

Kidoz Inc.
(TSXV: KIDZ / OTC: KDOZF)

BUY

Current Price: C\$0.30

Fair Value: C\$1.90

Risk*: 4

Expecting EBITDA To Turn Positive When Ad Spending Rebounds in Q4

Sector/Industry: Ad Tech

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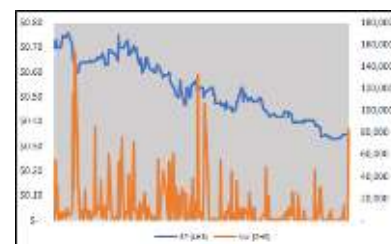
Highlights

- For Q2-2022, Kidoz reported **record revenue of \$2.5M, up 15% YoY**, but 10% lower than our forecast due to weaker than expected ad spending. Most ad-based tech companies, including Alphabet (NASDAQ: GOOGL), reported slower revenue growth in Q2. For example, YouTube's ad revenue was up just 5% YoY in Q2-2022 vs 84% in Q2-2021.
- Kidoz does not disclose performance metrics, but revenue **growth continues to come from expanded product offerings**, and the implementation of programmatic advertising last year, which allows advertisers to acquire ad space through auctions/bidding.
- We were pleased to see that the company has been able to geographically diversify its revenue-base. Europe accounted for 42% of revenue in Q2 vs 21% in Q1. We note that digital ad spending in Western Europe is expected to grow at a faster rate than in the U.S. (Source: eMarketer/Oberlo).
- Gross margins were down YoY, but improved QoQ (36% vs 39%), and were in line with our estimate.
- EBITDA and EPS were down YoY due to **increased investment in software development to support growth**. Although revenue was lower than expected, EBITDA and EPS were in line as SG&A expenses were significantly lower than expected. We had previously expected the company to expand its workforce faster.
- Slower growth in GDP and consumer spending remain headwinds to near-term digital ad spending. That said, **our outlook has improved since our previous update** in May 2022, as inflation has started to trend lower. We believe the Fed is likely to take a less hawkish stance in its meeting next month, which will likely result in stronger consumer confidence and spending in Q4.
- We expect EBITDA to turn positive in Q4**. Due to seasonality, Q4 is typically the strongest quarter, accounting for approximately 50% of annual revenue.

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Head of Research

Dushan Ratkovic, HBCom
Equity Analyst

KIDZ Price and Volume (1-year)



| | YTD | 12M |
|------|------|------|
| KIDZ | -47% | -55% |
| TSXV | -29% | -26% |

Company Data

| | |
|---------------|-------------------|
| 52-Week Range | C\$0.30 - C\$0.76 |
| Shares O/S | 132M |
| Market Cap. | C\$39M |
| Current Yield | N/A |
| P/E (forward) | N/A |
| P/B | 5x |

| Key Financial Data (FYE - Dec 31) (US\$) | 2021 | 2022E | 2023E |
|---|------------|------------|------------|
| Cash | 2,078,607 | 2,906,752 | 4,793,963 |
| Working Capital | 4,536,851 | 5,319,514 | 7,430,503 |
| Total Assets | 13,925,531 | 15,262,558 | 18,193,099 |
| Revenue | 12,475,480 | 17,052,500 | 24,381,000 |
| Net Income | (190,321) | 534,019 | 1,604,597 |
| EPS | 0.00 | 0.00 | 0.01 |

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

Financials

Q2 revenue was up 15% YoY, but 10% lower than our forecast due to lower ad spending

Although gross margins declined YoY as a result of volume discounts, they improved QoQ, and were in line with our estimate

Despite stronger revenue, EBITDA turned negative, and EPS deteriorated due to increased investment in software development

On a positive note, G&A expenses were 25% lower than expected

We expect EBITDA to turn positive in Q4-2022; note that Q4 typically accounts for 50% of annual revenue

