

Kidoz Inc.
(TSXV: KIDZ)

BUY

Current Price: C\$0.27

Fair Value: C\$0.94

Risk*: 4

Q1-2020 Inline – Userbase Continues to Grow

Sector/Industry: Mobile Games

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Highlights

- Kidoz Inc. (“Kidoz”, the “company”) reported financials results, with Q1-2020 revenue increasing 222% year-over-year. **Our 2020 and 2021 revenue forecasts of \$5.30 million and \$12.35 million, respectively, remain unchanged.**
- **Q1-2020 gross margin was exactly in-line with our expectations.** Expenses related to salaries, wages, consultants, and benefits decreased 53% year-over-year due to cost cutting initiatives. As a result, EBITDA, EBIT, and net margins in Q1-2020 improved drastically year-over-year.
- The company reported Q1-2020 EBITDA and net losses of -\$0.25 million and -\$0.40 million (EPS: -\$0.00), respectively. This compares to Q1-2019 EBITDA and net income of -\$0.61 million and -\$0.83 million (EPS: -\$0.01), respectively. **Our 2020 and 2021 net income forecasts of -\$1.26 million (EPS: -\$0.01) and \$0.38 million (EPS: \$0.00), respectively, remain unchanged.**
- Due to the COVID-19 pandemic, advanced economies are expected to contract 6.1% in 2020. Furthermore, ad spending is expected to decrease in 2020, with Q2-2020 expected to be the most heavily impacted quarter. On the other end, average screen-time has increased substantially. According to data from Circle Media Labs Inc., **screen time for kids was up 56.5% in the first week of April 2020 versus the last week of March 2020.**
- The Kidoz Network reported a surge in daily unique users due to the COVID-19 pandemic. With that said, we are cautious in assuming that advertisers will reinstate their pre-COVID-19 advertising budgets simply due to more users on the Kidoz Network. According to Kantar, **the COVID-19 pandemic is expected to adversely impact 70% of household’s income in G7 countries.** We believe that advertisers will take into consideration the decreased disposable income of households and be cautious in their ad spending for the remainder of 2020.

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KIDZ Price and Volume (1-year)



	YTD	12M
Return	-4%	-54%
TSXV	-5%	-7%

Company Data

52-Week Range	C\$0.13 - C\$0.58
Shares O/S	131,124,989
Market Cap.	C\$35.40 million
Current Yield	N/A
P/E (forward)	N/A
P/B	4.4x

Key Financial Data (FYE – DEC 31)	2016	2017	2018	2019	2020E	2021E
Cash	60,190	478,397	641,536	967,212	693,658	1,662,065
Working Capital	13,896	345,184	662,573	2,192,505	1,571,164	2,554,788
Total Assets	129,093	557,853	769,633	9,786,640	7,919,837	8,675,839
LT Debt to Capital	928.0%	125.9%	0.0%	0.0%	0.0%	0.0%
Revenue	278,921	93,475	106,978	4,517,379	5,297,750	12,351,721
Net Income	(3,156,302)	(1,741,951)	(2,592,831)	(14,654,232)	(1,264,276)	379,430
EPS	-0.05	-0.03	-0.04	-0.12	-0.01	0.00

***See last page for important disclosures, rating, and risk definitions. All figures in US\$ unless otherwise specified.**

COVID-19: The Economy, Ad Spending, and User Engagement

Advanced economies expected to contract 6.1% in 2020

Due to the COVID-19 pandemic, **advanced economies are expected to contract 6.1% in 2020, as shown below.**

The COVID-19 pandemic will severely impact growth across all regions.

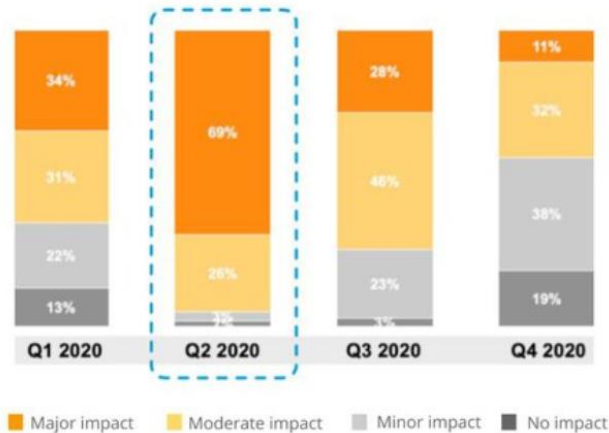
(real GDP, annual percent change)	2019	PROJECTIONS	
		2020	2021
World Output	2.9	-3.0	5.8
Advanced Economies	1.7	-6.1	4.5
United States	2.3	-5.9	4.7
Euro Area	1.2	-7.5	4.7
Germany	0.6	-7.0	5.2
France	1.3	-7.2	4.5
Italy	0.3	-9.1	4.8
Spain	2.0	-8.0	4.3
Japan	0.7	-5.2	3.0
United Kingdom	1.4	-6.5	4.0
Canada	1.6	-6.2	4.2
Other Advanced Economies	1.7	-4.6	4.5

Source: IMF

Ad spending expected to decrease in 2020

Furthermore, **ad spending is expected to decrease in 2020.** Q2-2020 is expected to be the most heavily impacted quarter for ad spending.

