

Tapinator, Inc. (TAPM)

Market Capitalization at 2/15/2021: \$4.5 million

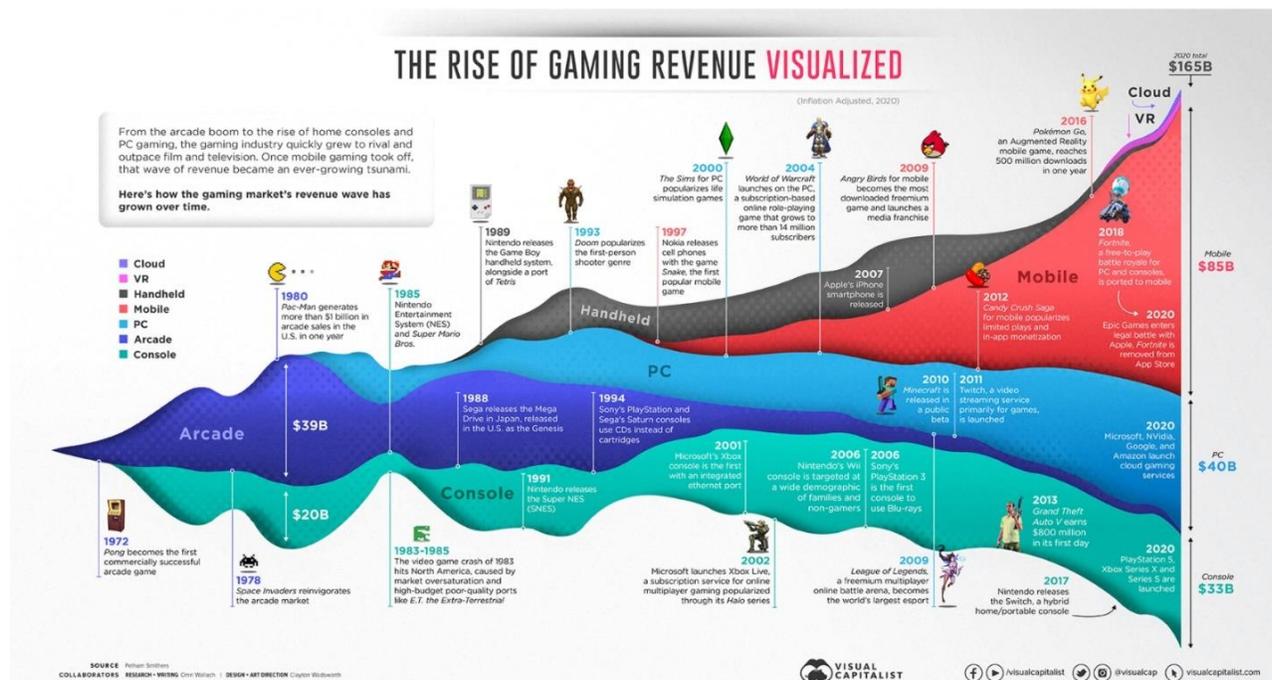
On June 14, 1815, just four days before the Battle of Waterloo, the famed economist, David Ricardo, helped the British Government raise £36 million. The price of the bonds was extremely depressed due to the size of the loan and the uncertainty of the outcome of the war. Ricardo held onto his position and became rich when news of Wellington's victory reached London. Ricardo made his fortune investing in the unknown and unknowable—who would win? The investment in British Government bonds in the summer of 1815 was an example of a situation with a very high level of uncertainty in unknown outcome distribution. Most investors today, like David Ricardo's contemporaries, want to invest in situations with predictable outcomes and smooth trajectories.

The reality is, however, unknowable situations are widespread and inherent in capital markets. Usually, what is believed to be known is overconfidence bias and lemming-like behavior. Fairlight Capital likes to invest in situations that are perceived to have a high level of uncertainty. This reduces competition for the purchase of securities. Investors stay clear of these situations because it is mentally difficult to deal with ambiguity, along with a real threat of a ruined reputation and career. Now on the positive side, unknowable situations with little investor interest can be associated with incredible investment returns.

