ESPACE MicroCaps

# FY 2015 and Q1 2016 Earnings Update – MAY 18, 2016

# Ackroo Inc. (AKR – TSX-V, $0.215)

| Ackroo Inc. | AKR - TSX-V |
|---|---|
| *(Currency is in CAD unless noted otherwise)* | |
| Last Price ($) | $0.215 |
| **12 Month Target Price ($)** | **$0.51** |
| **Return to target** | **137%** |
| 52-week high / low ($) | $0.55 / $0.08 |
| Average Daily Volume (90-Day) | 26,730 |
| **Market Info** | |
| Shares Outstanding (M) | 17.9 |
| Warrants (M) | 0.3 |
| Options (M) | 1.4 |
| Fully Diluted Shares Out (M) | 19.6 |
| Market Capitalization ($M) | $3.85 |
| Enterprise Value ($M) | $5.18 |
| **Most Recent Quarter** | **Q1 2016** |
| Revenue ($M) | 0.60 |
| Gross Margin (%) | 67% |
| EBITDAS ($M) | ($0.21) |
| Working Capital ($M) | ($1.13) |
| Total Debt ($M) | $1.33 |
| **Valuation** | |
| FY2015 EV/Revenue | 2,84 |
| Annualized Last 2 Quarters EV/Revenue | 2,25 |

| FYE: Dec 31 | FY 2015 | FY 2016E | FY 2017E | FY 2018E |
|---|---|---|---|---|
| Revenue ($M) | $1.82 | $3.30 | $4.96 | $7.95 |
| Gross Margin | 66% | 65% | 65% | 65% |
| EBITDAS ($M) | ($0.76) | ($0.08) | $0.52 | $1.68 |


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**- On April 26, 2016, Ackroo released its 2015 audited financial statements. Ackroo slightly beat our expectations on revenue and gross profits, but missed on EBITDAS by a little more than 3%.**

**- On May 5, 2016, Ackroo reported its Q1 2016 results, the best quarter in the company's history.**

**- On May 11, 2016, Ackroo made a final amendment to the payment terms for Dealer Rewards Canada acquisition: i) $330K by July 1, 2016, and ii) 24 monthly payments of 36,916$ beginning in January 2017.**

**- The private placement at 0.20$ announced on March 18, 2016, will close by the end of May. The debt restructuring has reduced the company's capital requirements and hence, CEO Steve Levely expects to raise a lesser amount than the previously stated goal of $2M.**

**- Our investment thesis and 3-year financial model remain unchanged with a price target of 0.51$, a 137% return potential from current share price.**

## Q4 and Annual 2015 Financial Summary

**On April 26, 2016, Ackroo released its 2015 audited financial statements, which showed continued improvement in all operational aspects of the business.**

- Total revenue for the year was up 37% to $1.822M from $1.328M in 2014.
- Subscription and service revenue increased 52% to $1.498M from $987K last year.
- EBITDAS, excluding foreign exchange gains and losses and a $100K provision for potential previous years SRED reversal, were reduced by 53% to ($757K).
- Ackroo slightly beat our expectations on revenue and gross profits, but missed on EBITDAS by a little more than 3%.
- Q4 2015 was a record quarter for Ackroo with sales of $601,758. The timing of certain yearly expenses, for instance $80K audit costs, and R&D tax credits explain why EBITDAS, which came in at ($207K), was higher than Q3 2015.

**The provision for potential previous years SRED reversal is a non-cash expense related to Scientific Research and Experimental Development tax credits received by Ackroo in 2013 and 2014 under previous management team.** The CRA is auditing their claims and therefore, Ackroo's auditors, Welch LLP, forced them to take a $100K provision. This is a conservative approach as no cash outlay is expected for now.

Compensation to key management personnel reached $414K in 2015, a 45% increase over 2014, which convinced us to ask more questions about management remuneration. Our findings reassured us. Compensation increased in 2015 for 2 reasons: a) Helena Mancini was announced as an executive in 2015, whereas she was not an executive in previous years, and b) Dan Liu worked fulltime as CFO in 2015 while John Chapman, previous CFO and now director, only served part-time in 2014.

