Creating Catalysts; UNTD to Spin FTD in Q1 ’13; Delivers Q2 Beat; Unlocking Value

**Investment Thesis**

UNTD at $4.20/sh, is trading with an EV of $513MM, just 3.2x and 6.4x trailing EBITDA and FCF, respectively. We believe this valuation fails to account for the solid e-commerce business that is FTD—soon to be a standalone public company—as well as optionality on a return to growth at Content & Media and/or Communications. Via new acquisition schoolFeed (a top 25 Facebook app with some 19MM registered members), digital yearbooks, and other mobile and Facebook apps, UNTD is attempting to engineer a nostalgia-driven reengagement with database members. At Communications, meanwhile, UNTD is attempting to forge a migration and ongoing business path from dial-up to low-cost mobile broadband with NetZero 4G. Either way, UNTD today is trading for less than the $747MM, 10x EV/EBITDA it paid to acquire FTD four years ago, and FTD is a stronger business under UNTD’s wing. Cash flow remains strong as well, with over 2x dividend coverage in 2012 (on a 9.5% yielding dividend) despite the marketing investment to launch NetZero 4G. And now, investors should not have long to wait; UNTD is spinning off its FTD e-commerce business into a separately-traded public company—an action that we believe will unlock significant shareholder value.

**Key Data Points**

- Q2 revenue, EBITDA, and pro forma EPS all beat, with $232MM, $35MM, and $0.18, compared with our estimates of $230MM, $31MM, and $0.14, and consensus of $232MM, $31MM, and $0.13, respectively.
- Reflecting continued sales and marketing impact from UNTD’s nascent 4G mobile service, Q3 revenue and EBITDA guidance of $172MM-$178MM in revenue and $23MM-$27MM EBITDA compares with our prior projections of $178MM and $27MM.
- We lower our FY '13 model from the prior $883MM, $151MM, and $0.75 EPS to $860MM, $144MM, and $0.72, respectively—now presuming a longer turn in both Communications and Content & Media.

**Valuation & Price Target**

Our price target remains based on a 6x EV/EBITDA multiple for UNTD’s blended businesses and declines from $9.44 to $8.72 due to lower growth expectations for 2013.

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**Business Description**

UNTD is a leading provider of consumer products and services over the Internet, where the company’s brands have attracted a large online audience that includes more than 60 million registered consumer accounts. UNTD operates in three segments: Communications, Content & Media (which primarily comprises the re-branded Memory Lane nostalgia site), and FTD. The company, with some 1,700 employees, is headquartered in Woodland Hills, CA.

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**Key Statistics & Estimates**

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<thead>
<tr>
<th>Share Price</th>
<th>$4.20</th>
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<tr>
<td>Price Target</td>
<td>$8.72</td>
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<tr>
<td>Market Cap (MM)</td>
<td>$380.1</td>
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<tr>
<td>Enterprise Value (MM)</td>
<td>$512.5</td>
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<td>Shares Outstanding (MM)</td>
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<td>Float (MM)</td>
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<tr>
<td>Average Daily Volume</td>
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<td>52-Week High</td>
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<td>52-Week Low</td>
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<th>Revenues</th>
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<th>2012</th>
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<tr>
<td>Q1 Mar</td>
<td>241,505 A</td>
<td>242,292 A</td>
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<td>Q2 Jun</td>
<td>255,565 A</td>
<td>231,857 A</td>
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<td>Q3 Sep</td>
<td>182,694 A</td>
<td>173,607 E</td>
<td>175,189 E</td>
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<td>Q4 Dec</td>
<td>217,921 A</td>
<td>210,871 E</td>
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<td>FY Dec</td>
<td>897,685 A</td>
<td>858,628 E</td>
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<td>N/A A</td>
<td>$0.21 E</td>
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<tr>
<td>Q2 Jun</td>
<td>$0.30 A</td>
<td>N/A A</td>
<td>$0.20 E</td>
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<td>Q3 Sep</td>
<td>$0.23 A</td>
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<td>$0.13 E</td>
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<td>Q4 Dec</td>
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<td>FY Dec</td>
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<th>Valuation</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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<tr>
<td>EV/EBITDA</td>
<td>2.8x</td>
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<td>P/E</td>
<td>7.4x</td>
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**Valuation & Price Target**

Our price target remains based on a 6x EV/EBITDA multiple for UNTD’s blended businesses and declines from $9.44 to $8.72 due to lower growth expectations for 2013.

