

# Fundamental

## Research Corp.

Investment Analysis for Intelligent Investors

September 4, 2019

### Inception Mining Inc. (OTCQB: IMII) – YTD Gold Production Up 30% as of Mid Q3

#### Sector/Industry: Junior Mining

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#### Market Data (as of September 4, 2019)

Current Price	US\$0.08
Fair Value	US\$0.32
Rating*	BUY
Risk*	4
52 Week Range	US\$0.06 - US\$0.55
Shares O/S	59,235,102
Market Cap	US\$4.74 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	N/A
YoY Return	33.3%
YoY OTCQB	16.8%

\*see back of report for rating and risk definitions.

\* All figures in US\$ unless otherwise specified.



#### Highlights

- On August 28, 2019, Inception Mining Inc. (“Inception”, “company”) announced production of 975 oz gold and 272 oz silver in the first half of Q3-2019 (up 400% YoY), bringing the total YTD production to approximately 2,520 oz gold equivalent, up 30% YoY.
- Q2 revenues were down 7% YoY, but up 20% QoQ, to \$1.10 million. H1-2019 revenues were down 14% YoY to \$2.02 million. As actual sales data were not disclosed, we suspect that revenues dropped due to lower gold prices.
- Gross margins increased YoY in Q2-2019 from 28% to 40%.
- EBITDA in Q2-2019 was -\$0.12 million versus -\$0.17 million in Q2-2018, and -\$0.94 million in Q1-2019.
- The company’s balance sheet is significantly leveraged from \$14.11 million in related party debt, and \$5.62 million in convertible notes.

Key Financial Data (FYE - Dec 31)	2016	2017	2018	2019	2020
Cash	\$194,652	\$51,802	\$50,857	\$1,293,143	\$2,622,965
Working Capital	-\$10,954,896	-\$13,508,790	-\$18,442,983	-\$27,273,034	-\$30,822,963
LT Debt	\$0	\$0	\$0	\$561,943	\$561,943
Total Assets	\$2,976,891	\$2,436,237	\$1,354,295	\$2,767,152	\$4,257,378
Revenues	\$5,954,562	\$3,631,759	\$3,967,869	\$6,233,793	\$7,891,460
Net Income (Loss)	\$17,354,157	-\$3,384,158	-\$5,626,014	-\$10,760,086	-\$5,036,734
EPS	\$0.35	-\$0.07	-\$0.11	-\$0.18	-\$0.09

**YTD  
Production  
Up 30% YoY**

In the first six months of 2019, the company produced 1,541 oz gold equivalent (99.5% gold and 0.5% silver), including 850 oz in Q1, and 691 oz in Q2. Comparable 2018 production data was not disclosed. As shown in the table below, the average gold grade was 2.12 gpt in H1-2019, lower than the 2.46 gpt in 2018 (full year). However, recovery rates improved from 40% to 44%.

**Production History**

	2014	2015	2016	2017	2018	Q1-2019	Q2-2019	2019 (6M)
Tonnage	55,183	77,168	113,999	90,356	91,932	27,755	23,623	51,378
TPD	148	211	312	248	252	308	262	284
Au grade (gpt)	2.89	3.58	2.86	2.4	2.46	1.91	2.39	2.12
Au contained (oz)	5,103	8,881	10,433	6,939	7,237	1,692	1,803	3,494
Au Recovery	48%	50%	53%	45%	40%	50%	38%	44%
Au recovered (oz)	2,485	4,440	5,482	3,125	2,932	845	688	1,533
Ag grade (gpt)		4.23	2.67	3.61	0.84	2.01	2.01	2.00
Ag contained (oz)		10,482	9,740	10,438	2,471	1,785	1,519	3,304
Ag Recovery		55%	55%	18%	40%	25%	16%	21%
Ag recovered (oz)		5,774	5,389	1,891	998	453	236	689
Gold equiv oz (produced)	2,485	4,529	5,565	3,154	2,947	850	691	1,541

Source: Company

On August 28, 2019, the company announced production of 975 oz gold and 272 oz silver in the first half of Q3-2019 (up 400% YoY), bringing the total YTD production to 2,508 oz gold and 960 oz silver, or approximately 2,520 oz gold equivalent, up 30% YoY.

