

INITIATING COVERAGE

Equity | Media & Entertainment/ Content

Grom Social Enterprises, Inc. (NASDAQ:GROM, Target Price: \$9.10)

Grom Social Enterprises Inc. ("Grom Social Enterprises", "Grom Social", "Grom") offers a leading social media platform for children under 13 years of age that offers brand-safe social media for kids, animation production, and web filtering for schools, government agencies, and private businesses. The company is strongly positioned to grow its top-line with new projects and inorganic growth opportunities like the most recent Curiosity Ink Media acquisition. Moreover, the company recently announced its result for the first quarter of 2021 showing substantial improvement with a 45% increase in the revenue as compared to the first quarter of 2020. As per the management the increase in sales is a dramatic rebound and brings Grom almost entirely back to where revenues were just prior to the March 2020 shutdowns related to Covid-19. In addition to the increase in revenues, the company witnessed a 17.7% increase in new users and more than an 11% increase in online duration of visits and these KPIs continue to show recent improvement. Grom Social appears to be a compelling investment opportunity not just for microcap investors but also for people who have invested in stocks like Netflix and Disney but are looking for a new and genuine growth stock within the online entertainment space.

Key Report Highlights

Industry View:	Attractive
Stock Rating:	Buy
Price Target:	\$9.10
Current Price:	\$4.73
52-Week-Range:	\$3.85 - \$19.5

Annual Income Statement	2021E	2022E	2023E
Revenues	10.40	19.90	27.10
Cost of Goods Sold	-3.54	-6.71	-9.13
Gross Income (excl. D&A)	6.86	13.19	17.97
EBITDA	-2.09	4.09	7.07
EBIT (incl. extraordinary exp)	-2.55	3.59	6.57
Net Income	-6.71	0.59	2.87
Cash from Operations	-1.97	3.76	6.50
Free Cash Flows	-1.95	3.72	6.43

INVESTMENT THESIS

This is our first report on Grom Social Enterprises and we look to provide a detailed account of the various drivers that will be responsible for the company's growth in the coming years. Online entertainment is considered one of the most sought-after sectors of investment in the world especially after the huge tailwinds witnessed by over-the-top (OTT) content providers like Netflix and Disney during the pandemic. However, there are few children-dedicated platforms that exist in this domain. Grom Social Enterprises is capitalizing on this niche through its own social media platform for children. The company generates most of its revenues through its Top Draw Animation studio which carries out animation projects for some of the largest entertainment companies of the world such as Disney and Nickelodeon. Baptista Research looks to evaluate the different factors that could influence Grom Social Enterprises' price in the near future and attempts to carry out an independent valuation of the company using a Discounted Cash Flow (DCF) methodology to determine a suitable price for the company's stock.

Growth & Margins	2021E	2022E	2023E
Sales Growth	68.8%	91.3%	36.2%
EBITDA Margin	-20.1%	20.6%	26.1%
EBIT Margin	-24.5%	18.1%	24.2%
Net Profit Margin	-64.5%	3.0%	10.6%

Valuation Ratios	Current	2021E	2022E
EV/ Sales	2.7	2.7	4.3
EV/ EBITDA	-13.5	13.4	16.3
EV/ EBIT	-11.0	15.2	17.5
Price/Earnings	-4.2	92.2	40.5

COMPANY OVERVIEW

Grom Social Enterprises, Inc., through its subsidiaries, operates as a media, technology, and entertainment company in the United States. The company operates a social media network for children under the age of 13 years called Grom Social. It also produces animated films and television series using its animation studio based in Manila, Philippines known as Top Draw Animation. The company's platform is known to provide web filtering services to schools and government agencies. Grom Social Enterprises was founded in 2012 and is headquartered in Boca Raton, Florida.

