ANGIE’S LIST | IAC

AN UNUSUAL MERGER ARBITRAGE CASE – by Sylvia Blount

On May 1st 2017 Angie’s List (NasdaqGS:ANGI) announced that it entered into a definite agreement with IAC (Nasdaq:GS:IAC) to sell the business for $615 million (Source: S&P CapitalIQ) and consequentially merge together with one of IAC main segments, HomeAdvisor, to which we refer in this article as NewCo.

The offer that IAC made to Angie’s List stockholders was for $8.50 per share or one share of NewCo. ANGI’s stock has skyrocketed since the announcement, with a closing price of $11.71 on May 16th 2017. This possibly shows a very positive perception of the deal from the market, and substantial expectations of reaching the proper amount of synergies in the early stages of the acquisition.

Strangely, there has not been much attention to this deal, and yet this potential transaction brings up several questions and valuation concerns. How can the price of Angie’s List be greater than the offer in cash of $8.50 per share? Will Angie’s List really benefit from the merger? How are Angie’s List and HomeAdvisor compatible? With a simple analysis, we will show you why shorting this stock can be the right thing to do.

Angie's List Headquarters in Indianapolis, IN.

IAC offer of $8.50 is well below analysts’ estimates of $10.58 per share, but the market has taken an even more bullish stance with the price per share going above the $11 threshold as confirmed by the most recent market movements of ANGI stock. As a matter of fact, ANGI stock has been buoyant since the acquisition announcement, showing as much as a 61% gain on May 2nd (the day after the announcement).

According to recent comments by Thomas R. Evans, Chairman of Angie's List, IAC and HomeAdvisor "would represent a perfect strategic match, creating tremendous shareholder value for Angie's List." Clearly the two companies could form a powerful combination, being both already market leaders. However, what is the right amount of synergies that the companies will have to achieve in order for the deal to make sense?

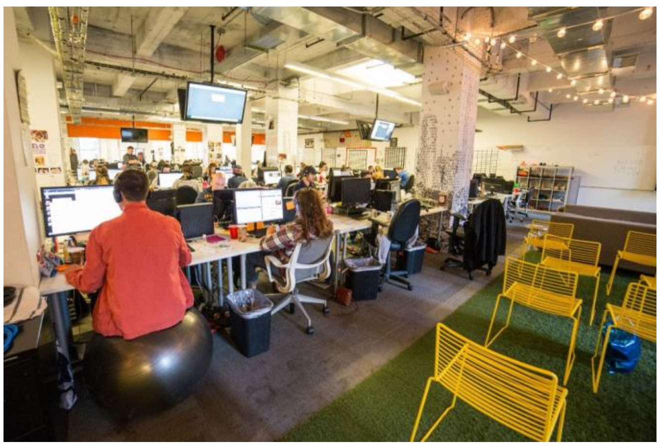
> "We will show you why shorting this stock can be the right thing to do."

Looking at ANGI today's price of $11.71, compared to IAC offer of $8.50, we wonder whether this merger could potentially not happen at all. The market might be telling us that Angie's List is worth more than $8.50 per share and the board along with the Company's advisors probably reached a lousy deal for their shareholders. However, in case shareholders in mass will be willing to accept for compensation a share of NewCo rather than $8.50 per share, there could be another possibility, that is NewCo is worth in fact at least $11.71 per share (if not more since in general we observe an M&A spread due to the uncertainty of regulatory approval etc.). If the latter is true, a key aspect to take into consideration is the integration of the two companies and the realization of the expected synergies. Will the integration happen based on which platform, Angie's List or HomeAdvisor? At a first look, the two platforms appear to be very different, in both style and way of reaching their users. Angie's List gives you direct access to an online directory of local businesses for all sorts of services you may need for your house. While, HomeAdvisor, still gives you access to home services, but reminds more of the process of getting an insurance quote, which is not really an exciting and quick approach.

Deciding which platform to use for NewCo will most likely be key to the swift delivery of synergies after the merger.

In order to explain ANGI's spike after the announcement, we should take a closer look at the synergies that could be achieved with this merger. While doing some stress testing on the expected synergy values, we discovered what we were already expecting: ANGI at its current price might be overvalued since the amount of synergies to be created would be far-reaching, hence, in strong doubt.

After calculating the cost of capital of Newco as a blend of the two entities, we computed the implied value of HomeAdvisor based on the revenue multiples of both IAC and Angie's List, since as a business unit of IAC the price of HomeAdvisor is not available. We then combined the enterprise values of Angie's List and HomeAdvisor, and used the capitalization formula to solve for NewCo's Free Cash Flow.



HomeAdvisor office in New York, NY.

A couple of pointers derived from this analysis: first, the two companies will have to grow at a rate that justifies the price of one share of NewCo (which again should be close to the current price per share of ANGI). Such growth will depend on whether the synergies are captured immediately or delayed. For our calculation, we assumed a normalized long term growth rate of 3%, and calculated the synergies that should be created by NewCo in order to justify again the price per share of NewCo.

It follows that, assuming that the synergies will not be created instantly, the company will have to grow at the long term growth rate of 11%. *This is clearly not sustainable*. As comparison, not even an internet company like Facebook has a similar long term growth rate; indeed, Facebook has a long term growth rate of approximately 3% as of May 16th 2017. If conversely such synergies will be immediately available to NewCo, they should be of approximately $170 million or about 21% of NewCo revenues.

Analyzing the cost structure of the two companies, we don't think that the variable costs will change significantly as a result of the merger. However, looking at Angie's List financials, we have identified approximately $50 million of SG&A that could be part of the realized synergies through integration in the early stages. Nonetheless, there should still be another $120 million in savings to be achieved in order to *justify* ANGI's *current price per share*.

In conclusion, in our view with more sound synergies of approximately $50 to $70 million it is reasonable to believe that the appropriate price for ANGI should be in line with the price prior to the announcement of the deal. That is, shareholders that accepts one share of NewCo could experience a drop in the value of their shares once the transaction is consummated. It might sound unusual, but management in this case may know better than the market.

If you are holding ANGI's shares, take the $8.50 and run away.

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