

Kidoz Inc.
(TSXV: KIDZ)

BUY

Current Price: C\$0.21

Fair Value: C\$0.94

Risk*: 4

Q2 Revenue Impacted by COVID-19; Long-term Fundamentals Remain Intact

Sector/Industry: Mobile Games

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Highlights

- Kidoz Ltd. (“Kidoz”, “KIDZ”, the “company”) reported financial results, with Q2-2020 revenue declining 10% year-over-year and 25% quarter-over-quarter. The deterioration in revenue was expected, given the adverse impact of COVID-19 on digital ad spend. With a number of major economies reopened, we expect revenue in subsequent quarters to rebound.
- Q2-2020 gross margin was 44.2%, largely in-line with our expectations of 45.1%. **Operating expenses (excluding depreciation and amortization) in Q2-2020 were \$0.53 million – a YoY decrease of 22%.** We are pleased to see KIDZ have the flexibility in reducing its cost base during uncertain times.
- Despite weak global digital ad spending expected amid the COVID-19 environment, long-term fundamentals remain intact. Global digital ad spending in 2020 is expected to be \$332.84 billion – a year-over-year increase of 2.4%. In 2021 and 2022, global digital ad spending is expected to grow 17.0% and 13.3%, respectively, (Source: eMarketer). **We believe that KIDZ is operating in a market (digital ad spending market) that is set to grow immensely over the long-term, and within that, a niche segment (kids digital ads) whose growth is further bolstered by the increasing adoption of smartphones and related technologies.**
- KIDZ share price has decreased approximately 20% since our previous report in June 2020. **We believe long-term fundamentals of the company remain strong, and the recent share price weakness offers opportunities for investors to enter at attractive price levels.**

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KIDZ Price and Volume (1-year)



	YTD	12M
KIDZ	-25%	-60%
TSXV	23%	24%

Company Data

52-Week Range	C\$0.12 - C\$0.52
Shares O/S	131,124,989
Market Cap.	C\$27.54 million
Current Yield	N/A
P/E (forward)	N/A
P/B	2.7 x

Key Financial Data (FYE - Dec 31)

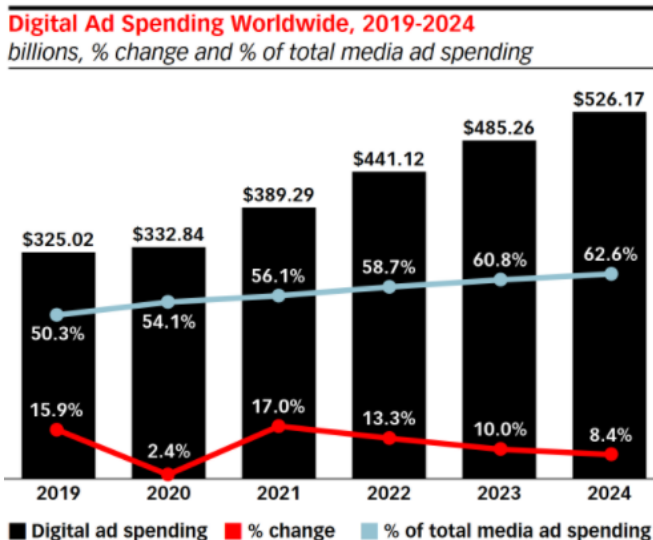
(US\$)	2016	2017	2018	2019	2020E	2021E
Cash	60,190	478,397	641,536	967,212	744,326	1,725,400
Working Capital	13,896	345,184	662,573	2,192,505	1,634,499	2,618,123
Total Assets	129,093	557,853	769,633	9,786,640	7,970,505	8,739,174
LT Debt to Capital	928.0%	125.9%	0.0%	0.0%	0.0%	0.0%
Revenues	278,921	93,475	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)	(1,200,941)	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.

Outlook remains positive

Long-Term Outlook for Digital Kid Advertising Remains Positive

Despite weak global digital ad-spending expected amid the COVID-19 environment, long-term fundamentals remain intact. Global digital ad spending in 2020 is expected to be \$332.84 billion – a year-over-year increase of 2.4%. **In 2021 and 2022, global digital ad spending is expected to grow 17.0% and 13.3%, respectively.** (Source eMarketer)