DRIVERS FOR GROWTH

1.	ROBUST BUSINESS MODEL
2.	TOP DRAW – A TOP-NOTCH ANIMATION STUDIO
3.	THE CURIOSITY INK MEDIA ACQUISITION
4.	EXCITING NEW DEVELOPMENTS
5.	HIGHLY EXPERIENCED MANAGEMENT TEAM

Robust Business Model

- Grom's biggest revenue earner and the largest contributor to its operating income is its animation studio subsidiary, also known as Top Draw Animation. It has been in the 2D animation business for over 2 decades and produces award-winning animation content for some of the largest international media companies in the world.
- Grom produces close to 250 half-hour episodes of 2D animation each year and caters to some of the top animation clientele in the world such as Disney, Warner Brothers, Scholastic, Nickelodeon, Hasbro, DreamWorks, and Cartoon Network.
- In addition, the company is not only COPPA (Children's Online Privacy Protection Act) compliant but also a powerful tool through which parents can monitor their children's online activity and ensure that the child is only consuming age-appropriate content.
- For children, the platform provides an excellent social media experience as kids can record and share videos, write comment, use hashtags, send messages to communicate with each other online, chat with cartoon characters, and stream the relevant video content.
- While blue chips like Disney are performing well, there are emerging companies like Grom producing excellent content and also providing a wide variety of children's offerings that have an immense upside potential.

Our Subsidiaries



Top Draw Animation, Inc
World-Class Animation Studio



Grom Social, Inc
Safe, Social Media App for Kids



Grom Educational Services, Inc
Web Filtering for Schools,
Government and Private Business



OTCQB: GRMM | 6

Source: Grom Social Enterprises Presentation

Top Draw– A Top Notch Animation Studio

- Grom has been in 2D animation for a while and made a major breakthrough came in the form of the acquisition of Top Draw Animation, a Philippines-based animation studio in June 2016.
- The company has a 30,000 square feet animation studio based in Manila in the heart of the Philippines. It has accumulated the production of more than 2000 half-hours of high-quality content under the Top Draw banner which indicates a strong content base for Grom's social media platform.
- Top Draw is the biggest revenue earner for Grom today and serves a wide variety of clients. It employs skilled animation experts who serve the needs of the top production houses.
- As a matter of fact, the animation studio was recently in the news for receiving financial incentives under the Film Development Council of the Philippines and its Film Philippines Office's (FPO) Film Location Incentive Program for the production of its animated TV series Bionic Max.
- The studio has a fantastic reputation after having worked for many well-known international productions such as My Little Pony: The Movie (2018), The Hollow (2018), and Penn Zero: Part Time Hero Season 2 (2017).

- From a revenue standpoint, Top Draw has a huge large order book position since 2020. The execution of these animation projects was forced to be on standstill in 2020 given the lockdown caused by the Covid-19 pandemic but all its projects are back on track in 2021.
- It is worth highlighting that Grom's revenues were \$8.3 million in 2019 prior to the pandemic and these delays forced the top-line down to \$6.16 million in 2020.
- However, with Top Draw executing the project pipeline, the company already has a trailing twelve-month revenue of \$6.74 million and if the current momentum continues then it should possibly go past the \$10 million mark in 2021.
- To sum up, Top Draw acts like a wonderful revenue generating cushion for Grom as it attempts to popularize its Grom Social platform and start monetizing on the same.

The Curiosity Ink Media Acquisition


- In April 2021, Grom Social announced its plans to acquire Curiosity Ink Media, a producer, and developer of original kid-friendly content. Curiosity is a global media company that produces feature films, television series, and physical books for a modern generation of kids and families.
- This acquisition will open new opportunities for Grom like original programming, including operating as an original content pipeline for Subscription Video on Demand (SVOD) services.
- Moreover, this move will allow the company to create cross-platform synergies whereby Curiosity content can debut on Grom Social and the company can also gain user feedback and help inform series development.
- There is a strong human resource upside as well as Curiosity Ink Media's top management team comprises ex-Nickelodeon President Russel Hicks and animation industry veteran Brent Watts who have been associated with some of the most legendary animation names such as Scooby Doo, SpongeBob and Dora franchises from Nickelodeon, the Dr. Seuss franchise, Shrek and Kung Fu Panda of DreamWorks Animation, and the Spider-Man franchise of Sony Pictures.
- Taking all these factors into consideration, Grom is poised to get a solid base in conceptualizing, developing, and creating original content which seems like an amazing opportunity to accelerate growth and efficiently monetize the platform in the near term.