Inception had announced a resource estimate in March 2019, which showed an inferred resource of 196 Koz to 471 Koz gold. The project holds a low sulfidation epithermal deposit over a steeply dipping fracture system with a 600 m strike and 70 m – 80 m width. The deposit consists of an **oxide zone** (depth – up to 45 m), a **transitional supergene** enrichment domain (typically 12-15 m thick, and the highest-grade zone), and a lower **sulfide zone** comprised of structurally controlled vein systems, stockwork, and hydrothermal explosion breccias. Mineralization is estimated to be open to depth; the deepest drill hole reached 200 m. **The authors of the technical report indicated that the upper end of their resource estimate is likely conservative, since the base of the sulfide domain has yet to be determined.**

**Summary of Inferred Mineral Resource Estimate – Geology Sulfide Model**

Domain	Rock Volume	Rock Mass	Avg. assay	Ounces (Au)
Oxide	1,856,300 m <sup>3</sup>	4,269,490 tonnes	0.75 g/t Au	112,949 oz
Supergene Enrichment	18,921 m <sup>3</sup>	51,087 tonnes	4.5 g/t Au	8,109 oz
Sulfide (geology model)	7,606,900 m <sup>3</sup>	20,538,630 tonnes	0.47 g/t Au	340,499 oz
Leach Pad	264,729 m <sup>3</sup>	476,512 tonnes	0.57 g/t Au	9,580 oz
			<b>total</b>	<b>471,137 oz</b>

**Summary of Inferred Mineral Resource Estimate – Interpolant Sulfide Model**

Domain	Rock Volume	Rock Mass	Avg. assay	Ounces (Au)
Oxide	1,856,300 m <sup>3</sup>	4,269,490 tonnes	0.75 g/t Au	112,949 oz
Supergene Enrichment	18,921 m <sup>3</sup>	51,087 tonnes	4.5 g/t Au	8,109 oz
Sulfide (interpolant model)	1,462,000 m <sup>3</sup>	3,947,400 tonnes	0.47 g/t Au	65,442 oz
Leach Pad	264,729 m <sup>3</sup>	476,512 tonnes	0.57 g/t Au	9,580 oz
			<b>total</b>	<b>196,080 oz</b>

*Source: Company*

Inception’s ore is currently being processed at the Cobra Oro facility, owned by Glen Eagle Resources (TSXV: GER). The facility, located 30 minutes from the mine, also processes ore from two other companies in the region. Inception and GER entered into a one-year contract in May 2019. **In a press release by Glen Eagle, the average grade of Inception’s ore in July was 2.4 gpt, which is encouraging as H1-2019’s average was only 2.12 gpt.** GER is planning to increase its facility’s capacity from 150 tpd to 250 tpd.

Inception’s current operation has the capacity to process up to 1,000 tpd of oxide material. The process flow chart consists of crushing, leaching, and an Adsorption, Desorption, and Refining (ADR) plant. The company decided to use toll milling to increase production capabilities and improve efficiency, while simultaneously lowering fixed costs. Also, the variable nature of the ore requires a modular crushing system which is capital intensive.

**An Updated Image of the Site**



*Source: Company*

*Upcoming Catalysts*

On September 3, 2019, the company announced it had retained a Honduran subcontractor. The contractor has already moved onsite and expects to setup a crushing circuit. Crushing ore to optimal levels will likely improve the recovery rates. Management also expects the production capacity to increase to 230 Kt per year, well exceeding 2018 production of 92 Kt.

The company’s upcoming plans on the project include the following:

- Management expects to produce 5,000 oz in 2019 (previously 6,000 oz)
- Increase production by potentially improving recovery rates.
- Initiate a new drill program to potentially confirm and expand the existing resource estimate.
- Initiate a Preliminary Economic Assessment (“PEA”) for expansion as well as initiate underground operations

*U.P. & Burlington, Idaho*

Due to the company’s focus on increasing production and margins at Clavo Rico, there have not been any developments / updates on the U.P. & Burlington project, located in Lemhi county, 6 miles northwest of the city of Salmon, Idaho. The U.P. & Burlington is one of several epithermal precious metal deposits in the region. The project has a historical resource estimate, calculated in 1935, of 122,600 tons at 0.581 opt (18.14 gpt) for 71,179 oz of contained gold.

