

Banxa Holdings Inc.

(TSXV: BNXA, OTCQX: BNXAF, FSE: AC00)

BUY

Current Price: C\$5.88

Fair Value: C\$15.58

Risk*: 4

Well Positioned to Capitalize on the Rising Investor Appetite for Cryptos – Initiating

Sector/Industry: Cryptocurrency

[Click here for more research on the company and to share your views](#)

Highlights

- Australia based Banxa is a **Payment Service Provider/PSP company**, that allows users to convert fiat-to-crypto and vice versa.
- The company is the **first and only PSP to go public to date. Shares are up 60% since our introductory note on January 7, 2021.**
- Banxa serves both B2B and B2C markets, with its flagship B2B solutions reaching 30M+ customers across 130+ countries through multiple partners. **Partners include top cryptocurrency exchanges such as Binance, Huobi, and OKEx.**
- **Banxa's Total Transaction Value (TTV) in H1-FY2021 (ended December 31, 2020) was \$195M, up 780% YoY. TTV in the first two months of Q3 was \$125M, surpassing full Q2-FY2021's \$111M. Q2 revenue was A\$4.5M, up 228% YoY.**
- **Bitcoin prices hit record highs this year.** The total MCAP of cryptos still accounts for less than 1% of fiat. The recent increase in investor appetite for cryptos has resulted in a significant increase in trading volume. For example, Binance's trading volume on March 11, 2021, was US\$25B vs US\$6B on January 1, 2021.
- We believe the popularity of cryptos is driven by their fast execution of transactions, the ability to bypass conventional intermediary fees, and in some cases, its use as a potential hedge against inflation (i.e. Bitcoin's limited supply). Although the sector is highly competitive, we believe **Banxa's affiliation with the top crypto exchanges, along with its early mover advantage, sets the company up for growth going forward.**

Risks

- The cryptocurrency market is subject to regulatory scrutiny and intervention.
- **The company operates in a highly competitive landscape.**
- Risk of technology failure.
- **Cybersecurity risk.**
- Crypto prices have been highly volatile.

Sid Rajeev, B.Tech, CFA, MBA
Head of Research

Iftexhar Mahmud, MBA, MSc
Analyst

BNXA Price and Volume (YTD)



	YTD	12M
BNXA	156%	N/A
TSXV	11%	179%

Company Data

52-Week Range	C\$1.58 - C\$6.88
Shares O/S	40,710,704
Market Cap.	C\$239M
Current Yield	N/A
P/E (forward)	N/A
P/B	33.74

Key Financial Data (FYE - June 30)	H1-2021	2021E	2022E	2023E
A\$				
Cash	\$ 3,302,948	\$ 2,358,250	\$ 6,242,550	\$ 26,534,122
Working Capital	\$ 7,234,122	\$ 5,855,629	\$ 13,789,032	\$ 33,199,108
Total Assets	\$ 14,819,138	\$ 14,833,802	\$ 25,097,907	\$ 50,546,106
Total Debt	\$ 3,525,379	\$ 3,525,379	\$ 1,525,379	\$ 1,525,379
Revenue	\$ 7,399,281	\$ 23,442,741	\$ 54,870,436	\$ 104,178,516
Net Income	\$ (908,045)	\$ (1,662,766)	\$ 7,399,113	\$ 18,379,147
EPS (basic)	\$ (0.03)	\$ (0.04)	\$ 0.18	\$ 0.45

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

Company Overview

Banxa went public in the first week of January 2021, making it the first publicly traded PSP in the digital assets industry.

The first payment gateway company in the Digital Assets industry to go public

Banxa has operated fiat gateway payment channels since 2014. In 2018, it launched its B2B product, and to date, has onboarded over 30 clients with over 30M customers. The company currently has over 50 employees, with operations in Australia (primary source of revenue), Europe, and North America.

Banxa provides an internationally compliant solution enabling customers to engage in fiat-to-crypto as well as crypto-to-fiat transactions. The company targets both consumers and businesses in over 130 countries. **It is a gateway partner for top cryptocurrency exchanges like Binance, Huobi and OKEx.** Banxa's solution allows exchanges to offer conversion options to their customers.