Exciting New Developments

- Grom Social most recently announced that Curiosity is introducing Santa.com, an online hub where kids and adults can experience classic holiday joy in a modern digital holiday venue.
- The platform will offer a special place to kids for registering their Christmas wish lists and also experience a virtual tour of the North Pole. This acts as a medium to de-stress the holidays for parents by providing them with tools to send personalized gifts that arrive wrapped, from the comfort of their very home.
- Santa.com will be launching in the fourth quarter of 2021 and can be a key catalyst for growth given this curated holiday hub can come as a unique experience in the market-leading to an increase in subscribers at large.
- In addition, the company also announced its plans to produce an original animated music holiday special which is inspired by annual classics like “Rudolph The Red Nosed Reindeer” and “Elf”. This production will focus on Santa’s efforts to modernize his North Pole workshop with the help of some technical upgrades making it all the more appealing to the kids.
- Curiosity has also recently partnered with Dynamite Entertainment, a leading independent publisher of comic books and graphic novels and this partnership has also brought Grom into the publishing arena.
- With the acquisition of Curiosity Ink, Grom is well on track to unlock its potential in the original content space and has ample of opportunities to grow in this space.

Highly Experienced Management Team

Our Team



| Executive Management

Zach Marks – Founder / Chief Content Developer

Darren Marks – Chairman / CEO / President
Over 30 years of public company experience at the CEO and Director level

Melvin Leiner – Vice Chairman / Executive Vice President / CFO
Over 40 years of high-profile senior executive level experience in the public and private sectors


Wayne Dearing – Founder and Managing Director of Top Draw Animation
Over 40 years of industry experience as manager and executive

| Independent Directors

Robert Stevens
Founded Somerset Capital Ltd in 2001

Norman Rosenthal
Founded Tempest Systems Inc. in 1986

Dr. Thomas J. Rutherford
World-renowned oncologist and a national expert in cancer



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Source: Grom Social Enterprises Presentation

- Grom Social is composed of a team of highly trained individuals led by Chairman and CEO, Brett Moyer who is also the founding member of the company.
- Mr. Moyer has served as president and CEO of Focus Enhancement Inc., a developer and marketer of proprietary video technology, for over 8 years before joining Grom Social.
- He is supported by George Oliva who joined Grom Social in 2019 as the Chief Financial Officer and brings more than two decades of experience in corporate finance, treasury, financial planning and analysis, international tax, and strategic planning.
- The Chief Accounting Officer and Vice President of Finance, Gary Williams has been with the company since its founding in August 2010. He has also served as the CFO of Quantum3D, Inc., a training and simulation technology company.
- Ed Green is a founding member of Grom Social Enterprises serving as Vice President of operations and has been responsible for all design, construction, implementation, management, and all financial and corporate matters involving the company's 5 stores and 70 employees.
- Overall, Grom Social consists of an excellent management team that continues to reinforce leadership and is well positioned to drive the company to unmatched growth levels.

HISTORICAL FINANCIAL STATEMENTS & PROJECTIONS

Income Statement	12/31/17	12/31/18	12/31/19	12/31/20	LTM
Total Revenues	7.69	8.64	8.30	6.16	6.74
Cost of Goods Sold	-4.25	-4.38	-4.61	-3.35	-3.54
Gross Profit	3.44	4.27	3.69	2.81	3.20
Selling General & Admin Expenses	-6.39	-7.30	-6.16	-5.20	-5.24
Other Expenses	-2.66	-0.37	-0.06	-0.06	-0.05
EBITDA	-5.61	-3.40	-0.48	-0.88	-2.09
Depreciation & Amortization	-1.14	-0.47	-0.44	-0.45	-0.47
Other Operating Expenses/ Income	0.01	-0.01	-2.06	-1.58	0.01
Operating Income	-6.74	-3.88	-2.98	-2.91	-2.55
Interest Expense	0.00	0.00	0.00	0.00	0.00
Other Non Operating Income (Expenses)	0.73	-0.98	-1.58	-3.06	-4.39
Gain (Loss) On Sale Of Investments	0.00	0.00	0.00	0.00	0.00
Asset Writedown	0.00	0.00	0.00	0.00	0.00
Other Unusual Items	0.00	0.00	0.00	0.00	0.00
EBT Incl. Unusual Items	-6.01	-4.86	-4.56	-5.97	-6.94
Net Income	-6.05	-4.88	-4.59	-5.74	-6.71
Net Income to Common Incl Extra Items	-6.05	-4.88	-5.33	-6.02	-6.99
Diluted EPS Excl Extra Items	-1.77	-1.22	-1.16	-1.07	-1.21
% Change YoY	52.80%	31.00%	5.00%	7.60%	
Weighted Average Diluted Shares Outstanding	3.42	4	4.61	5.63	5.8
% Change YoY	19.70%	16.90%	15.10%	22.20%	

