

Fundamental Research Corp.

Investment Analysis for Intelligent Investors

August 19, 2016

Shoal Games Ltd. (TSXV: SGW / OTCQB: SGLDF) – Preparing to launch Garfield Bingo in Q4

Sector/Industry: Mobile Games

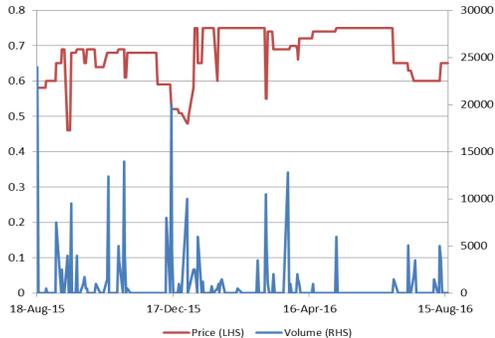
www.shoalgames.com

Market Data (as of August 19, 2016)

Current Price	C\$0.65
Fair Value	C\$1.52
Rating*	BUY
Risk*	5 (Highly Spec)
52 Week Range	C\$0.35 – C\$0.75
Shares O/S	59,535,637
Market Cap	C\$38.70 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	N/A
YoY Return	12.1%
YoY TSXV	50.1%

*see back of report for rating and risk definitions

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



Highlights

- The social gaming industry continues to witness major M&A activities. On July 31, 2016, a consortium of Chinese companies announced their intent to acquire Caesars Interactive Entertainment Inc.'s (Nasdaq: CZR) social and mobile gaming business, Playtika, for \$4.4 billion. One of Playtika's key assets is Bingo Blitz, which is one of the two established and dominant social bingo games.
- In Q2-2016, Shoal Games ("company", "Shoal") made a decision to divert most of their near-term focus and resources to the development of their new Garfield Bingo game, which is expected to be launched later this year.
- Shoal significantly reduced their marketing expenses to \$168k in Q2, down from \$202k in the previous quarter. Lower marketing dollars translated into lower revenues in the quarter (\$78k in Q2 versus \$111k in Q1).
- In Q2, the company closed two private placements and raised \$2 million by issuing 3.34 million common shares at \$0.60 per share. Shoal is currently pursuing a rights offering in Canada to holders of its common shares.
- Balance sheet remains healthy with no debt.
- We expect revenues in the second half to be soft as the company will not be spending much on marketing and player acquisition. We view the highly anticipated launch of Garfield Bingo in Q4 as the next big catalyst for Shoal's shares.

Key Financial Data (FYE - Dec 31)

(US\$)	2015	2016E	2017E
Cash	570,086	122,778	453,250
Working Capital	454,447	312,310	531,104
Total Assets	1,129,526	617,802	942,078
LT Debt to Capital	0.0%	0.0%	0.0%
Revenues	111,521	413,910	3,932,145
Net Income	(2,965,307)	(2,636,292)	219,279
EPS	-0.05	-0.04	0.00

*Success of
Pokemon Go*

The tremendous success of Pokemon Go since its launch in July, we believe, is a classic example of the power of new and innovative social games on gamers. With over 100 million downloads, Pokemon Go, is taking the social gaming world by storm. Like most social games, Pokemon Go, developed by Niantic Inc., is a free-to-play game with revenues coming from in-app purchases by players and/or advertising. Various sources state that players spent over \$250 million on the game in the first five weeks, with a potential to hit \$1 billion by year-end, excluding any potential advertising revenues. Currently, approximately 20% of the players spend money on the game.

*Owner of
Bingo Blitz
acquired for
\$4.4 billion*

On July 31, 2016, a consortium of Chinese companies, including an affiliate of Shanghai Giant Network Technology Co., Ltd. (SZE:002558 - one of China's largest online games companies) announced that they have entered into a definitive agreement with Caesars Interactive Entertainment, Inc. ("CIE") to acquire CIE's social and mobile games business in an all-cash deal for \$4.4 billion.

CIE, which generated \$240 million in revenues in Q-2016, is owned by Caesars Entertainment Corporation. CIE's assets include the World Series of Poker and Playtika (which includes Slotomania, House of Fun Slots, and Bingo Blitz). As per the transaction, CIE is selling all of its primary assets except the World Series of Poker.