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**Analyst Certification & Additional Disclosures**

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Hand Me the Keys

No doubt fed up with UNTD’s abysmal public market valuation, UNTD management handed over the keys to its board to unlock value by approving a plan to separate the conglomerate into two separately-traded public entities, sending FTD on its way to what will be a 2nd encore performance in the public market. Recall, UNTD acquired FTD in 2008 after the company’s first return to the public markets (Goldman Sachs-led IPO) following an earlier leveraged buyout by Leonard Green.

In fact, UNTD acquired FTD for $747MM in August 2008, at a 10x EV/EBITDA valuation that included a premium for brand, scale, international operations, superior AOV (over $62 in 2011), and high (mid-teen) operating margin. In contrast, FTD’s closest public comp 1-800-FLOWERS (FLWS) trades today at 6x EV/EBITDA despite a mid single-digit EBITDA margin, lack of international operations, and high physical inventory risk associated not just with flowers but with its various gift baskets and other sundry items as well.

FTD, on the other hand, is a pure e-commerce business and does not handle physical inventory. We believe FTD was somewhat of a neglected asset that had been milked for cash when UNTD acquired it, subsequently revitalized with concentrated re-branding and marketing campaigns that have been paying off in greater number of transactions and higher AOV pushed through the florist network to member dealers, leading to higher customer satisfaction. Accordingly, we believe FTD will be accorded—if not the 10x multiple UNTD paid to acquire it—something higher than the 6x multiple FLWS commands today once FTD spins off as a public company, likely in Q1 ’13.

In Content & Media, UNTD is still swimming against the tide in its efforts to alter the flow of this business, but the segment did generate $38MM in revenue and $7.5MM in EBITDA in Q2, on pace for a $33MM operating cash flow contribution in FY ’12. While this business remains underappreciated by investors, that sentiment could change in 2013 if schoolFeed and UNTD’s other initiatives can increase monetization of what amounts to a massive registered user database. In less than a year, schoolFeed’s free Facebook app that “enables users to find and connect with their high school friends and acquaintances, and offers an online yearbook and class directory with news feed, interest groups, online games and virtual currency” has generated 19MM registered members—users that UNTD will now cross sell to try paid subscriptions or purchase digital content. UNTD paid $7.5MM cash on closing for Palo Alto-based schoolFeed, and will contribute up to $27.5MM more over the next four years depending “upon the achievement of certain performance objectives.”

In Communications, UNTD still has some 709k paying accounts generating near $9/month revenues at what amounts to a 48% margin, before considering the company’s $4MM net investment in NetZero 4G during the period, dragging Communications segment margin down to 33.6%. With some offsetting revenues starting to trickle in, and UNTD still progressing down its three-pronged marketing test strategy (comprising national TV, direct response TV and mail, and Internet), the company expects net broadband marketing impact of $3MM-$3.5MM in Q3 and $11MM-$13MM for FY ’12 altogether.

In other words, UNTD is placing a $12MM bet in 2012 that it can lead Communications from a cash cow to a growth path via marketing mobile broadband services.

While management remained steadfast in its resolve not to give much data regarding NetZero 4G traction, we note that the company did record $936k in Communications products revenues in the quarter, the company’s first full three-month period pushing 4G. Assuming a $75 ASP per access device sold, this implies UNTD corralled about 12,500 NetZero 4G users in the period. Management did disclose that while it is adding new subscribers daily, conversion rate is low given the high dollar hurdle for prospective
mobile broadband customers to buy the hardware. And once UNTD gets a subscriber to cross this chasm, the company faces the further task of converting free users to paying subscribers. At any rate, the size of the bet is not overly large, and UNTD seems to be taking a good approach to test the market. The company certainly knows how to deliver low-cost access to subscribers at a profit, and this looks like a bet that could pay off.