- Grom Social has reported a top-line of \$1.88 million in its recent quarterly result which is a 45.1% appreciation over the previous quarter. The company reported a positive gross margin of 58% for the quarter ended 31-03-2020.
- The recent quarterly result was indicative of the fact that the company has taken a major step in its post-Covid recovery. Top Draw Animation's backlog of pending projects has started getting cleared and the management has started recognizing those revenues which is why there was a 45% top-line growth.
- Its EBIT for the quarter was \$-0.71 million and it witnessed a 33.5% margin expansion at the EBIT level which is definitely a positive outcome. It indicates that Grom is closing in on hitting the operating break even.
- When we analyze the company's annualized historical income statement, we see that the top-line was \$6.16 million for the previous financial year ending in 2020 as a result of the impact of the Covid-19, a 25.8% drop as compared to 2019.
- Grom Social's cost of goods sold has decreased in the trailing twelve month period and its gross margin has increased to 47.5%
- Non-cash expenses in the form of depreciation and amortization have gone up as compared to the result in 2019.
- The company should end 2021 much higher than 2020 as it was able to raise growth capital and is generating strong revenues from Top Draw.

Balance Sheet	12/31/17	12/31/18	12/31/19	12/31/20	LTM
Cash And Equivalents	0.44	0.63	0.51	0.12	0.58
Accounts Receivable	0.45	1.12	0.55	0.59	0.73
Other Receivables	0.00	0.00	0.00	0.00	0.00
Notes Receivable	0.00	0.00	0.00	0.00	0.00
Total Receivables	0.45	1.12	0.55	0.59	0.73
Inventory	0.43	0.01	0.03	0.05	0.03
Prepaid Expenses	0.78	0.33	0.27	0.31	0.34
Total Current Assets	2.34	2.22	1.41	1.14	1.68
Gross Property Plant And Equipment	3.23	3.67	4.90	5.35	5.28
Accumulated Depreciation	-2.38	-2.64	-3.17	-3.78	-3.91
Net Property Plant And Equipment	0.85	1.04	1.73	1.57	1.38
Goodwill	8.80	8.85	8.85	8.38	8.38
Other Intangibles	6.77	6.34	5.95	5.57	5.47
Deferred Tax Assets Long-Term	0.20	0.25	0.24	0.53	0.53

Other Long-Term Assets	0.08	0.11	0.08	0.08	0.08
Total Assets	19.05	18.81	18.26	17.27	17.51
Accounts Payable	0.88	0.68	0.81	1.13	0.78
Accrued Expenses	1.23	1.07	1.65	1.79	1.96
Short-term Borrowings	2.08	0.92	0.43	0.09	
Current Portion of Long-Term Debt	0.08	4.51	4.83	2.54	1.80
Current Portion of Capital Lease Obligations	0.00	0.00	0.26	0.30	0.30
Other Current Liabilities	1.59	1.78	0.74	1.12	0.93
Total Current Liabilities	5.86	8.96	8.72	6.98	5.79
Long-Term Debt	5.42	2.41	0.51	0.99	0.36
Capital Leases	0.00	0.00	0.63	0.33	0.25
Other Non Current Liabilities	0.67	0.65	0.23	0.37	0.37
Total Liabilities	11.94	12.03	10.08	8.67	6.77
Preferred Stock Convertible	0.00	0.00	0.00	0.01	0.01
Total Preferred Equity	0.00	0.00	0.00	0.01	0.01
Common Stock	0.12	0.14	0.17	0.19	0.19
Additional Paid In Capital	47.90	52.25	58.15	64.23	68.67
Retained Earnings	-40.84	-45.46	-50.05	-55.79	-58.11
Comprehensive Income and Other	-0.08	-0.15	-0.10	-0.04	-0.02
Total Common Equity	7.10	6.78	8.18	8.59	10.73
Total Equity	7.10	6.78	8.18	8.60	10.74
Total Liabilities And Equity	19.05	18.81	18.26	17.27	17.51
Total Shares Out. on Filing Date	3.88	4.53	5.72	5.95	6.01

- Grom Social Enterprises has a strong base of intangible fixed assets and goodwill as it is continuously investing in building content as well as carrying out new acquisitions like Curiosity
- When we analyze the fixed assets versus the revenues, we see that the ratio has fallen from 10.92x in 2016 to 4.57x for the trailing twelve month period. It means that Grom has a lot of potential left to be realized from its recent acquisitions.
- Grom Social has close to \$0.58 million in terms of liquidity i.e. cash and short term investments which is fairly decent given that it is nearly at operating break even.
- On the other hand, its payables for 2020 account for around 80.73 days in the sales cycle which means that the company gets sufficient credit.
- We forecast the fixed asset base follow a consistent turnover ratio over the years. Long term investments are zero. The average collection period of the company is not expected to change much as the credit policy of the management with respect to its products should remain consistent.
- Given the fact that Grom Social Enterprises is expected to turn EBITDA positive soon, it does provide the company with a certain amount of leeway to raise funding through debt to finance its growth and improve the Return on Equity of its shareholders through this financial leverage.

