Trickle Research

**Every raging river, every great lake, every
deep blue sea starts … with a trickle**

Research Note

08/28/2017

12 - 24 month Price Target: $7.50

Allocation: 5

Closing Stock Price at Initiation (Close 04/24/17): $1.90

Closing Stock Price @ 08/25/17: $1.37

Social Reality, Inc.

SRAX

(Stock Symbol – Nasdaq: SRAX)
www.srax.com

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This morning, MaxPoint Interactive (Nasdaq: MXPT) announced that they were being acquired *"in a deal valued at $95 million, which takes the company private two years after its public markets debut"*. The announcement notes that the acquirer is Valassis, a subsidiary of Michigan-based Harland Clarke Holdings, and the purchase price will be $13.86 per share in cash. MaxPoint closed on Friday at $5.52 per share, so the transaction represents a 150% premium to the prior close.

We will try to cut to the chase here and not belabor this.

Below is an excerpt from our initial coverage on SRAX, regarding current competitors:

> *SRAX recognizes the following as some of their competitors in one or more portions of their business: Criteo S.A. (Nasdaq: CRTO), MaxPoint Interactive, Inc. (Nasdaq: MXPT), Rocket Fuel Inc. (Nasdaq: FUEL) and Centro (private). If one spends any time checking the products and services of some of SRAX's competitors, there are a handful of issues that will likely become apparent. First, they don't all compete directly with SRAX across all parts of their businesses. That is, some tend to focus on specific parts of the business more than others. For example, MaxPoint and SRAX are both focused more on online to offline opportunities than perhaps on full eCommerce solutions.*

YoY Revenue Growth		2014	2015	2016	* 2017
SRAX		50.0%	** 491.7%	18.1%	32.8%
Criteo		69.5%	32.6%	36.7%	27.8%
Maxpoint		61.5%	39.4%	13.5%	5.1%
Rocketfuel		41.7%	15.9%	-7.5%	-11.0%

*2017 estimates are either from consensus estimates or company guidance. ** Includes 2014 acquisitions.*

Below is an excerpt from our most recent earnings update from a few days ago:

> *Lastly, we need to edify a comment we made on the call that we are not sure was completely digested. We asked about some of the consolidation we have seen in the space, specifically a recent acquisition of publicly traded Rocket Fuel (FUEL). Here is our concern. For those who follow our research in totality, we recently had a public company called ID Watchdog, that was acquired by one of the big three credit reporting bureaus (Equifax) in a cash buyout at $.40 per share. We initiated the coverage at around $.14 about 6 months prior to the buyout, so on the face that seems like a good deal. However, we think Equifax underpaid for the company, even though at the time they offered a 70% premium to the public market price for the stock at the time of the acquisition. The lesson there is that sometimes, small public companies trade at valuations that may not accurately reflect their true value. Sometimes small stocks end up trading well below their value because of adverse events along the way (an underperforming acquisition in SRAX's case), that the street ultimately oversells. By the way, the "overselling" may be a function of frustration by legacy shareholders, a lack of visibility required to attract new shareholders, the ill-effects of poor financing options or some combination of all three.*
>
> *We think these scenarios give potential acquirers opportunities to buy undervalued assets. (That may be especially true when tax nuances like potential carried losses are considered). Succinctly, sometimes these valuation discrepancies get large enough that acquirers can offer substantial premiums to the current market value of the stock and still be paying far less than the fair value of the assets. We belief that happened at ID Watchdog, and we believe it could happen here. Further, from the broader view, **the Rocket Fuel acquisition tells us that the space may be consolidating**. As we noted in prior SRAX research, we believe SRAX MD alone could potentially be sold for considerably more than the current market cap of the stock. We think the 2Q margin expansion (which essentially reflects the favorable*

margins in performing portions of the business like SRAX MD) speaks to that notion. We also think their attempts to add new additional vertical niches in automotive and sports are opportunistic given their demonstrated abilities at adding such verticals (ala SRAX MD). Further, as they addressed on the call, products like SRAX Social are designed to be data accumulators rather than direct revenue generators. Recall, we noted in the initial coverage, that the end game in SRAX might be a valuation determined by the massive amount of consumer data it collects along the way. We still believe in the validity of that concept, and we think that valuation would be considerably more than is currently reflected in the market cap.

