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Active Network Inc. | ACTV

Recommendation: Strong Sell

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October 31, 2012

The Active Network, Inc. | NYSE: ACTV

We believe shares of The Active Network, Inc. (NYSE:ACTV) are grossly overvalued, reflecting few, if any, of the serious risks that could threaten the company's existence. We believe the company is functionally insolvent and that management has taken to masking the company's weakening financial condition by gaming the accounting. As a result of our concern over the integrity of its financial reporting, we believe Active is at high risk of having to restate its historical financial results. We believe the growth story management has spun to investors is a bill of goods; the real story is between the lines of management share liquidations. ***We believe Active's stock has an intrinsic value today of $2.00 per share, ~75% below current trading levels.***

Research Highlights

Conclusion:	Strong Sell
Current Price:	$9.20
Price Target:	$2.00
Downside:	75%
Ticker:	ACTV
Exchange:	NYSE
Basic shares o/s	59.6
In the money options	4.0
Restricted Stock Units	1.7
Fully Dil. Shares	65.3
Market Cap:	$600.0
Unrestricted Cash:	$0.0
Current Debt (1):	$39.8
Enterprise Value:	$639.8

Fiscal Year Ended December 31,
$ in millions

Street Est.	**LTM**	**2012E**	**2013E**
Sales	$381	$428	$503
Adj. EBITDA	$39	$46	$76
Adj. EPS	(3c)	1c	32c

Valuation	**LTM**	**2012E**	**2013E**
EV/Sales	1.7x	1.5x	1.3x
EV/EBITDA	16.5x	14.0x	8.5x
P/EPS	NM	NM	28.4x
P/Tg. Book	32x		

(1) Working Capital Deficit

Red Flag Warning Signs of Functional Insolvency

- We believe Active, riddled with baggage from 40+ acquisitions, is rapidly speeding toward the brick wall of insolvency. The company appears to be hemorrhaging money, while navigating a cash crunch, and gaming its accounting to mask an increasingly fragile financial profile. We believe the company's $98m net cash position is misleading, and that the company has no excess cash. Active's Registration Fees Payable ("RFP") current liability account is effectively a direct claim on and has grown to exceed its cash balance. Signs of a stressed financial position include: Active is burning free cash flow at an alarming rate; it has doubled its line of credit and is drawing on its revolver; it has stretched to the max the time it takes to pay money owed to event organizers; it has deferred cash bonuses and increased stock-based comp far beyond analyst expectations; it has removed its long-standing CEO; and it has become the subject of increasingly frequent customer complaints claiming fraudulently billing practices.

Financial Statements Misleading at Best, Fabricated at Worst

- We believe that management is putting forth a deliberate effort to obscure a decline in its organic growth rate. In the past it had acquired one company after another and, typically, disclosed nothing of basic deal terms or target financials, enabling an undetectable gaming of growth rates and profitability metrics. With no ammo for new deals, it seems to have turned to accounting gimmickry. We believe Active is engaged in a new business practice enabling it to book 'gross' sales, and that it reports these sales as Net Registration Revenue. Each 'gross registration' is typically 7-10x the dollar value of a 'net registration,' and since Active management frequently cites Net Registration Revenue and Revenue Per Net Registration as key metrics of organic growth, we believe the implied purpose of mixing Gross Registration Revenue with Net Registration Revenue is to inflate revenue growth. Disclosures regarding this program have disappeared from Active's filings, but we believe it is a growing source of Net Registration Revenue.
- We have also found other irregularities in Active's financial accounts. In 2012, its RFP account became dislocated from the accounts that drive it. We estimate it is off by $34.8m, and believe this allows the company to appear more solvent.
- It is a red flag that Active has had 5 CFOs since 2004, for an average tenure of just 2.5 years.