Cash Flow Statement	12/31/17	12/31/18	12/31/19	12/31/20	LTM
Net Income	-6.05	-4.88	-4.59	-5.74	-6.71
Depreciation & Amortization	-0.25	0.40	0.44	0.46	0.48
Amortization of Goodwill and Intangible Assets	0.87	0.43	0.43	0.39	0.39
Total Depreciation & Amortization	0.62	0.82	0.86	0.85	0.87
Amortization of Deferred Charges	0.37	0.63	0.64	0.63	0.98
(Gain) Loss on Sale of Investments	0.00	0.00	0.00	0.00	0.00
Asset Writedown & Restructuring Costs	0.00	0.00	0.00	0.47	0.47
Stock-Based Compensation	3.33	1.21	0.84	0.64	0.54
Provision and Write-off of Bad Debts	0.00	0.00	0.04	-0.04	-0.04
Other Operating Activities	0.01	-0.05	0.01	1.11	2.06
Change In Accounts Receivable	-0.25	0.00	0.54	-0.01	-0.14
Change In Inventories	-0.02	-0.21	-0.02	-0.02	0.00
Change In Accounts Payable	-0.07	-0.03	0.15	0.32	-0.01

Change In Income Taxes	-0.04	-0.02	-0.04	0.24	0.25
Change in Other Net Operating Assets	0.82	0.65	-0.14	0.32	-0.24
Cash from Operations	-1.27	-1.87	-1.70	-1.22	-1.97
Memo: Change in Net Working Capital	0.45	0.39	0.49	0.85	-0.14
Capital Expenditure	-0.16	-0.58	-0.29	-0.57	-0.56
Cash from Investing	0.00	0.00	-0.25	0.19	0.02
Total Debt Issued	0.03	1.91	0.60	4.45	1.46
Total Debt Repaid	-0.13	-0.09	-0.26	-3.56	-0.66
Issuance of Common Stock	1.51	0.67	1.06	0.00	0.00
Repurchase of Common Stock	0.00	0.00	0.00	0.00	0.00
Issuance of Preferred Stock	0.00	0.00	0.41	0.48	1.43
Other Financing Activities	0.00	0.00	0.00	0.00	0.00
Cash from Financing	1.42	2.50	1.81	1.38	2.23
Net Change in Cash	-0.03	0.20	-0.13	-0.39	-0.25

- Grom Social Enterprises is expected to have non-cash expenses in the form of depreciation and amortization as the value of its intangible fixed assets is increasing.
- The company is expected to follow a standard payment period for its payables as well and the working capital changes are not expected to impact the overall cash flow from operations significantly in the coming years.
- It is worth noting that the company has significantly reduced its debt levels over the past few years and operates on nominal capital gearing as of today.
- Investments in capex are expected to be in the form of technology acquisitions. No dividend payouts are expected as the company is expected to invest its positive bottom-line in further growth.

Ratios	8/31/16	8/31/17	12/31/18	12/31/19	LTM
Return Ratios:					
Return on Assets %	-23.40%	-12.80%	-0.1	-10.20%	-0.089
Return on Capital %	-46.00%	-26.50%	-20.10%	-22.60%	-19.00%
Return On Equity %	-89.20%	-70.20%	-0.614	-68.50%	-0.725
Return on Common Equity %	-89.20%	-70.20%	-0.713	-71.80%	-0.755
Margin Analysis:					
Gross Profit Margin %	44.80%	49.30%	44.40%	45.60%	47.50%
SG&A Margin %	83.10%	84.40%	74.30%	84.50%	77.70%
EBITDA Margin %	-79.60%	-35.30%	-25.50%	-33.50%	-24.90%
EBITA Margin %	-76.40%	-39.90%	-30.70%	-40.90%	-32.10%
EBIT Margin %	-87.70%	-44.80%	-35.90%	-47.20%	-37.80%
Income From Continuing Operations Margin %	-78.60%	-56.40%	-55.30%	-93.20%	-99.50%
Net Income Margin %	-78.60%	-56.40%	-55.30%	-93.20%	-99.50%
Normalized Net Income Margin %	-61.10%	-35.20%	-34.80%	-42.40%	-39.00%
Net Avail. For Common Margin %	-78.60%	-56.40%	-64.30%	-97.70%	-103.70%
Levered Free Cash Flow Margin %	1.50%	-9.50%	-6.40%	-6.90%	-0.17
Unlevered Free Cash Flow Margin %	5.00%	-9.40%	-1.30%	-2.90%	-0.152

