008 Cohort	Total 2008-2011
Revenue	$2.3	$17.9	$62.2
Sales/Marketing Costs	$5.0	$4.1	$17.3
Cash Collected	$4.1	$18.6	$66.3

Source: Bazaarvoice Prospectus

For the current time, investors are left to marvel at the wildly bullish sell-side analyst commentary, and valuation techniques reminiscent of the internet heyday to justify their price targets. Take Credit Suisse for example, which proclaimed in their April 6th initiation report that "BV is a market leader in a duopoly, with a network larger than Amazon's (AMZN)." Most of the sell-side research indicates that BV has just one competitor called PowerReviews, and that BV has twice the market share. I suppose it depends on how you define which "market" BV is servicing since the market for web analytics and market research is pretty broad and intensely competitive.

If it truly is a duopoly, then it must exist because there are no profits in this market to attract other competition, or barriers to entry are incredibly high in this industry. If BV and PowerReviews are not the next Pepsi (PEP) / Coke (KO), Airbus / Boeing (BA) or FedEx (FDX) / UPS combo, then it appears Wall Street analysts are being overly generous in proclaiming them to be a market leader in a duopoly. Even BV admits in its prospectus that its competition is broad, intensely competitive, and subject to a changing landscape.

Our main competition is from traditional marketing and advertising programs used by businesses that remain hesitant to embrace social commerce solutions such as Ratings & Reviews. Additionally, some businesses have developed, or may develop in the future, social commerce solutions internally. These businesses may consider their internal solutions adequate, even if our solutions are superior. We have several direct and indirect competitors that provide third-party social commerce solutions, including companies like PowerReviews, Inc. and Revieworld Ltd. Additionally, we face potential competition from participants in adjacent markets that may enter our markets by leveraging related technologies and partnering with other companies. We may also face competition from companies entering our market, including large Internet companies like Google (GOOG) and Facebook (FB), which could expand their platforms or acquire a competitor. While these companies do not currently focus on our market, they have significantly greater financial resources and, in the case of Google, a longer operating history.

Given the competitive dynamics and struggle to make a profit in the industry, it came as no surprise to me that on May 24th, BV announced and closed the acquisition of PowerReviews. I'm still waiting for the analyst community to proclaim that BV no longer operates in a duoply, but now a dominant monopoly. The acquisition appears highly defensive, and at a steep price to BV shareholders at approximately $168 million, including $31 million in cash and 8.0 million shares (includes assumption/conversion of 1.6m options). PowerReviews had 2011 revenues of just $11.5 million, and earnings losses, so the deal values the company at 14.6x revenues.

The articulated strategic rationale is that the combined companies will deliver "higher ROI for clients through an enhancement of the technology platform and the merging of two great teams." The key metric that management guided investors towards was the combination of a larger client platform, with BV contributing 737 clients, and PowerReviews contributing 1,800. Investors' initial reaction was to bid up BV's stock price modestly on the announcement. However, investors might want to consider carefully that management offered no tangible roadmap or guidance as to how the deal would provide revenue and earnings growth synergies, or cost savings. The ultimate success or failure of the deal will depend on bottom-line financial results, which are still unproven and subject to above average risk.

Pro Forma BV/PowerReviews Deal
$ in millions

	Bazaarvoice	PowerReviews	Pro Forma
Clients	737	1,100	1,800
LTM Revenues	$106.1	$11.5	$117.6
Avg Rev/Client	$144,011	$10,455	$65,353
Fully Diluted Shares	66.1	8.0	74.1
Stock Price	$15.12		$18.00
Equity Value	$999.7		$1,333.9
Less: Cash	$125.2	($31.0)	$94.2
Enterprise Value	$874.6		$1,239.7
Ownership	89%	11%	100%
EV/Revenues	8.2x	14.6x	10.5x
EV/Client	$1,186,685	$152,982	$688,719

Notes:
PF ownership for options and warrant dilution assuming treasury stock method
BV valuation is pre deal announcement

Meanwhile, on the deal announcement call, management reiterated that in "the overall competitive landscape, there are dozens and dozens of companies competing for share of wallet around social, and reach and scale is incredibly important." At least this is one point I agree with the company.

The landscape of existing and potential competitors for social commerce solutions is deep and wide. In a quick internet search I found no less than 27 companies that are capable of assisting clients with aspects of their social commerce strategies. I have characterized the competition as direct, adjacent, and potential. Direct competitors offer essentially the same products and services as BV.

Adjacent competitors such as Google and Salesforce.com (CRM) could easily expand their platforms or acquire competitors to offer most of BV's products and solutions. Potential competitors include companies with a core focus on marketing services and analytics, that offer social solutions, and could move into the social reviews space. Examples of such companies include Coremetrics, a business owned by IBM.