Provider of both fiat-to-crypto and crypto-to-fiat transaction solutions

Conduit Between Crypto and Fiat



Source: Company Filings

Value Proposition

Banxa is focused on building **an internationally compliant fiat-to-crypto payment infrastructure for exchanges, wallets, and other businesses in the space.** It attempts to address the following issues in the digital assets sector:

Focused on building an internationally compliant payment infrastructure that addresses the current challenges of the Digital Assets Industry

Digital Assets Sector Challenges	Banxa Solution
<ul style="list-style-type: none"> Regulatory complexity, along with continually changing regulatory landscape in digital assets Fragmented payment structure Inefficiencies in running and managing multiple fiat-to-crypto networks and banking channels Liquidity challenges in digital currencies Fraud and other compliance related challenges 	<ul style="list-style-type: none"> Local and global payment options Single interface for exchanges, wallets, and other cryptocurrency businesses Compliant in markets it operates Full Anti-Money-Laundering (AML) and Know-Your-Customer (KYC) compliant infrastructure Fast processing times

Source: Company Filings, FRC

Revenue Model

Banxa generates revenue by charging a 0.5-5% commission on transaction value, which is inline with other operators. According to the company, TTV in H1-FY2021 (ended December 31, 2020) was \$195M, up 780% YoY. TTV in the first two months of Q3 was \$125M, surpassing full Q2-FY2021's \$111M.

Commission of up to 5%, in line with peers

Earns an additional 0-3% spread on customized solutions for B2B customers

Surge in transactions due to the recent investor appetite for digital assets

Serves both B2B and B2C markets

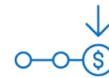
Banxa's Current and Planned Revenue Drivers



Currently

0-5% commission on order value

0-3% on spread depending on the supplier and partner



Future

Offering financial services (subject to financial services licenses etc)

- borrowing and lending
- interest bearing accounts
- trading fees
- other products typically seen at other financial institutions
- advertising revenue

Banxa's Processed Transaction Volume (\$A, MM)



Source: Company

Technology and Adoption

Business-to-Business

The company provides a plug-and-play Application Programming Interface (API), allowing its partners to offer end-to-end services (such as trade, borrow, lend, etc.) to their customers.

How Banxa Works on a B2B Platform



Step 1

Visit Partner Platform



Step 2

Select "Buy Crypto via Banxa"



Step 3

Choose one of Banxa's 12 global and local payment methods



Step 4

Make payment



Step 5

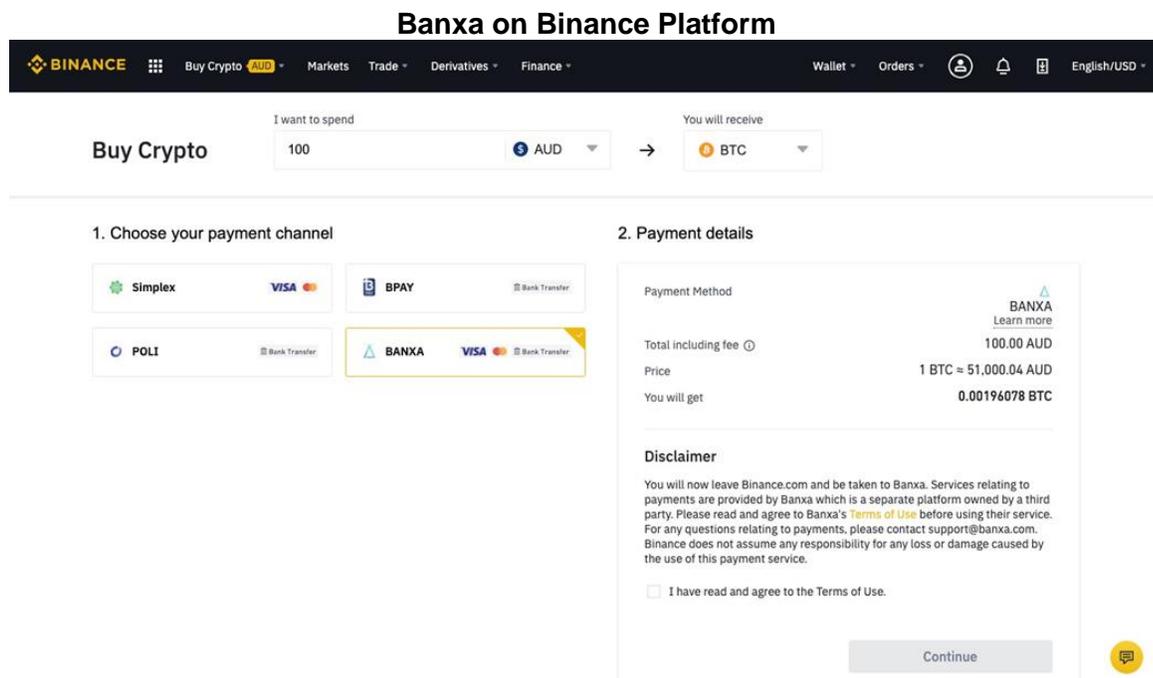
Crypto is sent straight into the users exchange/wallet account - no deposit address needs to be added, this is provided via API