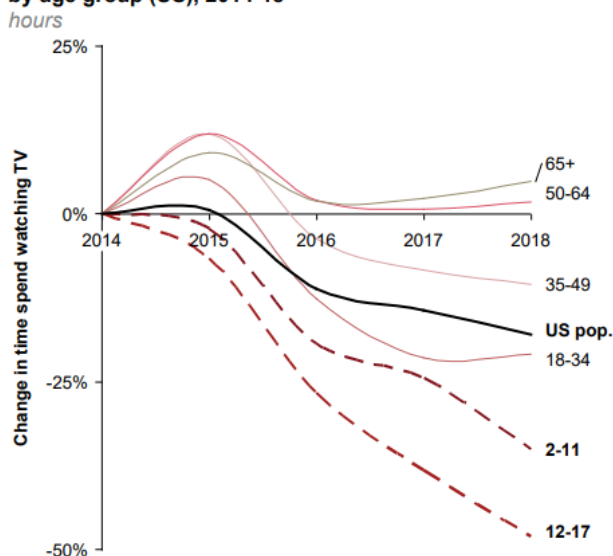


Source: eMarketer

Growing digital ad spending

Digital ad spending is set to continually capture market share from the overall media ad spending market. We believe this is attributable to a shift in media consumption towards digital platforms versus television and radio, among others.

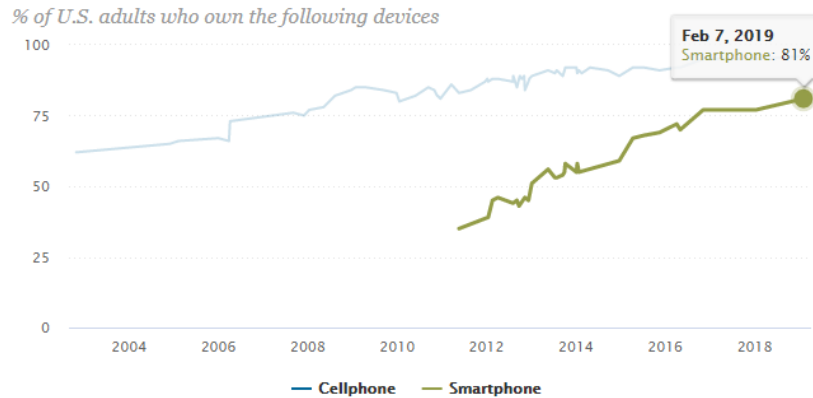
Hours spent weekly watching (live and time shifted) TV by age group (US), 2014-18



Source: Ofcom, Nielsen, PwC Analysis

Increasing smartphone ownership in adults

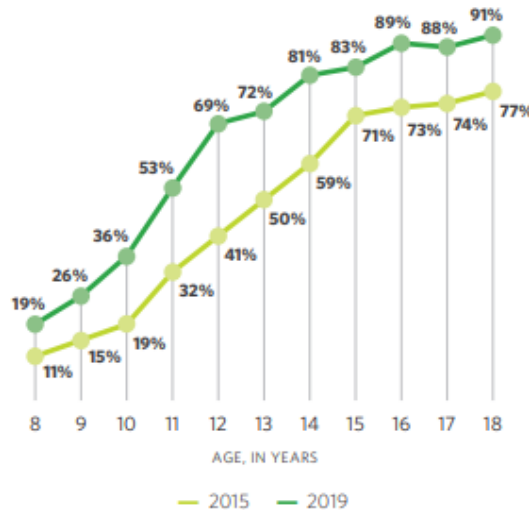
A key thing to point out is the number of kids aged two to 11 shifting away from television. We believe individuals in this age group are not actively choosing to move away from television, rather, it is parents who are enabling the adoption of digital mediums for kids. According to Pew Research, as of February 2019, 81% of American adults own a smartphone, versus 35% as of May 2011. We expect this percentage to be similar, if not higher, today.



Source: Pew Research

With growing smartphone ownership in adults, it is likely that an increasing number of parents are (1) providing their smartphones to their kids for use at home and/or (2) deeming it appropriate to purchase a smartphone for their kids at an early age. Shown below, smartphone ownership among kids has increased dramatically.

United States Smartphone Ownership by Age, 2015 vs 2019



Source: Common Sense Media

Kidoz is operating in a high growth market

Overall, Kidoz is operating in a market (digital ad spending) that is set to grow immensely over the long-term, and within that, a niche segment (kids digital ads) that is growing through the increasing adoption of smartphones and related technologies.

Financials

Revenue

KIDZ reported Q2-2020 revenue of \$0.74 million – a year-over-year (“YoY”) decline of 10%, and a quarter-over-quarter (“QoQ”) decline of 25%. H1-2020 revenue was \$1.72 million – a YoY increase of 53%. The company has not disclosed information on users and traffic, as was done for Q1-2020.

