Zacks Small-Cap Research

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Tapinator, Inc. (TAPM-OTC)

TAPM: 3Q15 Metrics Show Strong User Trends

Current Recommendation	**Buy**
Prior Recommendation Date of Last Change	07/9/2015
Current Price (11/16/15)	$0.33
Target Price	**$0.65**

OUTLOOK

Tapinator's user metrics continue to improve, we believe, with cumulative downloads up to roughly 135M at the end of 3Q15. This represents an approximately 39% increase from 97M attained at the end of 2Q15 and more than triple the roughly 35M achieved by the end of 3Q14. As the company's games library continues to expand, we would expect further increases in cumulative user metrics. A licensed title slated for 2Q16 release, based on a well-known franchise, represents the company's highest profile licensed property to-date, according to management. We believe it could contribute to further user metric improvements in 1H16.

SUMMARY DATA

52-Week High	**$1.57**
52-Week Low	**$0.15**
One-Year Return (%)	**N/A**
Beta	**-2.41**
Average Daily Volume (sh)	**165,119**
Common Shares Out (mil)	**57.1**
Market Capitalization ($mil)	**$19**
Short Interest Ratio (days)	**0.2**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**50**
Annual Cash Dividend	**N/A**
Dividend Yield (%)	**N/A**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2015 Estimate	**N/A**
P/E using 2016 Estimate	**N/A**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Software/ Gaming**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013					0.1 A
2014	0.1 A	0.2 A	0.3 A	0.4 A	0.9 A
2015	0.4 A	0.6 A	0.7 A	0.8 E	2.6 E
2016					4.1 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013					-$0.00 A
2014	-$0.00 A	$0.00 A	$0.00 A	-$0.00 A	$0.00 A
2015	$0.00 A	-$0.09 A	-$0.01 A	$0.00 E	-$0.10 E
2016					-$0.00 E

Quarters might not sum reflecting rounding, share count changes

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

Disclosures begin on page 9

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KEY POINTS

- Tapinator reported 3Q15 revenue of $728,128, a 191% advance compared to 3Q14. This growth reflects the company's expanding portfolio of both rapid-launch and full-featured games. On the higher revenue base, the company generated adjusted EBITDA of $73,914 versus $44,907 registered in 3Q14, which represented a 65% y/y advance.

- Tapinator continues to invest in new game development. The company introduced 26 new games during the quarter, including three Halloween themed titles. This brought its owned and operated portfolio to 153 mobile gaming titles. At the end of 3Q15, 37 titles had reached the one million download mark, up from 20 at the end of 2Q15 and 15 at the end of 1Q15.

- In May 2015, Tapinator introduced its first social casino game, *Video Poker VIP*, on the iOS platform for iPads. During 3Q15, *Video Poker VIP* launched on the iPhone, with several important updates. In 1Q16, the company intends to release multiplayer functionality in *Video Poker VIP* and anticipates that it will have a positive impact on engagement and monetization.

- Tapinator's business model has also recently expanded to include a greater focus on licensed titles that leverage well-known brands. Tapinator has released games inspired by Discovery's *Deadliest Catch* and *Nik Wallenda in Sky Balance*. Tapinator intends to develop a game based on a well-known movie franchise, although management has not disclosed the title yet. The game is slated for 2Q16 release and Tapinator has indicated that it will represent the highest profile licensed property that the company has leveraged thus far, based on a brand that is almost forty years old and films that have generated an aggregate $1+ billion.

- Tapinator also plans to enter the rapidly growing $680 million Middle Eastern and North African mobile gaming market through a new partnership with Tamatem, with local versions of several successful Tapinator titles slated for release in December 2015.

- Tapinator's rising traction with gamers is reflected in its user metrics and growing base of user downloads, we believe. Tapinator's cumulative downloads had reached roughly 135 million, up approximately 39% from 97 million at the end of 2Q15 and more than double the roughly 65 million at the end of 1Q15. Average monthly active users of 10.2 million increased 221% compared to 3Q14 and 32% compared to 7.73 million at the end of 2Q15. As the company's games library continues to expand, we would expect further increases in cumulative user metrics.

