Trickle Research

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

Q3F23 Earnings Update & Allocation Upgrade

OneSoft Solutions, Inc.

(OTC: OSSIF, TSX-V: OSS.V)

Report Date: 11/16/23

12- 24 month Price Target: US$.82

Allocation: *5

Closing Stock Price at Initiation (Closing Px: 09/27/22):US$.34

Closing Stock Price at This Target Increase (Closing Px: 08/21/23):US$.62

Closing Stock Price at This Allocation Increase (Closing Px: 11/16/23):US$.52

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Disclosure: Portions of this report are excerpted from OneSoft's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

For Q3F23 One soft reported revenues of CAD$2.77 million and Net Income of CAD$119,000. Those numbers compare to our estimates of CAD$2.55 million and Net Income of <CAD$386,000>. Contrary to our estimates, they achieved profitability, which they noted in their release, is their *"first profitable quarter since fiscal year ended December 31, 2018".* For perspective, that referenced period was more an anomaly than the norm at the time and thereafter. To translate, in our view, this transition to profitability is a marked milestone for the Company. As we have noted is some of our other coverage names, the current environment has proven especially challenging for small unprofitable companies, as access to capital to fund burn is becoming increasingly scarce and considerably more expensive (read: dilutive). We cannot overstate the advantages of being a small emerging company that is not burning cash in this environment. Frankly, since we often cover companies in pre-profitability positions, (which included OneSoft until this quarter), the Company's transition to profitability is refreshing and, in our view, speaks directly to their intrinsic value. We will expand on that thought, but first here is a brief overview of the quarter's other operating results.

Obviously, the revenue bump contributed to the positive earnings surprise, but there were some other notable line items that were perhaps subtle by themselves, but collectively added to the positivity.

For instance, gross margin improved to **76.9% of sales** versus our estimate of 72.1%. We have been consistently understating that number throughout our coverage, so it is becoming increasingly clear that there is more leverage in the gross margin than we have anticipated. We have made some adjustments to our model in that regard. Needless to say, combining higher revenues with better margins is a favorable combination.

Operating expenses totaled $2.02 million versus our estimate of $2.09 million, so those numbers were in line, but given the higher actual revenues versus our forecast, that was also a highly favorable comparison. At the time we cast the prior estimates, we actually thought we might be understating operating expenses a bit given the impact of the development and commercialization of new modules. Management is clearly dialed in here.

Looking ahead, we have a few high-level as well as more granular observations that might be worth considering.

First, we provided a question on the call that we thought they answered constructively. Specifically, we have posed the idea that the Company's CIM platform could become a de facto industry standard as adoption amongst the largest domestic pipeline operators continues to grow. Their answer, unless we are misinterpreting it, seems to be that the IRR analysis (and overall efficiency) of the platform is unmatched by legacy approaches and anything else that seems to be available in the marketplace. As a result, they see "change management" (the reluctance of management to pursue a new approach/technology simply because it requires them to implement and do something different) as their biggest challenge. We think that means, eventually, they will get most of the major operators on board, which, when combined with their applications for smaller operators, should give them access to the vast majority of the total addressable "pigable" domestic pipeline market. In short, we think their continued addition of "reference customers" is making it more difficult for the balance of the industry to *not adopt* CIM. That said, if there are 660,000 miles of pigable pipe, and they charge $136 per mile (from the Q3F23 MD&A) then that suggests the TAM is about $90 million. However, since the pipeline requires re-monitoring only every 5 or 6 years, then presumably that TAM needs to be spread over that same period, for an *annual* TAM of between $15 million and $18 million per year. That brings us to, once they saturate the domestic market with CIM what do they do for an encore?

In part, the answer to that question is that once they become a de factor standard (a position that appears to be improving with each new quarterly report), we think the customer base will be quite sticky (see the "change management" notion we addressed above), which should allow them improved pricing power. We have seen their pricing per mile increase as they have progressed, and their ability to drive that pricing should improve as they continue to consolidate the TAM.

The *other* answer to the aforementioned question is of course, "they upsell new modules (Corrosion, Geohazard, Risk Management) to the existing customer base, as well as to other customers where some modules may also apply to non-pigable pipelines". To be clear, in our view, the preponderant penetration of the domestic TAM with the CIM platform alone supports the current valuation of the shares (and perhaps a bit more), but valuation assessments beyond that, require additional contribution from the modules they have developed (are developing). Succinctly, our model assumes the eventual (36-48 months) product mix between CIM to modules to approximate 50/50. We submit, visibility on the CIM side of that is better today than on the module side, and that includes eventual pricing (which will be quite topical to the analysis). However, we do not see it as a stretch to believe that the upsell of modules to an existing customer base should be easier and faster than the adoption of CIM by large customers has proven to be. If we are wrong about that, our targets may prove aggressive, but that is how we see it.

Lastly, management spent a short time on the call addressing international markets. Whereas prior to the call, we viewed this as a potential and frankly a likely opportunity, we were not including it in our modeling. We still aren't. However, we think international sales are clearly coming if they have not already arrived. Again, that is likely to provide a basis for valuations that we are not currently imputing.