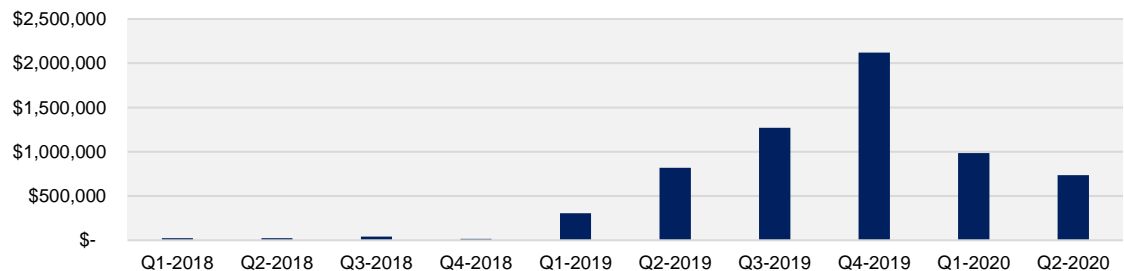
	Q2-2019	Q1-2020	Q2-2020
Ad Revenue	\$579,052	\$895,555	\$611,709
Content Revenue	\$239,234	\$88,424	\$125,118
Total Revenue	\$818,286	\$983,979	\$736,827

Source: Company, FRC

Q2-2020 revenue deteriorated, as expected

The deterioration in Q2-2020 revenue was expected, given the adverse impact of COVID-19 on digital ad spend (outlined in our previous reports). The following shows the quarterly trend in revenue.

Q1-2018 to Q2-2020 Revenue



Source: Company, FRC

Revenue rebound expected in subsequent quarters

With a number of major economies reopened, we expect Kidoz to report a slight increase in Q3-2020 revenue (compared to Q2-2020). In Q4-2020, we expect a sharp rebound versus Q3-2020 in accordance with the holiday season.

Our 2020, and 2021, revenue forecasts of \$5.30 million and \$12.35 million, respectively, remain unchanged.

Margins

Q2-2020 gross margin largely in-line

KIDZ reported a Q2-2020 gross margin of 44.2%, largely in-line with our expectations (45.1%). This is a strong improvement from 29.8% in Q2-2019, attributable to greater North American sales (which is a higher margin segment, according to management). Operating expenses (excluding depreciation and amortization) in Q2-2020 were \$0.53 million – a YoY decrease of 22%. We are pleased to see KIDZ have the flexibility in reducing its cost base during uncertain times, and **are revising our 2020 operating expense forecast nominally lower.** Despite improvements in gross margins, and a lower cost base, the net margin deteriorated nominally due to lower FOREX gains.

Q2-2020 operating expenses reduced

Margins	Q2-2019	Q2-2020
Gross	29.8%	44.2%
EBITDA	-53.7%	-28.8%
EBIT	-56.8%	-49.8%
Net	-48.7%	-49.0%

Source: Company, FRC

EBITDA and Net Loss

The following shows KIDZ's EBITDA and net loss:

Company Results	Q2-2019	Q2-2020	H1-2019	H1-2020
EBITDA	-\$439,749	-\$212,282	-\$1,040,574	-\$451,073
Net Loss	-\$398,296	-\$361,399	-\$1,224,600	-\$765,323
EPS	\$0.00	\$0.00	-\$0.01	-\$0.01

Our calculation of EBITDA differs from what KIDZ has reported due to our inclusion of stock-based compensation and the inclusion/exclusion of other small line items.

Source: Company, FRC

Our revised 2020 EBITDA and net income forecasts are -\$0.56 million and -\$1.20 million (EPS: -\$0.01), respectively, versus our previous forecasts of -\$0.62 million and -\$1.26 million, (EPS: -\$0.01), respectively. Our 2021 forecasts remain unchanged.

FRC Forecasts	2020E	2021E
EBITDA	-\$555,676	\$974,037
Net Loss	-\$1,200,941	\$379,430
EPS	-\$0.01	\$0.00

Source: Company, FRC

Cash Flows

Free cash flows ("FCF") improved YoY, primarily driven by stronger operating performance.

Summary of Cash Flows	2019 (6M)	2020 (6M)
Cash Flows from Operations	-\$1,188,698	\$144,085
Cash Flows from Investing	\$120,184	-\$7,108
Cash Flows from Financing	\$1,476,022	\$11,143
Net Change	\$407,508	\$148,120
Free Cash Flows	-\$1,068,514	\$136,977

Source: Company, FRC

Balance Sheet

At the end of Q2-2020, KIDZ reported a cash position of \$1.12 million, working capital of \$1.75 million, and a current ratio of 3.7x. We believe the company has a strong liquidity position.