Playtika was found in 2010, and was acquired by CIE in 2011, for \$103 million. In 2012, CIE acquired Buffalo Studios (owner of Bingo Blitz) for approximately \$53 million. According to Eilers Research and Krejcik Gaming, Playtika is currently the number one player in the \$3 billion social casino game business. Other sources state that Playtika has more than 6 million daily active users (DAUs), and 25 million monthly active users (MAUs) in 190 countries. **The \$4.4 billion acquisition reflects a Price to MAU of \$176.**

The social games industry has been very active in terms of M&A transactions. Larger players have used acquisitions to grow their revenues and earnings, as well as for diversification and to expand their base of players.

In June 2016, China's Tencent Holdings Ltd (SEHK: 700), one of the world's largest internet companies with a market capitalization of US\$244 billion, announced its plan to buy a majority stake in **'Clash of Clans' game maker Supercell for approximately \$8.6 billion**, putting a valuation of US\$10.2 billion on Supercell. Tencent's latest transaction is one of the world's biggest ever gaming deals. Clash of Clans, launched in 2012, has been one of the top grossing apps. Finland based Supercell generated \$2.3 billion in revenues (37% YOY growth) and \$930 million in profit in 2015. Supercell stated that they currently have 100 million DAUs across their four games.

The largest transaction prior to the above was Activision Blizzard's (Nasdaq: ATVI) acquisition of King Digital (makers of one of the most popular and top grossing games, Candy Crush Saga) for \$5.9 billion in November 2015.

The following table shows details of relevant acquisitions over the past few years.

Date	Acquirer	Target	Acquisition Price (\$, Millions)	MAU	Revenues (\$, Millions)	Price / MAU	Price / Revenues	
Oct-11	Caesars Entertainment Corporation (Nasdaq: CZR)	Playtika	\$103	5.8		\$17.76		
Dec-12	Caesars Entertainment Corporation (Nasdaq: CZR)	Buffalo Studios (Bingo Blitz)	\$53	2.7		\$19.48		
Jan-12	International Game Technology (NYSE: IGT)	Double Down Interactive	\$500	4.7	\$128.00	\$106.38	3.9	
Jan-13	Zynga (NASDAQ: ZNGA)	NaturalMotion	\$527		\$144.00		3.7	
Feb-14	GSN Games	Bingo Bash	\$160	4.8	\$60.00	\$33.33	2.7	
Feb-14	Caesars Entertainment Corporation (Nasdaq: CZR)	Pacific Interactive	\$108	2.7	\$27.50	\$40.00	3.9	
Jun-14	Bally Technologies (NYSE: BYI)	Dragonplay	\$100	3.0	\$30.00	\$33.33	3.3	
Aug-14	Zhongji Holdings (SHA: CN: 600634)	DianDian Interactive	\$960	20.0	\$72.00	\$48.00	13.3	
Nov-14	Scientific Games Corp.	Bally Technologies (NYSE: BYI)	\$5,100		\$1,370.00		3.7	
Dec-14	Churchill Downs Inc. (NASDAQ: CHDN)	Big Fish Games	\$885	10.0	\$278.00	\$88.50	3.2	
Jul-15	Stride Gaming PLC (LON: STR)	InfApps	\$39	0.5	\$13.70	\$78.40	2.9	
Nov-15	Imperus Technologies Corp (TSXV: LAB)	Akamon Entertainment	\$24	0.5	\$16.00	\$47.80	1.5	
Nov-15	Activision-Blizzard (NASDAQ: ATVI)	King Digital	\$5,900	474.0	\$2,270.00	\$12.45	2.6	
Jun-16	Tencent Holdings Ltd	Majority stake in Clash of Clans maker Supercell	\$10,200		\$2,300.00		4.4	
Jul-16	Chinese Consortium	Playtika	\$4,400	25.0	\$960.00	\$176.00	4.6	
	Average (excluding outliers)						\$58.45	3.4
	Min						\$12.45	1.5
	Max						\$176.00	13.3

Source: Fundamental Research and Various Sources

The average price to revenue ratio of the above acquisitions was 3.4x, and the price to MAU ratio was \$58.

One of the most attractive features of mobile games is that developers are able to tune a game’s settings and features based on real-time user response and feedback to improve the game’s performance. Therefore, a committed approach to game analytics can significantly increase the profitability of a game. We have been very pleased with management’s continued efforts to improve Trophy Bingo’s features and potentially increase monetization and retention of its players.