Which quarters will be most impacted by ad spending cuts?



Source: Advertiser Perceptions COVID-19 report. Base = 201 ad execs surveyed March 17-20.

Screen-time for kids has increased substantially

On the other end, average screen-time has increased substantially. According to data from Circle Media Labs Inc., **screen time for kids was up 56.5% in the first week of April versus the last week of March.** It may seem counterintuitive for advertisers to decrease ad spending while screen-time has been increasing. To this point, as we have outlined in our previous update report, “advertisers are reluctant to spend what could be lost dollars if supply chain shocks prevent them from getting their products to market” (Source: eMarketer).

The Kidoz Network reported a surge in DUU

The Kidoz Network has reported a surge in daily unique users (“DUU”) due to the COVID-19 pandemic, as shown below. We believe the COVID-19 pandemic has resulted in a quicker adoption rate of the Kidoz Network by users.

Daily Unique Users on the KIDOZ Network



Source: Kidoz

The COVID-19 pandemic is expected to adversely impact household income

An economic downturn in 2020 is expected to decrease the amount of disposable income that families have. **The COVID-19 pandemic is expected to adversely impact 70% of household’s income in G7 countries (Source Kantar).**

	Total G7	Canada	France	Germany	Italy	Japan	GB	USA
Coronavirus has already impacted on my household income	31%	36%	24%	20%	39%	20%	29%	38%
Coronavirus has not yet impacted on my household income but I expect it to in the future	39%	40%	41%	38%	43%	45%	41%	36%
TOTAL – Already impacted / I expect it to impact	70%	76%	65%	58%	82%	65%	70%	74%
Coronavirus will have no impact on my household income	23%	19%	29%	35%	14%	26%	26%	20%
Don't know	7%	5%	6%	7%	4%	9%	4%	7%

Source: Kantar

Cautious in assuming that advertisers will reinstate their pre-COVID-19 advertising budgets

We are cautious in assuming that advertisers will reinstate their pre-COVID-19 advertising budgets simply due to more users on the Kidoz Network. We believe that advertisers will take into consideration the decreased disposable income of households, and as a result, be cautious in their ad spending for the remainder of 2020.

Financials

Q1-2020 revenue improved 222% YoY

Kidoz reported Q1-2020 revenue of \$0.98 million – a year-over-year (“YoY”) improvement of 222%. A YoY comparison is not directly comparable, as Kidoz Ltd. was acquired in Q1-2019.

91% of the revenue in Q1-2020 came from ad revenue, with the remainder coming from content revenue (such as subscriptions of Rooplay, in-app purchases on social bingo sites and Rooplay Originals). On an annualized basis, this would imply revenue of \$3.93 million – significantly below our 2020 revenue forecast of \$5.30 million. However, readers should note that digital ad revenue exhibits seasonality, and tends to be significantly higher in Q4 compared to Q1 – Q3 (Source: Monetize More).

Ad spending expected to rebound in Q4-2020

With a number of major economies reopening (China, Canada, United States, etc.), if COVID-19 does not force these economies back into a shut-down, we believe ad spending will rebound sharply in Q4 in time for the holiday season. Furthermore, Kidoz has been, since our last update report:

- (1) investing in programmatic technology – launching a new programmatic bidder-server to help drive revenue growth. This will enable publishers and advertisers to automate the purchase of ads through an automated bidding process.
- (2) expanding its brand outreach capabilities by appointing KIDSMEDIA (a third-party advertising agency based in Madrid) to be its sales agent in Spain.

For the time being, we are leaving both our 2020, and 2021, revenue forecasts of \$5.30 million and \$12.35 million, respectively, unchanged.

Margins improved due to cost synergies with the acquisition of Kidoz Ltd.

Margins

The company’s Q1-2020 gross margin was exactly in-line with our 2020 forecast. Expenses related to salaries, wages, consultants, and benefits decreased 53% YoY due to cost cutting initiatives. As a result, EBITDA, EBIT, and net margins in Q1-2020 improved significantly compared to Q1-2019.

