

Trickle Research

Every raging river, every great lake, every
deep blue sea starts ... with a trickle



Earnings Update – 4Q & Fiscal 2017 04/12/18

12 - 24 month Price Target: \$7.50

Allocation: 5

Closing Stock Price at Initiation (Close 04/24/17): \$1.90

Date of Allocation Upgrade from 4 to 5: 06/07/17

Closing Stock Price at Upgrade (Close 06/07/17): \$1.44

Closing Stock Price @ 04/11/18: \$5.00

Social Reality, Inc.

SRAX

(Stock Symbol – Nasdaq: SRAX)

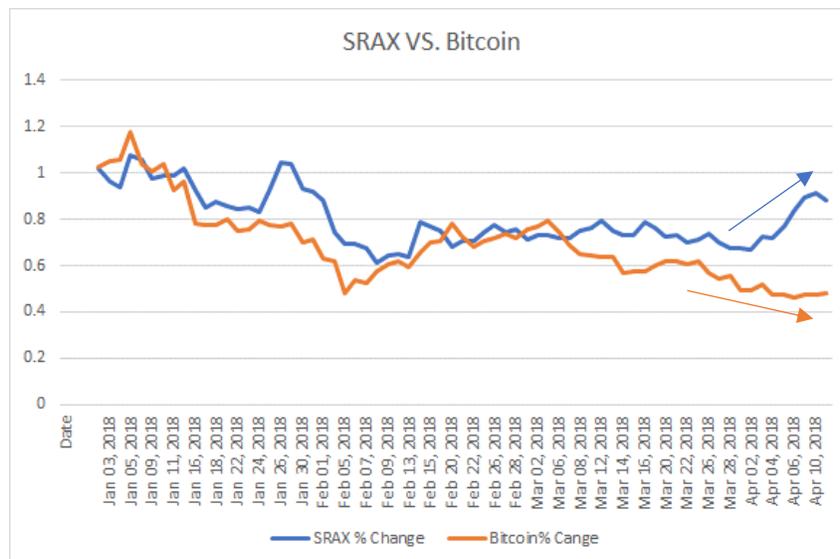
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We have to admit, SRAX has not been easy to follow, and more specifically not easy to model. Recall, they essentially executed a purge of low margin perhaps even unprofitable business, which turned the operating model upside down... but not in bad way. The results have been marked revenue compression offset by impressive margin expansion, and ultimately a better operating picture. In addition, they also executed a capital restructuring which has left them in a much better working capital spot, but it came at the expense of some measurable dilution. We wish we could say it now looks like the business and associated numbers will begin to normalize, but as CFO J.P. Hannan noted on the earnings call “there is a lot of movement”. That is an understatement. On the other hand, while the moving parts are difficult to discern (read: poor visibility), we think that SRAX is in a better position than it has likely been since we initiated the coverage one year ago. However, the stock has since that time traded at over 4X that initiating price, and currently sits at nearly 3X that initiating price, so we are apparently not the only ones who share that opinion. That said, here are a few bullet points/observations regarding where we see the Company today.

First, the numbers were actually much closer to “in-line” than any of the prior reporting periods during our coverage. For Q4F17 they reported revenues of \$6.5 million and net income of \$.02 per share, versus our estimates of \$7.1 million and <\$.02>. Some of the differences were attributed to an extraordinary boost in margins that as we understand it was related to the settlement with a prior customer. But to be honest, while the top and bottom line numbers were *relatively* close, a lot of the items in between were not, which is a bit like saying it’s better to be lucky than good. We clearly still do not have a good handle on projecting the operating model. We are not sure anyone does at this point, a notion that we think is supported by management’s suspension of guidance. Clearly, the operating model will continue to be a bumpy ride for the foreseeable future. We recognize that speaks to the validity of price targets derived from poor visibility, but we continue to believe there are relevant factors that support better valuations.

From the 10,000-foot view, the stock has staged an impressive diversion as of late that we think is worth noting. Recall, we have argued for some time now that while our valuation thesis has primarily been based on the legacy/core business (specifically SRAXmd), we have been of the view that much of the stock’s *advances* over the past six months or so have been tied to BIGToken and their entrée into the cryptocurrency craze as opposed to those core endeavors. However, over the past few weeks, the stock has managed to perform exceedingly well relative to the compression in Bitcoin and most other things “crypto”, which leads us to believe that either we were overstating the relationship, or maybe the street is beginning to see things our way, or maybe some of each. We think the improved Q4 results speak to that.



There is little doubt, the potential sale of SRAXmd is not lost on those following the stock. The questions on the earnings call make that point quite clear. To reiterate, we will take a little credit for illuminating the notion that SRAXmd was likely worth more than the market cap of the stock. Although, the market cap of the stock has advanced significantly since the initiation (we will circle back to that below) so that idea is less certain today than it was back then, but, we continue to believe that SRAX in its entirety, probably remains undervalued because of the associated value of the SRAXmd portion. We hope to get some clarity on that soon in the form of an announcement regarding the sale of the asset. Obviously, that will likely provide us with the single best piece of visibility we can get with respect to the current value of SRAX. We would add, while the 10K references that the Company believes they will have sufficient resources to operate the business at full tilt for the next 12 months, our math suggests that a SRAXmd sale is a clear caveat to that view. We await that event with bated breath. Clearly, the SRAXmd sale will make our model, and we assume any other model out there, obsolete. To put that into perspective, our model estimates that for 2018, SRAXmd will generate something in the realm of 30% of all revenues, but well over 50% of gross margin. Granted, maybe we are aggressive in that assessment of SRAXmd to the whole, but regardless, its absence while generating significant capital, will have a marked impact on the forward operating model and as such will illicit revisions.