As mentioned in our previous reports, Shoal’s plan with Trophy Bingo is to offer an innovative product that engages bingo players in new and challenging ways, and attract players away from the established bingo games, such as Bingo Bash and Bingo Blitz. Each of these games are estimated to have more than 1 million DAUs (daily active users), and 4.5 million MAUs (monthly active users). Players are likely to play multiple titles of the same genre. Market research firm Newzoo indicates that social casino gamers play an average of

Update on Shoal’s Development

5.6 titles in a genre.

The following points highlight Shoal’s key priorities at this time:

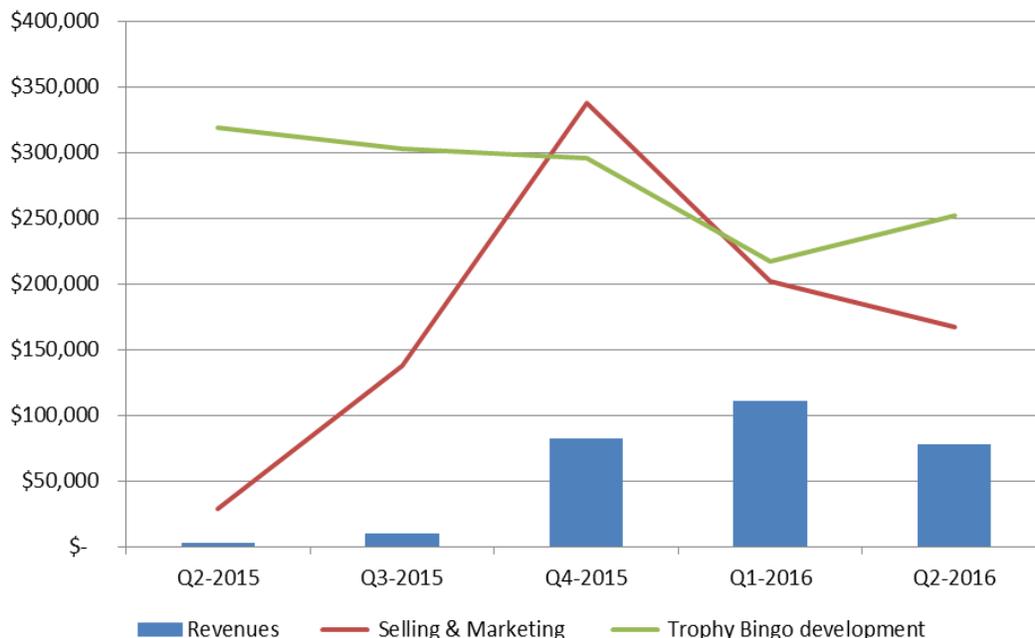
- In June 2016, SGW **announced the launch of a new version of the Trophy Bingo**. The new version adds another 20 levels to the previous version, taking the game to 140 levels in total, and contains a new tournament game mode titled “Top Dog”.
- Shoal’s team continues to be focussed on enhancing game play, expanding content, and delivering innovative game modes so that players will become immersed in Trophy Bingo. The game **is currently live in three languages** – English, Spanish and French. Management plans to add Swedish, Dutch, Portuguese, and Italian in the near-term.
- Shoal’s primary focus at this time is the launch of a new mobile bingo game featuring the iconic cartoon cat Garfield, in Q4-2016. In April 2016, Shoal had announced that it licensed the rights to Garfield from Paws Inc., the sole owner of the copyrights and trademarks of Garfield. The new game, we believe, is likely to instantly appeal and capture the attention of the approximately 17 million Facebook (Nasdaq: FB) fans of Garfield. This should allow Shoal to attract a much larger user-base at a much lower player acquisition costs.

Diverting marketing dollars to the development of Garfield Bingo

As a result of the above activities, the company decided to divert most of their near-term focus and resources to development instead of spending dollars on marketing and player acquisitions. **We see this as a very pragmatic strategy as the probability of increasing player retention and monetization will be much higher with an improved Trophy Bingo platform, and the launch of Garfield Bingo.**

In Q2, Shoal prepaid \$0.86 million for development expenses to their development partner, Roadhouse Interactive. The Trophy Bingo / Garfield Bingo team at Roadhouse now consists of 18 individuals, up from 12 at the time of our initiating report in February 2016. Shoal significantly reduced their marketing expenses to \$168k in Q2, down from \$202k in the previous quarter. The decline in marketing spending impacted the company’s overall performance in Q2, as revenues dropped from \$111k in Q1, to \$78k in Q2. The following chart shows the decline in marketing dollars and the corresponding decline in revenues.