3Q15 RESULTS

Tapinator (OTC:TAPM) reported another strong quarter from a top-line perspective, with 3Q15 revenue of $728,128 up 191% compared to 3Q14. This growth reflects the company's expanding portfolio of both rapid-launch and full-featured games. On the higher revenue base, the company generated adjusted EBITDA of $73,914 versus $44,907 registered in 3Q14. This represents a 65% year-over-year advance. While adjusted EBITDA was up significantly, the aforementioned 65% year-over-year improvement did not match the 191% revenue improvement, implying that the company did not benefit from operating leverage or scale as its revenue improved.

However, Tapinator is re-investing in its business right now in order to generate future growth. The company's $169,666 in R&D more than doubled (+114%) compared to 3Q14 and Tapinator spent $107,512 on Marketing and PR compared to $12,789 in last year's 3Q. Finally, reflecting the strategy

to focus greater attention on high profile licensed titles, Tapinator incurred $13,667 in Licensing and royalty fees in the quarter against no such fees in 3Q14.

Tapinator recorded a 3Q15 operating loss of ($173,038) versus operating income of $33,835 generated in 3Q14. This swing to an operating loss primarily reflects the above-noted expense increases, including higher personnel and marketing expense, combined with increased development and software amortization.

Tapinator recorded a net loss of ($582,390) for 3Q15, which included a $327,402 non-cash charge related to the amortization of the company's debt discount, as well as the above-noted increase in amortization of capitalized software costs. By comparison, Tapinator registered net income of $33,835 in the same period of 2014. The net loss masks underlying positive trends in the company's core business, in our view.

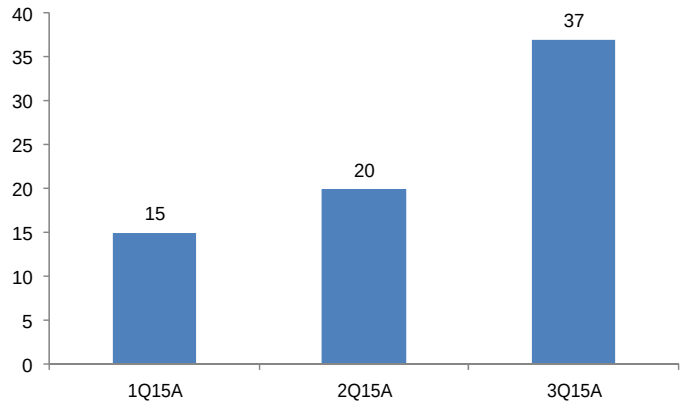
Liquidity and Balance Sheet

Tapinator's cash balance was $1.79 million at September 30, 2015 compared to $121,740 at December 31, 2014. In June 2015, the company raised $2.0 million through the issuance of a $2.24 million 8% senior convertible note due January 1, 2017, with five-year warrants to purchase 10.9 million shares and five-year callable warrants to purchase 10.9 million shares. The company used a portion of the capital to reduce debt. Based on its reassessment of shares available to settle outstanding warrants and potential conversion of convertible debentures into shares, the company restated its 1H 2015 net loss to ($293,149) from ($4,987,720) and its stockholders' equity from a deficit of ($3,346,159) to $3,348,412 as of June 30, 2015.
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GROWING PORTFOLIO OF GAMES; IMPROVING PLAYER METRICS

Tapinator continues to invest in new game development. The company introduced 26 new games during the quarter, including three Halloween themed titles. This brought its owned and operated portfolio to 153 mobile gaming titles. These games have cumulatively achieved over 100 million cumulative downloads to-date. At the end of 3Q15, 37 titles had reached the one million download mark, up from 20 at the end of 2Q15 and 15 at the end of 1Q15. Seven Tapinator full-featured titles have been selected as Best New Games at the end of 3Q15 and one as Free App of the Week on iOS.

