Michael Mahoney comments on Ancestry.com valuation and acquisition potential.

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Ancestry.com Topping Facebook Cash Yield Invites LBO: Real M&A
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By Tara Lachapelle

June 8 (Bloomberg) -- For private-equity firms scouring the Internet for a deal, Ancestry.com Inc. is generating more free cash per share by researching families than Facebook Inc. does connecting friends.

Ancestry, which helps users trace their roots online, is considering a sale and working with Frank Quattrone's Qatalyst Partners LLC to find buyers, a person familiar with the situation said this week. After the shares surged 11 percent on the news, the company is generating more free cash for each dollar of equity than 96 percent of the U.S. Internet and e- commerce industry, according to data compiled by Bloomberg. It is also almost four times higher than the yield of Facebook.

While Ancestry lost almost a third of its market value amid concern the cancellation of a television show featuring its genealogy research will damp subscriber growth, Piper Jaffray Cos. says the $1.1 billion company still may attract suitors as analysts project record sales this year and next. With Provo, Utah-based Ancestry trading at a price-earnings ratio that's less than half the industry median, Valuentum Securities Inc.
and shareholder Hodges Capital Management Inc. said leveraged buyout firms could be lured by its valuation and lack of debt.

"Given the high free cash flow yield, it does seem like a private-equity firm would potentially be a logical acquirer,"
Aaron Garcia, a fund manager at Milwaukee-based Broadview Advisors LLC, said in a telephone interview. "Any time there's uncertainty in the name, the valuation gets compressed. But I don't really feel like the loss of the TV show is that meaningful. There are a lot of ways for these guys to continue to grow."

NBC Show

Garcia co-manages the $546 million FMI Focus Fund, which owns Ancestry shares and has outperformed 97 percent of rival funds over the past five years, according to data compiled by Bloomberg.

Heather Erickson, a spokeswoman for Ancestry, said the company doesn't comment on speculation, when asked whether it is weighing a sale or has been approached by buyers.

Founded in 1983 as a publisher of genealogical books and magazines, Ancestry evolved into an online family-history research and data website. The company, which has posted a profit every year since at least 2007, said it had 1.87 million paying subscribers as of March 31.

Ancestry's stock, which reached a high for the year of
$33.09 on Feb. 3, fell more than 30 percent over the next four months as a TV show it had sponsored since 2010 faced cancellation on Comcast Corp.'s NBC network. The show "Who Do You Think You Are?" generated interest in Ancestry and attracted new subscribers, the company said, by tracking celebrities such as Martin Sheen and Marisa Tomei as they explored their roots with the help of its

research. The show ultimately wasn’t renewed and the final episode aired on May 18.

Private Equity

As Ancestry considers a sale, it will probably attract interest from private-equity firms, a person with knowledge of the situation, who declined to be identified because the process is private, said this week. While the news sparked an 11 percent gain in the stock on June 6, the shares were still down 32 percent in the last 12 months through yesterday.

That left Ancestry trading at 17.5 times profit, compared with a median price-earnings ratio of about 43 for U.S. Internet and e-commerce companies with market values greater than $500 million, data compiled by Bloomberg show.

The dip in Ancestry’s stock price creates an opportunity for potential buyers willing to bet the website will keep adding subscribers, said Gene Munster, a Minneapolis-based analyst for Piper Jaffray.

‘Grossly Undervalued’

“It’s grossly undervalued,” he said in a phone interview. Concern that the show’s cancellation will hurt sales “is misplaced. Our bet is that it’s going to continue to grow.”

Today, Ancestry’s shares gained 4.9 percent to $26.31, the fifth-biggest gain among 86 companies in the Bloomberg U.S. Internet Index.

Analysts are projecting Ancestry’s revenue will climb to a record $528 million in 2013, an increase of 32 percent from last year, estimates compiled by Bloomberg show. Net income may also rise to an all-time high of $85.6 million next year, the estimates show.

Ancestry’s 11 percent free cash flow yield in the last 12 months is higher than 23 out of 24 similar-sized U.S. Internet and e-commerce companies, data compiled by Bloomberg show. It also tops Facebook’s yield of 2.8 percent and Netflix Inc.’s 5.3 percent. Only Expedia Inc.’s free cash flow yield is higher at 12 percent, the data show.

Facebook, the world’s biggest social-networking company, may be interested in acquiring Ancestry to capture its subscription-based revenue and cash flow, according to Michael Mahoney, senior managing director at Falcon Point Capital LLC in San Francisco, who said he subscribes to Ancestry’s site. His firm oversees $300 million, including Ancestry shares.

Intellectual Property

Shares of Facebook have dropped 31 percent since its initial public offering on May 17 amid concern the company won’t be able to sell enough advertising in the future to justify its valuation.

Ancestry’s intellectual property of more than 8 billion historical records may appeal to Facebook, said Trey Hays, a research analyst at Dallas-based Hodges Capital, which manages $700 million and also owns the stock.

Ashley Zandy, a spokeswoman for Menlo Park, California- based Facebook, declined to comment on whether it’s considering a bid for the company. Dave Goldberg, husband of Facebook Chief Operating Officer Sheryl Sandberg, and Mike

Schroepfer, Facebook's vice president of engineering, are members of Ancestry's board.

A private-equity firm would still be the more likely suitor, said Brian Nelson, president of equity research at Valuentum Securities in Woodstock, Illinois.

Cash Generator

"Cash generation is still king for private equity," Nelson said in a phone interview. A financial buyer could "throw a mountain of debt on the company. Because it generates a lot of recurring cash flow, they can use it to pay off the debt service costs."

Going private may also help Ancestry focus on expanding its business without scrutiny from public shareholders, especially as short sellers target the stock, Hodges' Hays said.

"It might makes sense for them to go at it as a private firm and flourish that way," Hays said in a phone interview.

About 15 percent of Ancestry's 42.6 million outstanding shares were sold short as of June 5, more than the industry's average short interest ratio of 8 percent, according to data compiled by New York-based research firm Data Explorers. In a short sale, traders sell borrowed stock on the assumption the price will drop, enabling them to profit by buying it back at a lower price.

Fair Price

One challenge will be agreeing on a takeover price because management may not be eager to sell at the shares' current depressed valuation, Broadview's Garcia said. A buyer would have to pay a premium of more than 82 percent just to match the stock's all-time high of $45.70 in April 2011.

According to Garcia, $35 a share would be a fair price for Ancestry, while Valuentum's Nelson said the stock is worth $47 a share based on his discounted cash flow analysis.

Ancestry "is significantly undervalued," Nelson said. "This is a move by management to sidestep the market's perception of the firm and really go after the best way for shareholders to extract the most value. It makes a lot of sense that they hired a shop to market them around to potential suitors."

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