	Tonnage	Au grade (gpt)	Au (oz)
Indicated Resource	58,600	20.70	38,813
Inferred Resource	64,000	15.80	32,366
<b>Total</b>	<b>122,600</b>	<b>18.14</b>	<b>71,179</b>

*Source: Company*

*Revenues down 7% YoY in Q2*

Q2 revenues were down 7% YoY, but up 20% QoQ, to \$1.10 million. H1-2019 revenues were down 14% YoY to \$2.02 million. Although production data were disclosed, the company has not disclosed sales data. We suspect that the decline in revenues was due to lower gold prices.

STATEMENTS OF OPERATIONS									
(in US\$) - YE Dec 31st	Q1-2018	Q1-2019	YoY	Q2-2018	Q2-2019	YoY	2018 (6M)	2019 (6M)	YoY
Revenues	1,179,440	921,442	-22%	1,182,145	1,101,765	-7%	2,361,585	2,023,207	-14%
COGS	1,687,599	1,228,511	-27%	853,526	656,103	-23%	2,541,125	1,884,614	-26%
<b>Gross Profit</b>	<b>(508,159)</b>	<b>(307,069)</b>		<b>328,619</b>	<b>445,662</b>		<b>(179,540)</b>	<b>138,593</b>	
<b>EXPENSES</b>									
General and administrative	477,811	620,321	30%	498,979	561,140	12%	976,790	1,181,461	21%
Stock based compensation									
<b>EBITDA</b>	<b>(985,970)</b>	<b>(927,390)</b>		<b>(170,360)</b>	<b>(115,478)</b>		<b>(1,156,330)</b>	<b>(1,042,868)</b>	
Amortization	10,275	9,088		9,236	9,071		19,511	18,159	
<b>EBIT</b>	<b>(996,245)</b>	<b>(936,478)</b>		<b>(179,596)</b>	<b>(124,549)</b>		<b>(1,175,841)</b>	<b>(1,061,027)</b>	
Interest expense	791,566	1,350,338	71%	1,080,031	4,883,947	352%	1,871,597	6,234,285	233%
<b>EBT</b>	<b>(1,787,811)</b>	<b>(2,286,816)</b>		<b>(1,259,627)</b>	<b>(5,008,496)</b>		<b>(3,047,438)</b>	<b>(7,295,312)</b>	
Non-recurring expenses	(302,105)	1,500,005		-475,487	-2,640,472		(777,592)	(1,140,467)	
Taxes				0	0				
Non-controlling interest	-1,234	-164		801	77		-433	-87	
<b>Net Profit (Loss)</b>	<b>(1,484,472)</b>	<b>(3,786,657)</b>		<b>(784,941)</b>	<b>(2,368,101)</b>		<b>(2,269,413)</b>	<b>(6,154,758)</b>	
EPS	-0.03	-0.07		-0.01	-0.04		-0.04	-0.11	

Source: FRC / Company

As the company has not disclosed actual sales, we are not in a position to estimate the production cost per oz. **Gross margins increased YoY in Q2-2019 from 28% to 40%**. This is a very positive development especially considering that gross margins were negative in Q1-2019. Q2-2019 margins also beat the Gold Producers' Industry average of 29% (Source: S&P Capital IQ). Our discussions with management indicated that the production cost figures also include expansion / upgrade costs, which is why there is significant volatility / fluctuations in margins. Costs are likely to be volatile until operations stabilize.

Margins	Q1-2018	Q1-2019	Q2-2018	Q2-2019	2018 (6M)	2019 (6M)	Gold Producers
Gross	-43.1%	-33.3%	27.8%	40.4%	-7.6%	6.9%	29.1%
EBITDA	-83.6%	-100.6%	-14.4%	-10.5%	-49.0%	-51.5%	24.1%
EBIT	-84.5%	-101.6%	-15.2%	-11.3%	-49.8%	-52.4%	7.2%
Net	-125.9%	-410.9%	-66.4%	-214.9%	-96.1%	-304.2%	-3.1%

Source: FRC

EBITDA in Q2-2019 was -\$0.12 million versus -\$0.17 million in Q2-2018, and -\$0.94 million in Q1-2019. Interest expense increased 352% YoY (due to a significant increase in debt, described below) to \$4.89 million in Q2-2019. The company reported a net loss of \$2.37 million (EPS: -\$0.04) in Q2-2019 versus \$0.78 million (EPS: -\$0.01) in Q2-2018. In H1-2019, the company reported a net loss of \$6.15 million (EPS: -\$0.11) versus \$2.27 million (EPS: -\$0.04) in H1-2018.