Revising near-term projections



Shoal was also able to lower their General and Administrative (“G&A”) costs by 29% QOQ, from \$0.20 million to \$0.14 million.

In Q2-2016, the company reported a net loss of \$0.62 million (EPS: -\$0.01) versus \$0.67 million in Q2-2015 (EPS: -\$0.01) and \$0.63 million (EPS: -\$0.01) in Q1-2016.

As a result of the change in marketing strategy, we are pushing out our revenue forecasts by three quarters. We are adjusting our 2016, and 2017, revenue estimates to \$0.41 million and \$3.93 million versus our previous estimates of \$1.74 million and \$6.93 million, respectively. As for EPS, our revised estimates for 2016, and 2017, are net loss of \$2.64 million (EPS: -\$0.04) and net profit of \$0.22 million (EPS: \$0.00) versus our previous forecasts of net loss of \$2.02 million (EPS: -\$0.03) and net profit of \$1.75 million (EPS: \$0.03).

Our long-term outlook remains positive, and therefore, we are not making any significant changes to our long-term projections.

Free cash flows were -\$1.90 million in the first six months of 2016, versus -\$1.04 million in the comparable period in the previous year.

Recent financings

Summary of Cash Flows	2015 (6M)	2016 (6M)
Cash Flows from Operations	(1,041,690)	(1,895,924)
Cash Flows from Investing	(272)	-
Cash Flows from Financing	-	1,513,354
Net Change	(1,041,962)	(382,570)
Free Cash Flows	(1,041,962)	(1,895,924)

In Q2, the company closed two private placements and raised a gross amount of \$2 million by issuing 3.34 million common shares at \$0.60 per share.

With the completion of this financing, Shoal commenced a **rights offering in Canada** to holders of its common shares at the close of business on July 5, 2016, wherein shareholders will receive one right for each common share held. Ten rights will entitle the shareholder to purchase one common share:

- At \$0.60 per share until August 15, 2016
- At \$0.65 per share from August 16 to September 15, 2016
- At \$0.70 per share from September 16 to October 11, 2016

If all of the rights are exercised, the company may issue up to 5.95 million shares, and raise up to \$3.57 million to \$4.17 million, depending on when the rights are exercised.

At the end of Q2-2016, the company had \$0.19 million in cash, with no debt. Working capital and the current ratio were \$0.95 million, and 8x, respectively.

Liquidity Analysis	2015	Q2-2016
Cash	\$570,086	\$187,516
Working Capital	\$454,447	\$954,319
Current Ratio	3.56	8.02
Debt / Capital	0.0%	0.0%
LT Debt / Capital	0.0%	0.0%

Stock options and warrants: The company has no options or warrants outstanding.

Valuation

Our Discounted Cash Flow (“DCF”) model has a revised valuation of \$1.52 per share, down from our previous estimate of \$1.56 per share.

DCF Valuation		2016E	2017E	2018E	2019E	2020E	Terminal
Funds Flow from Operations (US\$)		(1,137,662)	223,794	4,484,139	9,726,886	15,075,652	
Change in Working Capital (US\$)		577,925	111,677	(775,450)	(951,545)	(973,694)	
Cash from Operations (US\$)		(559,738)	335,472	3,708,689	8,775,342	14,101,958	
CAPEX (US\$)		(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	
Free Cash Flow (US\$)		(564,738)	330,472	3,703,689	8,770,342	14,096,958	
Present Value (US\$)		(535,302)	281,444	2,833,979	6,029,530	8,707,574	66,746,434
Discount Rate	11.3%						
Terminal Growth	3.0%						
Present Value (C\$)	\$92,470,023						
Cash - Debt* (C\$)	\$2,759,151						
Fair Value (C\$)	\$95,229,175						
Shares O/S*	62,512,419						
Value per Share (C\$)	\$1.52						

* assumes completion of 50% of the current rights offering to raise approx. \$1.9M

We are adjusting our fair value estimate from \$1.60 to \$1.52 per share, and maintain our BUY rating on Shoal's shares.