The following is a current example of a situation with high uncertainty and significant illiquidity surrounded by a negative perception. Tapinator is a developer of mobile phone gaming apps with a focus on social casino games—a \$5.7 billion submarket of the \$85 billion mobile gaming market.

Tapinator to Make Product Announcement at Leading Blockchain Conference Press Release | 01/22/2018

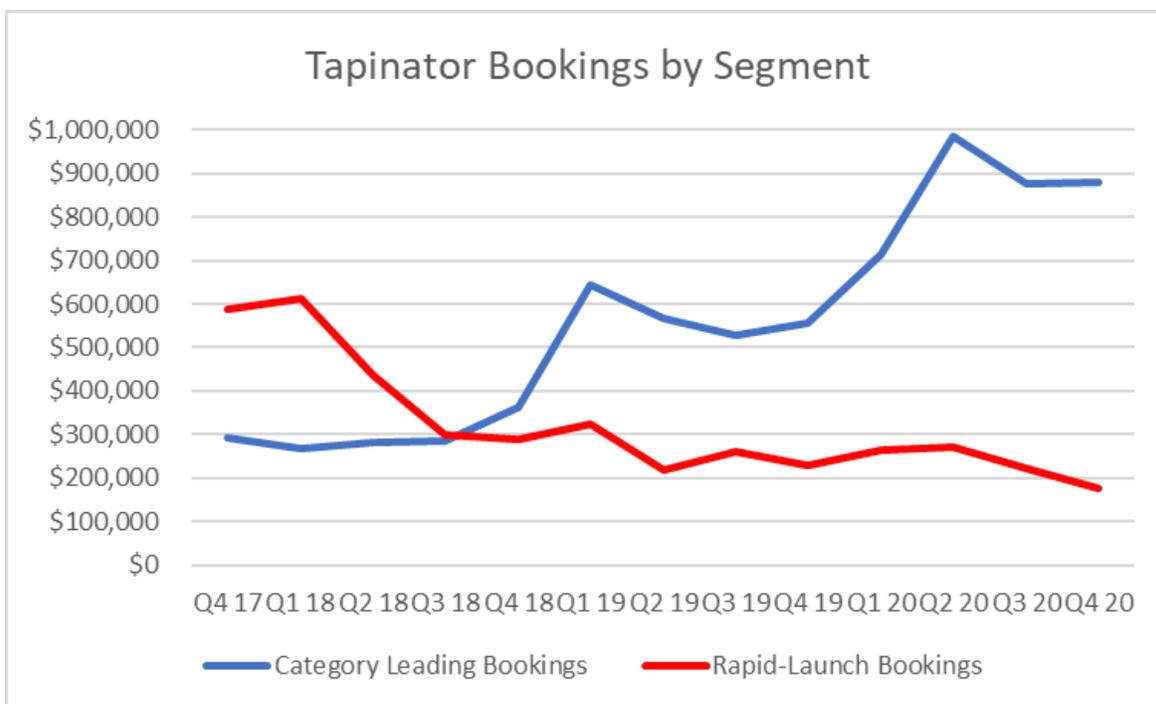
NetworkNewsWire Announces Publication on Blockchain's Use in Modern Gaming and Other Applications Press Release | 01/10/2018