Asset Turnover:

Asset Turnover	0.4	0.46	0.45	0.36	0.39
Fixed Assets Turnover	10.92	9.17	6.01	3.74	4.57
Receivables Turnover	15.45	11.02	9.94	10.87	10.59
Inventory Turnover	10.39	20.08	239.03	86.23	122.39
Working Capital Turnover	-2.19	-1.28	-1.14	-1.06	-1.64
Short Term Liquidity:					
Current Ratio	0.4	0.25	0.16	0.16	0.29
Quick Ratio	0.15	0.2	0.12	0.1	0.23
Op Cash Flow to Current Liab	-0.22	-0.21	-0.19	-0.18	-0.34
Avg. Cash Conversion Cycle	-11.72	-20.81	-20.5	-67.09	-43.27
Avg. Days Sales Outstanding	23.62	33.12	36.71	33.68	34.48
Avg. Days Outstanding Inventory	35.14	18.17	1.53	4.24	2.98
Avg. Days Payable Outstanding	70.47	72.1	58.74	105.02	80.73

Long-Term Solvency:

Total Debt / Equity	1.065	115.60%	81.40%	49.50%	25.30%
Total Debt / Capital	0.516	53.60%	44.90%	33.10%	20.20%
Total Liabilities / Total Assets	62.70%	63.90%	55.20%	50.20%	38.70%
EBIT / Interest Expense	-10.23	-3.79	-1.75	-2.08	-1.44
EBITDA / Interest Expense	-9.29	-2.99	-1.02	-1.21	-0.74
(EBITDA - Capex) / Interest Expense	-9.53	-3.56	-1.19	-1.62	-1.06
FFO Interest Coverage	-1.93	-1.83	-1	-0.87	-1.11
FFO to Total Debt (x)	-0.17	-0.24	-0.25	-0.29	-0.72
Total Debt / EBITDA	-1.24	-2.57	-3.83	-2.51	-2.07
Net Debt / EBITDA	-1.16	-2.36	-3.53	-2.44	-1.62
Net Debt / (EBITDA - Capex)	-1.14	-1.98	-3.03	-1.82	-1.14

- The receivables turnover helps quantify a company's effectiveness in collecting the money owed by clients and demonstrates how well it uses and manages the credit it extends to customers.
- As per the days receivable, the company takes an average period of 10.59 days to collect money from its clients which appears to be reasonable.
- The inventory turnover shows the number of times a given company has sold and replaced inventory during the year and is an indicator of how many days of working capital is blocked in inventory.
- As per the inventory days ratio, Grom Social holds an average inventory of 122 days which appears to be on the higher side and blocking its working capital. However, this is largely the content inventory associated with the Covid-19 pandemic and should go down with time.
- The accounts payable turnover is a short-term liquidity measure used to quantify the rate at which a company pays off its suppliers. It shows how many days of credit a company gets from its suppliers.
- As per the days payable, the company takes an average period of 80.73 days to pay off its creditors which appears to be reasonable.
- The fixed asset turnover ratio measures how well a company generates sales from its tangible as well as intangible fixed assets. The higher the ratio, the greater the company's efficiency to its assets to generate revenues.
- Grom Social's fixed assets turnover ratio of 4.57 has increased in the last twelve months indicating that the company is generating greater revenues from its fixed assets.
- The total asset turnover ratio measures the value of a company's sales or revenues relative to the value of its assets. The higher the asset turnover ratio, the more efficient a company is, with respect to using its assets to generate revenues.
- Grom Social's total assets turnover has increased to 0.39 indicating that the Covid-19 recovery is on track. This ratio should go back to its earlier highs of around 0.5.