Healthy balance sheet with \$3.8M in working capital, and little debt

None of the outstanding options/warrants are in-the-money

| STATEMENTS OF OPERATIONS | | | | | | | | | |
|--------------------------|-----------|-----------|-------|-----------|-----------|------|-----------|-------------|------|
| Y/E Dec 31 | Q1-2021 | Q1-2022 | YoY | Q2-2021 | Q2-2022 | YoY | 2021 (6M) | 2022 (6M) | YoY |
| Revenue | 1,567,942 | 2,283,974 | 47% | 2,177,505 | 2,513,613 | 15% | 3,735,447 | 4,797,587 | 28% |
| COGS | 872,901 | 1,453,079 | 66% | 1,153,172 | 1,541,648 | 34% | 2,026,073 | 2,994,727 | 48% |
| SG&A Expense | 834,939 | 886,436 | 6% | 1,257,744 | 1,278,945 | 2% | 2,285,268 | 2,866,614 | 25% |
| Development | 337,293 | 516,639 | 53% | 366,046 | 644,054 | 76% | 703,339 | 1,160,693 | 65% |
| Stock-based Compensation | 77,021 | 159,990 | 100% | 192,585 | 184,594 | -4% | 269,606 | 344,592 | 28% |
| EBITDA | (149,898) | (572,180) | -282% | (425,996) | (491,574) | -15% | (575,894) | (1,063,754) | -85% |
| EBITDA (adjusted) | (72,877) | (360,851) | | 52,446 | (262,553) | | (20,431) | (623,404) | |
| Net Profit (Loss) | (347,044) | (731,042) | -111% | (545,086) | (721,677) | -32% | (892,121) | (1,452,719) | -63% |
| EPS | (0.00) | (0.01) | | (0.00) | (0.01) | | (0.01) | (0.01) | |

| Margins | Q1-2021 | Q1-2022 | Q2-2021 | Q2-2022 | 2021 (6M) | 2022 (6M) |
|-------------------|---------|---------|---------|---------|-----------|-----------|
| Gross | 44% | 36% | 47% | 39% | 46% | 38% |
| EBITDA | -10% | -25% | -20% | -20% | -15% | -22% |
| EBITDA (adjusted) | -5% | -16% | 2% | -10% | | |
| EBIT | -20% | -32% | -28% | -25% | -24% | -28% |
| Net | -22% | -32% | -25% | -29% | -24% | -30% |
| SG&A | 54% | 61% | 53% | 56% | 54% | 58% |
| Share-based | 4.9% | 9.3% | 8.8% | 7.3% | 7.2% | 7.2% |

| Summary of Cash Flows | 2021 (6M) | 2022 (6M) |
|-------------------------------|-----------|-----------|
| Operating | 313,830 | (321,547) |
| Investing | (5,580) | (10,592) |
| Financing | 19,331 | (16,815) |
| Net | 327,581 | (348,954) |
| Free Cash Flows to Firm (FCF) | 308,250 | (332,139) |

| Liquidity Analysis | 2021 | Q1-2022 | Q2-2022 |
|--------------------|-------------|-------------|-------------|
| Cash | \$2,078,607 | \$2,080,470 | \$1,729,653 |
| Working Capital | \$4,536,851 | \$4,099,272 | \$3,773,961 |
| Current Ratio | 2.06 | 3.13 | 3.01 |
| Debt / Capital | 0.5% | 0.5% | 0.6% |

Source: FRC

Stock Options and Warrants

| | # Options | Strike Price | Value | Warrants | Strike Price | Value |
|--------------------------|------------------|---------------|--------------------|----------------|---------------|------------------|
| | 1,106,000 | 1.02 | \$1,128,120 | 230,000 | 0.98 | \$225,400 |
| | 200,000 | 0.66 | \$132,000 | | | |
| | 506,150 | 0.54 | \$273,321 | | | |
| | 713,000 | 0.54 | \$385,020 | | | |
| | 859,600 | 0.50 | \$429,800 | | | |
| | 2,520,000 | 0.50 | \$1,260,000 | | | |
| | 1,275,000 | 0.50 | \$637,500 | | | |
| | 2,030,400 | 0.45 | \$913,680 | | | |
| Total Outstanding | 9,210,150 | \$0.56 | \$5,159,441 | 230,000 | \$0.98 | \$225,400 |
| In-the-Money | - | - | - | - | - | - |

Source: FRC / Company Filings

Sector Outlook

Global digital ad spending is expected to grow 16% this year vs 30% last year

Long-term outlook remains strong

In 2022, digital ad spending in Western Europe is expected to grow at a faster rate than in the U.S. (17% vs 14%)