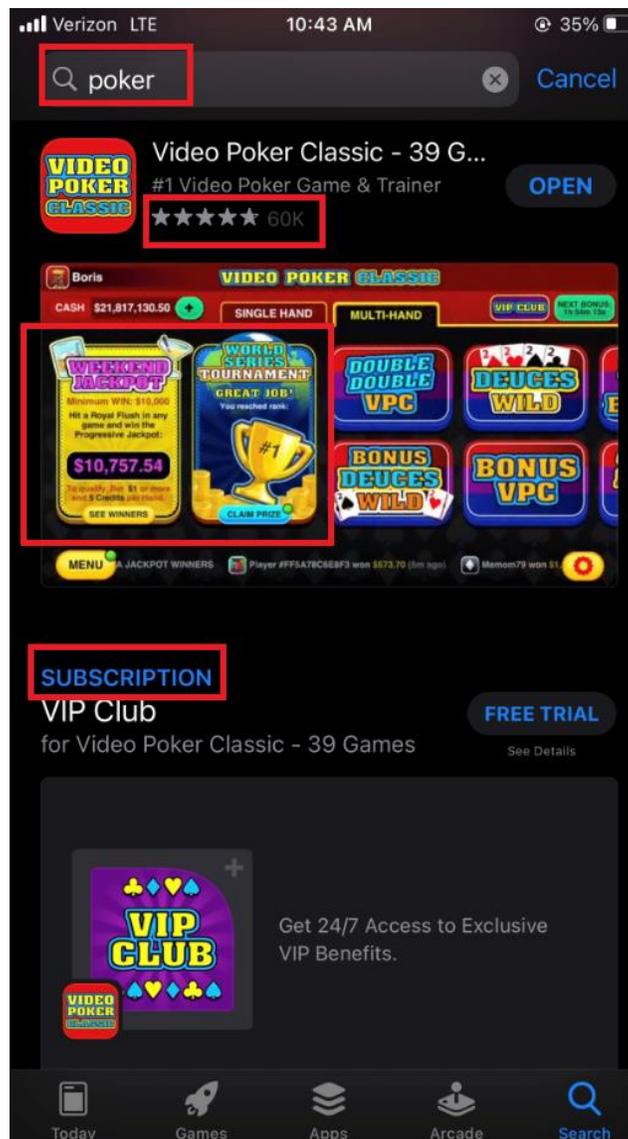
Over the last five years, Tapinator’s share price has dropped by over 80%. So what happened—did the business deteriorate or did investor perception change, or both? In earlier years, Tapinator originally focused on rapid launch mobile games. These are games built on software engines that can be used to quickly build new games. For example, Tapinator used the same engine to build big rig parking, airplane flying and school bus driving games. Rapid launch games can reach popularity rapidly and also amass a huge number of downloads quickly. During 2015 and 2016, the investing public had a very positive perception of Tapinator’s future growth and the company issued highly sought after shares. Unfortunately, for these early investors, rapid launch games have a very short life span and earn very little money. It is very difficult to monetize rapid launch games as competition is intense and consumers change playing habits very quickly .

Recognizing this difficulty, Tapinator changed strategy to focus on leading games where it can build repeat visitors and higher consumer engagement. This, however, takes more effort and time. Instead of building thousands of games, Tapinator now focuses on a few core games, builds communities and launches one or two games a year. The games can take months or years of development. But leading games can generate millions or even hundreds of millions of dollars a year in revenue. Rapid launch games just don’t have this possibility.

The following graph shows Tapinator’s bookings (revenues plus change in deferred revenues) by segment over the last three years.



The Category Leading segment includes the Company’s most popular game *Video Poker Classic*. Tapinator has invested significant resources into the game over the last three years. *Video Poker Classic* is in the third spot in the app store’s poker search rankings after industry giants *World Series of Poker* and *Zynga Poker*. It has 60,000 ratings and 4.7 stars versus 177,000 and 59,000 ratings and 4.4 and 4.5 stars for *World Series of Poker* and *Zynga Poker*.