Improvement in FCF
due to stronger
operating
performance

Strong liquidity
position

Liquidity Analysis	Q2-2020
Cash	\$1,115,332
Working Capital	\$1,753,820
Current Ratio	3.68
Debt / Capital	0.4%
LT Debt / Capital	0.4%

Source: Company, FRC

Stock Options and Warrants

At the end of Q2-2020, KIDZ had 5.88 million options (weighted average exercise price of \$0.40) and nil warrants outstanding. None of the options are in the money.

Valuation

The following shows our forecasted income statements for KIDZ.

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	2,896,431	4,532,769	6,285,921	8,862,372	13,051,557	19,914,907
Selling & Marketing	400,000	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, Salaries & Provision for Doubtful Accounts	592,130	966,558	1,159,870	1,391,844	1,670,212	2,004,255
Bad Debt Expense						
G & A	788,856	1,839,221	3,276,363	5,485,871	9,248,222	15,614,217
EBITDA	-555,676	974,037	4,384,369	8,554,268	15,819,996	28,302,665
Amortization & Depreciation	645,265	594,607	550,281	511,496	477,559	447,864
EBIT	-1,200,941	379,430	3,834,088	8,042,772	15,342,438	27,854,801
Interest & Bank Charges						
Exchange Rate and Unusual Items						
EBT	-1,200,941	379,430	3,834,088	8,042,772	15,342,438	27,854,801
Unusual Gain or Loss						
Income Taxes			1,150,226	2,412,832	4,602,731	8,356,440
Net Earnings for the period	-1,200,941	379,430	2,683,861	5,629,941	10,739,706	19,498,361

Source: FRC

DCF valuation
remains unchanged

Our Discounted Cash Flow (“DCF”) valuation on KIDZ is C\$0.94 per share, which remains unchanged from our previous update report. We are maintaining our BUY rating. Although KIDZ share price has decreased approximately 20% since our previous report, we believe long-term fundamentals of the company remain strong.

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 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			
Selling & Marketing	369,321	400,000	500,000
Development	1,014,041	1,115,445	1,226,990
Stock Based Compensation	15,890	47,670	59,588
Compensation, Salaries & Provision for Doubtful Accounts	732,241	592,130	966,558
Bad Debt Expense			
G & A	717,142	788,856	1,839,221
EBITDA	-1,110,167	-555,676	974,037
Amortization & Depreciation	546,270	645,265	594,607
EBIT	-1,656,437	-1,200,941	379,430
Interest & Bank Charges	3,302		
Exchange Rate and Unusual Items	26,008		
EBT	-1,627,127	-1,200,941	379,430
Unusual Gain or Loss	-13,877,385		
Income Taxes	-850,280		
Net Earnings for the period	-14,654,232	-1,200,941	379,430
EPS	-0.12	-0.01	0.00

BALANCE SHEET (in US\$)- YE Dec 31st	2019	2020E	2021E
Assets			
Cash	967,212	744,326	1,725,400
Accounts receivable	2,392,778	1,433,055	1,669,918
Prepaid expenses	109,914	71,653	166,992
Current Assets	3,469,904	2,249,034	3,562,309
Property and equipment	27,182	44,919	65,188
Other Assets			
Goodwill, intangible assets, and other	6,289,554	5,676,553	5,111,676
Total Assets	9,786,640	7,970,505	8,739,174
Liabilities & Shareholders' Equity			
Accounts payables & accrued liabilities	1,251,684	588,820	918,471
Derivative			
Lease	25,715	25,715	25,715
Related parties			
Current Liabilities	1,277,399	614,535	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	-41,753,393	-41,373,963
Total Liabilities & Shareholders' Equity	9,786,640	7,970,505	8,739,174

STATEMENTS OF CASH FLOWS			
(in US\$)- YE Dec 31st	2019	2020E	2021E
Operating Activities			
Net earnings for the period	-14,654,232	-1,200,941	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	-508,006	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	-662,864	329,651
Changes in working capital	-243,465	335,121	-2,551
Cash from (used in) operations	-1,210,357	-172,886	1,031,073
Financing activities			
Proceeds from secured borrowings, net	-278,063		
Government Loan			
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	-222,886	981,073
Cash beginning of period	641,536	967,212	744,326
Cash end of period	967,212	744,326	1,725,400

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:

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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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