Beyond SRAXmd, we expect the new verticals SRAXauto and SRAXfan to begin making contributions in the current year. We are not suggesting they will be substantial, but we remain optimistic about the prospects of each, and here again some of that enthusiasm stems from the success of *md*. We would add, we suspect the elevated SG&A in Q4 is more related to these new verticals, as we think much of the BIGToken development was capitalized. The 10K includes some discussion of that nature, as well as some metrics on the BIGToken outlays. Again, we think SRAX is devoting considerable resources to these new verticals despite much of the attention being on BIGToken.

As we alluded to, we have not been particularly pointed about our assessments of the Company's BIGToken crypto currency initiatives. That's is not because we don't like the idea(s) or we are overtly skeptical of the cryptocurrency/blockchain thing in general, but rather it's because we didn't feel like we understood it well enough to opine intelligently about it. Frankly, we think there are many people acting like they "understand" it better than they likely do, but maybe that is just our own insecurity around our abilities to quickly grasp such things. But, *we are* learning, and we are beginning to understand the vision that Chris Maglino and his team are developing. For example, one thing we have understood from the start, was that if BIGToken's success centered on an understanding of consumers and their preferences as well as access to the same, then BIGToken had/has merit, because that is SRAX's wheelhouse. Moreover, along those same lines, if BIGToken's success depends on SRAX's ability to develop relevant proprietary digital applications to make the whole thing work, they have a leg up there as well because they have been doing that in the space for some time now. They have proven they can develop these applications, as well as scale them, and they have also demonstrated that they can sell them. Again, in our view, those are important attributes of SRAX vis-à-vis their BIGToken endeavors.

More specifically, we think management's visions for BIGToken addresses some of the shortcomings (maybe even the elephants in the room) that dog the space in general. For example, the BIGToken platform is designed to generate profits from the (permitted) sale of consumer data to advertisers (again, SRAX's expertise) and those profits are to be retained by the enterprise to repurchase/transact BIGTokens from those who want to sell them (at the "net asset/cash" value accumulated by the enterprise). We think that little *wrinkle* (an ongoing business that retains the profits and uses them to repurchase coins from those who choose to sell them), sets this apart from many of the crypto stories we have seen. In fact, it may make BIGToken look more like a mutual fund than a cryptocurrency. Granted, we certainly have not seen the business plan of every, or most or even many ICO's, but the narrative regarding the space is enough to tell you that this makes BIGToken different from many. Secondly, being a public company SRAX is keenly aware of the influence that the SEC might have over what they or others are doing with these financial instruments. We acknowledge the moxie of many crypto and ICO pioneers to "stick it to the man", but we think (as SRAX apparently senses as well) that "fighting city hall" probably won't end well. We think their notion (as we comprehend it) to register their offering with the SEC and provide a convertible feature to the coin makes it unique and more (legally) tenable. Moreover, SRAX shareholders will apparently

receive a coin dividend, adding to the uniqueness of the medium. Further, BIGToken is a subsidiary of SRAX so it will need to stand on its own. We think that is an important point given our notions about the value of the legacy business. Granted, until they can successfully complete the offering, BIGToken's progress will depend on SRAX's resources (see the discussion above about the sale of SRAXmd) and their willingness to use those resources to advance BIGToken. Although we would add, they recently released the alpha version of the platform the other day, marking a bit of a milestone and it appears that they will move into beta in the current year, so they are making continued progress on moving the initiative forward.

To reiterate, we are not in position to try to value BIGToken at this time, although, given our sense about the value of SRAXmd and the remaining legacy business relative to the current market cap, it looks to us like the street is not valuing BIGToken at much of anything. The notion we raised above regarding the stock's recent divergence from Bitcoin values may support that idea. In addition, it's interesting to us that, at least as we understand it, BIGToken's cross hairs are squarely fixed on eliminating the scenario that has Zuckerberg testifying in front of Congress these days. While we can't predict if BIGToken will attract users in a time frame and in amounts to make it all successful, *it is undeniable that the approach is topical to the current climate*. In our view, it is conceivable that BIGToken could be on the right side of a tide of potential regulation that might shape the digital advertising landscape at points in the future. We think that is worth pursuing.