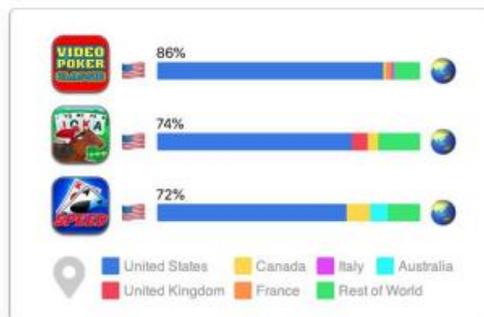
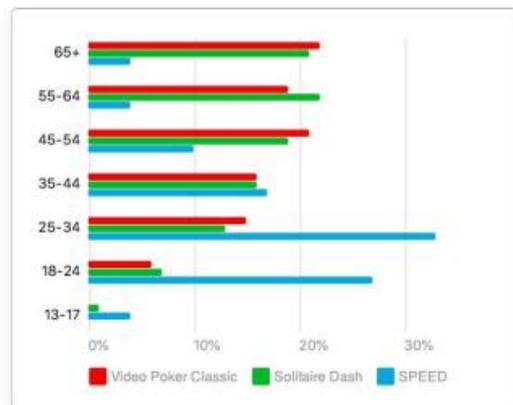
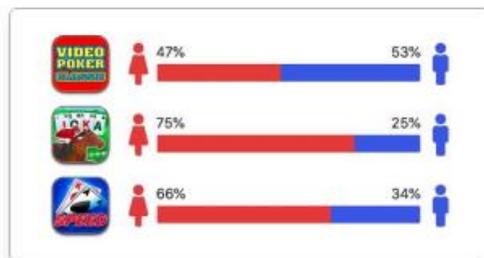
Tapinator has achieved a high ranking by focusing on adding new functionality during the last two years. Additional functionality includes live operations to create and execute events and promotions designed to maximize retention, revenue and player happiness. Live operations deliver additional content (e.g. new levels), chances to win large sums of virtual currency, limited time themed events, live tournaments and progressive mega jackpots. *Video Poker Classic* now has significantly improved player profiles and stats, better player segmentation, more advanced player rankings, and better rewards for loyal players. These features create higher player retention and monetization. New features, a large number of in-depth player profiles, customer reviews and app store rankings make it difficult for other software developers to create new mobile video poker games that can draw customers away from established video poker games.

Additionally, Tapinator is using its resources to better target its core market: 45+ year old adults. Older individuals play the same game longer and have greater spending ability than younger adults and children. Older individuals will play the same game for months, if not years. Young adults and kids, on the other hand, will download ten (rapid launch) games in one day and very often do not have the financial means to make app store purchases.

