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Viq Solutions

(VQSLF-OTC)

VQSLF: 2Q19 Improvements

VIQ Solutions recently reported 2Q19 financial results, with revenue of \$6.2 million up 88% year-over-year. Gross profit came in at \$2.45 million compared to \$1.1 million in the prior year quarter. VIQ generated adjusted EBITDA of \$419,000, up 193% year-over-year. A new five-year contract with the Western Australia Police Force commenced after the quarter; it is expected to add more than \$1 million in recurring annual revenue.

OUTLOOK

The company's gross margin was 39.6% compared to 33.6% in 2Q18. The company expects gross margins to improve further, reflecting its strategy to drive business towards a recurring SaaS revenue model and the transition from 100% manual workflow to AI collaboration, and growing scale as it continues to increase the number of minutes it transcribes. Moreover, management noted recently that the company is pursuing another acquisition that could close in 2H19.

Current Price (08/14/19) \$0.09
Valuation **\$0.30**

SUMMARY DATA

52-Week High **\$0.15**
52-Week Low **\$0.08**
One-Year Return (%) **-37**
Beta **-1.35**
Average Daily Volume (sh) **30,706**

Shares Outstanding (mil) **189**
Market Capitalization (\$mil) **\$16**
Short Interest Ratio (days) **1**
Institutional Ownership (%) **10%**
Insider Ownership (%) **21%**

Annual Cash Dividend **\$0.00**
Dividend Yield (%) **0.00**

5-Yr. Historical Growth Rates
Sales (%) **255**
Earnings Per Share (%) **N/A**
Dividend (%) **N/A**

P/E using TTM EPS **N/A**
P/E using 2019 Estimate **N/A**
P/E using 2020 Estimate **1.9x**

Zacks Rank **N/A**

Risk Level **High**
Type of Stock **N/A**
Industry **Technology Services**
Zacks Rank in Industry **N/A**

ZACKS ESTIMATES

Revenue

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2017	2.9	3.2	3.2	2.4	11.7
2018	3.0	3.3	3.1	2.1	11.5
2019	6.4	6.2 A	6.1E	8.4E	27.1 E
2020	-	-	-	-	36.3 E

Per Share Data

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2017	0.00	0.00	0.00	0.00	0.00
2018	-0.00	-0.00	-0.00	-0.03	-0.04
2019	-0.00	-0.01A	-0.00E	0.01E	-0.01E
2020	0.00E	0.00E	0.02E	0.03E	0.05E

Quarters might not add to annual reflecting rounding
Disclosures on page 13

KEY POINTS

- VIQ Solutions recently reported 2Q19 financial results. Revenue came in at a record \$6.2 million, which represents an 88% year-over-year advance. Gross profit came in at \$2.45 million compared to \$1.1 million in the prior year quarter. VIQ generated adjusted EBITDA of \$419,000, up 193% year-over-year.
- In July, the company announced a new five-year contract with the Western Australia (WA) Police Force, which is expected to add more than \$1 million in recurring annual revenue at a gross margin of 25% to 50%. The contract began on July 1 and so it did not contribute to 2Q19 revenue.
- The company's gross margin was 39.6% compared to 33.6% in 2Q18. The company expects gross margins to improve further, reflecting its strategy to drive business towards a recurring SaaS revenue model and the transition from 100% manual workflow to AI collaboration, and growing scale as it continues to increase the number of minutes it transcribes.
- VIQ recently hired an SVP of Sales and Business Development with extensive sales experience to lead its efforts to grow its business and boost its market share.
- The company is also pursuing a roll-up strategy within the digital transcription space and has completed several transactions. Management noted recently that VIQ is pursuing another acquisition that could close in 2H19.