Follow the Money! **Insiders are Cashing Out**

- Insiders have been liquidating their shareholdings at a rapid pace. Most concerning, total overall management ownership has fallen from 24.4% pre-IPO to 18.5% immediately post-IPO (one and a half years ago) to 2.3% today. Recently demoted CEO David Alberga and current CEO Matt Landa have liquidated almost their entire stakes. The linkage between shareholder interests and executive wealth is almost completely broken.
- There's still more to grab out of the piggy bank. The Board has a history of rewarding management despite missing incentive performance targets. Further, it recently changed management compensation policies to justify management salary increases of >20%, against the backdrop of shareholders suffering a 40% post-IPO share price decline.

ACTV's Rebranding as a Fast Growth "SaaS/Cloud" Company is Misleading; Shares are Significantly Overvalued

- Active's financial and operational profile look nothing like the high growth and margin profiles of other SaaS companies – gross margins are 1,100 bps lower than peers, while average revenue per employee is 50% lower.
- Active's core markets are maturing, hence the need for persistent acquisitions or accounting gimmickry to meet the Street's lofty growth expectations. Sell-side analysts continue to fall hook, line and sinker into the company's flawed pitch. As a group, they have shown embarrassingly large forecast error since Active came public. We contend that analysts are misguided in awarding the company the high end of SaaS peer multiples, when in reality Active is a collection of mediocre Web 1.0 and business process outsourcing (BPO)-type revenue models deserving a much lower multiple.

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[illegible]

[illegible]

[illegible]

- It rapidly burned through its strong, post-IPO excess cash position. We believe it now has no excess cash.
- It recently doubled its line of credit in July 2012 with no explanation.
- It deferred management cash bonuses that were to be paid earlier in the year into Restricted Stock Units (RSUs) in August [illegible]
- It undertook sudden managerial changes [illegible] -sourced CEO, thereby cutting his salary [illegible]
- It is the subject of increasingly frequent customers complaints claiming that Active is engaged in fraudulent billing practices
- It may be having trouble retaining employees, evidenced by dramatic increases in stock-based compensation expenses. Initially expected to be $3.5m for 2012, analysts are now expecting an expense of $15m.
- It has made no cash or equity- [illegible]
- It has stretched to the maximum the number of days to pay money owed to event organizers, a measure we refer to as Days Due to Customers Outstanding.

[illegible]

[illegible]

[illegible]

[1] [illegible]

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[illegible]

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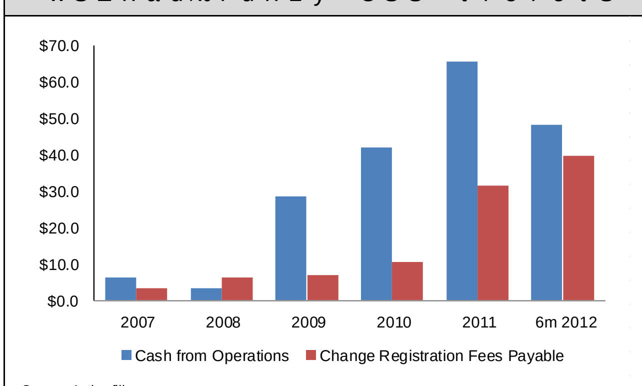
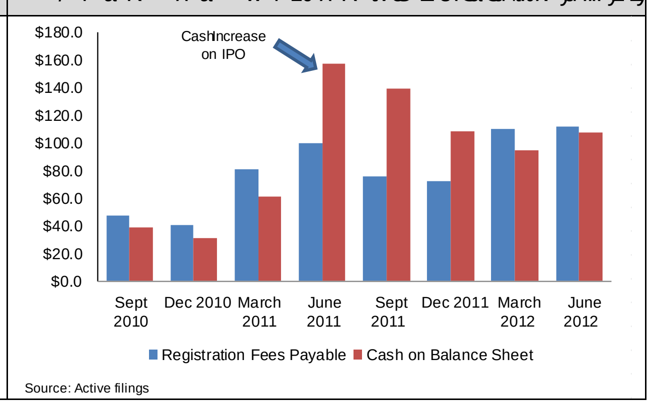