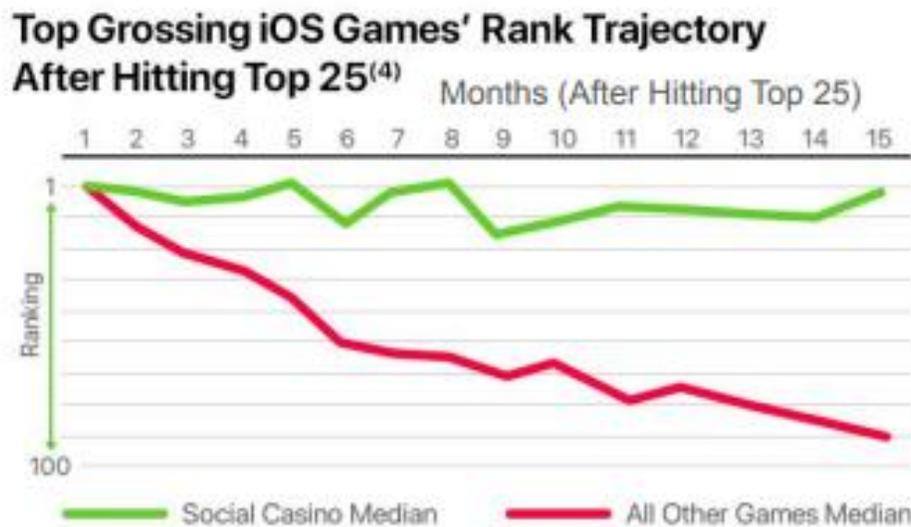


Category Leading Mobile Apps

Player Demographics

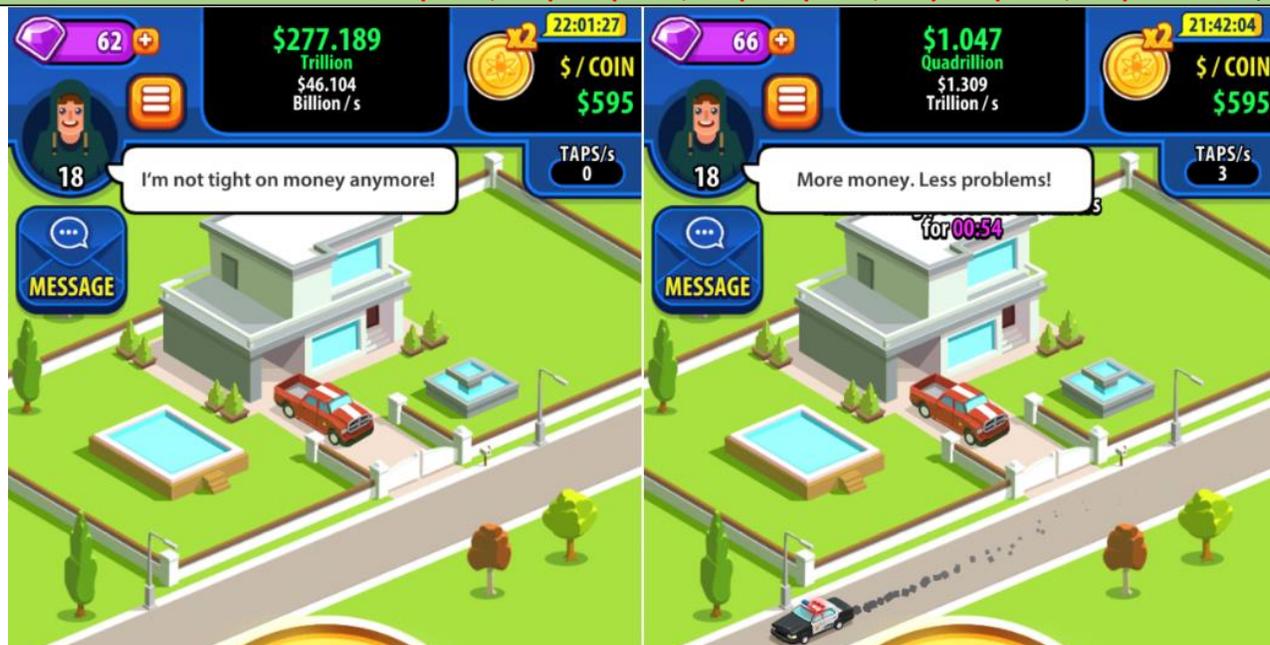


Proven ability to create products targeting a variety of demographics.



Over the last five years, Tapinator failed to live up to market expectations for growth. It did, however, materially improve profitability and revenue visibility. *Video Poker Classic* now throws off cash that can be used to further strengthen its community and also build new games. So while the share price is down over 80%, revenue stickiness is up significantly.

Tapinator Income Statement					
	2016	2017	2018	2019	2020
Total Revenue	\$3,731,773	\$3,141,360	\$2,872,278	\$3,760,322	\$4,454,940
Cost of Revenue	(\$1,168,176)	(\$1,033,452)	(\$884,202)	(\$1,234,776)	(\$1,362,467)
R&D	(\$81,200)	(\$140,772)	(\$243,694)	(\$317,555)	(\$425,431)
Marketing	(\$472,351)	(\$518,099)	(\$377,917)	(\$777,989)	(\$394,545)
G&A excl. SBC & Financing	(\$1,172,894)	(\$1,210,013)	(\$1,053,079)	(\$1,254,307)	(\$1,254,986)
Amortization Software	(\$767,187)	(\$709,615)	(\$614,130)	(\$647,705)	(\$493,141)
Depreciation	(\$50,275)	(\$21,927)	(\$9,933)	(\$5,552)	(\$3,307)
Adjusted Operating Income	\$19,690	(\$492,518)	(\$310,677)	(\$477,562)	\$521,063
One-time financing	\$0	\$0	(\$188,000)	(\$222,911)	(\$112,963)
Stock Based Compensation	(\$30,902)	(\$173,552)	(\$1,857,274)	(\$1,560,962)	(\$379,139)
Impairment Software	\$0	(\$256,310)	(\$320,311)	(\$114,171)	(\$374,428)
Operating Income / Loss	(\$11,212)	(\$922,380)	(\$2,676,262)	(\$2,375,606)	(\$345,467)
Change in Deferred Revenue	\$85,402	\$357,429	\$268,737	(\$235,470)	(\$64,818)
Adj. Op Inc + Change in Def Revs	\$105,092	(\$135,089)	(\$41,940)	(\$713,032)	\$456,245
Capitalized Software Costs	(\$1,194,628)	(\$818,094)	(\$806,708)	(\$606,717)	(\$674,420)
Cash Flow	(\$272,074)	(\$221,641)	(\$224,585)	(\$666,492)	\$278,273



Screenshots from Tapinator's game *Crypto Trillionaire*.