In any event, investors soon will not have to worry about how Communications affects e-commerce, or what digital yearbooks have to do with Mothers’ Day flowers. We believe UNTD’s plan to separate FTD—a dominant, profitable e-commerce asset with over $600MM in revenues—will unlock significant shareholder value, particularly so as investors have remained disinclined (so far as we can tell) to attach any value to Communications and Content & Media.

Even at UNTD’s $4.50/sh after-market price, UNTD is trading at just 3.4x trailing and 3.9x FY ’12e EV/EBITDA. With moderate success in Communications and/or Content & Media turnaround, as we have currently modeled, projected EV/EBITDA falls back to 3.3x in FY ’13. Indeed—knock on wood—next year investors could be getting two for the price of one, an FTD asset valued as high as UNTD’s current EV today, plus a social content, media and communications business with over $250MM in revenue and some $65MM-$70MM in EBITDA that not only is not shrinking but which also could actually be growing.
## FY 2023

### Revenues:
- Content & Media: 257,438
- Communications: 230,235
- FTDA: 548,871

### Cost of revenues:
- United Online Inc. Model -- UNTD: 214,885

### Gross Profit:
- 454,518

### Operating Expenses:
- Sales and marketing: 173,042
- Product development: 56,715
- G&A and other unallocated corp expense: 22,952

### Operating profit:
- 321,976

### EBITDA:
- 160,224

### Add back: EBITDA for interest:
- 36,527

### Net income (loss):
- (216,105)

### Diluted EPS, GAAP:
- (1.30)

### Weighted Diluted Shares Outstanding:
- 74,209

### Income (loss) from operations:
- (-9.4%)

### Net income (loss):
- (-14.4%)

### P/E, GAAP:
- (3.8)

### Net cash and cash equivalents per share:
- (4.16)

### Selected Balance Sheet Data:
- Cash and investments: 104,514
- Inventories: 58,901
- A/P + Accrued liabilities: 126,520

### Market cap:
- 531,679

### EBITDA (LTM):
- 190,427

### Dividend yield:
- 16.7%

### Net cash and cash equivalents per share:
- (4.14)

### Selected Financial Data:
- Price: 4.20
- Market cap: 337,339
- Net cash: (308,963)
- Enterprise value: 620,641
- EBITDA (LTM): 190,427
- Dividend yield: 16.7%
- Net cash and cash equivalents per share: (4.14)

### Earnings growth Y/Y:
- 5%

### Market cap:
- 317,684

### Debt:
- 431,477

### Shares outstanding:
- 344,117

### Dividends:
- 0.78

### EBITDA:
- 190,427

### Diluted EPS:
- 0.79

### EV/Sales:
- 0.9

### P/E:
- 5.3

### Capex in period:
- 19,886

### EV/Sales:
- 0.9

### Earnings Growth:
- 5%

### P/E:
- 5.3

### Capex in period:
- 19,886

### Earnings Growth:
- 5%

### P/E:
- 5.3

### Capex in period:
- 19,886

### Earnings Growth:
- 5%

### P/E:
- 5.3

### Capex in period:
- 19,886

### Earnings Growth:
- 5%
Appendix A

Disclosure for United Online

I, Mike Crawford, certify that this report reflects my personal beliefs about this company and that no portion of my compensation was, is or will be directly or indirectly related to the specific recommendations or views discussed in this report.

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- Competition - The industry is highly competitive and many of the Company's competitors have greater resources.
- Dividend - The Company could choose to eliminate its dividend.
- Economy - Macro-economic issues such as increasing oil and gas prices and a possible drop in consumer spending could have a negative impact on the Company's business.
- Further Potential Risks - See the Company's SEC filings, particularly its 10-K filing, for a discussion of further potential risks.