We remain constructive on OneSoft's management and its growing foothold in the space. While the analysis beyond current (higher) pricing requires a sharper pencil than it did at the time of our initiation, we continue to see pathways to valuations closer to our targets, and potentially beyond. We would add their faster-than-anticipated path to profitability, and the variables that go along with that, have in our view de-risked the story from our initiating coverage as well, which also speaks to higher valuations given our basic and fundamental DCF approach to our targets. As a result, we reiterate our 12-24 month price target of US$.82. While we are inclined to raise that, we will look for a few more data points to revisit the inclination. Further, given what we think looks like a shifting of the prevailing winds (from "in their face" to "at their back"), which includes the de-risking notion we just suggested, we are increasing our allocation from 4 to *5. We will reassess these as well as our model assumptions following their year-end release (or other pertinent information preceding that), and we assume that will include (and we are eager to see) new/added guidance for Fiscal 24.

Projected Operating Model

(Reflected in Canadian Dollars)

OneSoft Solutions Inc.						
Projected Operating Model						
(Reflected in Canadian Dollars)						
By: Trickle Research						
	(actual)	(actual)	(actual)	(estimate)	(estimate)	(estimate)
	3/31/2023	6/30/2023	9/30/2023	12/31/2023	Fiscal 2023	Fiscal 2024
Revenue	**$ 2,217,382**	**$ 2,524,250**	**$ 2,770,457**	**$ 3,001,851**	**$ 10,513,940**	**$ 15,435,201**
Direct Costs	$ 649,171	$ 603,102	$ 639,762	$ 710,315	**$ 2,602,350**	**$ 3,423,984**
Gross Profit	**$ 1,568,211**	**$ 1,921,148**	**$ 2,130,695**	**$ 2,291,536**	**$ 7,911,590**	**$ 12,011,217**
Salaries and Employee Benefits	$ 1,431,575	$ 1,449,913	$ 1,506,021	$ 1,550,278	**$ 5,937,787**	**$ 6,715,280**
Sales and Marketing	$ 281,150	$ 354,375	$ 278,671	$ 327,927	**$ 1,242,123**	**$ 1,539,638**
General and Adminsitrative	$ 266,661	$ 331,570	$ 232,703	$ 330,111	**$ 1,161,045**	**$ 1,526,112**
Operating Expenses	$ 1,979,386	$ 2,135,858	$ 2,017,395	$ 2,208,315	**$ 8,340,954**	**$ 9,781,030**
Software Development Costs Capitalized	$ (51,953)	$ (33,281)	$ (77,911)	$ (65,814)	**$ (228,959)**	**$ (288,449)**
Operating Expenses, net of Captialized Costs	**$ 1,927,433**	**$ 2,102,577**	**$ 1,939,484**	**$ 2,142,502**	**$ 8,111,996**	**$ 9,492,581**
Loss Before Other Expenses	**$ (359,222)**	**$ (181,429)**	**$ 191,211**	**$ 149,034**	**$ (200,406)**	**$ 2,518,636**
Stock Based Compensation	$ 178,876	$ 269,616	$ 108,179	$ 100,000	**$ 656,671**	**$ 800,000**
Amortization of Intangibles	$ 119,462	$ 109,220	$ 109,463	$ 110,558	**$ 448,703**	**$ 453,397**
Depreciation of Property and Equipment	$ 7,904	$ 7,628	$ 5,069	$ 4,600	**$ 25,201**	**$ 18,400**
Interest Income	$ (32,641)	$ (31,271)	$ (34,018)	$ (33,673)	**$ (131,603)**	**$ (157,896)**
Foreign Exchange Loss	$ 2,389	$ 34,496	$ (92,325)	$ -	**$ (55,440)**	**$ -**
Other	$ -	$ (37,500)	$ (24,048)	$ -	**$ (61,548)**	**$ -**
Total Other Expenses	**$ 275,990**	**$ 352,189**	**$ 72,320**	**$ 181,485**	**$ 881,984**	**$ 1,113,901**
Gain (Loss) Before Income Tax	**$ (635,212)**	**$ (533,618)**	**$ 118,891**	**$ (32,451)**	**$ (1,082,390)**	**$ 1,404,734**
Income Tax						
Net Gain (Loss)	**$ (635,212)**	**$ (533,618)**	**$ 118,891**	**$ (32,451)**	**$ (1,082,390)**	**$ 1,404,734**
Other Comprehensive Gain (Loss)	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Net Gain/(Loss) per share -Basic	**$ (0.01)**	**$ (0.00)**	**$ 0.00**	**$ (0.00)**	**$ (0.01)**	**$ 0.01**
Net Gain/(Loss) per share - Diluted	**$ (0.01)**	**$ (0.00)**	**$ 0.00**	**$ (0.00)**	**$ (0.01)**	**$ 0.01**
Basic Shares Outstanding	**120,836,714**	**121,058,918**	**121,599,861**	**121,724,861**	**121,305,088**	**122,349,861**
Diluted Shares Outstanding	**122,133,729**	**121,058,918**	**123,037,389**	**123,793,267**	**122,505,826**	**125,787,378**

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Portions of this publication excerpted from company filings or other sources are noted in italics and referenced throughout the report.

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 my performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that I 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 add to positions around allocation upgrades. 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 attached to more traditional 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.