Competition in the social media marketing and solutions market appears to be intensifying at a rapid pace. Just recently, Salesforce.com acquired Buddy Media for $689 million, while Oracle acquired Virtue for $300 million and Collective Intellect. While Buddy Media is perceived to be an adjacent competitor to BV, having CRM's muscle behind it may be a catalyst for increasing movement into BV's space. Oracle's move to buy Collective Intellect is a direct competitive threat; the company collects, processes and synthesizes online consumer conversations.

	Competitive Assessment			Product / Solution Offering			
	Direct	Adjacent	Potential	Social Reviews	Social / Marketing Solutions	Social Media Research/ Analytics	Social Network
Reevoo	x			x	x	x	
Lithium	x			x	x		
Oracle	x			x	x	x	
Google		x			x	x	x
Facebook		x			x	x	x
Twitter		x				x	
NM Incite (Nielsen)		x				x	
Buddy Media (CRM)		x			x	x	
Jive Software		x			x		x
Yammer		x					x
Chatter (Salesforce)		x					x
Hootsuite (Adobe)		x			x	x	
socialkik		x			x		
Merkle		x			x		
WebTrends		x			x		
comScore						x	
ValueClick			x		x		
Gemius			x			x	
Compete			x		x	x	
Experian			x		x	x	
Ipsos			x			x	
GFK Group			x		x	x	
Harris Interactive			x			x	
Adometry			x		x	x	
DynamicLogic			x			x	
InsightExpress			x			x	
Coremetrics (IBM)			x		x	x	
Acquity Group			x		x	x	

Source: Public market research

After 12 hours of meticulously reviewing BV's product offering vis-à-vis a wide landscape of actual and potential competitors, my head was spinning in social confusion from trying to figure out how BV could differentiate itself and maintain its market position among all of these potential competitors.

Recall that BV's main value proposition to its customers are: 1) capturing and displaying word-of-mouth content 2) analyzing this data and; 3) distributing and syndicating the content. In other words, when you boil it down to basics, they collect, analyze and display data. This appears to be exactly what every company I've identified in the table above is capable of doing.

What I also find striking is that only 1 out of 4 sell-side reports I reviewed even bothered to mention any potential threat from the likes of Google. Therefore, it came as no surprise to me that not a single analyst commented when on April 30th and June 5th, Google Analytics released new features that appear to directly compete with BV's attempt to grow its own analytics business. The new set of social reports produced by Google Analytics help measure the impact of social marketing initiatives and evaluate the effect social media has on a company's goals and e-commerce activities. The 4 new reports aggregate key data points to help see the complete picture of how social marketing and media affect a business.

So what is BV really worth?

So how do you value a company with a long history and future of losses, an expensive new acquisition with integration risks, and an admittedly uncertain business model with rapidly escalating competition? Any traditional discounted cash flow (DCF) analysis would surely depend on very subjective assumptions. Morgan Stanley and Piper Jaffray do not even attempt the futile exercise of a DCF. On the other hand, Credit Suisse does perform a DCF and arrives at a $20 price target, but wisely initiates BV at a Neutral rating, and warns that the stock is richly valued. Deutsche Bank stands alone with its most aggressive $27 price target, arrived at with a combination of a DCF analysis and multiple of sales target.

In fact, in the absence of any positive EBITDA or EPS targets in the near-term for BV, the only price justification the analysts use is a multiple of sales. The obvious handicap here is that the analysts reference other EPS negative businesses in rapidly evolving markets such as Jive Software (JIVE) and NetSuite (N). A summary of the current analyst price targets and justifications are provided in the table below.

Broker	Target	Commentary
Piper Jaffray	Buy / $21	We note a healthy current valuation on BV shares due to frothy comparable valuations for the Cloud/Social peer group; Our $21 price target is derived by applying an 8.8x EV/revenue multiple to our CY2013 revenue forecast of $158.4 million. We view EV/revenue analysis as more meaningful for early-stage companies that have not yet reached a mature margin or cash flow profile
Morgan Stanley	Overweight / $24	Our $24 target represents 0.32x EV/Sales/Growth, in line with high growth peers. We believe a growth-adjusted EV/Sales multiple is the most appropriate metric for valuing BV. BV currently trades at 7.3x EV/CY13 Sales or 0.25x on a growth-adjusted basis, a slight premium to the peer group average of 0.24x but a discount to other high-growth names like JIVE (0.33x) and N (0.44x)
Credit Suisse	Neutral / $20	While there is much to like about the BV story, its shares have appreciated ~61% since its IPO, there is limited upside potential to our $20 target price and we would prefer to wait for a better entry point.
Deutsche Bank	Buy / $26	Our $26 PT is based on 10x 2013 EV/Revenue, and is supported by a DCF analysis with 14% WACC and 18x terminal multiple, as cash flows grow with scale. Risks include high customer acquisition costs, entry by larger social networking players and acquiring customers in a macro downturn.