Free cash flows in H1-2019 were -\$1.51 million versus -\$42k in H1-2018.

*Leveraged  
Balance  
Sheet*

Summary of Cash Flows		
(\$, mm)	2018 (6M)	2019 (6M)
Operating	\$0.01	-\$1.51
Investing	-\$0.01	\$0.00
Financing	-\$0.04	\$1.48
Effects of Exchange Rate	-\$0.00	-\$0.00
Net	-\$0.04	-\$0.04
<b>Free Cash Flows to Firm (FCF)</b>	<b>-\$0.00</b>	<b>-\$1.51</b>

At the end of Q2-2019, the company had cash and working capital of \$13k and -\$22.28 million, respectively. The following table summarizes the company's liquidity position:

Liquidity & Capital Structure	2016	2017	2018	Q2-2019
Cash	194,652	51,802	50,857	12,732
Working Capital	(10,954,896)	(13,508,790)	(18,442,983)	(22,281,777)
Current Ratio	0.1	0.1	0.0	0.0
LT Debt	-	-	-	561,943
Total Debt	11,591,502	13,497,064	17,464,381	22,011,378
LT Debt / Capital	0.0%	0.0%	0.0%	-95.5%
Total Debt / Capital	705.5%	2484.7%	-2818.9%	-3739.1%
EBIT Interest Coverage	-0.60	-0.79	-0.39	-0.03

Source: FRC

The negative working capital was primarily because of \$14.11 million in related party debt. Interest on this is accrued at 18% p.a. In addition, the company has convertible notes payable of \$5.62 million, and derivative liabilities (related to the convertible notes payable) of \$6.40 million. Interest on the convertible notes (10% p.a.) is also accrued. Total debt was \$26.42 million at the end of Q2-2019.

	2018	Q1-2019	Q2-2019
Notes payable - related parties	\$6,822,657	\$6,937,178	\$6,953,913
Accrued interest - related parties	\$6,647,300	\$6,906,655	\$7,152,869
<b>Total</b>	<b>\$13,469,957</b>	<b>\$13,843,833</b>	<b>\$14,106,782</b>
Total Convertible Notes Payable	\$2,281,894	\$2,981,000	\$5,615,000
Less Unamortized Discount	-\$1,112,499	-\$1,028,583	-\$4,404,845
<b>Convertible notes payable, net of debt discounts</b>	<b>\$1,169,395</b>	<b>\$1,952,417</b>	<b>\$1,210,155</b>
Derivative liabilities	\$2,547,806	\$4,613,816	\$6,397,194
Secured borrowings, net	\$217,223	\$166,697	\$237,247
Notes payable, net of debt discounts	\$60,000	\$60,000	\$60,000
<b>Total Debt</b>	<b>\$18,576,880</b>	<b>\$21,665,346</b>	<b>\$26,416,223</b>

Source: FRC / Company Data

*Stock Options and Warrants*

*Valuation and Rating*

**The highly leveraged balance sheet remains concerning.** All of the related party notes have to be paid out by 2024. Most of the convertible notes are only due by 2021 / 2022. The remaining convertible notes (\$275k) are due in November.

The company currently has 10.19 million warrants (weighted average exercise price of \$0.52 per share) and no options outstanding. Currently, all of the warrants are ‘out-of-the-money’.

**Our revenue forecast for 2019 is \$6.23 million (previously \$5.23 million) from gold production of 5,040 oz (previously 4,560 oz) at an average gold price of \$1,400 per oz in H2-2019.** Our forecast for 2020 is \$7.89 million (previously \$7.60 million) from gold production of 6,150 oz (unchanged) at a \$1,350 per oz (previously \$1,300 per oz) gold. Our EPS forecasts are net losses of \$10.76 million (EPS: -\$0.18), previously \$4.90 million (EPS: -\$0.09) in 2019, and \$5.04 million (EPS: - \$0.09), previously \$3.91 million (EPS: -\$0.07), in 2020.