SECOND QUARTER 2019 REVIEW

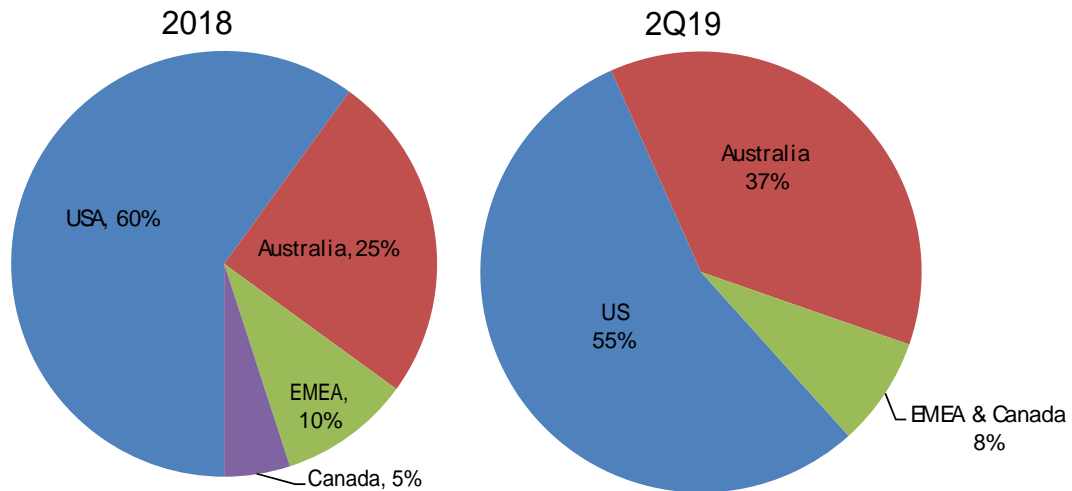
Toronto, Canada and Phoenix, Arizona-based VIQ Solutions (VQSLF-OTC and VQS-TSXV), which operates a technology platform that offers artificial intelligence (AI) enabled video capture software and audio recording with voice-to-text capabilities, recently reported 2Q19 financial results. Revenue came in at a record \$6.2 million, which represents an 88% year-over-year advance from \$3.2 million recorded in 2Q18.

The company also recently signed new contracts (see below), with a sizable one closing subsequent to the quarter end. Therefore, it did not contribute to 2Q19 revenue, but these new additions are expected to contribute to 2019 annual revenue and support our 2019E projection of \$27.5 million, we believe. On the higher revenue base, the company reported gross profit of \$2.45 million. This compares to gross profit of \$1.1 million in the prior year quarter. On the higher gross profit, VIQ generated adjusted EBITDA of \$419,000. This represents a 193% year-over-year increase.

VIQ management ascribes its 2Q19 financial improvements to the successful execution of its growth strategy. Key aspects of the strategy include:

- Transitioning toward recurring SaaS accounts to improve the quality of revenue
- Growing the client base via strategic M&A transactions
- Expanding gross margins by driving cybersecurity, AI and cloud solutions for transcription clients
- Cross-selling a growing suite of software products
- Boosting recurring, higher margin revenue

VIQ Global Revenue Breakdown



Source: Company reports

VIQ has about 1,200 customers globally. The company's single largest market is the U.S. Some 55% of 2Q19 revenue was generated in the U.S., with another 37% coming from Australia and the remaining 8% from EMEA markets and Canada. The slight difference in the geographical revenue breakdown compared to 2018 represents some minor quarterly variance, according to management.

VIQ markets its platform primarily to law enforcement, insurance, judicial, legal, medical and transcription service providers. VIQ subsidiary Net Transcripts, for example, targets law enforcement transcription, while Transcription Express targets insurance. Roughly 40% of VIQ's clients are in public safety, 25% in insurance and the remaining 35% are in the justice and legal sector. VIQ is Criminal Justice Information Services (CJIS) compliant. At this point, all of the company's U.S. transcriptionists have met federal and state security checks to enable VIQ to maintain its CJIS standards.

GROSS MARGIN EXPANSION

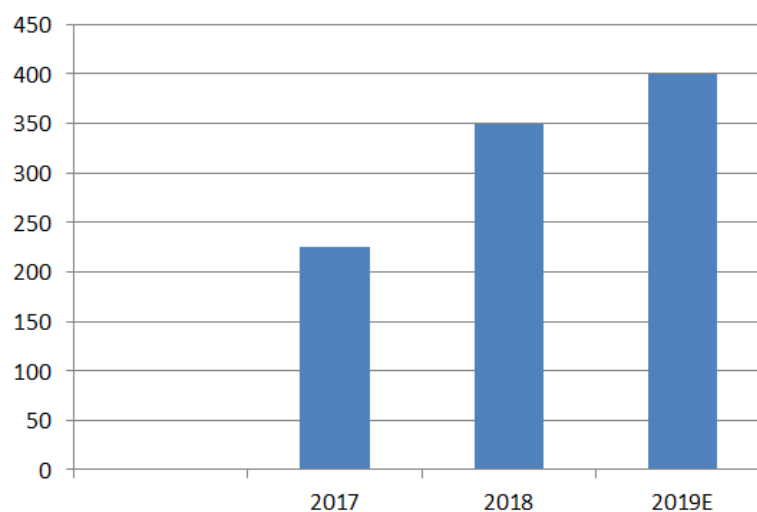
Management Anticipates Further Gross Margin Improvement