So as an investment manager, we are often asked: what are the shares worth? This is a difficult question. An easier question is what are the shares not worth, and how does this compare to the current share prices? At \$8.00 a share, Tapinator is valued at \$4.5 million and has an enterprise value to cash flow multiple of 15.8x. This is cash flow after investments in new games and growth. If instead we use *Adjusted Operating Income + Change in Deferred Revenue* (a proxy for cash flows without growth investments), the multiple is 9.7x. Note Tapinator has no debt or excess cash and has a clean capital structure (read no dilutive securities to common shareholders). A 9.7x multiple seems unreasonable based on the earlier analysis. *Video Poker Classic* is unlikely to disappear anytime soon and will likely be around generating revenues for years. We now have two quarters of revenue data since the height of the pandemic and Category Leading Bookings have yet to decrease materially.

Further, Tapinator is better valued using revenues not cash flows. The company could easily be sold to a larger competitor (think Zynga, Playtika, SCPL, etc.) and most costs would be eliminated with no impact to revenues. Acquisitions in the gaming industry, typically occur at 3-6x revenues. Is *Video Poker Classic*, much different than the slot machines that have sucked up granny's nickels for years?

Based on a multiple of revenues, the shares are worth \$18 to \$37.

Segment	TTM Revenue Est.	Multiple	Value
Video Poker Classic	\$2,758,848	3.0x	\$8,276,544
Crypto Trillionaire	\$123,888	1.0x	\$123,888
Rapid Release	\$932,554	0.5x	\$466,277
Solitaire Dash & Other Leading Games	\$639,650	2.0x	\$1,279,299
Enterprise Value			\$10,146,009
per Share Value			\$18.41

Segment	TTM Revenue Est.	Multiple	Value
Video Poker Classic	\$2,758,848	6.0x	\$16,553,088
Crypto Trillionaire	\$123,888	1.0x	\$123,888
Rapid Release	\$932,554	1.0x	\$932,554
Solitaire Dash & Other Leading Games	\$639,650	4.0x	\$2,558,598
Enterprise Value			\$20,168,129
per Share Value			\$36.60



Ok, so that is what the revenues are worth, but will we ever see them as investors? No and yes. No, we will likely never see dividend payments for the foreseeable future. Instead, Tapinator will take the cash inflows and reinvest them back into *Video Poker Classic* along with trying to create new leading games. If the Company is successful this will lead to share price appreciation. If they are not successful, shares will languish. This is what creates the uncertainty accompanied by negativity at the current moment.

Will management throw the money away or will they continue to grow Video Poker Classic and possibly create another hit? If management fails, it is possible investors lose big.

Creating a hit game is difficult and larger players are spending millions and billions to do just this. The land race to grab rankings on the app store is no longer in the early innings and now it takes large marketing budgets to get people to find new games. However, there are other growth avenues for Tapinator with higher probabilities of success.

The first is real money games. Extending the current poker franchise to capture real money gambling can be done by using live ops and building larger communities. Video poker can represent 20% of gross casino revenue. Totaling gaming revenue in U.S. casinos is approximately \$45 billion dollars. The total addressable market for real money mobile based video poker gaming will be very large in coming years.





Category Leading Mobile Games

Video Poker Classic⁽¹⁾ Marketing Opportunity Unit Economics



- In real money casinos, video poker can comprise ~ 20% of gaming revenue.⁽²⁾
- In 2019, revenue for the social casino market reached \$5.7 billion.⁽³⁾
- We believe that there is significant growth opportunity for Video Poker Classic to capture a much greater percentage of the social casino market.

The second is increasing the marketing budget. To-date, Tapinator has done very little marketing but now this is a viable strategy due to better cash flow visibility. Video poker’s share of the \$5.7 billion mobile social casino market is very small compared video poker in real casinos meaning there is a significant path for future growth.



Future Opportunities

A Clear Path for Continued Growth



Extend social casino titles to rapidly legalizing real-money online gaming market.