The following table shows that gold producers are currently trading at an average Enterprise Value (EV) to resource (100% of measured and indicated and 50% of inferred) of \$185 per oz.

Gold Producers	EV / Resources \$ /oz
Barick	\$366
Newmont	n/a
Polyus	\$123
Agnico Eagle	\$660
AngloGold	\$55
Kinross Gold	\$230
Gold Fields	n/a
Sibanye	\$56
Yamana	\$284
B2Gold	\$224
Alamos	\$254
Hamony	\$16
Eldorado Gold	\$45
Premier Gold	\$63
Gran Colombia	\$35
<b>Average (excl outliers)</b>	<b>\$185</b>
Min	\$16
Max	\$660

*Source: S&P Capital IQ*

Based on the above multiple, we are valuing Clavo Rico’s resource at \$44 million. We used a resource of 234 Koz, which is 50% of the higher end of 471 Koz. Our net fair value estimate on Inception’s shares dropped to \$0.32 per share (due to higher debt) versus our estimate of \$0.48 per share in our previous report.

Although a significant portion of the outstanding debt is due to related parties, we remain

*Risk*

concerned regarding the company's highly leveraged balance sheet. Note that most of the debt is long-term. Based on the steep decline in Inception' share price since our previous report (from \$0.32 to \$0.08 per share), and our current fair value estimate of \$0.32 per share, **we are revising our rating on Inception's shares from a HOLD to BUY.**

We believe the company is exposed to the following key risks (not exhaustive):

- The value of the company is highly dependent on commodity prices (primarily gold and silver).
- Exchange rate risks associated with operating in Honduras.
- Upside is subject to the company's ability to ramp up of production.
- Leveraged balance sheet.
- Like all juniors, the company is also exposed to exploration and development risks.

Our risk rating is lowered from 5 (Highly Speculative) to 4 (Speculative).

## Appendix

<b>STATEMENTS OF OPERATIONS</b>					
(in US\$) - YE Dec 31st	2016	2017	2018	2019E	2020E
Revenues	5,954,562	3,631,759	3,967,869	6,233,793	7,891,460
COGS	3,238,385	3,230,904	3,553,550	4,626,376	5,533,175
<b>Gross Profit</b>	<b>2,716,177</b>	<b>400,855</b>	<b>414,319</b>	<b>1,607,418</b>	<b>2,358,285</b>
<b>EXPENSES</b>					
General and administrative	4,887,048	1,449,735	2,035,203	2,289,603	2,404,084
Stock based compensation					
<b>EBITDA</b>	<b>(2,170,871)</b>	<b>(1,048,880)</b>	<b>(1,620,884)</b>	<b>(682,186)</b>	<b>(45,799)</b>
Amortization	799,474	639,097	225,395	231,030	236,806
<b>EBIT</b>	<b>(2,970,345)</b>	<b>(1,687,977)</b>	<b>(1,846,279)</b>	<b>(913,216)</b>	<b>(282,604)</b>
Interest expense	4,933,633	2,127,518	4,756,764	10,989,205	4,754,920
<b>EBT</b>	<b>(7,903,978)</b>	<b>(3,815,495)</b>	<b>(6,603,043)</b>	<b>(11,902,421)</b>	<b>(5,037,524)</b>
Non-recurring expenses	-25,258,773	-430,968	-975,993	(1,140,467)	
Taxes					
Non-controlling interest	638	-369	-1,036	-1,867	-790
<b>Net Profit (Loss)</b>	<b>17,354,157</b>	<b>(3,384,158)</b>	<b>(5,626,014)</b>	<b>(10,760,086)</b>	<b>(5,036,734)</b>
EPS	0.35	-0.07	-0.11	-0.18	-0.09