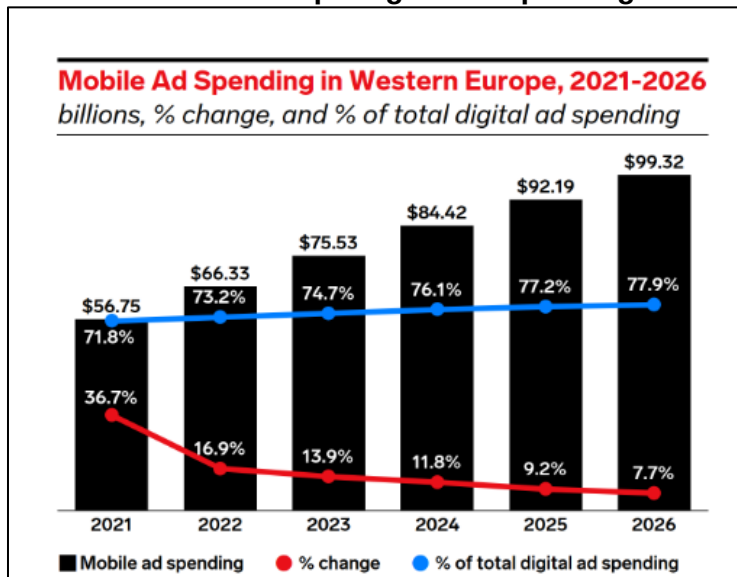
We are not making any material revisions to our EPS forecasts; the impact of our lower revenue forecasts and higher development expenses was offset by lower SG&A expense forecasts

Global Digital Ad Spending



Source: Statista

Western Europe Digital Ad Spending



Source: eMarketer

FRC Projections and Valuation

| | 2022E (Old) | 2022E (New) | 2023E (Old) | 2023E (New) |
|------------|--------------|--------------|--------------|--------------|
| Revenue | \$19,010,057 | \$17,052,500 | \$25,247,880 | \$24,381,000 |
| EBITDA | \$1,278,429 | \$1,234,649 | \$2,563,451 | \$2,494,153 |
| Net Income | \$571,232 | \$534,019 | \$1,663,501 | \$1,604,597 |
| EPS | \$0.00 | \$0.00 | \$0.01 | \$0.01 |

Source: FRC

No material change in our DCF valuation

| DCF Valuation | Q3-Q4 2022E | 2023E | 2024E | 2025E | 2026E | 2027E | Terminal |
|-----------------------------------|---------------|-----------|-----------|-------------|-------------|-------------|-------------|
| Funds Flow from Operations (US\$) | 1,977,174 | 2,210,908 | 4,833,708 | 9,936,309 | 19,630,061 | 29,463,454 | |
| Change in Working Capital (US\$) | (727,482) | (223,777) | (705,582) | (1,305,772) | (1,828,245) | (2,469,769) | |
| Cash from Operations (US\$) | 1,249,692 | 1,987,211 | 3,928,126 | 8,630,537 | 17,801,815 | 26,993,685 | |
| CAPEX (US\$) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | (100,000) | |
| Free Cash Flow (US\$) | 1,149,692 | 1,887,211 | 3,828,126 | 8,530,537 | 17,701,815 | 26,893,685 | |
| Present Value (US\$) | 1,105,429 | 1,612,936 | 2,908,240 | 5,760,603 | 10,625,684 | 14,349,503 | 155,578,823 |
| Discount Rate | 12.5% | | | | | | |
| Terminal Growth | 3% | | | | | | |
| Present Value (US\$) | \$191,941,217 | | | | | | |
| Cash - Debt (US\$) | \$1,683,113 | | | | | | |
| Fair Value (US\$) | \$193,624,330 | | | | | | |
| Shares O/S | 131,581,499 | | | | | | |
| Value per Share (C\$) | \$1.90 | | | | | | |

Source: FRC

We are maintaining our BUY rating, and adjusting our fair value estimate from C\$1.92 to C\$1.90 per share. Although we are expecting a relatively soft Q3, we believe ad spending will rebound in Q4 amid increased consumer spending and confidence. Advertisers that have postponed their marketing initiatives are likely to allocate larger marketing budgets when they resume spending later this year.