Re-engage users and maximize revenue with personalized offers, gameplay and communication.

Launch new leading mobile franchises that can be #1 or #2 within their categories.

Scale daily active users and revenue via marketing. Continue to grow retention rates and average revenue per daily active user.

If Tapinator is moderately successful in any of these endeavors, investors could see a 10x or more return. There are several opportunities for a 10x return.

- 1) Real money gambling. This is difficult to quantify and currently counts for \$0 in revenue. But *Video Poker Classic* is well positioned to benefit as states and governments open up online gambling to generate new taxes. Note that this is also a risk as it opens the door for competitors to create new video poker platforms with real money gambling that can gain rankings on app stores and steal customers. **Unknown odds of success**
- 2) Increased live ops. More Live op features and events will further deepen the customer experience and increase revenue per user. **High probability of success**
- 3) New games. New game success is very hard to predict. But with Tapinator's focus on category leading games this could be a home run, or also could be a negative value if cash is used to develop unpopular games. **Unknown odds of success – especially for outsiders. However, see management's recent actions surrounding share purchases for clues.**
- 4) Increase marketing spend on existing games. This is Tapinator's highest probability avenue to create value for shareholders. Now that Tapinator is cash flow positive it has resources to invest in marketing for *Video Poker Classic*. In the above graph, TAPM believes a \$1 increase in marketing spend can add \$3.8 in additional revenue. Assume TAPM spends \$0.5 million on new marketing which adds \$1.9 million in new revenue for *Video Poker Classic*. Now *Video Poker Classic* generates \$4.7 million in revenue, and at 6x this is worth \$28 million versus the current market capitalization of \$4.5 million. One can see how rapidly the value of TAPM's shares could appreciate if marketing spend grows to \$1 million to \$2 million. **Medium to High probability of success**

The biggest indicator of probability for successful outcomes in the super nanocap space is how management and the Board of Directors treat nonaffiliated common shareholders. Here Tapinator earns an A+. In 2018, they repurchased all Series B preferred shares which were convertible into 12% of the shares outstanding. With a depressed share price, the Company is not issuing new shares, RSUs or options to management. Additionally, in February 2020, Tapinator withdrew a share offering due to the depressed share price. Instead, in 2020, management purchased 4% of all outstanding shares using open market purchases with their own money. Further, in August 2020, Tapinator leadership committed to purchasing \$300,000 of stock through open market purchases or private transactions. These actions indicate that management is looking to build shareholder value rather than increase revenues at any cost.

The \$300,000 buying commitment has been made pursuant to contractual covenants with the Company and is shared equally between Ilya Nikolayev, Tapinator's Chairman & CEO, and Andrew Merkatz, Tapinator's President & CFO.

Messrs. Nikolayev and Merkatz offered the following joint statement: "Following the publication of our second quarter results in which we delivered the best bookings, net income, earnings per share, and adjusted EBITDA results in the Company's history, including a 27% EBITDA margin, we felt it important to publicly demonstrate to the market our strong belief that Tapinator's equity is fundamentally and deeply undervalued. We believe this ongoing cash commitment sends an important signal to our shareholders that we are fully dedicated to enhancing the Company's equity value. With this added market support, a public float of less than 400,000 shares, and an exciting new social casino game that we expect to launch in the coming months, we believe Tapinator's stock is well positioned for significant capital appreciation."



Will Tapinator generate more mooooola or burn through cash? Only time will tell.

<https://www.visualcapitalist.com/50-years-gaming-history-revenue-stream/>

https://scholar.harvard.edu/files/rzeckhauser/files/unknown_unknowable.pdf

<https://s26.q4cdn.com/174933132/files/presentation/TAPM-Investor-Presentation-November-2020.pdf>

<https://www.otcmarkets.com/stock/TAPM/news/Tapinator-Provides-Update-on-Video-Poker-Classic-the-1-Video-Poker-Game-on-Mobile?id=285408>

<https://www.otcmarkets.com/stock/TAPM/news/Tapinator-Management-Makes-300000-Insider-Buying-Commitment?id=272149s>

<https://backend.otcmarkets.com/otcapi/company/research/221575/content>

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