Source: Company

Highly competitive space

Banxa’s fee structure is similar to other operators. In addition to Banxa, there are several alternative payment gateway providers, and the sector is highly competitive. Companies such as Moonpay (250+ partners and 80+ cryptocurrencies) and Simplex (350+ partners and 50+ cryptocurrencies) are direct competitors. **We believe Banxa has a competitive advantage as it allows local payment options in each market it operates in** (such as POLi in Australia, SEPA in Europe, Interac in Canada) – **providing local and easier conversion options for customers.**

Provides a wide range of payment options



Source: Company

Banxa’s payment service can be accessed through banxa.com, B2B customers (exchanges), and/or company-owned domain names. Per management, the company has compliance procedures in place to ensure that every transaction is verified, and in compliance with local regulations. Banxa also works with multiple security providers to ensure safety to its clients. One such provider is Chainalysis – a U.S. based blockchain analysis company that provides investigation, compliance, and risk management services in 50 countries.

Simplifying process for partner companies, while ensuring compliance and verifications



Source: Company

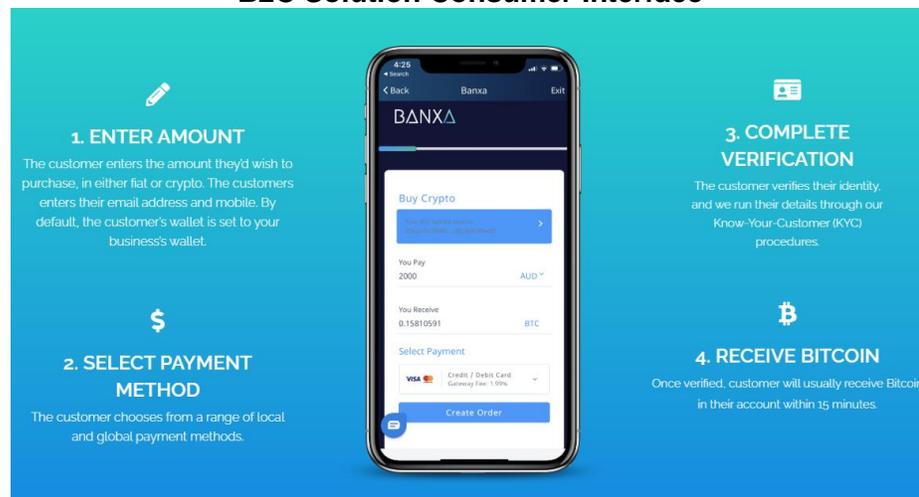
Management has indicated that they have a strong pipeline of new customers awaiting to be onboarded. Going forward, Banxa plans to become a fintech platform offering its own financial services, such as borrowing, lending, interest bearing accounts, and trading, subject to receipt of licenses.

Business-to-Consumer

Banxa owns a range of domains in various countries to enable retail customers to convert fiat to digital currencies.



B2C Solution Consumer Interface



Source: Company

We found that Banxa's service has high ratings on Trustpilot – 4.3 / 5 based on 6,124 reviews. The vast majority of reviews cited a very efficient and trustworthy process.