Source: Analyst reports

On the one hand, the company tells investors exactly what the shares are worth. On page 72 of the company's prospectus, they detail that the last valuation analysis on January 17, 2012 conducted by the board prior to going public was $9.60 per share. This is consistent with the initial IPO range. Why investors have bid up the shares by 75% in the absence of any material financial improvement represents pure speculation and investor euphoria. Therefore, it comes as no surprise that the company's CEO and CFO have already made preparations to sell stock under Rule 10b5-1 while the stock is at elevated levels.

It's not exactly a ringing endorsement for the long-term prospects of the company when the two highest level executives decide to sell shares in a little more than a month since coming public, and in the face of an acquisition they describe as being excited about. The lock-up is set to expire in August, and a few months later PowerReviews' shareholders will also get an opportunity to unload shares.

If we strip out the fluff of being a "social" and "SaaS" company, and focus on the actual fundamentals of BV's business as a struggling marketing services company, we get to a more realistic valuation for the stock. In the table below, I've listed the valuations of marketing service and social media companies. On an enterprise value to 2012 calendar revenue basis, BV should trade closer to its marketing service peers at 1.5x - 2.5x revenue and not 8.7x.

Marketing and Digital Service Companies
($ in millions, except per share figures)

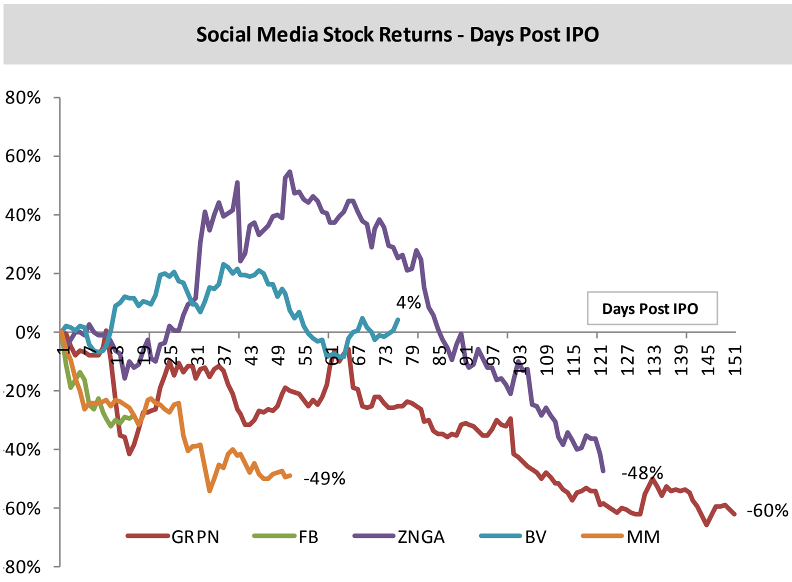
		Stock	% of			'12E-'13E	'12E-'13E	LTM				Enterprise Value /						Price /
		Price	52-wk	Ent.	LTM	Revenue	EPS	EBITDA	P / E			EBITDA			Revenue			Tang Book
Name	Ticker	6/28/2012	High	Value	EBITDA	Growth	Growth	Margin	LTM	2012E	2013E	LTM	2012E	2013E	LTM	2012E	2013E	Value
Marketing and Digital Services																		
GFK AG	GFK	$48.19	96%	$2,226	$311	8.0%	14.4%	16.2%	16.8x	12.7x	11.1x	7.2x	7.3x	6.7x	1.2x	1.2x	1.1x	NM
Ipsos SA	IPS	$28.48	66%	$2,054	$219	30.0%	7.8%	11.5%	6.5x	9.0x	8.3x	9.4x	8.1x	7.0x	1.1x	1.1x	0.9x	NM
ValueClick	VCLK	$14.00	64%	$1,147	$76	11.7%	10.9%	12.7%	8.3x	9.0x	8.1x	15.2x	5.3x	4.6x	1.9x	1.6x	1.5x	3.1x
Acxiom	ACXM	$13.91	93%	$1,226	$237	-2.3%	-5.4%	20.1%	26.8x	20.1x	21.2x	5.2x	5.2x	5.3x	1.0x	1.1x	1.1x	1.1x
Arbitron	ARB	$34.68	78%	$907	$119	5.2%	13.3%	27.7%	17.5x	15.4x	13.6x	7.7x	6.9x	6.4x	2.1x	2.0x	1.9x	NM
Comscore	SCOR	$15.72	56%	$487	$49	16.3%	26.2%	20.2%	16.4x	15.3x	12.1x	10.0x	9.2x	7.7x	2.0x	1.8x	1.5x	6.0x
Responsys	MKTG	$12.00	66%	$481	$27	17.9%	50.0%	20.2%	57.1x	60.0x	40.0x	17.6x	19.2x	13.7x	3.6x	3.0x	2.5x	1.2x
Acquity Group	AQ	$9.40	104%	$190	$20	NA	NA	18.7%	40.9x	18.8x	11.8x	9.5x	6.8x	4.9x	1.8x	1.3x	0.9x	1.0x
Harris Interactive	HPOL	$1.10	81%	$55	$6	NA	NA	3.5%	NM	NA	NA	9.8x	5.0x	NA	0.3x	0.2x	NA	NM
					Max	30.0%	50.0%	27.7%	57.1x	60.0x	40.0x	17.6x	19.2x	13.7x	3.6x	3.0x	2.5x	6.0x
					Average	12.4%	16.8%	16.8%	23.8x	20.0x	15.8x	10.2x	8.1x	7.1x	1.7x	1.5x	1.4x	2.5x
					Min	-2.3%	-5.4%	3.5%	6.5x	9.0x	8.1x	5.2x	5.0x	4.6x	0.3x	0.2x	0.9x	1.0x
Social Media																		
Facebook	FB	$31.50	70%	$64,206	$2,130	31.0%	26.9%	52.7%	80.8x	60.6x	47.7x	30.1x	24.1x	17.6x	15.9x	12.8x	9.8x	6.5x
Groupon	GRPN	$10.00	32%	$5,290	($45)	29.2%	288.9%	-2.4%	NM	55.6x	14.3x	NM	14.8x	7.6x	2.8x	2.2x	1.7x	13.7x
Linkedin	LNKD	$103.65	86%	$10,086	$80	48.5%	76.8%	12.9%	691.0x	150.2x	85.0x	126.7x	58.3x	33.6x	16.4x	11.1x	7.5x	17.0x
Zynga	ZNGA	$5.53	35%	$3,012	($422)	21.4%	37.0%	-34.6%	NM	20.5x	14.9x	NM	6.9x	5.1x	2.5x	2.1x	1.7x	2.6x
Pandora	P	$10.17	39%	$1,614	($20)	43.3%	145.5%	-6.6%	NM	NM	203.4x	NM	NM	179.3x	5.3x	3.8x	2.6x	18.5x
						48.5%	288.9%	52.7%	691.0x	150.2x	203.4x	126.7x	58.3x	179.3x	16.4x	12.8x	9.8x	18.5x
					Max	34.7%	115.0%	4.4%	385.9x	71.7x	73.1x	78.4x	26.0x	48.6x	8.6x	6.4x	4.7x	11.6x
					Average	21.4%	26.9%	-34.6%	80.8x	20.5x	14.3x	30.1x	6.9x	5.1x	2.5x	2.1x	1.7x	2.6x
					Min													
Bazaarvoice (1)	**BV**	**$18.00**	**85%**	**$1,240**	**($18)**	**15.3%**	**31.0%**	**-15.5%**	**NM**	**NM**	**NM**	**NM**	**NM**	**NM**	**10.5x**	**9.2x**	**8.0x**	**21.8x**