Tapinator Titles Exceeding One Million Downloads



Source: Company reports

Two new full featured games that Tapinator had introduced in summer 2015, *Rotatio* and *Dice Mage*, achieved strong results during the quarter. *Dice Mage* was selected as a Best New Game and reached the #2 position in Free Dice games, ranking among the top-10 grossing dice games.

Combo Quest became Apple's Free App of the Week in October. The game garnered more than one million downloads during that week. The latest version of *Combo Quest* was featured as a *Best New Game Update* earlier this month, which marks the fourth time that the title has been featured in the App Store. Tapinator has added new in-app purchase opportunities to *Combo Quest* and believes that *Combo Quest* and *Dice Mage* both have franchise potential.

The quick-fix arcade game *Rotatio* was also featured as a Best New Game. Consistent with its strategy to leverage successful games and brands, the company plans to launch a major update of *Rotatio* later this month.

Growing Focus on Social Casino Gaming

Until recently, the company had been almost exclusively focused on free-to-play mobile games, with roughly 80% of its games ad supported and free-to-play. The other roughly 20% of the game portfolio has been monetized through in-app purchases. With the increase in gamers' time spent on mobile games, consumers' willingness to spend on mobile games has increased. The worldwide market for sales of virtual goods was estimated at roughly $15 billion in 2014, according to market research provider In-Stat. With the market shift towards in-app purchases, Tapinator also hopes to transition its revenue mix over the next 12-24 months to 50% advertising and 50% micro transactions.

Tapinator hopes to boost revenue and shift the revenue mix through its recent entrance into the social casino gaming niche. Social casino games are casino-style games such as blackjack, poker, slots and others that monetize through virtual currency purchases instead of real money payouts, according to VentureBeat. Social casino games generate over $2.5 billion annually, with the lion's share of revenue from mobile users. There is some concern that the social casino gaming market has matured and that growth has slowed, although Tapinator believes that video poker is less competitive than other social casino categories on mobile platforms and represents a strong growth opportunity.

In May 2015, Tapinator launched its first social casino game, *Video Poker VIP*, on the iOS platform for iPads. *Video Poker VIP* combines popular video poker gameplay with mobile slot machine-like mechanics, according to management. During 3Q15, *Video Poker VIP* launched on the iPhone, with several important updates. The company remains optimistic about the game's prospects and intends to broaden *Video Poker VIP* distribution to Google Play and the Amazon Appstore, as well. In 1Q16, Tapinator also plans to release multiplayer functionality in *Video Poker VIP* and anticipates that it will have a positive impact on engagement and monetization. The company reiterated its commitment to the social casino category and to the *Video Poker VIP* game as part of its strategy to continue to boost revenue and expand margins.

Licensed and Social Games

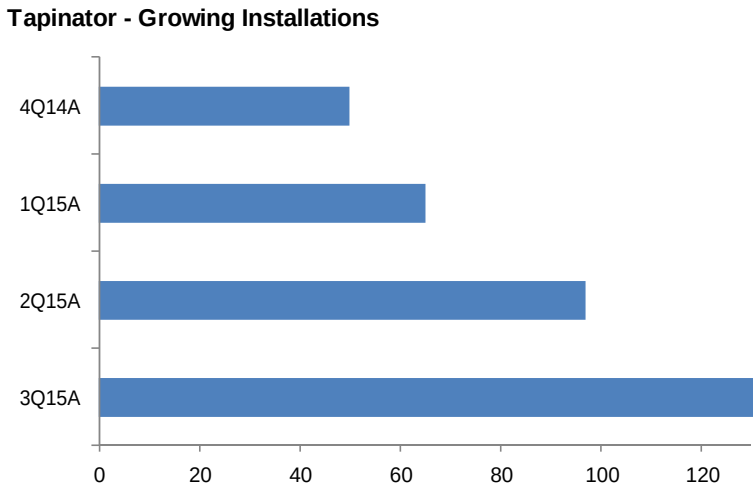
Towards the goal of shifting its portfolio towards games that are monetized through micro purchases, Tapinator's business model has also recently expanded to include a greater focus on licensed game titles leveraging well-known brands. Management believes the successful launch of two recent celebrity games – *Nik Wallenda in Sky Balance* and *Melissa Etheridge* in a song-based game – support its decision to pursue this strategy.