Banxa.com

Reviews 6,124 • Excellent



Source: Trustpilot

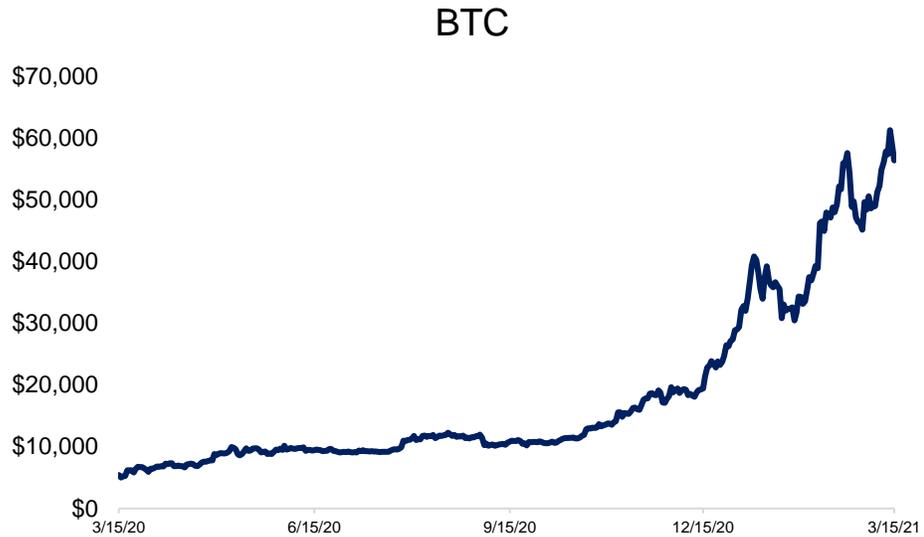
Designed to allow retail customers to convert fiat-to-crypto with ease

High ratings by users, noting efficiency and trustworthiness

Market Overview

Bitcoin prices hit record highs this year, and have brought significant investor attention to digital assets. **Bitcoin is currently trading at US\$56k, an increase of 945% YoY.**

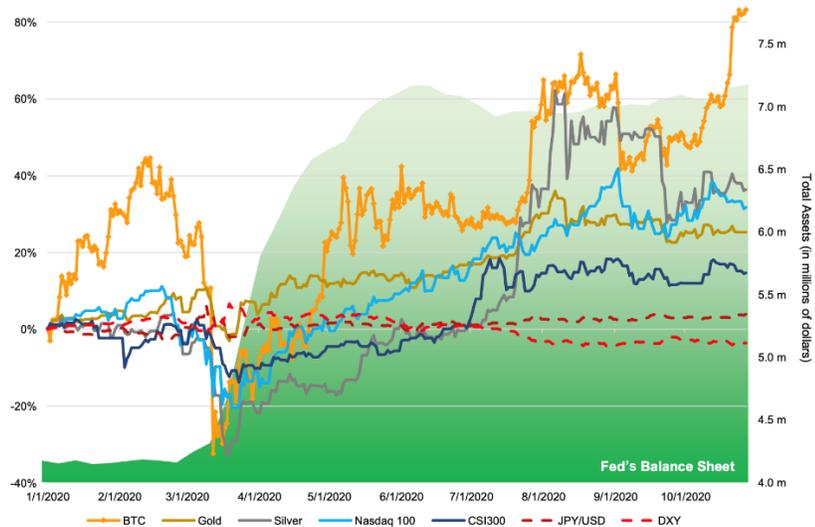
Bitcoin prices at record highs



Source: Yahoo! Finance, FRC

Bitcoin outperformed other major asset classes and indices in 2020.

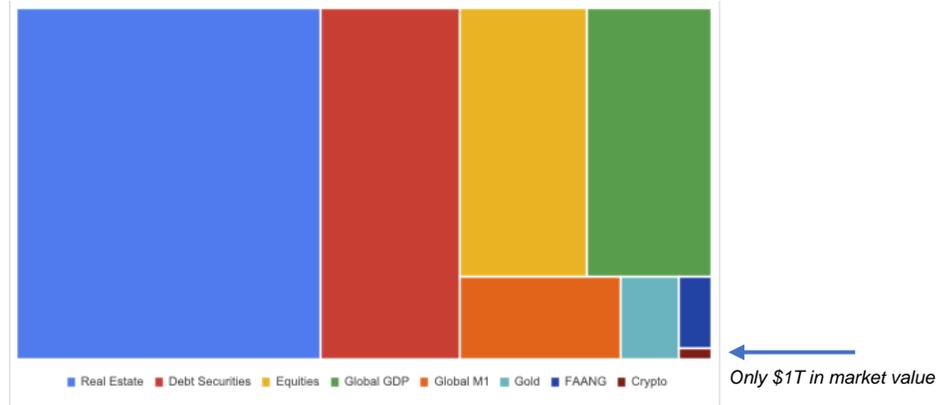
Bitcoin outperformed major indices in 2020



Source: Coinmarketcap.com

According to Coinmarketmap, the total market capitalization of cryptocurrencies is currently US\$1.55T; this is less than 1% of the global fiat market.