(1) Pro forma for PowerReviews acquisition
Source: Company financials, Wall St. estimates.

Summary

BV has a history of burning cash for an extended period of time, and its recently announced deal to acquire PowerReviews is expensive, defensive, and does not offer investors a clear roadmap to profitability. Competition in the social media marketing and solutions market appears to be intensifying at a rapid pace, as evidenced by Salesforce.com's acquisition of Buddy Media and Oracle's purchases of Virtue and Collective Intellect. Google is also increasing its social analytics efforts through new and enhanced features.

With the passing of the Facebook IPO and the share price down by 30% from the IPO price, the social media craze is showing signs of fizzling fast. The following chart illustrates the post-IPO performance of social media stocks and reveals that the average stock price is down by 37%.



The naked reality that BV is nothing more than a marketing and digital service company will slowly set in. I believe the shares should trade at a more reasonable multiple closer to its marketing and digital service peers of 1.5x - 2.5x revenues. Other social media companies are already being revalued at this normalized multiple. For example, both Groupon and Zynga now trade around 2.0x 2012E revenues. It's also worth considering that Facebook, which is the only proven and profitable company in the social media universe, is now trading at 11.0x 2012E sales versus BV's 8.7x multiple.

Therefore, given BV's above average competitive and financial risk, I arrive at a maximum price target of approximately $5.64/share.

BV Share Price Target

		Multiple Range		
Valuation Metric	**Value**	**1.5x**	**--**	**2.5x**
CY 2012E Sales	$134.6	$4.00	--	$5.81

Note: Assumes $82m in cash and 73.6m FD shares