Source: Active filings



Source: Active filings

Active's Adjusted Free Cash Flow
$ in millions

	2007	2008	2009	2010	2011	6m 2011	6m 2012	LTM 6/12
Reported Cash from Operations	$6.23	$3.32	$28.50	$42.10	$65.70	$66.39	$48.20	$47.51
Change in Registration Fees Payable	($3.45)	($6.28)	($7.00)	($10.50)	($31.73)	($58.89)	($39.90)	($12.74)
Change in Deferred Revenue (1)	--	--	--	--	--	--	($13.10)	($13.10)
Adjusted Cash from Operations	$2.78	($2.96)	$21.50	$31.60	$33.97	$7.50	($4.80)	$21.67
Capitalized Software Development	($4.11)	($10.69)	($14.50)	($15.60)	($18.60)	($9.48)	($10.90)	($20.02)
Purchase of PP&E	($5.94)	($7.14)	($10.40)	($14.70)	($12.50)	($5.33)	($9.40)	($16.57)
Adjusted Free Cash Flow	($7.28)	($20.80)	($3.40)	$1.30	$2.87	($7.31)	($25.10)	($14.92)

(1) Estimated impact of StarCite and RTP impact on deferred revenue impact that won't convert to cash

- We began by deriving an estimate of the gross dollar amount of each sale:
  - Active reported the increase in credit card fees for 2011 as $6.2m, and assuming it pays a processing rate of 3.0%, implying that Gross Registration Sales increased by $206.7m on an increased registration count of 10.09m, for an average transaction size of $20.48
- We then multiplied this average transaction size by the total number of registrations for each period to estimate the Gross Registration Revenue
- Next, we subtracted Net Registration Revenue (i.e. the fees that Active retains as revenue) from Gross Registration Revenue to estimate the amount Active owed its customers over the course of each period, which we labeled Total Due to Customers
- We next estimated Days Due to Customers Outstanding (DDCO), or the number of days owed for the Total Due to Customers

$ in millions except registration figures

			Quarter Ending			Quarter Ending					Quarter Ending	
	2008	2009	Sept 201	Dec 2010	2010	Mar 2011	June 201	Sept 201	Dec 2011	2011	Mar 201	June 201
Registrations (thousands)	25,074	65,461	20,474	15,323	70,182	14,859	24,597	23,513	17,305	80,274	18,223	28,036
Net Revenue per Registration	$4.08	$2.66	$2.54	$2.56	$2.82	$3.46	$2.84	$2.59	$2.68	$2.85	$3.49	$2.99
Net Registration Sales	$102.4	$174.0	$52.1	$39.3	$197.6	$51.4	$69.7	$60.9	$46.4	$228.5	$63.5	$83.9
Gross Registration Sales (est)	$800.9	$1,309.2	$419.3	$313.8	$1,437.3	$304.3	$503.7	$481.5	$354.4	$1,644.0	$373.2	$574.2
Total Due To Customers (est)	$698.5	$1,135.2	$367.2	$274.6	$1,239.8	$252.9	$434.0	$420.7	$308.0	$1,415.6	$309.7	$490.3
Credit Card Fee Increase	N/A	$13.1	N/A	N/A	$5.7	$1.9	$2.0	$2.0	$0.3	$6.2	N/A	N/A
Inc. Gross Registration Sales	N/A	$436.7	N/A	N/A	$190.0	$63.3	$66.7	$66.7	$10.0	$206.7	N/A	N/A
Registration Fees Payable (RFP)	$22.6	$30.2	$47.3	$40.7	$40.7	$81.2	$99.6	$76.2	$72.4	$72.4	$110.2	$112.3
DDCO (est)*	11.6	9.6	11.6	13.3	11.8	28.9	20.6	16.3	21.2	18.4	32.0	20.6

* DDCO = Days due to Customers Outstanding = (Total Due To Customers / Day Count for Period) / Registration Fees Payable (RFP)

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Growing Inventories, Gross Registration Sales Ommissions = Problems
$ in millions