The higher \$2.45 million gross profit noted above represents a gross margin of 39.6%. This compares to gross margin of 33.6% recorded in the prior year second quarter. It represents a year-over-year improvement of about six percentage points.

The company expects gross margins to improve further, reflecting its strategy to drive business towards a recurring SaaS revenue model and the transition from 100% manual workflow to AI collaboration. Management estimates that AI collaboration could reach 80% of workflow by the end of 2021. Management also notes that there is an incremental margin increase with each client migration into the cloud. Moreover, the company expects to achieve growing scale as it continues to increase the number of minutes it transcribes. This is another factor that likely will contribute to margin improvement, management believes.

Specifically, according to VIQ, transcriptions needed for insurance claims or court proceedings result in roughly 3.8 billion pages of transcribed documents per annum in the United States alone. These documents primarily are produced using analog methods, according to management. AI technology represents a substantial improvement, as it can assist in accelerating turnaround time and improving accuracy. Moreover, with the company's software, the documents can be stored in the cloud and accessed in a cyber secure way.

Minutes of data transcribed (in millions)



Source: Company reports

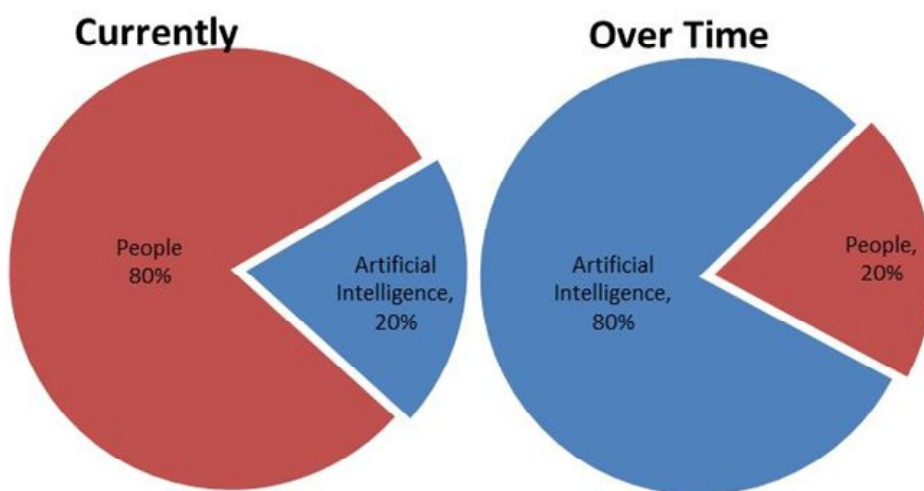
According to VIQ, the company's customers capture approximately 400 million minutes of audio and video evidence annually, of which VIQ transcribes about 30 million annual minutes. This is less than 10% of its customer volume and VIQ believes that it can boost its penetration rate with its new technology.

Moreover, the volume of data that its core customers capture is also likely to grow, it would seem. According to IDC (International Data Corporation) predictions, "by 2025 the global datasphere – the amount of data created in the world – will grow to 163 zettabytes (that is a trillion gigabytes). That's ten times the 16.1ZB of data generated in 2016." IDC estimates that almost one fifth of that data will be critical to our daily lives and almost one tenth will be hypercritical.

Driving AI Integration Will Contribute to Margin Expansion

As it accelerates the integration of AI into its platform, the company expects gross margins to continue to expand. Human to machine collaboration via an integrated cloud-based platform driven by speech recognition is one of the underlying foundations of the VIQ AI-enabled transcription platform. VIQ's platform enables clients to streamline their document-creation process and to improve efficiency by leveraging AI tools. With VIQ, customers can obtain results faster with higher volume per worker and reduced unitary cost and production time, according to management. The company's strategy is to enable machines to perform most of high-volume speech to text conversion to enable workers to focus more on quality assurance.