Financial Forecasts	2020	2021E	2022E	2023E
Total Revenues	6.16	10.4	19.9	27.10
% Change YoY		68.83%	91.35%	36.18%
Cost of Goods Sold	-3.35	-3.54	-6.71	-9.13
% Margin	-54.38%	-34.04%	-33.70%	-33.70%
Gross Profit	2.81	6.86	13.19	17.97

% Margin	45.62%	65.96%	66.30%	66.30%
EBITDA	-0.88	-2.09	4.09	7.07
% Margin	-14.29%	-20.10%	20.57%	26.08%
Operating Income	-2.91	-2.55	3.59	6.57
% Margin	-47.24%	-24.52%	18.06%	24.24%
Net Income	-5.74	-6.71	0.59	2.87
% Margin	-93.18%	-64.52%	2.99%	10.58%
Cash from Operations	-1.22	-1.97	3.76	6.50
% Margin	-19.81%	-18.94%	18.91%	23.97%
Free Cash Flows	-1.03	-1.95	3.72	6.43
% Margin	-16.72%	-18.75%	18.72%	23.73%

- We have used the above mentioned assumptions with respect to Grom Social's income statement and cash flows in order to carry out the detailed discounted cash flow (DCF) valuation of the company. These forecasts are based on a fundamental understanding of the business obtained from the management and a some logical assumptions based on our industry knowledge.

DISCOUNTED CASH FLOW (DCF) VALUATION

Key DCF Assumptions

WACC	17.6%
CoD	0.0%
CoE	17.6%
Market Rate	5.2%
Risk Free Rate	2.0%
Beta	3.0
Terminal Value	115.18
Tax Rate	0.0%

- For the purpose of carrying out the discounted cash flow valuation of Grom Social Enterprises, we have used the standard capital asset pricing model (CAPM).
- We have used a 5.2% equity market risk premium based on the S&P 500 returns for the past 5 years, which has recently dropped owing to the COVID-19 situation. The risk-free rate has been assumed as the 10-year U.S. Treasury Yield Constant of 2%.
- The company's stock has limited volume so the data available is insufficient to calculate an accurate beta value so we use a highly conservative approach and apply a beta of 3 which is on the higher side indicating a high level of volatility as is usually the case with microcap stocks.
- This is used in order to arrive at the cost of equity (CoE) of 17.6% which appears reasonable for a fast-growing technology company like Grom Social Enterprises. The company has nominal long-term debt and interest payments and hence the cost of debt is assumed as 0%.

EV and Market Cap	Current	2021E	2022E
Price (\$)	4.73	9.10	19.00
Outstanding Number of shares (million)	5.95	6.01	6.11
Total Market Cap (millions)	28.14	54.79	116.09
Net Debt	0.13	-0.10	-0.90
Enterprise Value (millions)	28.14	54.69	115.19

- After incorporating the CoE and the CoD and average tax rate of 0%, we arrive at a Weighted Average Cost of Capital (WACC) of 17.6%.
- The terminal value is a key component of any DCF valuation as it accounts for the largest chunk of the total projected value of the company. There are a number of methodologies used to determine the same such as the perpetual growth rate method or the multiples method.
- In this case, we have gone ahead and assumed the terminal value using a an exit EV/Revenue multiple of 4.25x for the forecasted revenues of 2022 given the huge potential of the company's social media platform.
- This results in an EV/EBITDA multiple of 16.3x for the terminal year of 2022 which is quite reasonable given the high growth prospects and strong profitability of Grom Social Enterprises.

Valuation Ratios	Current	2021E	2022E
EV/ Sales	2.71	2.75	4.25
EV/ EBITDA	-13.47	13.36	16.30
EV/ EBIT	-11.04	15.22	17.54
Price/Earnings	-4.19	92.23	40.48

- After applying the discount rate (WACC) of 17.6%, we arrive at a price target of \$9.10 for 2021.
- Our target price at the end of 2022 is \$19 which implies a total appreciation of more than 5x in the coming 3 years in the stock price and implies a fantastic return for investors.
- During this phase, we see the EV/ Revenues gradually appreciating to 4.25x and the EV/EBITDA to fall to the 16.3x mark in by the year 2022 given the fact that market is expected to recognize the high potential of Grom Social after a string of strong results resulting in multiples expansion.

