

Fundamental

Research Corp.

Investment Analysis for Intelligent Investors

December 1, 2016

Shoal Games Ltd. (TSXV: SGW / OTCQB: SGLDF) – Preparing for two major product launches

Sector/Industry: Mobile Games

www.shoalgames.com

Market Data (as of December 1, 2016)

Current Price	C\$0.54
Fair Value	C\$1.50
Rating*	BUY
Risk*	5 (Highly Spec)
52 Week Range	C\$0.40 – C\$0.77
Shares O/S	59,708,318
Market Cap	C\$32.24 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	N/A
YoY Return	-20.6%
YoY TSXV	44.5%

*see back of report for rating and risk definitions

*All the figures are in US\$ unless otherwise specified.



OTC: SGLDF

Highlights

- Shoal Games Ltd. (“Shoal”, “company”) is currently preparing for two major product launches.
- The first one, Garfield Bingo, was launched on November 30, 2016. We expect Garfield’s brand name and its global following to enable the company to attract a large user-base at significantly lower costs. Shoal’s first bingo app, Trophy Bingo, has had over 0.60 million downloads, and has generated over \$0.50 million in revenues to date.
- The second product, Rooplay, is likely to be launched in Q1-2017. Rooplay is a cloud-based gaming / educational platform for children. The target market of this app is significantly larger than the bingo market.
- The company had a setback in August when their development partner, Roadhouse Interactive, was placed into receivership. However, Shoal quickly got back on their feet and assembled an in-house development team – clearly demonstrating the benefits of having a strong management team.
- Management had made a decision back in Q2 to scale back their marketing expenses until the launch of the upcoming products. Lower marketing dollars translated into lower revenues in the quarter (\$53k in Q3 versus \$78k in Q2).
- We expect the next six months to be a very exciting period for the company with the upcoming product launches.

Key Financial Data (FYE - Dec 31) (US\$)

	2015	2016E	2017E
Cash	570,086	7,082	74,993
Working Capital	454,447	(54,588)	(1,019,109)
Total Assets	1,129,526	525,861	298,500
LT Debt to Capital	0.0%	0.0%	0.0%
Revenues	111,521	295,650	1,720,793
Net Income	(2,965,307)	(2,503,086)	(964,100)
EPS	-0.05	-0.04	-0.02

Garfield Bingo launch in December 2016

Shoal launched its second product / app, Garfield Bingo, on November 30, 2016, on the Apple app store. The app is expected to be launched on both Amazon and Google on December 8, 2016.

The company had announced in April 2016 that it licensed the rights to Garfield from Paws Inc., the sole owner of the copyrights and trademarks of Garfield. The new game, we believe, is likely to instantly appeal to, and capture the attention of the approximately 17 million Facebook (Nasdaq: FB) fans of Garfield. This should allow Shoal to attract a much larger user-base at much lower player acquisition costs.

Management expects the app to be launched in English, Spanish, and Portuguese, and to be on the app stores (Apple, Google and Amazon) within a couple of months. The app will be built on the same mobile platform as Trophy Bingo. Since its launch, Trophy Bingo has had over 0.60 million downloads, and has generated over \$0.50 million in revenues

Subsequently, the company expects to launch Garfield Bingo China in early 2017, by partnering with a local distribution company. China is a major market for mobile gaming. As an example of the potential for a Garfield game in China - in December 2015, Animoca Brands (ASX: AB1) launched a localised version of their popular mobile game, *Garfield Chef*, in China through Xiaomi – the number one smart phone manufacturer in China. The app has already had 7 million downloads since its launch.

Rooplay launch in Q1-2017

In September 2016, the company announced that it has entered into a licensing arrangement with a private London (UK) based company called Rooplay Inc. According to the company, Rooplay has developed an innovative cloud-based gaming / educational platform for children. Although details were not disclosed, the company has stated that Rooplay will eventually offer thousands of curated games, developed in house and licensed from third-parties. According to management, Rooplay will be the first platform of its kind to offer personalized and child-led educational experiences. It will be run on a subscription based, recurring revenue business model.