	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	
Total Net Revenue	$72.7	$99.0	$89.6	$76.0	$64.4	$121.6	
Net Registration Revenue	$51.4	$69.7	$60.9	$46.4	$63.5	$83.9	
Gross Registration Sales	$0.0	$0.0	$0.9	$1.5	N/A	N/A	< Material
% Net Actually Gross	0.0%	0.0%	1.5%	3.2%	N/A	N/A	< Ommissions
Registration Inventory on B/S	$0.0	$1.8	$1.1	$1.7	$3.1	$4.0	
QoQ Growth	--	--	*-39.2%*	*50.9%*	*85.5%*	*28.9%*	

Source: SEC filings

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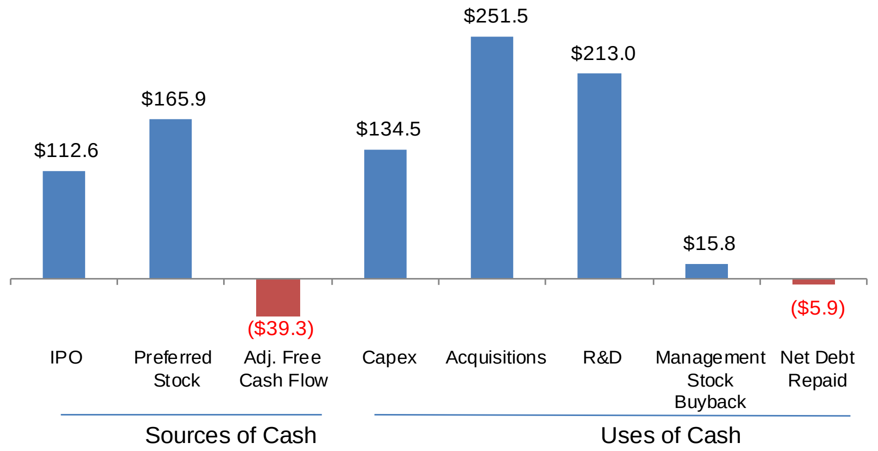

Source: Company Financials

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Chief Financial Officer	Tenure / Years		Note	Reference
Natalya Smith	Prior 2004	N.A.	Resign Pre-IPO	S-1 Filing
John Creelman	2004	< 1 year	Resign Post IPO Withdrawl	S-1 Filing
Norman Dowling	Sept 2004- Jan 2008	3.5 years		Press Release - 2008
Steven Kemper	Mar 2008 - 2010	2 years	Resign during debt restructuring	Press Release - 2008
Scott Mendel	Mar 2010 - Current	2 years	Current	Press Release - 2010

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$ in millions

	ACTIVE 2004 Busted IPO	ACTIVE 2011 Re-IPO
Marketing Pitch	Leader in high growth market Reduce costs, inc efficiencies	Network Effects, Cloud Platform Recurring Revenue, Economies of Sc
Growth Pitch	Pursue Acquisitions Expand Application/Mktg Services Increase Registrations/Customers	Pursue Acquisitions Expand Application/Mktg Services Increase Registrations/Customers *International Expansion*
Key Facts		
CFO Change Pre-IPO	Yes	Yes
Auditor Change Pre-IPO	Yes	No
Revenue Transparency	Higher	Lower
M&A Deals Completed	9	28+
Addressable Market	$33 billion	$110 billion
Customer Organizations	10,100	47,000
Employee Headcount	119	2,604
Income Statement (1)		
LTM Revenue	$16.5	$289.1
LTM Gross Profit Margin	80%	56%
R&D Expense	$0.0	$62.5
LTM GAAP Net Loss	($0.5)	($25.5)
margin	*-2.8%*	*-8.8%*
Balance Sheet		
Registration Fee Payable/ Curr Liabili	30%	45%
Goodwill + Intangibles/Assets	50%	58%
Accumulated Deficit	($76.2)	($266.4)
Total Book Equity	$14.4	($192.3)
Operational Efficiency		
Revenues/Employee Headcount	$138,824	$111,018
Customer Orgs/Employee Headcount	85	18