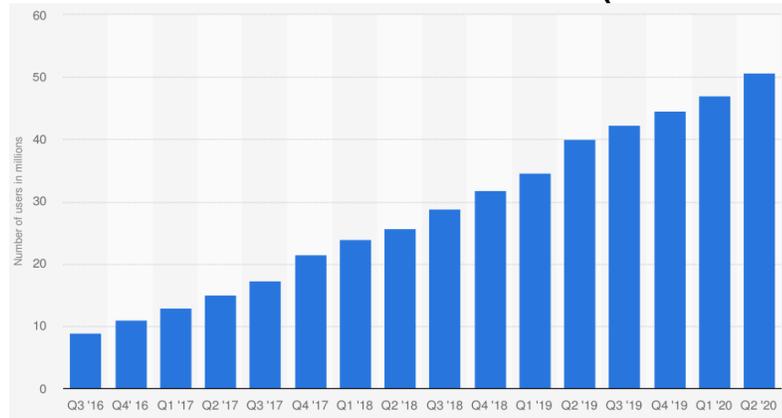
Despite the huge growth, cryptos are still a very small percentage of global assets



Source: Blockworks.co

The number of blockchain wallet users has grown from under 10M in Q3-2016, to over 63M by Q4-2020, reflecting the sector's rapid growth.

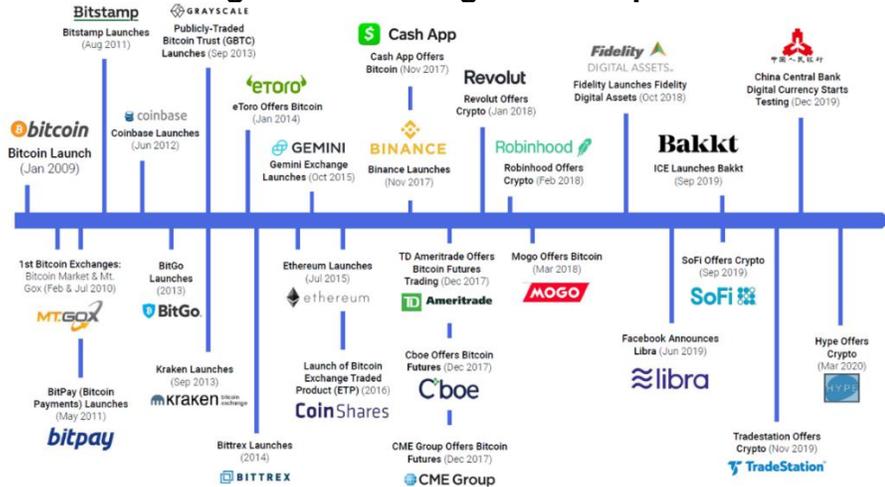
Number of Blockchain Wallet Users Worldwide (Q3-2016 to Q2-2020)



Source: Statista

Wallet users growing

Big Names Moving into the Space



Source: Zebo.com

In 2021, Mastercard (NYSE: MA), Bank of New York Mellon (NYSE: BK), JPMorgan (NYSE: JPM) and Morgan Stanley (NYSE: MS) stated their intention to get into crypto offerings

We note that the top three exchanges, in terms of single-day spot trading volume, account for 81% of trading value (US\$49B), and all three are partners of Banxa: Binance (US\$33.6B, 55.4%), Huobi (US\$8.9B, 14.6%), and OKEx (US\$6.6B, 10.8%).

Crypto-Exchanges by Single Day Spot Trading Volume (March 15, 2021)



Source: TokenInsight

Banxa onboarded the biggest three exchanges that account for 81% of spot trading volume

We believe the popularity of cryptocurrency stems from two key factors, the fast execution of international transactions, and ability to bypass certain fees associated with the conventional banking system. In addition, certain cryptos (such as bitcoin) have limited supply, and have the potential to be a hedge against inflation. This feature is prompting investors to move a percentage of their capital from gold (a traditional inflation hedge and safe haven asset) to bitcoin. We expect the above features to drive demand and crypto usage.

Demand drivers of cryptos

Management and Board

The company’s board and management hold 21% of the outstanding shares.