Margins	Q1-2019	Q1-2020
Gross	41.8%	45.1%
EBITDA	-200.5%	-25.8%
EBIT	-201.1%	-40.2%
Net	-270.1%	-41.1%

Source: Company, FRC

EBITDA and Net Loss

The following shows the company's EBITDA and net loss:

Company Results	Q1-2019	Q1-2020
EBITDA*	-\$0.61 mn	-\$0.25 mn
Net Income	-\$0.83 mn	-\$0.40 mn
EPS	-\$0.01	-\$0.00

* Our calculation of EBITDA differs from Kidoz's reported EBITDA due to our inclusion of stock-based compensation and the inclusion/exclusion of other small line items.

Source: Company, FRC

Our 2020 and 2021 EBITDA and net income forecasts remain unchanged, as shown below:

FRC Forecasts	2020	2021
EBITDA	-\$0.62 mn	\$0.97 mn
Net Income	-\$1.26 mn	\$0.38 mn
EPS	-\$0.01	\$0.00

Source: FRC

Free cash flows ("FCF") improved due to stronger operating performance.

FCF improved due to strong operating performance

Summary of Cash Flows	Q1-2019	Q1-2020
Cash Flows from Operations	(585,273)	(400,604)
Cash Flows from Investing	158,144	(4,909)
Cash Flows from Financing	1,616,678	(16,187)
Net Change	1,189,549	(421,700)
Free Cash Flows	(427,129)	(405,513)

Source: Company, FRC

At the end Q1-2020, the company reported a cash position of \$0.55 million, \$1.93 million in working capital, and nil debt.

Cash position of \$0.55 million, \$1.93 million in working capital and nil debt

Liquidity Analysis	Q1-2020
Cash	\$545,512
Working Capital	\$1,927,546
Current Ratio	3.38
Debt / Capital	0.0%
LT Debt / Capital	0.0%
EBIT Interest Coverage Ratio	n/a

Source: Company, FRC

Stock Options and Warrants: We estimate that the company has 3.13 million options (weighted average exercise price of \$0.45) and nil warrants outstanding. None of the options are in the money.

Valuation

The following shows our forecasted income statements for Kidoz, which remain unchanged from our previous update report.

STATEMENTS OF OPERATIONS						
(in US\$) - YE Dec 31st	2020E	2021E	2022E	2023E	2024E	2025E
Total Revenue	5,297,750	12,351,721	22,003,184	36,841,657	62,108,606	104,860,942
Cost of Sales	2,909,325	6,785,328	11,258,410	19,331,911	33,120,671	56,497,893
Gross Profit	2,388,425	5,566,393	10,744,774	17,509,745	28,987,935	48,363,049
Expenses	2,959,766	4,532,768	6,285,921	8,862,371	13,051,556	19,914,905
Selling & Marketing	250,000	500,000	500,000	500,000	500,000	500,000
Development	1,115,445	1,226,990	1,349,689	1,484,657	1,633,123	1,796,435
Stock Based Compensation	47,670	59,588	74,484	93,105	116,382	145,477
Compensation & Consultation	805,465	966,558	1,159,870	1,391,844	1,670,212	2,004,255
Provision for Doubtful Accounts						
Bad Debt Expense						
G & A	788,856	1,839,221	3,276,362	5,485,870	9,248,220	15,614,214
EBITDA	-619,011	974,037	4,384,369	8,554,269	15,819,997	28,302,667
Amortization & Depreciation	645,265	594,607	550,281	511,496	477,559	447,864
EBIT	-1,264,276	379,430	3,834,088	8,042,773	15,342,439	27,854,803
Interest & Bank Charges						
Exchange Rate and Unusual Items						
EBT	-1,264,276	379,430	3,834,088	8,042,773	15,342,439	27,854,803
Unusual Gain or Loss						
Income Taxes			1,150,226	2,412,832	4,602,732	8,356,441
Net Earnings for the period	-1,264,276	379,430	2,683,862	5,629,941	10,739,707	19,498,362
EPS	-0.01	0.00	0.02	0.04	0.08	0.15
Shares	131,124,989	131,124,989	131,124,989	131,124,989	131,124,989	131,124,989

Source: FRC

Updated valuation
on Kidoz is C\$0.94
per share

Our updated DCF valuation on Kidoz is C\$0.94 per share versus our previous estimate of C\$1.00 per share. The deterioration was due to weakness in the US\$. **We are maintaining our BUY rating.**

Risks

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

- Any unfavorable changes in regulations in the future may impact the company's business.
- Ability to attract publishers and brands will be key to long-term growth.
- COVID-19 has an impact on the company's top-line revenue that is not easily quantifiable.
- The company is operating in a highly competitive space.
- The average daily trading volume is relatively low as shares are thinly traded.