(1) LTM period through March 31st
Source: 2004 and 2011 S-1 filings

$ in millions

	Q1 2010	Q2 2010	Q1 2011	Q2 2011	Change (1)	Q1 2012	Q2 2012	Change (1
Registration Count ('000)	12,921	21,464	14,859	24,597	14.7%	18,223	28,036	17.2%
Technology Revenue	$54.9	$71.2	$63.1	$85.6	17.9%	$84.1	$108.2	29.3%
Technology COGS	$27.0	$32.3	$33.0	$38.7	20.8%	$45.7	$50.8	34.6%
COGS % (Q1+Q2)		47.1%		48.2%			50.2%	
Technology Gross Margin (Q1+Q2)		52.9%		51.8%			49.8%	

(1) Year-over-year first half percentage change
Source: Company filings

$ in millions

	Q1 2010	Q2 2010	Q1 2011	Q2 2011	Change (2)	Q1 2012	Q2 2012	Change (2
Cost of Net Revenue	$28.1	$34.1	$34.2	$40.2		$47.0	$52.9	
Credit Card Fees (est)	$7.3	$13.3	$9.2	$15.2		$11.3	$17.3	
Headcount Expense (est) (1)	$20.8	$20.8	$25.0	$25.0	20.2%	$35.7	$35.6	42.7%
Stock-Based Compensation	$0.03	$0.03	$0.02	$0.04	1.9%	$0.06	$0.19	358.2%
Headcount: Cost of Net Rever	1,299	1,416	1,267	1,435		1,595	1,740	
Cost Per Unit Headcount (est)	$15,997	$14,699	$19,713	$17,422	21.0%	$22,395	$20,454	15.4%
Headcount Cost Per 1,000 Registrations (est)	$1.24	$0.68	$1.33	$0.71	5.8%	$1.23	$0.73	-3.8%

(1) Cost of net revenue minus estimated credit card fees
(2) Year-over-year first half percentage change
Source: Company filings; our estimates.

Active Margin Analysis

	2010	March 2011	June 2011	Sept 2011	Dec 2011	2011	March 2012	June 2012
		Quarter Ending					Quarter Ending	
Sales/Marketing Exp.	21.1%	23.2%	19.1%	19.1%	22.7%	20.8%	25.3%	19.4%
YoY Change	0.3%	3.1%	0.5%	-1.5%	-0.5%	-0.3%	2.1%	0.3%
R&D Expense	21.9%	22.1%	16.5%	19.7%	21.8%	19.8%	21.4%	16.9%
YoY Change	-2.3%	1.5%	-3.5%	-0.9%	-2.1%	-2.1%	-0.7%	0.4%
G&A Expense	15.2%	14.5%	12.4%	13.1%	21.7%	15.2%	16.7%	13.5%
YoY Change	-1.1%	-1.1%	-1.7%	-0.7%	6.4%	0.0%	2.2%	1.1%
Total Change	-3.1%	3.4%	-4.6%	-3.1%	3.8%	-2.4%	3.5%	1.8%

Note: Unadjusted for stock compensation expense

$ in millions

	2010	March 2011	June 2011	Sept 2011	Dec 2011	2011	March 2012	June 2012
		Quarter Ending					Quarter Ending	
Adjusted Revenue	$279.6	$73.0	$99.3	$89.6	$76.0	$337.4	$99.1	$125.2
Adjusted EBITDA	$25.1	$2.9	$20.4	$12.7	$0.4	$37.8	($3.0)	$20.2
% margin	*9.0%*	*4.0%*	*20.6%*	*14.2%*	*0.5%*	*11.2%*	*-3.0%*	*16.1%*
% YoY change	*2.5%*	*2.5%*	*6.1%*	*1.4%*	*-4.2%*	*2.2%*	*-7.0%*	*-4.5%*
GAAP Gross Margin	56.6%	53.0%	59.4%	55.5%	51.8%	55.3%	50.3%	56.5%
% YoY change	0.7%	-2.6%	1.1%	-1.9%	-2.6%	-1.3%	-2.8%	-2.9%