We believe that Rooplay not only allows Shoal to expand its product portfolio, but also the opportunity to diversify outside the niche bingo market, which is currently dominated by two leaders – Bingo Blitz and Bingo Bash. **Rooplay's target market is significantly larger than the approximately \$150 million annual bingo gaming market.**



The co-founders of Rooplay, John Streit and Amir Shadmand (brief biographies below), have

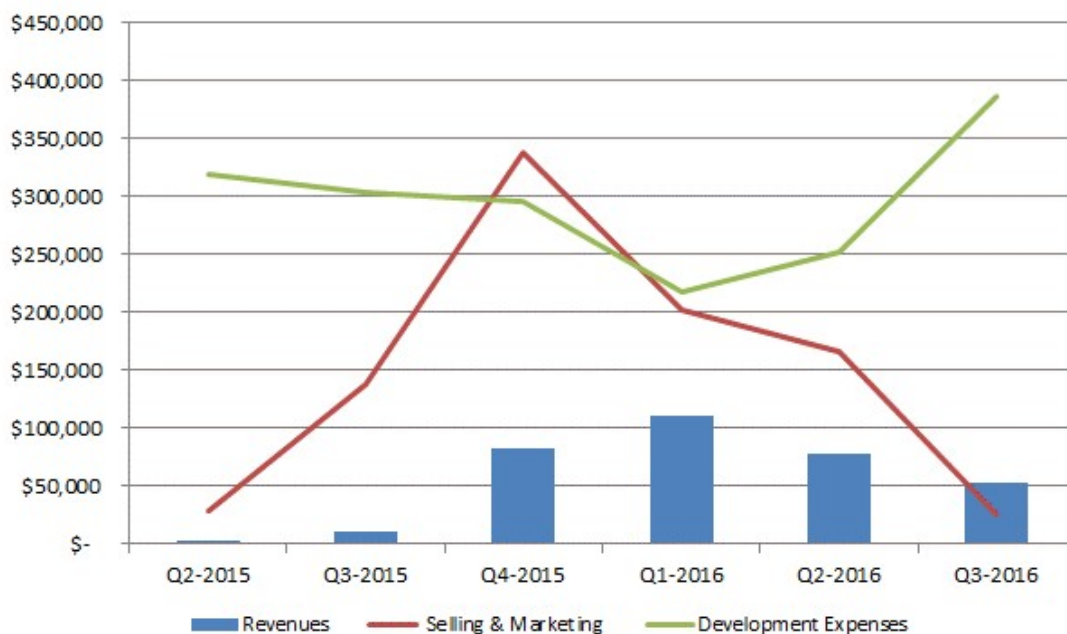
Update on marketing and development efforts

taken on Advisory roles to assist in the advancement of the technology and the launch of the product.

- *John Streit has over 17 years of technology leadership, strategy, project management, technical architecture and digital production expertise. Until recently, John was the CTO of OgilvyOne worldwide, London where he led local and dispersed teams of more than 100 members in the development and delivery of software applications to large commercial organisations.*
- *Amir Shadmand holds a PhD degree in mobile telecommunications from the King's College London where he received a number of awards and grants in his research. Amir is an expert in mobile cloud gaming technologies and is the co-founder and CEO of SUPENTA, the makers of Flitchio which is the world's first smartphone case with a built in game controller.*

Rooplay is expected to be launched in Q1-2017. We consider this as a very positive move by Shoal's management as the diversification approach significantly increases the company's probability of success – a strategy used by most of the companies in the space. We will closely monitor the company's future disclosures on the product to get a clearer understanding of management's game plan and the product's potential.

Delay in financings to fund player acquisition strategies prompted the company to scale back its marketing expenses associated with Trophy Bingo to preserve capital until the launch of Garfield Bingo. In Q3 Shoal reduced their marketing expenses significantly to \$26k, down from \$168k in the previous quarter. The decline in marketing spending impacted the company's overall performance in Q3, as revenues dropped from \$78k in Q2, to \$53k in Q3. The following chart shows the decline in marketing dollars and the corresponding decline in revenues.



**Q3
Performance
Highlights**

**Balance sheet
and cash flows**

As shown above, development costs increased from \$251k in Q2 to \$387k in Q3 due to the upcoming product launches.