Risks

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

- Operates in a highly competitive space.
- Unfavorable changes in regulations
- **Ability to attract publishers and brands will be key to long-term growth.**
- Exchange rate

Maintaining our risk rating of 4

Appendix

| INCOME STATEMENT | | | |
|---------------------------------------|-------------------|-------------------|-------------------|
| (in US\$) - YE Dec 31st | | | |
| | 2021 | 2022E | 2023E |
| Total Revenue | 12,475,480 | 17,052,500 | 24,381,000 |
| Cost of Sales | 7,143,148 | 10,231,500 | 14,628,600 |
| Gross Profit | 5,332,332 | 6,821,000 | 9,752,400 |
| Expenses | | | |
| Selling & Marketing | 641,393 | 801,468 | 975,240 |
| Development | 1,678,848 | 2,324,876 | 2,479,867 |
| Stock Awareness Program | 402,845 | 256,655 | 513,310 |
| Stock Based Compensation | 660,266 | 639,992 | 767,990 |
| Compensation, Salaries & Consultation | 701,964 | 807,259 | 1,614,517 |
| G & A | 604,882 | 756,103 | 907,323 |
| EBITDA | 642,134 | 1,234,649 | 2,494,153 |
| Amortization & Depreciation | 606,391 | 606,391 | 606,391 |
| EBIT | 35,743 | 628,258 | 1,887,762 |
| Interest & Bank Charges | 241 | - | - |
| Exchange Rate and Unusual Items | (9,628) | - | - |
| EBT | 26,356 | 628,258 | 1,887,762 |
| Income Taxes | 216,677 | 94,239 | 283,164 |
| Net Earnings for the period | (190,321) | 534,019 | 1,604,597 |
| EPS | 0.00 | 0.00 | 0.01 |

| BALANCE SHEET | | | |
|---|-------------------|-------------------|-------------------|
| (in US\$)- YE Dec 31st | | | |
| | 2021 | 2022E | 2023E |
| Assets | | | |
| Cash | 2,078,607 | 2,906,752 | 4,793,963 |
| Accounts receivable | 6,627,864 | 7,622,044 | 9,146,452 |
| Prepaid expenses | 105,468 | 126,562 | 151,874 |
| Current Assets | 8,811,939 | 10,655,357 | 14,092,289 |
| Property and equipment | 20,523 | 20,523 | 20,523 |
| Goodwill, intangible assets, and other | 5,093,069 | 4,586,678 | 4,080,287 |
| Total Assets | 13,925,531 | 15,262,558 | 18,193,099 |
| Liabilities & Shareholders' Equity | | | |
| Accounts payables & accrued liabilities | 4,243,020 | 5,303,775 | 6,629,719 |
| Lease | 32,068 | 32,068 | 32,068 |
| Current Liabilities | 4,275,088 | 5,335,843 | 6,661,787 |
| Loans payable | 47,248 | - | - |
| Deferred tax liability | 210,499 | - | - |
| Lease | 41,999 | 41,999 | 41,999 |
| Shareholder's Equity | | | |
| Share Capital | 49,964,919 | 49,964,919 | 49,964,919 |
| Foreign Currency Translation | 24,580 | 24,580 | 24,580 |
| Deficit | (40,638,802) | (40,104,783) | (38,500,185) |
| Total Liabilities & Shareholders' Equity | 13,925,531 | 15,262,558 | 18,193,099 |

STATEMENTS OF CASH FLOWS

(in US\$)- YE Dec 31st

2021

2022E

2023E

Operating Activities

Net earnings for the period (190,321) 534,019 1,604,597

Items not involving cash

Depreciation 606,391 606,391 606,391

Gain on derivative liability (60,207) - -

Deferred income tax expense 210,499 - -

Unrealized foreign exchange loss 134 - -

Stock Based Compensation 660,266 - -

Shares issued for services 179,293 - -

Stock awareness program 83,572 - -

1,489,627 1,140,410 2,210,988

Accounts Receivable (2,694,324) (994,180) (1,524,409)

Prepaid Expenses (15,498) (21,094) (25,312)

Accounts payable and accrued expenses 2,071,728 803,008 1,325,944

Changes in working capital (638,094) (212,265) (223,777)

Cash from (used in) operations 851,533 928,145 1,987,211

Financing activities

Proceeds from secured borrowings, net 200,000 - -

Government Loan (200,000) - -

Payment on operating lease liabilities (29,851) - -

Options / Warrants 31,264 - -

Cash provided by financing activities 1,413 - -

Investing activities

Acquisition of equipment/subsidiary (8,152) (100,000) (100,000)

Long-term cash equivalent 7,768 - -

Cash used in investing activities (384) (100,000) (100,000)

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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