Note: Revenue adjusted for impact of acquisition accounting rules

$ in millions

	Fiscal Yr Ended Dec 31st			LTM
	2004	2005	2006	Jun-07
Revenues	$22.2	$23.0	$24.8	$23.2
% growth	--	*3.6%*	*7.9%*	*-3.6%*
Pre-Tax EBIT	($2.1)	($1.9)	$0.7	($0.3)
Depreciation/Amort.	$2.1	$2.4	$2.4	$2.4
Other Charges	$0.0	$0.0	$0.0	$0.0
EBITDA	$0.0	$0.5	$3.2	$2.0
% margin	*0.2%*	*2.4%*	*12.7%*	*8.8%*
Capex	$2.9	$1.5	$1.8	$1.8
EBITDA less Capex	($2.9)	($0.9)	$1.4	$0.3

Source: http://www.sec.gov/Archives/edgar/data/12239/000110465907054110/0001104659-07-054110-index.htm
http://www.sec.gov/Archives/edgar/data/12239/000110465907051691/a07-17816_1ex99d1.htm

$ in millions

	Fiscal Year Ended Dec 31				
	2008	2009	2010	2011	2012E
Revenues	$50.5	$47.9	$44.5	$45.0	$36.0
% growth	*12.5%*	*-5.3%*	*-7.0%*	*1.1%*	*-19.9%*
Pre-Tax EBIT	($18.4)	($6.2)	--	--	
Depreciation/Amort.	$5.3	$4.9	--	--	
Other Charges	$2.9	$1.9	--	--	
EBITDA	($7.7)	$3.7	--	--	($5.5)
% margin	*-15.3%*	*7.6%*	--	--	*-15.3%*
Capex	($2.5)	($0.2)	--	--	--
Free Cash Flow	($12.0)	$0.4	--	--	--
Book Equity	$20.9	$19.6	$15.9	$18.4	--

Source: http://www.sec.gov/Archives/edgar/data/1085621/000119312512117265/d283132d10k.htm

Note: 2012E as per Q1'12 management conf call guidance

Comparison of Annual Incentive Performance Targets
$ in millions

Company	Ent. Value	Annual Incentive Performance Targets	% Mix
Ariba	$4,500	Non GAAP Revenue and Net Income	50/50%
NetSuite	$4,476	Revenue, EBIT Margin, Operating Cash Flow	60/15/25%
Tibco	$4,022	Revenue, Adj EBIT Margin, Discretionary Individual, EPS (1)	40/40/20%
Concur Tech	$3,400	Non GAAP Pre-Tax Earnings per Share	100%
Ultimate Software	$2,534	Adj EBITA	100%
Taleo	$1,900	Bookings, Revenue, Adj EBITDA Margin, TE Renewal Rates	40/20/20/20%
Realpage	$1,535	Revenue, Adj EBITDA, Individual Performance Rating	20/45/25%
Vistaprint	$1,174	Revenue and EPS	50/50%
Kenexa	$1,300	Adj EBIT, Specific Corporate Objectives, IMM (2)	40/40/20%
Shutterfly	$943	Revenue and Adj EBITDA	50/50%
Medidata Solutions	$811	Revenue/EBITDAO, Customer Satisfaction, Product Goals	65/10/25%
Monster	$731	Revenue, Bookings, Operating Inome, EPS (3)	33/33/33%
Synchronoss	$683	Revenue, Adj EBITDA Margin	65/35%
Active Network	$641	Revenue and Adj EBITDA	50/50%
WebMD Health	$500	No financial targets chosen due to changing business conditions	--
Constant Contact	$500	Revenue, EBITDA Margin, Customer Satisfaction	Variable
Digital River	$173	Revenue, EBIT, Business Unit Specific Performance	45/30/25%