KEY RISKS

- It is important to highlight the key risks associated with an investment in Grom Social Enterprises as well as the inherent risks associated with the financial projections and price forecasts presented in this report.
- Grom has experienced net losses for several years, since inception, and has a high accumulated deficit. If the management is unsuccessful in implementing several initiatives to improve revenues, it can have an adverse impact on its business, prospects, operating results, and financial condition.
- The company's ability to continue as a going concern is contingent upon the ability to raise additional capital through the sale of securities and possible incurrence of debt. Additionally, the future capital requirements of the company depend on many factors including the rate of revenue growth, selling price of the products and research and development efforts which raise substantial doubt about Grom's ability to continue as a going concern.
- One of the key risks that the company faces is its ability to continue as a going concern because the management does not expect that existing operational cash flow will be sufficient to fund presently anticipated operations. Therefore, the company will need to raise additional funds and is currently exploring alternative sources of financing.
- If Grom Social fails to retain existing users or add new users, or if its users decrease their level of engagement, the revenue, financial results, and business of the company may be significantly harmed.
- In addition, there is a possibility that the company's strategy to create new and original content, charge users for that content and attempt to secure advertisers to pay to advertise on its app, could fail to attract or retain users or generate revenue. Maintaining and enhancing the brand will depend largely on management's ability to continue to provide age-appropriate, enjoyable, reliable, trustworthy, and innovative content and services.
- Moreover, users may be able to circumvent the controls Grom has in place to prevent abusive, illegal or dishonest activities and behavior on its website, and may engage in such activities and behavior despite these controls.
- Lastly, the company's ability to provide reliable service to its users largely depends on the efficient and uninterrupted operation of the Grom Social platform, relying on people, processes, and technology to function effectively. Any significant interruption to, failure of, or security breaches affecting, the platform could result in significant expense, a loss of users, and harm the business and reputation.
- It is worth highlighting that the extent to which Covid-19 impacts the financial results of the company is highly uncertain and could significantly disrupt the operations including sales, manufacturing and supply chain-related activities. It could also result in social, economic, and labor instability in the countries where the customers are present.
- The company's future success depends on its ability to enhance new technologies and products that address the market needs in a timely manner. Grom Social may not be able to identify, develop, acquire, market or support new or enhanced technologies because of its complex nature which can act as a huge drawback to future growth.
- Global economic, political and other conditions may adversely affect trends in consumer, business and government spending, which may adversely impact the demand for Grom Social's services and its revenue and profitability.

- Another one of the biggest risks to Grom Social Enterprises's model is the fact that the company's top-line growth is assumed to be consistently growing by a certain rate in the model. There is a possibility that this assumption might not hold true if the COVID-19 situation persists for too long. With respect to our price projection, we would like to clarify that the valuation of Grom Social Enterprises in this report is specific to the date of the analysis i.e. 1st July 2021.
- We must emphasize that the projected valuation and the share price of Grom Social Enterprises are dependent on the realization of the revenue growth, free cash flows and the other assumptions taken into account. Our analysis cannot be directed to providing any assurance about the achievability of these financial forecasts. There is a possibility that the actual results of the company are different from the projected results as a result of unexpected events and circumstances such as the realization of the threats mentioned in the paragraph above. Lastly, we would like to clarify that we had no interaction with the management of the company and they did not comment on the achievability or the reasonableness of the assumptions underlying the financial forecasts. Please check out our detailed disclosures at the end for further details.

ANALYST RATINGS

- Buy: Expected to outperform market over next 6 to 12 months. Minimal risk to fundamentals and valuation. Good long-term investment.
- Outperform: Expected to outperform the market over next 6 to 12 months but there is a moderate risk to fundamentals and valuation.
- Sell: Expected to significantly underperform the market over next 6 to 12 months. There is a strong likelihood of the security delivering negative returns and a very high risk to fundamentals and valuation.
- Underperform: Expected to underperform the market over next 6 to 12. There is a moderate to high risk to fundamentals and valuation.
- Hold: Expected to perform in line with the market over next 6 to 12 months. However, there is a moderate to high risk to fundamentals and valuation.

ANALYST INDUSTRY VIEWS

- Attractive: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
- In-Line: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.
- Cautious: The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.
- Benchmarks for each region are as follows: North America - S&P 500; Latin America – MSCI EM Latin America Index; Europe – MSCI Europe; Japan - TOPIX; Asia - relevant country index or sub-regional index. Please contact us to know the relevant index in case it is not specified in the report.

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