Growing Use of AI in Document Conversion



Source: Company reports

The rise in sources of data that will be converted to content and the need to access and analyze the content is driving the need to convert data more efficiently. Management believes that as the volume of data continues to increase, pressure to transform digital evidence to documents and transcripts will mount. Technological trends that will drive this, management believes, include the growing need to secure the transfer of media and a proliferation of low-cost devices that enable the collection of significant volumes of audio and video information. Rising data capture from audio and video devices, sensors, body cameras, drones and smartphones, among other devices, lead to a growing volume of data. Management believes that as this trend continues, pressure to transform data to documents and transcripts digitally leveraging AI technology will mount. VIQ enables clients to transform audio to content digitally via a cyber-secure AI speech recognition technology.

VIQ expects roughly 33% and 60% of the content it works on in 2019 and 2020, respectively, will use some element of automated AI technology. Moreover, VIQ began to transition its recurring revenue toward a SaaS and AI revenue model that provides services to customers on a recurring monthly fee basis based on VIQ's average customer contract length of 5+ years.

NEW CONTRACTS EXPECTED TO ADD HIGH MARGIN REVENUE

In July, the company announced a new five-year contract with the Western Australia (WA) Police Force, which oversees more than 150 police stations across eight metropolitan and seven regional districts. The WA Police Force believes that it polices the world's largest, single police jurisdiction. With this new contract, the company notes that its subsidiary Spark & Cannon has become Australia's largest provider of law enforcement transcription services.

Reflecting its extensive jurisdiction, the WA Police Force generates more than 4,563 transcript requests annually, according to VIQ. Based on the number of transcripts expected to be generated, VIQ anticipates that the new contract will add more than \$1 million in recurring annual revenue. If the margins align with those of other recent similar contracts, the company expects gross margin of 25% to 50% on the new revenue. The contract began on July 1. Therefore, WA Police Force revenue was not included in 2Q19 results.

In addition, the company's Net Transcripts subsidiary signed new contracts that added an aggregate 96 new United States enforcement clients. In May 2019, the company added 83 new recurring clients. Then in June, the company added 13 new clients and also renewed contracts with three existing clients.

GROWING SALES EFFORT

The company recently announced that it had hired industry veteran Tony Incardona as SVP of Sales and Business Development. He has more than 30 years of sales experience. He will be responsible for building a global sales organization, strengthening the corporate sales strategy and creating global partnerships. The company notes that this "is a critical step in VIQ's ability to ... drive new business around the world and to achieve revenue growth objectives."

Prior to joining VIQ, as a Vice President, Mid-Market U.S. & Field Sales Engineering at Nuance Healthcare, Mr. Incardona likely saw first-hand the digital transformation of the medical transcription industry begin to accelerate. He directed the sales and service efforts of all U.S. stand-alone clinics and hospitals with approximately 500 beds at Nuance Healthcare.

M&A ROLL-UP STRATEGY COMPLEMENTS ORGANIC GROWTH

The company is pursuing a roll-up strategy within the digital transcription space and has completed several transactions. The transcription industry is fragmented, according to VIQ, with myriads of mom and pops operating small companies. Specifically, the company believes there are more than 1,800 small players in the fragmented market. At the same time, VIQ management believes the market is undergoing major disruption as companies adopt AI technology to boost productivity and economics. The company believes its technology platform extends its total addressable market to an estimated \$8.5 billion, with an estimated \$6.4 billion in government services and \$2.1 billion in Insurance related services.

VIQ acquired three companies in 2018, investing \$20 million over the past few years in M&A and product development. In November 2018, the company acquired Net Transcripts, a leading provider of documentation services to the law enforcement sector. The transaction added more than 350 law enforcement clients throughout the U.S. and \$6.8 million in annual recurring revenue.

In December 2018, the company acquired two leading providers of transcription services to the insurance, government and legal markets based in the U.S. One company is Transcription Express, in Gilbert, Arizona. The other is Seattle, Washington-based HomeTech. Together these companies added \$6.4 million in annualized recurring revenue and more than 55 insurance clients, including more than a dozen Fortune 500 insurance customers covering 49 states. These transactions also increased the company's opportunity to cross-sell its growing product portfolio. VIQ's M&A strategy helps expand its portfolio of services.