<b>BALANCE SHEET</b>					
<b>(in US\$) - YE Dec 31st</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>
<b>ASSETS</b>					
<b>CURRENT</b>					
Cash and cash equiv.	194,652	51,802	50,857	1,293,143	2,622,965
A/R	11,094	170	5,548	31,169	39,457
Inventory	1,483,830	1,430,182	570,614	693,956	829,976
Prepaid	24,745	46,437	26,376	29,014	31,915
<b>Total Current Assets</b>	<b>1,714,321</b>	<b>1,528,591</b>	<b>653,395</b>	<b>2,047,281</b>	<b>3,524,313</b>
PPE, Mining Assets	1,262,570	907,646	700,900	719,870	733,065
<b>Total Assets</b>	<b>2,976,891</b>	<b>2,436,237</b>	<b>1,354,295</b>	<b>2,767,152</b>	<b>4,257,378</b>
<b>LIABILITIES</b>					
<b>CURRENT</b>					
A/P	1,077,715	1,540,317	1,631,997	1,387,913	1,659,953
Notes payable	295,739	266,035	277,223	277,223	277,223
Convertible notes	10,000	231,767	1,169,395	648,212	648,212
Due to related party	11,285,763	12,351,455	13,469,957	18,964,560	23,719,480
Derivative liability	-	647,807	2,547,806	8,042,409	8,042,409
<b>Total Current Liabilities</b>	<b>12,669,217</b>	<b>15,037,381</b>	<b>19,096,378</b>	<b>29,320,316</b>	<b>34,347,276</b>
Convertible notes				561,943	561,943
Mine reclamation	256,070	352,713	341,845	341,845	341,845
<b>SHAREHOLDERS EQUITY</b>					
Share capital	3,058,229	3,437,295	3,934,274	5,321,336	6,821,336
Non-controlling interest	(7,512)	(7,881)	(8,917)	(8,917)	(8,917)
Deficit	(12,999,113)	(16,383,271)	(22,009,285)	(32,769,371)	(37,806,105)
<b>Total shareholders' equity (deficiency)</b>	<b>(9,948,396)</b>	<b>(12,953,857)</b>	<b>(18,083,928)</b>	<b>(27,456,952)</b>	<b>(30,993,686)</b>
<b>Total Liabilities and Shareholders Equity</b>	<b>2,976,891</b>	<b>2,436,237</b>	<b>1,354,295</b>	<b>2,767,152</b>	<b>4,257,378</b>

<b>STATEMENTS OF CASH FLOWS</b>				
<b>(in US\$) - YE Dec 31st</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>
<b>OPERATING ACTIVITIES</b>				
Net profit for the year	-3,384,527	-5,627,050	-10,760,086	-5,036,734
<b>Adjusted for items not involving cash:</b>				
Depreciation	639,097	225,395	231,030	236,806
Stock compensation / option expense	151,448	351,458		
Non-recurring expenses / Others	302,904	1,467,835	10,989,205	4,754,920
<b>Funds From Operations</b>	<b>-2,291,078</b>	<b>-3,582,362</b>	<b>460,149</b>	<b>-45,008</b>
<b>Change in working capital</b>				
A/R	-17,368	16,640	-25,621	-8,288
Inventory	82,653	839,691	-123,342	-136,020
Prepaid	4,851	-14,601	-2,638	-2,901
A/P	2,181,020	2,565,603	-244,084	272,040
<b>NET CASH USED IN OPERATING ACT</b>	<b>-39,922</b>	<b>-175,029</b>	<b>64,464</b>	<b>79,822</b>
<b>INVESTING ACTIVITIES</b>				
Related party				
PP&E	-287,501	-30,499	-250,000	-250,000
<b>NET CASH USED IN INVESTING ACTI</b>	<b>-287,501</b>	<b>-30,499</b>	<b>-250,000</b>	<b>-250,000</b>
<b>FINANCING ACTIVITIES</b>				
Equity	49,000	42,000	1,427,822	1,500,000
Debt	135,608	157,650		
<b>NET CASH FROM FINANCING ACTIVI</b>	<b>184,608</b>	<b>199,650</b>	<b>1,427,822</b>	<b>1,500,000</b>
Foreign Exchange / Others	-35	4,933		
<b>INCREASE IN CASH FOR THE YEAR</b>	<b>-142,850</b>	<b>-945</b>	<b>1,242,286</b>	<b>1,329,822</b>
<b>CASH, BEGINNING OF THE YEAR</b>	<b>194,652</b>	<b>51,802</b>	<b>50,857</b>	<b>1,293,143</b>
<b>CASH, END OF THE YEAR</b>	<b>51,802</b>	<b>50,857</b>	<b>1,293,143</b>	<b>2,622,965</b>

**Fundamental Research Corp. Equity Rating Scale:**

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale:**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company’s capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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