Name	Position(s)	# Shares Outstanding	% of Total
Domenic Carosa	Chairman	6,232,468	15.31%
Holger Arians	CEO	869,000	2.13%
Doron Joseph Cohen	Director	407,142	1.00%
Shyamal Rishikant Deo	Senior Officer	14,400	0.04%
Konstantin Lichtenwald	Senior Officer	733,328	1.80%
Matthew Lucas Cain	Director	-	0.00%
Iain Forbes Clark	Senior Officer	-	0.00%
Joshua Adam D'AMBROSIO	Senior Officer	-	0.00%
Jan-Moritz Hartmann	Senior Officer	-	0.00%
Joshua Landau	Director	-	0.00%
Bill Kyriacou	Director	290,246	0.71%
Wayne Scott Miller	Director	21,428	0.05%
Daniel Kajouii	Director	21,428	0.05%
Michael Jason Mire	Director	21,428	0.05%
Noah Herscovici	Director	21,428	0.05%
Total Insider Holding		8,632,296	21.20%
Total Shares Outstanding		40,710,704	100.00%

Source: Company Filings

Brief biographies of the senior management and board members, as provided by the company, follow:

Domenic Carosa – Founder , Chairman

Domenic is a tech pioneer, having founded or invested in over 50 technology companies over the last 25 years, both private and public. Domenic holds a Masters of Entrepreneurship & Innovation (MEI) from Swinburne University Australia.

Holger Arians – CEO

Holger has previously built and run several startups. Prior to BANXA, Holger oversaw and worked closely with a portfolio of 30 early stage technology companies as CEO of Dominet Venture Partners. Holger holds an Executive MBA from Mannheim and Essec Business Schools and is an Alumni of Harvard Business School.

John D’Ambrosio – General Manager

Josh is an experienced risk and compliance executive serving in Ernst & Young’s IT Risk Advisory team for 5 years prior to joining BANXA in July 2017. Prior to these roles, Josh founded and scaled a social sports company to become the Australian market leader in its industry.

Iain Clark - CTO

Iain was previously the CTO of public listed company Crowd Media for 7 years. Before that he was a Vice President at Goldman Sachs in London. He is focused on technical excellence, platform security and executing the companies strategic vision.

Financials

Financial Year End June 30, A\$	Q1-FY2020	Q1-FY2021	YoY%	Q2-FY2020	Q2-FY2021	YoY%
Total Revenues per Financial Statements	\$1,937,057	\$2,902,901	50%	\$1,371,529	\$4,496,380	228%
Buy transactions	\$7,874,490	\$79,765,327	913%	N/A	N/A	
Sell transactions	\$1,440,251	\$1,236,037	-14%	N/A	N/A	
Total Transaction Volume	\$9,314,741	\$81,001,364	770%	\$14,200,000	\$111,000,000	682%
Gross Profit	\$204,676	\$611,038	199%	\$506,295	\$869,799	72%
Gross Margin	10.57%	21.05%		36.91%	19.34%	
Gross Profit / Total Transaction Volume	2.20%	0.75%		N/A	0.78%	

Source: Company Filings, FRC

FYE - June 30, A\$	Q2-2020	Q2-2021	6M-2020	6M-2021
Revenue	1,371,529	4,496,380	3,308,586	7,399,281
Direct Costs	865,234	3,626,581	2,597,618	5,243,315
EBITDA (Adjusted)*	(540,483)	(1,160,341)	(1,225,371)	(1,325,595)
Net Loss	(1,285,910)	(457,818)	(1,895,319)	(951,914)
EPS	(0.04)	(0.01)	(0.07)	(0.03)

*Adjusted for Share Based Compensation

\$4.5M in revenue in Q2, up 228% YoY

Despite strong revenue, EBITDA declined because of higher SG&A

Strong balance sheet

As at December 31, 2020, A\$	Q1-FY2021	Q2-FY2021
Cash	\$3,108,283	\$3,302,948
Working Capital	\$894,754	\$7,234,122
L/T Debt	\$446,599	\$446,599
Total Assets	\$6,458,739	\$14,819,138

Source: Company Filings, FRC

Stock Options and Warrants

At the end of Q2-FY2021, the company had 3.75M options at a weighted average exercise price of \$0.98, and 0.61M warrants at an exercise price of \$1.00, outstanding. All the options and warrants are in-the-money. The company can raise up to C\$4.16M if all in-the-money instruments are exercised.

FRC Projections

Assumptions:

1. The crypto market is projected to grow by 32% p.a. from 2020 to 2025, per Verified Market Research.
2. We are estimating Banxa's share to reach 0.025% of total trading volume by 2025, up from the current 0.005%.
3. Flat fee structure of 2.50%.