Tapinator recently released a game inspired by Discovery's show *Deadliest Catch* and the company is also optimistic about other licensed IP opportunities. Tapinator intends to develop a game based on a well-known movie franchise. This title is slated for 2Q16 release and management has indicated that it will represent the highest profile licensed property that the company has leveraged thus far. The brand is almost forty years old, according to management, and the films have generated more than $1 billion. In 4Q15, the company intends to announce the game, as well as several other full-featured titles currently under development slated for 2016 introduction.

Entering the Arabic Speaking Market

Tapinator also plans to enter the rapidly growing $680 million Middle Eastern and North African mobile gaming market through a new publishing partnership with Tamatem, with local versions of several successful Tapinator titles planned for December 2015. Among these titles, Tapinator will release local language versions of *Cop Duty Simulator 3D* and *Trucker Parking 3D*. According to data cited by the company from Gulf Communications Council Telecommunications Regulators, smartphone penetration in Saudi Arabia and the UAE exceeds 75% of the population. The company views this as a significant opportunity, particularly as less than 1% of all mobile gaming content is available in Arabic, with only 250 Arabic games available on the App Store compared to roughly 400,000 English language titles, according to GamesIndustry.biz.

Rising User Metrics



Source: Company reports

Tapinator's rising traction with gamers is reflected in its user metrics and growing base of user downloads, we believe. Tapinator's cumulative downloads had reached roughly 135 million, up approximately 39% from 97 million at the end of 2Q15 and more than double the roughly 65 million at the end of 1Q15. Average monthly active users of 10.2 million increased 221% compared to 3Q14 and 32% compared to 7.73 million at the end of 2Q15. As the company's games library continues to expand, we would expect further improvements in its cumulative user metrics.

Tapinator 3Q15 Player & Game Metrics

	Metric	Y/Y %Chg	Q/Q %Chg
Average DAUs	0.591	223%	25%
Average MAUs	10.2	221%	32%
Average New Daily Downloads	0.424	247%	19%
Cumulative Downloads*	135	282%	39%
Cumulative Game Library Titles*	153	135%	20%

Metrics millions except game library *As of September 30, 2015
DAUs Daily active users MAUs Monthly active users
Source: Company reports

RECENT NEWS

On November 5, 2015, the company announced a new partnership with Tamatem, Inc. to jointly release local language versions of some of its successful titles in Arabic speaking markets.

On October 26, 2015, Tapinator announced plans to release ten games during October of 2015, including three Halloween themed games – *Halloween Party Bus Driver 3D, Goat-Z in Zombie City* and a special Halloween edition of *Burn It Down*.

On October 6, 2015, the company announced that *Combo Quest* had become the Free App of the Week on Apple's iOS platform, which marked the fourth feature placement for the title in the App Store.

On September 16, 2015, the company announced that it planned a number of 4Q15 major game updates within its Full-Featured Games portfolio, as part of its ongoing strategy to continue boosting key user metrics. These include:

- *Video Poker VIP* 2.2
- *Dice Mage* 1.1
- *Burn It Down* Halloween edition
- *Rotatio* 2.0

RISKS

- TAPM is not cash flow positive and may need to seek additional short-term funding that could dilute shareholders.
- Competition continues to increase, which could make it difficult for TAPM to execute its growth strategy.
- Industry spending on player acquisitions and marketing could push Tapinator to increase its spending, as well, which could have a negative impact on the company's results and cash position.
- The company is not fully reporting.
- The social casino gaming sector could prove more competitive and difficult to penetrate than management anticipates.
- Its increased emphasis on licensed product could pressure overall margins.