We expect executive compensation to decrease in 2016 since both Helena Mancini and Dan Liu left the company and haven't been replaced yet. The $35,000 termination benefits (3 months' salary) in Q3 2015 were related to Helena's departure. On the other hand, salary of CEO Steve Levely has remained flat the last 2 years at $160,000 annually. All company executives and directors receive a base salary and are eligible to bonuses based on performance criteria like total revenue, monthly recurring revenue growth, margin attainment, etc.

**We believe management is well aligned with shareholders through performance based compensations, insider ownership of shares and out-of-the-money options.**

## Q1 2016 Financial Summary

**On May 5, 2016, Ackroo reported its Q1 2016 results, the best quarter in the company's history on an EBITDAS basis** (if we exclude grants and tax credits, whose timing can vary)**.**

- Total revenue was up 42% year-over-year to $548K from $385K in 2015.
- Subscription and service revenue increased 142% to $518K from $214K last year.
- Product sales decreased to $30K from $171K in Q1 2015. Ackroo had a large $100K order from Landmark Theatres when they went live in the Blackhawk Network last year. It was a two-year card inventory order so we should expect a similar re-order in Q1 of next year.
- EBITDAS, excluding foreign exchange gains and losses, reduced 57% to ($88K). Note that Ackroo expensed $26K in IR-related activities in the first quarter. We don't expect the company to sustain such level of IR expenses in the future.

**Ackroo made two acquisitions during the quarter: OnTab and D1Mobile. The latter should contribute positively to revenue and gross profits beginning in Q2 2016.** Since our initial report, additional details have been disclosed regarding the D1Mobile acquisition.

*Royalty Bonus:* The seller can earn 40% in cash performance bonus on annual recurring revenue exceeding $50,000, plus any amount paid for consulting services from 4 strategic clients over a period of two years. One of them is a very large account that D1Mobile provided mobile consulting services to, but they did not have on their Appetite platform.

*Additional Bonus:* Freshii and Yogen Fruz were on old and independent platforms of D1Mobile that now belong to Ackroo. An additional bonus was put in place in case Ackroo decides to sell these platforms to these two customers within the first 60 days. Management has assured us it won't happen.

**In Q1 2016, the company completed the bulk of the migration of their old DealerCard platform to the Ackroo Anywhere (AKR3) platform. The DealerCard platform migration is a critical advancement for the company as it shows their ability to acquire technologies and integrate them into their operations.** They can now focus on migrating Dealer Rewards Canada (DRC) customers to AKR3 in order to remove the 40% licensing fee they have to pay on monthly recurring revenue to use the vendor's platform. We are talking about a $290,000 annual opportunity at current DRC revenue run-rate.

**Finally, we would like to outline this excerpt from Q1 2016 MD&A:** *"Organically the Company grew both the Ackroo Anywhere business both by increasing the number of merchants supported as well as the revenue per location received. With the introduction of more Marketing services the company saw great organic growth through services this quarter further validating this aspect of the offering. The Company plans to leverage this success into future quarters."*

**As explained in their current investor deck and on their website, Ackroo now provides marketing services to their loyalty customers.** They log into merchant's systems and look for key metrics and data that the merchants can use to better market to their customers (like reward member inactivity). If merchants choose not to leverage the data and tools within the platform to market to their customers Ackroo will offer to do it for them on a pay per piece or per email basis. The ROI has been tremendous for customers so far and it has been driving significant organic growth for Ackroo. We believe it's a great example of the sticky relationship Ackroo can build by leveraging the potential of its platform.

## Outlook and catalysts

**In January, 440,000 warrants were exercised at 0.25$, including 360,000 by CEO Steve Levely[1], and 7.434M warrants expired.** As a young CEO, Mr Levely learned the hard way that you cannot rely on the exercise of warrants to finance an acquisition. Bad market conditions lead to a weak stock price, and then to a serious balance sheet issue. This is what brought us the tremendous opportunity to invest in Ackroo shares at such undervalued levels. Finding a great operator and capital allocator is a much more difficult task than finding capital, which should be available to recapitalize Ackroo and finance its multiple growth opportunities.