The Rocket Fuel acquisition was announced July 18, 2017, which means that over the past 45 days or so, two of the competitors on the list from the initial coverage have been acquired. As an aside, as we also noted in the initial coverage, we think MaxPoint is probably the most relevant comp in terms of business focus (merging digital advertising with brick-and-mortar retail). As we noted a few days ago, and today's news appears to support, **consolidation is an emerging theme in the industry.**

Of course, that statement brings us to the usual place we end up when considering company valuations, which is that if SRAX were to be acquired, what would that valuation be? These transactions may not help answer that question definitively but here are a couple of things to consider. To be sure, both Rocket Fuel and MaxPoint were losing considerable amounts of money. For fiscal 2016, Rocket Fuel reported revenues of $456 million and a loss of $65 million, while MaxPoint generated $149 million in sales and a loss of $18 million for the same period. For 2Q fiscal 2017, those numbers were $91 million/-$18 million and $33 million/-$5 million respectively. Obviously, the buyers were not valuing the transactions on historic EBITDA, although we would assume that their expectations for the integration of the acquired assets into their own likely did. We think it is fair to suggest, especially after SRAX's 2Q margin expansion and near breakeven operating results, SRAX appears to be closer to positive EBITDA than either of these two recently acquired enterprises. Keep in mind, the Company has guided to positive adjusted EBITDA of $2 million to $5 million for the current fiscal year. Again, we are not sure what drove the valuation decisions of the acquirers in these two transactions, but we would add that at least anecdotally, if SRAX were to trade at the same ttm price-to-sales ratio as MaxPoint was acquired at, the number would be around $2.75 per share, and if they were to be valued at the same premium that was just paid for MaxPoint, that price would be $3.75 per share. Again, we think SRAX is much closer to profitable operations than either of these two could reasonably argue, so we also think that suggests a much higher relative valuation.

Just to circle back on an issue we have raised multiple times here, we think SRAX MD alone is worth multiples of the current stock price, and we don't think that is lost on potential acquirers. We believe the Company has attracted suitors of at least pieces of the business in the past, and we think the recent consolidation in the space makes additional inquiries of that nature more likely not less.

We continue to view the stock as significantly undervalued, and we think these recent transactions may support that view. As an extension, we view the industry consolidation as a potential catalyst for the stock, and a catalyst that's likelihood appears to be increasing.

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Rating System Overview

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for our performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that we favor the stock (at respective/current levels) more than a stock with a rating of 1.

As a guideline, here is a suggestion on how to use the allocation system.

Our belief at Trickle is that the best way to participate in the micro-cap/small cap space is by employing a diversified strategy. In simple terms, that means you are generally best off owning a number of issues rather than just two or three. To that point, our goal is to have at least 20 companies under coverage at any point in time, so let's use that as a guideline. Hypothetically, if you think you would like to commit $25,000 to buying micro-cap stocks, that would assume an investment of $1000 per stock (using the diversification approach we just mentioned, and the 20 stock coverage list we suggested and leaving some room to perhaps add another 5 of the names from our profiles). We generally start initial coverage stocks with an allocation of 4. Thus, at $1000 invested per stock and a typical starting allocation of 4, your "investment unit" would be the same $250 we used in the example above.   Thus, if we initiate a stock at a 4, you might consider putting $1000 into the position ($250 * 4). If we later raise the allocation to 6, you might consider adding two additional units or $500 to the position. If we then reduce the allocation from 6 to 4 you might consider selling whatever number of shares you purchased with 2 of the original 4 investment units.   Again, this is just a suggestion as to how you might be able to use the allocation system to manage your portfolio.

For those hung up on the tradition of more typical rating systems (Buy, Sell, Hold) we would submit the following guidelines. A Trickle rating of 1 thru 3 would best correspond to a "Speculative Buy" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.
A Trickle rating of 4 thru 6 might best (although not perfectly) correspond to a standard "Buy" rating.
A Trickle rating of 7 thru 10 would best correspond to a "Strong Buy" however, ratings at the higher end of that range would indicate something that we deem as quite extraordinary..... an "Extreme Buy" if you will. You will not see a lot of these.