PROJECTED INCOME STATEMENT AND BALANCE SHEET

Tapinator, Inc. Income Statement & Projections ($)

	1Q14	2Q14	3Q14	4Q14	2014	1Q15A	2Q15A	3Q15A	4Q15E	2015E	2016E
Revenue	$95,984	$226,320	$250,339	$370,806	$943,449	$411,883	615,358	$728,128	$815,773	$2,571,142	$4,113,828
Expenses											
Platform fees	28,763	67,736	73,322	110,867	280,688	132,000	184,311	217,791	244,732	778,834	1,234,148
R&D	55,300	125,939	79,172	80,754	341,165	91,307	141,543	169,666	154,997	557,513	680,166
Licensing & royalties								13,667			
Marketing & PR							41,795	107,512	50,000	199,307	243,155
General and administrative	20,029	20,246	64,009	192,865	297,149	163,836	391,028	392,530	394,493	1,341,887	1,677,358
Total expenses	104,092	213,921	216,503	384,486	919,002	387,143	758,677	901,166	844,222	2,877,541	3,834,827
Operating income (loss)	(8,108)	12,399	33,836	(13,680)	24,447	24,740	(143,319)	(173,038)	(28,448)	(306,398)	279,001
Loss on chg derivative liabs							4,694,571		2,000	4,696,571	1,000
Debt discount amort							114,146	327,402	114,000	555,548	340,000
Interest expense	-			15,941	15,941	15,754	40,899	81,950	41,000	179,603	181,399
Pretax income (loss)	(8,108)	12,399	33,836	(29,621)	8,506	8,986	(4,992,935)	(582,390)	(185,448)	(5,751,787)	(243,398)
Income taxes	25				614	3,146	626	-	500	4,272	5,000
Net income (loss)	(8,133)	12,399	33,836	(29,621)	7,892	5,840	(4,993,561)	(582,390)	(185,948)	(5,756,059)	(248,398)
Per share data:											
LPS	($0.00)	$0.00	$0.00	($0.00)	$0.00	$0.00	($0.09)	($0.01)	($0.00)	($0.10)	($0.00)
Avg. shares out	36,700,000	45,874,372	55,498,545	55,570,208	55,641,871	55,819,919	55,285,873	57,089,948	57,089,948	56,321,422	56,446,798

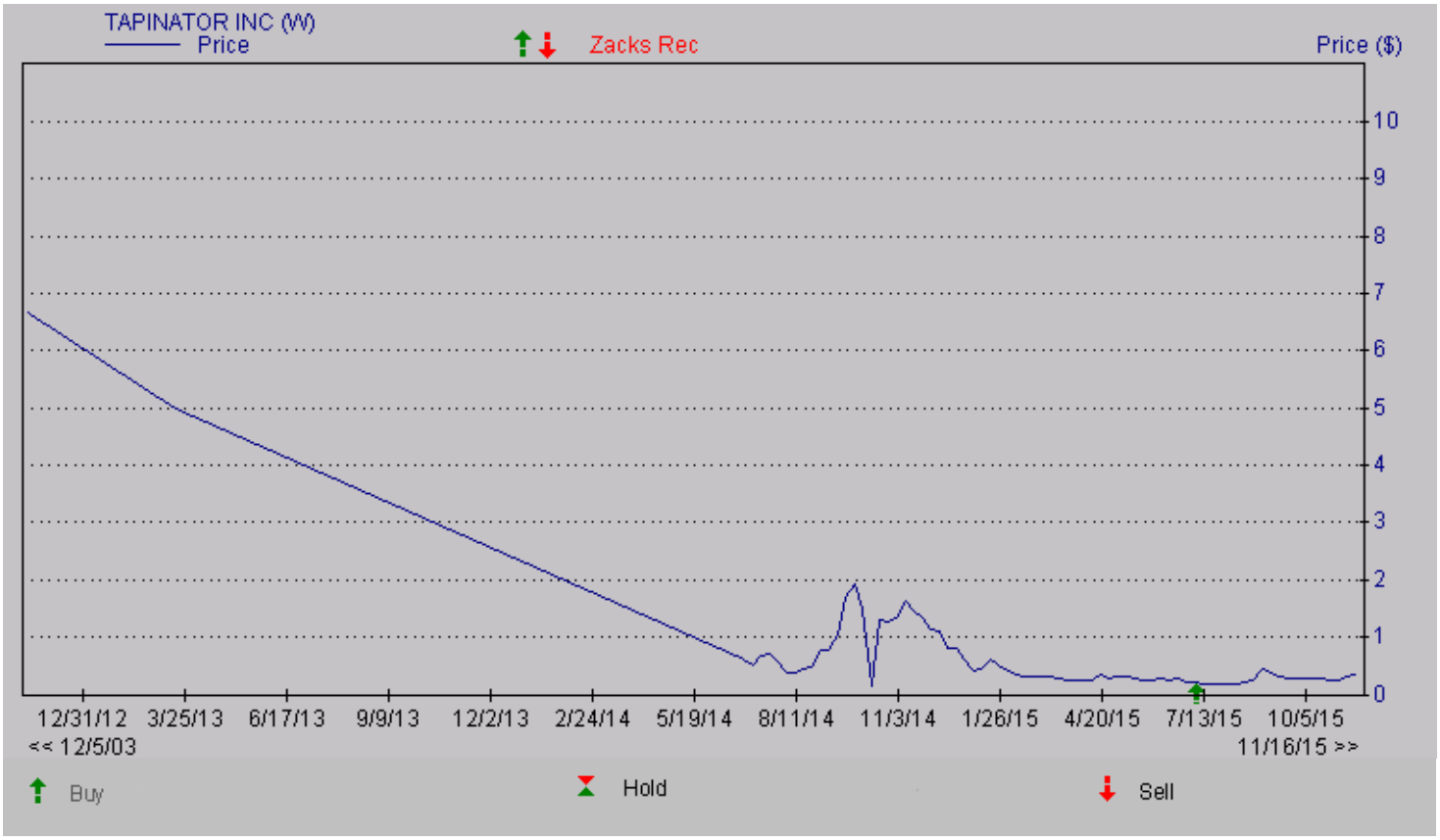
Tapinator, Inc. Consolidated Balance Sheets ($)