(1) If EPS growth < 15%, bonuses reduced by 20%
(2) Internal Measure Metirc (IMM) = (Bookings + Enterprise Contract Revenue Targets)*EBIT %
(3) If EPS < $0.46/share or EBIT growth < 50% of revenue growth, then bonuses reduced

Active Bonus Plan History

$ in millions

	FY 2009	FY 2010	FY 201
Revenue Target Achieved	No	Yes	No
EBITDA Target Achieved	No	Yes	No
Deferred Payment	Yes	Yes	Yes
Cash Payment	Yes	Yes	Yes (1
% of Target Payout	25%	42%	25%
Date Paid	July-10	Apr-11	Aug-12
Total Payment	$0.61	$3.50	$0.38

Source: Proxy and S-1

(1) converted to Supplemental Performance RSUs on 8/28/12 due to liqudity cru

[illegible]

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Active Peer Group Used By Compensation Committee

$ in millions

	Ent Value	LTM Sales	EV/Sales	FY2011	FY2012	
Ariba	$4,500	$517	8.7x		x	Additions
Tibco	$3,929	$992	4.0x		x	Additions
Kenexa	$1,300	$318	4.1x		x	Additions
Vistaprint	$1,174	$1,020	1.2x		x	Additions
Medidata Solutions	$925	$197	4.7x		x	Additions
Monster	$810	$992	0.8x		x	Additions
Digital River	$270	$401	0.7x		x	Additions
NetSuite	$4,476	$269	16.6x	x	x	
Concur Tech	$3,400	$417	8.2x	x	x	
Ultimate Software	$2,534	$298	8.5x	x	x	
Taleo	$1,900	$309	6.2x	x	x	
Realpage	$1,535	$292	5.3x	x	x	
Synchronoss	$797	$253	3.2x	x	x	
Shutterfly	$755	$531	1.4x	x	x	
Active Network	$641	$382	1.7x	x	x	
WebMD Health	$500	$505	1.0x	x	x	
Constant Contact	$283	$234	1.2x	x	x	
Demand Media	$635	$345	1.8x	x		Deletions
comScore	$485	$244	2.0x	x		Deletions
Blue Nile	$415	$361	1.1x	x		Deletions
QuinStreet	$296	$370	0.8x	x		Deletions
Reachlocal	$266	$415	0.6x	x		Deletions
Intralinks	$242	$212	1.1x	x		Deletions

	Ent Value	LTM Sales	EV/Sales
Average Additions	$1,844	$634	3.4x
Average Deletions	$390	$325	1.3x

Source: Active Proxy Filing

PRESCIENCE POINT
RESEARCH GROUP

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Active Management's Salary Increases

Executive	Role	Annualized Base Salary 2011	2012	% Inc.
Alberga	CEO	$390,000	$500,000	28.2%
Landa	President	$350,000	$450,000	28.6%
Mendel	CFO	$290,000	$350,000	20.7%
Dejanovic	CTO	$400,000	$450,000	12.5%
Roland	HR	$205,000	$236,000	15.1%
Total Exec Team		$1,635,000	$1,986,000	21.5%

Source: Proxy and 8-k filing 5/4/12

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- In Aprl 2009, the company lowered its valuation to $1.96 per share and granted 1.5 million options. The valuation just a few months prior was $4.78 per share, or 144% higher. (S1, page 55)
- Then in March 2010, the company granted another 1.7 million options at $1.96 per share. Within a few months, the valuation was adjusted to $3.78, or 93% higher.
- However, the most egregious option practice occurred in March 2011, just months before IPO. According to the subsequent event disclosure buried near the very end of the [illegible] *the Compensation Committee approved a grant of 1.485 million stock options to directors and executive officers at an exercise price of $7.88 per share*. [illegible] received in April 2011 of this action, it certainly appears to be a dirty move ahead of new shareholders joining the party at the IPO price of $15.00 per share in May 2011. This amounts to $10.5 million of value given to insiders ahead of the IPO.

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