Maintaining our risk
rating of 4

We are maintaining our risk rating of 4 (Speculative).

Appendix

STATEMENTS OF OPERATIONS			
(in US\$) - YE Dec 31st			
	2019	2020E	2021E
Total Revenue	4,517,379	5,297,750	12,351,721
Cost of Sales	2,778,911	2,909,325	6,785,328
Gross Profit	1,738,468	2,388,425	5,566,393
Expenses	2,832,745	2,959,766	4,532,768
Selling & Marketing	369,321	250,000	500,000
Development	1,014,041	1,115,445	1,226,990
Stock Based Compensation	15,890	47,670	59,588
Compensation & Consultation	732,241	805,465	966,558
Provision for Doubtful Accounts			
Bad Debt Expense			
G & A	717,142	788,856	1,839,221
EBITDA	-1,110,167	-619,011	974,037
Amortization & Depreciation	546,270	645,265	594,607
EBIT	-1,656,437	-1,264,276	379,430
Interest & Bank Charges	3,302		
Exchange Rate and Unusual Items	26,008		
EBT	-1,627,127	-1,264,276	379,430
Unusual Gain or Loss	-13,877,385		
Income Taxes	-850,280		
Net Earnings for the period	-14,654,232	-1,264,276	379,430
EPS	-0.12	-0.01	0.00
Shares	121,208,912	131,124,989	131,124,989

BALANCE SHEET			
(in US\$)- YE Dec 31st	2019	2020E	2021E
Assets			
Cash	967,212	693,658	1,662,065
Accounts receivable	2,392,778	1,433,055	1,669,918
Prepaid expenses	109,914	71,653	166,992
Current Assets	3,469,904	2,198,366	3,498,974
Property and equipment	27,182	44,919	65,188
Other Assets			
Goodwill and identified intangible assets	6,289,554	5,676,553	5,111,676
Total Assets	9,786,640	7,919,837	8,675,839
Liabilities & Shareholders' Equity			
Accounts payables & accrued liabilities	1,251,684	601,487	918,471
Derivative			
Lease	25,715	25,715	25,715
Related parties			
Current Liabilities	1,277,399	627,202	944,186
Loans payable			
Lease	101,900	101,900	101,900
Shareholder's Equity			
Share Capital	48,935,213	48,982,883	49,042,471
Foreign Currency Translation	24,580	24,580	24,580
Deficit	-40,552,452	-41,816,728	-41,437,298
Total Liabilities & Shareholders' Equity	9,786,640	7,919,837	8,675,839

STATEMENTS OF CASH FLOWS			
(in US\$)- YE Dec 31st	2019	2020E	2021E
Operating Activities			
Net earnings for the period	-14,654,232	-1,264,276	379,430
Items not involving cash			
Depreciation	546,270	645,265	594,607
Bad Debt expense			
Settlement of debt			
Reversal of progressive jackpots provision			
Sale of US players and related assets			
Trophy Bingo Amortization			
Profit on Subsidiary Sale			
Gain on sale of domain name/others			
Amortization of operating lease ROU assets			
Deferred income tax recovery	-752,205		
Stock Based Compensation	15,890	47,670	59,588
Impairment	13,877,385		
Issuance of consultant stock options			
Loss on disposal of equipment / Others			
	-966,892	-571,341	1,033,624
Accounts Receivable	-963,129	959,723	-236,863
Other Assets			
Prepaid Expenses	25,004	38,261	-95,339
Players Float			
Security Deposits			
Provision for progressive jackpots			
Accounts payable and accrued expenses	694,660	-650,197	316,984
Changes in working capital	-243,465	347,788	-15,218
Cash from (used in) operations	-1,210,357	-223,554	1,018,406
Financing activities			
Proceeds from secured borrowings, net	-278,063		
Private Placement	1,763,200		
Proceeds from issuance of shares			
Dividends Paid			
Advanced subscriptions			
Payment on operating lease liabilities and ROU assets	-79,715		
Options / Warrants			
Cash provided by financing activities	1,405,422	-	-
Investing activities			
Acquisition of equipment/subsidiary	-6,514	-50,000	-50,000
Proceeds on sale of domain name, net transaction costs			
Software Development			
Proceeds from sale of US players and related assets			
Proceeds on disposal of equipment			
Long-term cash equivalent			
Payments on ROU assets			
Security deposits			
Proceeds from sale of subsidiary	183,264		
Goodwill / Others	-46,139		
Cash used in investing activities	130,611	-50,000	-50,000
Increase (decrease) in cash	325,676	-273,554	968,406
Cash beginning of period	641,536	967,212	693,658
Cash end of period	967,212	693,658	1,662,065

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.

Fundamental Research Corp. Risk Rating Scale:

1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

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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