	31-Dec-13	30-Jun-14	30-Sep-14	31-Dec-14	31-Mar-15	30-Jun-15	30-Sep-15
Cash & equivalents	12,418	24,415	213,072	121,740	70,753	1,845,462	1,792,224
Accounts receivable	34,198	139,371	116,366	130,681	137,682	261,934	302,114
Prepaid expenses						13,470	59,836
Due from related parties	9,790	57,160	117,168	-	-	-	-
Total current assets	56,406	220,946	446,606	252,421	208,435	2,120,866	2,154,174
Property and equipment	2,158	1,777	1,587	17,500	6,213	7,841	12,416
Software development costs	-	3,078	176,954	1,260,865	1,367,249	1,207,045	1,200,920
Capitalized financing costs						108,135	90,047
Investments	-	12,500	14,086	19,086	19,086	19,086	19,086
Security deposits	5,690	5,800	5,800	19,840	14,040	14,040	14,040
Total assets	**64,254**	**244,102**	**645,033**	**1,569,712**	**1,615,023**	**3,477,013**	**3,490,683**
Accounts payable	9,750	10,535	3,442	6,596	961	4,171	95,299
Accrued expenses	7,000			50,329	35,235	-	
Due to related parties	25,811	130,107	205,374	129,327	112,273	67,177	104,605
Senior convertible debenture, net of (	-	-	-	-	-	-	116,940
Total current liabilities	42,561	140,642	208,816	186,252	148,469	71,348	316,844
Notes payable	-	-	-	203,954	281,208	-	
Senior convertible debenture						57,253	350,819
Derivative liabilities	-	-	-	-	-	-	-
Total liabilities	**42,561**	**140,642**	**208,816**	**390,206**	**429,677**	**128,601**	**667,663**
Redeemable Preferred Stock				773,499	773,499	-	
Total stockholders' equity	21,693	103,459	436,217	406,007	411,847	3,348,412	2,823,020
Total liabilities and stockholders'	**64,254**	**244,102**	**645,033**	**1,569,712**	**1,615,023**	**3,477,013**	**3,490,683**

Pro forma

Source: Company reports, Zacks

HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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