**In order to recapitalize its balance sheet and execute on organic and inorganic growth opportunities, Ackroo announced on March 18, 2016, that the company is conducting a private placement offering of up to 10,000,000 shares priced at 0.20$ each.** The private placement is still open and will close by the end of May. Steve Levely expects to raise a lesser amount than the previously stated goal of $2M, since he was able to restructure the DRC payment terms on May 11, 2016. Now, Ackroo has to pay $330K to the DRC

[1] The warrant exercise by CEO Steve Levely was done through a non-cash transaction. The Related Party loan of $90K bears no interest, has no specific repayment terms and is collateralized by the shares issued to Mr Levely. If he leaves the company, he has to reimburse the loan or give back the shares. The 360,000 warrants were acquired in a private transaction for an undisclosed amount in the 5 figures.

vendor by July 1, 2016, and will pay the remaining $800k over 24 monthly payments of 36,916$ (including 10% interest) beginning in January 2017.

**The biggest short-term catalyst for AKR will be the closing of its private placement.** The recapitalization of Ackroo's balance sheet will de-risk our investment thesis. A fair valuation at 4 times EV/Revenue today would bring AKR shares to 40+ cents. Here are a few other positive future catalysts to expect:

- Acquisitions
- New referral and integrated product partners
- Contracts with large brands
- Mobile and e-gifting product enhancements
- Access to more growth capital

## Financial Snapshots

| | FY 15 | FY 14 | FY 13 | FY 12 |
|---|---|---|---|---|
| Revenue | 1 822 224 | 1 328 166 | 1 284 016 | 681 142 |
| (-) COGS | 611 898 | 360 888 | 426 451 | 166 825 |
| Gross Profit | 1 210 326 | 967 278 | 857 565 | 514 317 |
| (-) OPEX | 2 066 868 | 2 716 753 | 3 430 474 | 4 123 264 |
| (-) Grants and tax credits* | (100 000) | (135 428) | (77 480) | (183 701) |
| EBITDAS** | **(756 542)** | **(1 614 047)** | **(2 495 429)** | **(3 425 246)** |
| | | | | |
| **Key Metrics** | | | | |
| Revenue Growth y/y | 37% | 3% | 89% | |
| Gross Margin | 66% | 73% | 67% | 76% |
| Improvement in EBITDAS loss | 53% | 35% | 27% | |
| | | | | |
| **Working Capital** | **(1 130 290)** | **(510 687)** | **176 218** | **3 234 124** |

| | Q1 16 | Q4 15 | Q3 15 | Q2 15 | Q1 15 |
|---|---|---|---|---|---|
| Revenue | 548 300 | 601 758 | 519 766 | 315 562 | 385 138 |
| (-) COGS | 189 523 | 199 815 | 183 914 | 91 028 | 137 141 |
| Gross Profit | 358 777 | 401 943 | 335 852 | 224 534 | 247 997 |
| (-) OPEX | 447 063 | 618 250 | 479 770 | 513 708 | 455 140 |
| (-) Grants and tax credits* | - | (9 777) | (90 223) | - | - |
| EBITDAS** | **(88 286)** | **(206 530)** | **(53 695)** | **(289 174)** | **(207 143)** |
| | | | | | |
| **Key Metrics** | | | | | |
| Revenue Growth y/y | 42% | 72% | 61% | 10% | 4% |
| Gross Margin | 65% | 67% | 65% | 71% | 64% |
| Improvement in EBITDAS loss | 57% | 51% | 79% | 22% | 63% |
| | | | | | |
| **Working Capital** | **(1 180 833)** | **(1 130 290)** | **(807 723)** | **(846 879)** | **368 620** |

* Tax credits in Q4 2015 exclude a $100K provision for potential previous years SRED reversal
**EBITDAS excluding foreign exchange gains and losses

## Disclosure

***Philippe Bergeron-Bélanger and Mathieu Martin own 232,500 shares of Ackroo. MicroCaps Research Canada Inc., owner of Espace MicroCaps, and Philippe will subscribe to 90,000 and 27,500 units of the private placement respectively. MicroCaps Research Canada Inc. provides advisory services to Ackroo on a month-to-month basis at a flat rate of 1,500$ per month.***

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