Our sense here is to raise our price target. (Actually, the current price of the stock and the added dilution puts us close to the original implied market cap of our target). As we suggested, when we first started covering SRAX, it had been discounted for a handful of struggles and some of our (contrarian) thesis simply boiled down to our sense that there were still some very viable pieces to the story and management could right the ship. Over the past year, they have managed to walk much of that walk, as the financial/fundamental posture of SRAX is now considerably better by nearly every measure. They still have work to do on several fronts, but it is clearly in better standing. While that begs for better targets, we would like to stick around and see if we get some clarity on SARXmd and perhaps even BIGToken before we cross that bridge. The Company's recent narrative suggests that while not definitive just yet, it is more likely forthcoming than not. We will revisit the model, our targets and our allocation assessments when that becomes available.

Projected Operating Model

Social Reality Inc. ("SRAX")						
Projected Operating Model						
By: Trickle Research LLC						
	(estimate)	(estimate)	(estimate)	(estimate)	(estimate)	(estimate)
	<u>03/31/18</u>	<u>06/30/18</u>	<u>09/30/18</u>	<u>12/31/18</u>	<u>Fiscal 2018</u>	<u>Fiscal 2019</u>
Revenues	\$ 5,168,000	\$ 7,705,816	\$ 7,961,771	\$ 9,610,953	\$ 30,446,540	\$ 36,244,045
Cost of revenue	\$ 2,227,370	\$ 3,284,747	\$ 3,353,371	\$ 3,919,606	\$ 12,785,094	\$ 15,649,065
Gross profit	\$ 2,940,630	\$ 4,421,069	\$ 4,608,400	\$ 5,691,347	\$ 17,661,446	\$ 20,594,980
Operating expense:	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
General, selling and administrative expense	\$ 4,750,160	\$ 5,054,698	\$ 5,085,413	\$ 5,183,314	\$ 20,073,585	\$ 18,406,785
Impairment of goodwill	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Restructuring and Other Operating expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Income (loss) from operations	\$ (1,809,530)	\$ (633,629)	\$ (477,012)	\$ 508,032	\$ (2,412,139)	\$ 2,188,194
Other income (expense):	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Write off of contingent consideration	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Interest income (expense)	\$ (201,971)	\$ (145,147)	\$ (44,688)	\$ -	\$ (391,806)	\$ -
Amortization of Debt Issuance Costs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Accretion of Put Warrants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other Income (expense)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Other income (expense)	\$ (201,971)	\$ (145,147)	\$ (44,688)	\$ -	\$ (391,806)	\$ -
Income (loss) before provision for income taxes	\$ (2,011,501)	\$ (778,776)	\$ (521,700)	\$ 508,032	\$ (2,803,945)	\$ 2,188,194
Provision for income taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net income (loss)	\$ (2,011,501)	\$ (778,776)	\$ (521,700)	\$ 508,032	\$ (2,803,945)	\$ 2,188,194
Net loss per share, basic	\$ (0.20)	\$ (0.07)	\$ (0.04)	\$ 0.04	\$ (0.25)	\$ 0.17
Net loss per share, basic and diluted	\$ (0.16)	\$ (0.07)	\$ (0.04)	\$ 0.04	\$ (0.23)	\$ 0.17
Weighted average shares outstanding, basic	10,110,590	10,931,643	11,752,696	12,402,696	11,299,406	12,937,696
Weighted average shares outstanding, basic and diluted	12,595,590	11,752,696	11,752,696	12,402,696	12,125,920	12,937,696

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Rating System Overview

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for our performance purposes, 1 "investment unit" equals \$250) and 10 representing 10 investment units or \$2,500. Obviously, a rating of 10 would suggest that we favor the stock (at respective/current levels) more than a stock with a rating of 1.

As a guideline, here is a suggestion on how to use the allocation system.

Our belief at Trickle is that the best way to participate in the micro-cap/small cap space is by employing a diversified strategy. In simple terms, that means you are generally best off owning a number of issues rather than just two or three. To that point, our goal is to have at least 20 companies under coverage at any point in time, so let's use that as a guideline. Hypothetically, if you think you would like to commit \$25,000 to buying micro-cap stocks, that would assume an investment of \$1000 per stock (using the diversification approach we just mentioned, and the 20 stock coverage list we suggested and leaving some room to perhaps add another 5 of the names from our profiles). We generally start initial coverage stocks with an allocation of 4. Thus, at \$1000 invested per stock and a typical starting allocation of 4, your "investment unit" would be the same \$250 we used in the example above. Thus, if we initiate a stock at a 4, you might consider putting \$1000 into the position ($\$250 * 4$). If we later raise the allocation to 6, you might consider adding two additional units or \$500 to the position. If we then reduce the allocation from 6 to 4 you might consider selling whatever number of shares you purchased with 2 of the original 4 investment units. Again, this is just a suggestion as to how you might be able to use the allocation system to manage your portfolio.

For those hung up on the tradition of more typical rating systems (Buy, Sell, Hold) we would submit the following guidelines. A Trickle rating of 1 thru 3 would best correspond to a "Speculative Buy" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.

A Trickle rating of 4 thru 6 might best (although not perfectly) correspond to a standard "Buy" rating.

A Trickle rating of 7 thru 10 would best correspond to a "Strong Buy" however, ratings at the higher end of that range would indicate something that we deem as quite extraordinary..... an "Extreme Buy" if you will. You will not see a lot of these.