The following table shows our projected revenue for Banxa:

Banxa's Financial Year	2021E	2022E	2023E	2024E	2025E
Total Trading Volume	\$20,410,380,000,000	\$27,013,137,930,000	\$35,751,888,050,355	\$47,317,623,834,645	\$62,624,875,145,153
TTV of Banxa	\$937,709,623	\$2,194,817,457	\$4,167,140,638	\$7,185,864,331	\$15,656,218,786
		134%	90%	72%	118%
Assumed % of Total Volume	0.0046%	0.0081%	0.0117%	0.0152%	0.0250%
Banxa Fee	2.50%	2.50%	2.50%	2.50%	2.50%
Banxa Revenue	\$23,442,741	\$54,870,436	\$104,178,516	\$179,646,608	\$391,405,470
Banxa COGS	\$17,582,055	\$38,409,305	\$67,716,035	\$98,805,635	\$195,702,735
Banxa Gross Profit	\$5,860,685	\$16,461,131	\$36,462,481	\$80,840,974	\$195,702,735

Source: FRC

Valuation

Based on the above projections, we arrived at a fair value estimate of C\$15.58, based on our Discounted Cash Flow and comparables valuation models.

Fair value estimate of C\$15.58

DCF Model	2021E	2022E	2024E	2025E	Terminal
EBIT(1-tax)	(2,015,429)	7,580,816	68,963,259	180,699,307	
Non-Cash Expenses	334,273	584,289	1,839,524	3,961,418	
Change in Working Capital	433,794	(2,049,102)	(5,674,462)	(14,301,234)	
Cash from Operations	(1,247,361)	6,116,004	65,128,321	170,359,491	
CAPEX	(50,000)	(50,000)	(50,000)	(50,000)	
Free Cash Flow	(1,297,361)	6,066,004	65,078,321	170,309,491	
Present Value	(1,209,796)	4,918,763	39,901,930	90,802,660	415,541,370
Discount Rate	15.0%				
Terminal Growth	3%				
Present Value	569,816,644				
Cash - Debt	3,777,569				
Fair Value	573,594,213				
Shares O/S	44,343,069				
DCF Value per Share (C\$)	\$12.55				
Peer Group EV/R Multiple (median)	36.1x				
EV/R Implied Value per Share (C\$)	\$18.61				
AUD to CAD conversion rate used	0.97				
Fair Value Estimate (C\$)	\$15.58				

Source: FRC

The following table illustrates our model's sensitivity to key assumptions:

		Discount Rate				
		30%	25%	15%	12%	10%
Market Share (2025E)	0.005%	\$9.25	\$9.30	\$9.68	\$10.06	\$10.53
	0.020%	\$10.61	\$11.13	\$14.10	\$16.69	\$19.87
	0.025%	\$11.06	\$11.74	\$15.58	\$18.91	\$22.98
	0.050%	\$13.33	\$14.78	\$22.95	\$29.97	\$38.54
	0.075%	\$15.59	\$17.82	\$30.32	\$41.03	\$54.10

Source: FRC

The following table shows Enterprise Value to Revenue (EV/R) of a few Canadian listed crypto companies. We note that none of the companies are directly comparable to Banxa.

Company	Ticker	Focus	Market Cap (C\$)	EV (C\$)	Revenue (C\$)	EV/R
Galaxy Digital Holdings Ltd.	TSX: GLXY	Digital Assets	\$1,650M	\$1,180M	No Revenue	N/A
Netcents Technology Inc.	CSE: NC	Payment Gateway	\$76M	\$76M	NM	N/A
Voyager Digital Canada	CSE: VYGR	Digital Assets	\$2,730M	\$2,280M	\$4.38M	520.5x
HIVE Blockchain Technologies Ltd.	TSXV: HIVE	Digital Assets	\$1,690M	\$1,840M	\$38.53M	47.8x
Blockchain Foundry Inc.	CSE: BCFN	Blockchain Solutions	\$30.48M	\$31.36M	\$1.28M	24.5x
Banxa Holdings Inc*	TSXV: BNXA	Payment Gateway	\$239.38M	\$239.16M	\$22.74M	10.5x

*2021 Estimate

Mean	\$1,069.31M	\$941.09M	\$16.73M	150.8x
Median	\$944.69M	\$709.58M	\$13.56M	36.1x

Source: Company Filings, Yahoo! Finance, FRC

We believe Banxa is well positioned to capture the rising popularity of crypto investments. Although the sector is highly competitive, Banxa's affiliation with the top crypto exchanges, and early mover advantage, will play a key role in its growth going forward. **We are initiating coverage with a BUY rating, and a fair value estimate to C\$15.58.**

Banxa's forward EV/R is 10.5x vs the comparables' median of 36x

Risk rating of 4

Risks

We believe the company is exposed to the following risks (list is non-exhaustive):

- The cryptocurrency market is subject to governmental scrutiny and intervention.
- The company operates in a highly competitive landscape.
- Risk of technology failure.
- Cybersecurity risk.
- Prices of cryptos have been highly volatile.