Risks

The following risks, though not exhaustive, may cause our estimates to differ from actual results:

- The social games sector is highly competitive. There are over one million apps each available on both the App Store and Google Play stores.
- The social bingo gaming market is currently dominated by two established players.
- Keeping players engaged is critical and requires continuous development and innovation.
- Trophy Bingo is in its early stages and has yet to start to generate significant revenues.
- The company may have to pursue equity financings, which may dilute existing shareholders.
- The social games sector is not subject to any material regulations. Any unfavorable changes in regulations in the future may impact the company's business.
- Management and insiders own over 75% - 80% of the outstanding shares. Therefore, the liquidity and the average daily trading volume of SGW's shares are low at this time.

We assign a risk rating of 5 (Highly Speculative).

APPENDIX

STATEMENTS OF OPERATIONS				
(in US\$)- YE Dec 31st	2014	2015	2016E	2017E
Net Revenues	32,470	111,521	413,910	3,932,145
Cost of Sales	482,013	482,012	482,013	
Gross Profit	-449,543	-370,491	-68,103	3,932,145
Expenses				
Selling & Marketing	247,258	549,726	711,437	1,576,113
Trophy Bingo development	1,181,382	1,230,216	978,224	1,076,046
Compensation & Consulation	532,287	438,572	482,429	530,672
G & A	212,649	356,647	392,312	431,543
EBITDA	-2,623,119	-2,945,652	-2,632,504	317,771
Amortization	3,470	3,467	3,788	4,515
EBIT	-2,626,589	-2,949,119	-2,636,292	313,256
Interest & Bank Charges	510	1,089		
Exchange rate and Unusual items	-44,617	-33,582		
EBT	-2,670,696	-2,981,612	-2,636,292	313,256
Gain from sale of domain name	6,677,759	16,305		
Income Taxes	848		-	93,977
Net Earnings for the period	5,062,233	-2,965,307	-2,636,292	219,279
EPS	0.07	-0.05	-0.04	0.00

BALANCE SHEET				
(in US\$)- YE Dec 31st	2014	2015	2016E	2017E
Assets				
Cash	2,876,386	570,086	122,778	453,250
Accounts receivable	122,056	44,948	13,621	393,215
Prepaid expenses	14,367	17,205	464,917	78,643
Current Assets	3,012,809	632,239	601,316	925,108
Property and equipment	9,269	6,314	7,526	8,010
Other Assets	964,025	482,013	-	-
Security Deposits	10,642	8,960	8,960	8,960
Total Assets	3,996,745	1,129,526	617,802	942,078
Liabilities & Shareholders' Equity				
Equity				
Accounts payables & accrued liabilities	107,911	145,226	256,440	361,437
Related parties	48,668	32,566	32,566	32,566
Current Liabilities	156,579	177,792	289,006	394,003
Loans payable				
Shareholder's Equity				
Share Capital	19,257,040	19,334,290	21,347,644	21,347,644
Foreign Currency Translation	24,580	24,580	24,580	24,580
Deficit	-15,441,454	-18,407,136	-21,043,428	-20,824,149
Total Liabilities & Shareholders' Equity	3,996,745	1,129,526	617,802	942,078

STATEMENTS OF CASH FLOWS				
(in US\$)- YE Dec 31st	2014	2015	2016E	2017E
Operating Activities				
Net earnings for the period	5,062,233	-2,965,787	-2,636,292	219,279
Items not involving cash				
Depreciation	3,470	3,467	3,788	4,515
Trophy Bingo Amortization	482,013	482,012	482,013	
Gain on sale of domain name	-6,677,759	-16,305		
	-1,130,043	-2,496,613	-2,150,491	223,794
Accounts Receivable	159,201	77,213	31,327	-379,594
Other Assets	877	1,682		
Prepaid Expenses	97,728	-2,838	-447,712	386,274
Security Deposits				
Accounts payable and accrued expenses	-30,260	37,518	111,214	104,997
Changes in working capital	227,546	113,575	-305,170	111,677
Cash from (used in) operations	-902,497	-2,383,038	-2,455,662	335,472
Financing activities				
Private Placement	1,400,000		2,013,354	
Exercise of Stock Options	9,350	77,250		
Cash provided by financing activities	1,409,350	77,250	2,013,354	-
Investing activities				
Acquisition of Equipment	-4,969	-512	-5,000	-5,000
Cash used in investing activities	1,878,330	-512	-5,000	-5,000
Increase (decrease) in cash	2,385,183	-2,306,300	-447,308	330,472
Cash beginning of period	491,203	2,876,386	570,086	122,778
Cash end of period	2,876,386	570,086	122,778	453,250

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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