In August 2016, the company's development partner, Roadhouse Interactive Limited, was placed in receivership. The company had prepaid approximately \$0.50 million to Roadhouse, which had to be written off in Q3. Roadhouse was one of the leading independent developers in Vancouver, with brand name clients. Although their demise was concerning, management of Shoal was able to quickly deal with the setback by providing direct employment to the key members of the development team at Roadhouse. The company brought in a new VP of Development, Kirsten Forbes (brief biography below), who was previously the VP Product Development at Roadhouse Interactive.

Kirsten has been making games since 1997. As Executive Producer at Radical Entertainment she made AAA console titles, shipping 11 high-profile games including CSI and Crash Bandicoot. Following Radical, Kirsten co-founded Silicon Sisters Interactive, Vancouver's first female led game development studio, where she shipped three premium titles. Prior to Shoal Games, Kirsten was VP Product Development at Roadhouse Interactive.

Shoal leased a new office in Vancouver, and currently has a nine-member development team there, in addition to a few programmers from the Rooplay team in London.

In Q3-2016, the company reported a net loss of \$1.16 million (EPS: -\$0.02) versus \$0.76 million in Q3-2015 (EPS: -\$0.01) and \$0.62 million (EPS: -\$0.01) in Q2-2016. For the nine-month period, the net loss was \$2.41 million (EPS: -\$0.04) versus \$2.15 million (EPS: -\$0.04) in the comparable period in the previous year. Excluding the write-off, the company reported a net loss of \$0.66 million (EPS: -\$0.01) in Q3-2016, and a net loss of \$1.91 million (EPS: -\$0.03) in the nine-month period.

Revenue and EPS forecasts – We have adjusted our 2016 revenue and EPS forecast from \$414k to \$296k, and from -\$2.64 million (EPS: -\$0.04) to -\$2.50 million (EPS: -\$0.04), respectively. As for 2017, we have revised our forecasts from \$3.93 million to \$1.72 million, and from \$0.22 million (EPS: \$0.00) to -\$0.96 million (EPS: -\$0.02).

Free cash flows were -\$2.03 million in the first nine months of 2016 versus -\$1.58 million in the comparable period in the previous year.

Summary of Cash Flows	2015 (9M)	2016 (9M)
Cash Flows from Operations	(1,580,357)	(2,022,550)
Cash Flows from Investing	(272)	(5,104)
Cash Flows from Financing	77,250	1,539,985
Net Change	(1,503,379)	(487,669)
Free Cash Flows	(1,580,629)	(2,027,654)

At the end of Q3-2016, the company had \$82k in cash. Working capital and the current ratio

were -\$86k, and 0.7x, respectively. The company had \$27k in zero-interest shareholder loans.

Liquidity Analysis	2014	2015	Q1-2016	Q2-2016	Q3-2016
Cash	\$2,876,386	\$570,086	\$151,697	\$187,516	\$82,417
Working Capital	\$2,856,230	\$454,447	-\$59,042	\$954,319	-\$85,750
Current Ratio	19.24	3.56	0.79	8.02	0.66
Debt / Capital	0.0%	0.0%	0.0%	0.0%	33.0%
LT Debt / Capital	0.0%	0.0%	0.0%	0.0%	0.0%

The company has a line of credit and loan arrangement with the Chairman, Tarnie Williams, and another major shareholder, for up to \$5 million; none was drawn at the end of Q3. We expect the company to use this facility to fund development costs and G&A expenses for the next 3 to 6 months.

Stock options and warrants: The company has no options or warrants outstanding.

Valuation

Our revised DCF valuation is \$1.50 per share versus our previous estimate of \$1.52 per share. Note that our valuation does not account for any potential upside from Rooplay. We will incorporate Rooplay into our valuation once we have more information on the product and once the terms and conditions of the licensing agreement are disclosed.

Risks

The following risks, though not exhaustive, may cause our estimates to differ from actual results:

- The social games sector is highly competitive. There are over one million apps each available on both the App Store and Google Play.
- The social bingo gaming market is currently dominated by two established players.
- Keeping players engaged is critical and requires continuous development and innovation.
- Trophy Bingo is in its early stages and has yet to start generating significant revenues.
- The company may have to pursue equity financings, which may dilute existing shareholders.
- The social games sector is not subject to any material regulations. Any unfavorable changes in regulations in the future may impact the company's business.
- Management and insiders own over 75% - 80% of the outstanding shares. Therefore, the liquidity and the average daily trading volume of SGW's shares are low at this time.