Several Potential Acquisition Candidates

The company has several other potential acquisition candidates under review. The company recently noted that it is pursuing another acquisition that it anticipates could close in the second half of 2019. We would expect this and other future acquisitions to further expand the company's client base. The three accretive acquisitions noted above that were completed in 2018 expanded VIQ's customer base, adding 450 customers.

CYBERSECURITY CRITICAL

The growth in the amount of critical data that needs to be stored, shared and used will drive demand for maintaining the privacy of sensitive information. At the same time, it will lead corporate entities to become more and more vulnerable to data breaches.

Industry insiders believe that there is a substantial gap between the volume of sensitive data that is being produced and stored and the volume that is being stored *securely*. Importantly, this gap is expected to widen. In fact, IDC estimates that nearly 90% of all data created in the global datasphere will require some level of security by 2025, but not even half will be secured.

Market research firm Gartner forecasts that global spending on information security technologies and services will exceed \$114 billion this year, representing a 12.4% advance compared to 2017. Gartner forecasts that the market will reach \$124 billion in 2019, an 8.7% year-over-year increase. Gartner estimates that privacy concerns about sensitive data will fuel 10% or more of market demand for security services through 2019, impacting several segments of the economy. These statistics underscore the need to provide a highly secure platform, we believe.

The company is focused on offering its services in a cyber secure platform. In fiscal year 2018, VIQ expanded its product portfolio by developing new technologies based on mobility, secure workflow, Cloud-based and SaaS offerings.

FINANCIAL OUTLOOK

The company's 2Q19 revenue of \$6.2 million was slightly below our \$6.58 million forecast. Nevertheless, with the new contracts signed in May and June, expected acceleration of clients migrating to technology assisted transcription services and the potential impact of the company's roll-up strategy if a new acquisition closes in 2H19, we are leaving our 3Q19 and 4Q19 revenue forecasts unchanged. On the 2Q19 variance from our forecast, our new annual 2019E forecast is now \$27.1 million.

On its recent quarterly earnings call, management noted that it is comfortable with 2019E expected revenue of more than \$27 million and has good visibility into some \$25 million of recurring 2019 revenue. Reflecting slightly higher than forecast operating expenses registered in 2Q19, we are raising our estimates for operating expenses in subsequent 2019 quarters. Our revised forecast for annual operating expense is now \$10.9 million versus \$7.8 million earlier.

RECENT NEWS

- On July 31, 2019, the company announced 2Q19 results.
- VIQ announced that it had hired Tony Incardona as its new SVP of Global Sales and Business Development on July 30, 2019.
- On July 9, 2019, the company announced its new contract with the WA Police Force in Australia and others in the United States.
- On May 22, 2019, the company announced that its Net Transcripts subsidiary signed 83 new law enforcement clients.
- VIQ Solutions announces record Q1 2019 earnings, with revenue up 112% year-over-year on May 8, 2019.
- On April 29, 2019, VIQ Solutions outlined its outlook for strong 2019 growth.
- April 25, 2019, VIQ Solutions appointed new CFO Alexie Edwards.
- The company launched AI-enabled NetScribe™ on April 2, 2019.
- VIQ hired a new Chief Information Officer and Chief Marketing Officer effective January 31, 2019.

RISKS

We believe risks include those outlined below, among others.

- Among the biggest risks, in our view, is that the VIQ Solutions does not gain market share as quickly as the company expects, which leads to slower than anticipated revenue ramp.
- The company might not migrate its customers to its higher margin services or recurring revenue model as quickly as it expects.
- The company could incur unanticipated costs associated with its roll-up strategy and for marketing to promote its new platform.
- Additional M&A transactions that the company anticipates might take longer than expected to close or might not close at all.
- Competition could increase.