We are assigning a risk rating of 4.

Appendix

STATEMENTS OF OPERATIONS (\$) YE June 30	H1-2021	2021E	2022E
Revenue	7,399,281	23,442,741	54,870,436
Total Revenues	7,399,281	23,442,741	54,870,436
COGS	5,243,315	17,582,055	38,409,305
Gross Profit	2,155,966	5,860,685	16,461,131
SG&A	3,481,561	7,541,841	8,296,025
Share-based compensation	100,641	301,923	548,704
EBITDA	(1,426,236)	(1,983,079)	7,616,401
D&A	16,175	32,350	35,585
EBIT	(1,442,411)	(2,015,429)	7,580,816
Net financing expense	181,703	363,406	181,703
EBT	(1,624,114)	(2,378,835)	7,399,113
Income tax expense			
Unusual/Non-recurring expense	(716,069)	(716,069)	
Net Income (Net Loss)	(908,045)	(1,662,766)	7,399,113
FX Translation	43,869	43,869	
Comprehensive Income (Comprehensive Loss)	(951,914)	(1,706,635)	7,399,113
EPS	(0.03)	(0.04)	0.18
Shares	33,740,842	40,710,704	40,710,704

BALANCE SHEET (\$)			
YE June 30	Q2-2020	2021E	2022E
Assets			
Cash	3,302,948	2,358,250	6,242,550
Receivables	4,063,296	4,688,548	10,974,087
Inventories	5,586,851	5,586,851	5,586,851
Prepays and other current assets	152,394	468,855	548,704
Deposits	1,558,157	1,558,157	1,558,157
Current Assets	14,663,646	14,660,660	24,910,350
PP&E and ROU assets	3,849	21,499	35,914
Intangible assets - goodwill	151,643	151,643	151,643
Total Assets	14,819,138	14,833,802	25,097,907
Liabilities & Shareholders' Equity			
Payables and accrued liabilities	3,649,272	5,024,779	9,341,066
Income tax	145,754	145,754	145,754
Employee benefits	156,093	156,093	156,093
Deferred consideration	399,625	399,625	399,625
Current portion of borrowings	3,078,780	3,078,780	1,078,780
Current Liabilities	7,429,524	8,805,031	11,121,318
Employee benefits	28,304	28,304	28,304
Borrowings	446,599	446,599	446,599
Total Liabilities	7,904,427	9,279,934	11,596,221
Equity	12,903,445	13,205,368	13,754,072
Reserves, Deficit and AOCI	(5,988,734)	(7,651,500)	(252,386)
Total Liabilities and Shareholder's Equity	14,819,138	14,833,802	25,097,907

STATEMENTS OF CASH FLOWS (\$)	H1-2021	2021E	2022E
YE June 30			
Operating Activities			
Net loss for the period	(908,045)	(1,662,766)	7,399,113
Items not involving cash			
D&A		32,350	35,585
Accrued interest			
Share-based compensation		301,923	548,704
FFO	(908,045)	(1,328,493)	7,983,403
Prepaid expense		(316,461)	(79,850)
Receivables		(625,252)	(6,285,539)
Inventory		-	-
Deposits		-	-
Accounts payable and accrued liabilities		1,375,507	4,316,287
Changes in WC	-	433,794	(2,049,102)
Cash from (used in) Operations	(5,043,125)	(894,698)	5,934,301
Financing activities			
Equity	3,769,452	3,769,452	
Debt	1,974,836	1,974,836	(2,000,000)
Related party loans	520,000	520,000	
Cash provided by Financing Activities	6,264,288	6,264,288	(2,000,000)
Investing activities			
PP&E	(14,312)	(50,000)	(50,000)
Payment for Intangible Assets			-
Acquisition related payments	28,793		
Cash used in Investing Activities	14,481	(50,000)	(50,000)
Increase (decrease) in Cash	1,235,644	5,319,590	3,884,301
FOREX			
Cash beginning of Period	2,067,304	3,302,948	2,358,250
Cash end of Period	3,302,948	2,358,250	6,242,550

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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