We assign a risk rating of 5 (Highly Speculative).

APPENDIX

STATEMENTS OF OPERATIONS				
(in US\$)- YE Dec 31st	2014	2015	2016E	2017E
Net Revenues	32,470	111,521	295,650	1,720,793
Cost of Sales	482,013	482,012	482,013	
Gross Profit	-449,543	-370,491	-186,363	1,720,793
Expenses				
Selling & Marketing	247,258	549,726	445,617	688,417
Development	1,181,382	1,230,216	1,243,053	1,305,206
Compensation & Consulation	532,287	438,572	149,439	164,383
G & A	212,649	356,647	474,826	522,309
EBITDA	-2,623,119	-2,945,652	-2,499,298	-959,522
Amortization	3,470	3,467	3,788	4,578
EBIT	-2,626,589	-2,949,119	-2,503,086	-964,100
Interest & Bank Charges	510	1,089		
Exchange rate and Unusual items	-44,617	-33,582		
EBT	-2,670,696	-2,981,612	-2,503,086	-964,100
Unusual gain or loss	6,677,759	16,305		
Income Taxes	848		-	0
Net Earnings for the period	5,062,233	-2,965,307	-2,503,086	-964,100
EPS	0.07	-0.05	-0.04	-0.02

BALANCE SHEET				
(in US\$)- YE Dec 31st				
	2014	2015	2016E	2017E
Assets				
Cash	2,876,386	570,086	7,082	74,993
Accounts receivable	122,056	44,948	37,273	172,079
Prepaid expenses	14,367	17,205	464,917	34,416
Current Assets	3,012,809	632,239	509,272	281,488
Property and equipment	9,269	6,314	7,630	8,052
Other Assets	964,025	482,013	-	-
Security Deposits	10,642	8,960	8,960	8,960
Total Assets	3,996,745	1,129,526	525,861	298,500
Liabilities & Shareholders' Equity				
Accounts payables & accrued liabilities	107,911	145,226	231,293	268,031
Deferred income				
Loans payable/ borrowings			300,000	1,000,000
Related parties	48,668	32,566	32,566	32,566
Current Liabilities	156,579	177,792	563,859	1,300,597
Loans payable				
Shareholder's Equity				
Share Capital	19,257,040	19,334,290	20,847,644	20,847,644
Foreign Currency Translation	24,580	24,580	24,580	24,580
Deficit	-15,441,454	-18,407,136	-20,910,222	-21,874,322
Total Liabilities & Shareholders' Equity	3,996,745	1,129,526	525,861	298,500

STATEMENTS OF CASH FLOWS				
(in US\$)- YE Dec 31st	2014	2015	2016E	2017E
Operating Activities				
Net earnings for the period	5,062,233	-2,965,787	-2,503,086	-964,100
Items not involving cash				
Depreciation	3,470	3,467	3,788	4,578
Trophy Bingo Amortization	482,013	482,012	482,013	
Gain on sale of domain name	-6,677,759	-16,305		
	-1,130,043	-2,496,613	-2,017,285	-959,522
Accounts Receivable	159,201	77,213	7,675	-134,807
Other Assets	877	1,682		
Prepaid Expenses	97,728	-2,838	-447,712	430,501
Security Deposits				
Accounts payable and accrued expenses	-30,260	37,518	86,067	36,738
Changes in working capital	227,546	113,575	-353,969	332,432
Cash from (used in) operations	-902,497	-2,383,038	-2,371,254	-627,089
Financing activities				
Proceeds from secured borrowings, net			300,000	700,000
Private Placement	1,400,000		1,513,354	
Exercise of Stock Options	9,350	77,250		
Cash provided by financing activities	1,409,350	77,250	1,813,354	700,000.00
Investing activities				
Acquisition of Equipment	-4,969	-512	-5,104	-5,000
Cash used in investing activities	1,878,330	-512	-5,104	-5,000
Increase (decrease) in cash	2,385,183	-2,306,300	-563,004	67,911
Cash beginning of period	491,203	2,876,386	570,086	7,082
Cash end of period	2,876,386	570,086	7,082	74,993

Fundamental Research Corp. Equity Rating Scale:

Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

Hold – Annual expected rate of return is between 5% and 12%

Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

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2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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