PROJECTED INCOME STATEMENT

VIQ Solutions Inc. Income Statement & Projections (\$)

	Mar-18	Jun-18	Sep-18	Dec-18	2018	Mar-19	Jun-19 A	Sep-19	Dec-19	2019E	2020E
Revenue	\$3,006,145	\$3,290,981	\$3,055,320	\$2,110,358	\$11,462,804	\$6,359,223	\$6,189,458	\$6,110,640	\$8,448,175	\$27,107,496	\$36,250,000
Cost of sales	1,814,129	2,186,370	2,188,864	1,684,856	7,874,219	3,322,085	3,739,216	3,322,087	4,606,108	14,989,496	18,668,750
Gross profit	1,192,016	1,104,611	866,456	425,502	3,588,585	3,037,138	2,450,242	2,788,553	3,842,067	12,118,000	17,581,250
Gross margin	39.7%	33.6%	28.4%	20.2%	31.3%	47.8%	39.6%	45.6%	45.5%	44.7%	48.5%
Selling & administrative expenses	995,501	1,465,201	1,237,344	1,835,678	5,533,724	2,513,865	1,799,433	1,361,078	1,061,078	6,735,455	6,695,806
Research & development expenses	134,844	88,567	103,777	131,487	458,675	200,611	231,824	116,230	110,419	659,084	580,499
Stock-based compensation	73,331	42,423	100,784	(247,999)	(31,461)	24,301	90,280	50,392	45,353	210,326	282,963
Loss on revaluation of conversion liab	-	-	-	186,444	186,444	(357,930)	320,828	128,331	70,582	161,811	217,450
FX	(124,940)			323,120	198,180	19,750	126,889	50,756	62,176	259,570	
Depreciation & amortization	50,574	47,197	45,367	505,735	648,873	792,529	856,408	685,126	548,101	2,882,165	756,781
Total operating expenses	1,129,310	1,643,388	1,487,272	2,734,465	6,994,435	3,193,126	3,425,662	2,391,914	1,897,709	10,908,411	8,533,498
Operating income	62,706	(538,777)	(620,816)	(2,308,963)	(3,405,850)	(155,988)	(975,420)	396,639	1,944,358	1,209,589	9,047,752
Interest income	30	1,104	615	537	2,286	623	178	670	50	1,521	2,470
Interest expense	(1,744)	(2,189)	(2,730)	(89,821)	(96,484)	(405,306)	(331,935)	(300,000)	(300,000)	(1,337,241)	(104,270)
Other inc / (exp)	591	(591)		(66,142)	(66,142)	(210,484)	(212,178)	(200,000)	(200,000)	(822,662)	(71,480)
FX		40,515	(65,928)	25,413						-	
Business acquisition & fin'g costs				(2,488,873)	(2,488,873)	-	-	-	-	-	-
Pretax income	61,583	(499,938)	(688,859)	(4,927,849)	(6,055,063)	(771,155)	(1,519,355)	(102,690)	1,444,408	(948,793)	8,874,472
Tax				(11,571)	(11,571)	-	-	-	-	-	-
Net inc/ (loss)	61,583	(499,938)	(688,859)	(4,939,420)	(6,066,634)	(771,155)	(1,519,355)	(102,690)	1,444,408	(948,793)	8,874,472
FX	(213,504)	(176,916)	102,802	191,719	(95,899)	(377,430)	(82,768)	(80,000)	(80,000)	(95,899)	(100,000)
Comprehensive loss	(151,921)	(676,854)	(586,057)	(4,747,701)	(6,162,533)	(1,148,585)	(1,602,123)	(182,690)	1,364,408	(1,044,692)	8,774,472
<i>Per share data:</i>											
LPS	(\$0.00)	(\$0.00)	(\$0.00)	(\$0.03)	(\$0.04)	(\$0.00)	(\$0.01)	(\$0.00)	\$0.01	(\$0.01)	\$0.05
Avg shares out	161,205,502	161,294,113	161,433,649	163,330,992	161,816,064	183,404,871	188,862,956	183,804,871	184,004,871	184,736,488	185,904,871

Source: Company reports, Zacks estimates

BALANCE SHEET AND CASH FLOW STATEMENT

VIQ Solutions Inc. Consolidated Statement of Cash Flows (\$)

