

## The Ad Company That Could Return +100% Next Year

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Admit it: You still have in the back of your desk drawer that long-forgotten key ring attached to the mini flashlight with the name of an insurance company emblazoned on it. The one you picked up at the auto show three years ago. And the flashlight still works.

But if you've been seeing a lot fewer of these "chotskies" recently, and if the magnet on your refrigerator still displays the home team's schedule for the 2006 season, blame the economy. When commerce slows, companies cut discretionary expenses.

But when an economy turns, one of the first orders of business is to re-build awareness in the eyes of customers. Ad campaigns are an obvious solution, but many companies also look to splash their name on as many products as possible, giving out freebies and other promotional items that reinforce what's known as "brand ubiquity."

As branding budgets loosen in 2010, Chicago-based **Innerworkings (Nasdaq: INWK)** should be a clear beneficiary. Prior to the recent economic downturn, the company established itself as an emerging leader in the printing/branding field, as sales soared to \$419 million in 2008 from just \$5 million in 2002. That's a lot of neon highlighters. More recently, the company has faced challenges, but as those problems resolve, sales growth should return, and profit levels look to expand at an even faster clip.

This past year surely took its toll, as sales likely fell closer to \$400 million, and per-share profits likely fell by more than half to around \$0.15. (Innerworkings releases year-end results in mid-February). Though full-year sales were likely flat in 2009, organic sales growth has been negative for several quarters, including a -15% drop from a year earlier in the three months ended Sept. 30.

Yet as is the case with many companies, the economic slowdown forced Innerworkings to take an ax to expenses. And as we saw in the corporate restructuring programs back in the 1990s, profits should grow modestly as the economy initially rebounds, but really expand when the economy is in its second or third year of the growth cycle.

Barring a “double-dip” recession, Innerworkings’ 2010 revenue base is likely to grow about +10%, thanks to a combination of new business wins and a modest bounce back in spending among existing customers. Assuming that key customers resume historical spending rates by 2011, and Innerworkings is able to continue to secure new customers, sales could grow another +10-15%, while profits expand at a far faster clip. This assumes that the company holds off making acquisitions – which have typically been accretive.

Though the company is likely to earn around \$0.30 a share in 2010, profits could well approach \$0.45 by 2011, assuming a net profit margin of 4% on \$525 million in sales. Net margins approached 5% in the summer of 2008 before sales started to fall. If Innerworkings’ management can boost net profit margins back to the 5% range, and sales growth rebounds another 15% in 2011 to around \$600 million, then per share profits would rise further to around \$0.60. While profits appear poised to rebound, share prices haven't yet reflected the improved outlook, having fallen from around \$16 two years ago to the mid single-digits.

As the economy rebounds, look for Innerworkings to resume its acquisitive ways. The printing/branding industry is still highly fragmented, and management has noted that a range of acquisition targets remain in their sights. The key for investors – which management repeatedly acknowledges – is for the company to seek growth that is profitable, and not just for the sake of top-line expansion.

Organic growth remains on tap as well: Innerworkings is able to handle printing assignments at a lower cost than clients can get on their own. Indeed, many customer wins come not from poaching accounts from rivals but from a decision to outsource the function. That process of outsourcing still has ample room to play out. The amount of spending in play is sizable when you consider how many direct mail pieces, brochures, catalogs and promotional items are generated each year.

With a rebounding economy, a fragmented industry, and a proven desire to boost sales through direct customer wins and acquisitions, Innerworkings looks set to resume its heady growth rates by next year. Although management will likely retain a still-cautious tone for 2010 on next month’s conference call, the long-term outlook is bright.

-- David Sterman

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Disclosure: David Sterman does not own shares of any security mentioned in this article.