	2017	2018	Mar-19	Jun-19
Net loss	(851,117)	(6,066,634)	(771,155)	(1,519,355)
Depreciation & amortization	237,982	648,873	792,529	856,408
Stock-based compensation	384,000	(31,461)	24,301	90,280
Loss on revaluation of conversion liab		186,444	(357,930)	320,828
Other				676,144
Provisions	5,875	(6,129)	7,115	19,473
Deferred income tax expense	(123,089)	11,571	(1,934)	4,769
Unrealized foreign exchange loss	238,401	196,455	402,282	1,005,090
Changes in working capital	<u>(714,011)</u>	<u>3,543,308</u>	<u>(246,153)</u>	<u>(2,358,643)</u>
Cash used in operating activities	(821,959)	(1,517,573)	(150,945)	(905,006)
Purchase of property & equipment	(187,035)	(49,092)	(12,155)	(25,496)
Business acquisitions	-	(9,605,683)	-	-
Development costs	(1,227,936)	(1,881,792)	(400,091)	(506,521)
Change in restricted cash	<u>(3,114)</u>	<u>4,406</u>	<u>(268)</u>	<u>433</u>
Cash used in investing activities	(1,418,085)	(11,532,161)	(412,514)	(531,584)
Proceeds from exercise of stock options	47,135	28,800	17,758	(2,429)
Repayment of debt			(40,000)	(254,305)
Payment of interest on debt			(41,896)	(130,774)
Payment of interest on lease obligations			(22,029)	52,869
Repayment of lease obligations			(94,886)	(171,195)
Proceeds from exercise of warrants	572,944	-	-	-
Net proceeds from convertible debt	-	4,692,327	-	-
Other		6,345,166	-	1,925,000
Proceeds from private placement	3,644,091	-	-	-
Finance lease advances	<u>-</u>	<u>(20,491)</u>	<u>(10,667)</u>	<u>(3,659)</u>
Cash provided by financing activities	4,264,170	11,045,802	(191,720)	1,415,507
Net (decrease) increase in cash	2,024,126	(2,003,932)	(755,179)	(21,083)
FX	158,664	(185,423)	24,904	16,900
Period end cash	\$4,112,123	\$1,922,768	\$1,192,493	\$1,188,312

VIQ Solutions Inc. Consolidated Balance Sheets (US\$)

	2017	2018	Mar-19	Jun-19
Cash	\$4,112,123	\$1,922,768	\$1,192,493	\$1,188,312
Receivables	2,180,533	3,023,127	3,436,522	3,740,870
Inventories	71,083	58,195	105,047	194,550
Prepaid expenses & deposits	<u>83,381</u>	<u>161,170</u>	<u>266,931</u>	<u>333,772</u>
Total current assets	\$6,447,120	\$5,165,260	\$5,000,993	\$5,457,504
Restricted cash	42,118	37,712	37,980	37,547
Property & equipment	173,299	111,437	101,061	102,142
Right of use assets	0	0	841,203	740,728
Intangible assets	1,849,969	11,358,813	11,181,289	10,931,390
Goodwill	796,841	4,277,887	4,284,847	4,370,935
Deferred tax assets	<u>438,167</u>	<u>368,997</u>	<u>371,558</u>	<u>367,409</u>
Total assets	\$9,747,514	\$21,320,106	\$21,818,931	\$22,007,655
Trade & other payables	1,182,919	4,384,831	3,999,809	2,995,788
Share appreciation rights plan obligations	651,451	257,164	235,494	238,786
Current portion of long-term debt		1,155,518	1,155,518	1,072,073
Conversion feature derivative liability		3,290,832	3,004,126	4,619,805
Current portion lease obligations			388,561	377,308
Provisions	498,096	458,959	391,873	419,022
Contract liabilities	405,563	454,789	579,927	643,842
Current portion of obligations - finance lease	<u>40,239</u>	<u>38,231</u>	<u>33,400</u>	<u>29,716</u>
Total current liabilities	2,778,268	10,040,324	9,788,708	10,396,340
Deferred tax liability	88,270	29,752	30,379	30,999
Convertible debt		1,563,554	1,563,554	2,627,086
Long-term debt		6,877,061	7,260,001	7,395,143
Lease obligation			466,373	388,744
Provisions	78,767	72,638	79,753	85,987
Obligations under finance lease	<u>40,355</u>	<u>21,872</u>	<u>16,036</u>	<u>16,061</u>
Total liabilities	2,985,660	18,605,201	19,204,804	20,940,360
Shareholders' equity	6,761,854	2,714,905	2,614,127	1,067,295
Total liabilities & shareholders' equity	9,747,514	21,320,106	21,818,931	22,007,655

Source: Company reports

HISTORICAL STOCK PRICE



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