

January 13, 2022

GROM: Recent Acquisition Marks Inflection Point; Initiating at Buy with \$5 Price Target

Summary

Grom Social Enterprises, Inc. is a media, technology, and entertainment company that focuses on delivering content to children under the age of 13. We are initiating coverage on the shares with a Buy rating with a price target of \$5 based on a sum-of-the-parts analysis.

Most of the company's revenue is derived from its wholly owned subsidiary, TD Animation, which contracts with major entertainment companies to produce animated content. The company purchased Curiosity Ink Media, a creator and developer of original content geared towards children, in August 2021. In connection with the acquisition, the company appointed Russell Hicks to Managing Director of TD Animation, which we believe marks an inflection point for the company. Russell Hicks has more than 40 years of experience within the animation industry and was involved with the production of hits such as Scooby-Doo, SpongeBob Square Pants, Dora the Explorer, and Paw Patrol. Additionally, he has built relationships with colleagues within the industry, who hold major decision-making roles at top entertainment companies. In our opinion, this will help TD Animation win more contracts and grow its top line. Additionally, we believe there could be significant upside if Russell Hicks were to develop and produce another hit, which we do not believe is being considered by the market.

Investment Highlights

Acquisition of Curiosity Ink Media

- The company purchased Curiosity Ink Media (CIM) in August 2021. CIM is a creator, developer, and producer of kids and family entertainment content that was created by Russell Hicks in 2018. We believe the company is poised to benefit from the increase in expected spending on content from major streaming services.
 - Russell Hicks has a history of success and was involved in the development of hits such as Scooby-Doo, SpongeBob Square Pants, Dora the Explorer, and Paw Patrol.
 - He was a driving force behind the success of Nickelodeon in the early 2000s, where he was the president of content and production from 2012–2017 and Chief Creative Officer from 1998–2012. We believe his past history of developing hit content is repeatable.
 - The team at CIM has a strong incentive to develop successful content due to the earn-out structure from the acquisition. Grom paid roughly \$5.7M for

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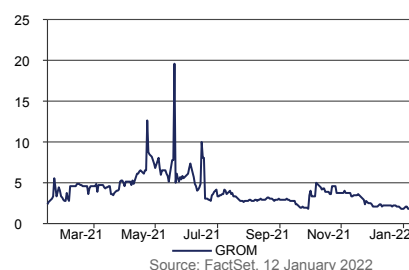
MARKET DATA

Rating	Buy
Price Target	\$5.00
Price	\$1.90
Average Daily Volume	316
Market Cap (\$M)	\$24.0
Enterprise Value (\$M)	\$14.9
Dividend Yield	0.0%

ESTIMATES

	2021E	2022E	2023E
EPS	(1.16)	(0.73)	(0.55)
P/E	(1.6)x	(2.6)x	(3.5)x
Revenue (\$M)	6.5	7.6	8.4
EV/Sales	2.3x	2.0x	1.8x

One Year Performance Chart



Please see analyst certification and important disclosures on page 22 of this report.

CIM up front, but the selling party has the opportunity to earn up to \$17.5M more upon achieving certain EBITDA targets from 2023-2025.

- According to Ampere Research, streaming services spent more than \$220B for content in 2021, representing an increase of 14% over 2020. In 2022, Ampere expects investment for content to exceed \$230B, representing an increase of 4.5%.[1]

Top Draw Animation Tailwinds.

- With recent contract wins in 4Q21, we believe the company's backlog is roughly \$8.6M, which represents a 33% increase above the backlog stated at the beginning of FY21 and a 23% increase above the backlog stated at the beginning of FY20.
 - Russell Hicks was appointed to Managing Director of Top Draw Animation in August 2021. The founder of Top Draw Animation, Wayne Dearing, resided in the Philippines and retired in August 2021. The company now has direct access to Hollywood through the connections that Russell Hicks has built over the past 40 years.
 - According to former Nickelodeon executive, Paul Ward, who joined the company in March 2021 as President of Grom, many of Russell Hicks' colleagues hold key decision-making roles at major companies such as NBC Universal, Netflix, Hulu, and Amazon.
 - As a result, we believe the company's Top Draw Animation business win new contracts going forward.

Positive Momentum in KPIs and Revenue Trends.

- Grom boasts a high online usage duration versus some of its peers and continues to grow its user base. The company currently has roughly 2.5M total monthly active users, up from 876K in 2019, representing approximately 60% growth per year.

Valuation. We derived our \$5.00 price target using a sum of the parts analysis and used a relative valuation from peers. Our price target implies a return of 173%

Risks. Risks include illiquidity of shares, history of losses, dilution in shares, competition. In addition, we strongly encourage investors to review regulatory filings for additional risk factors.

[1] <https://www.fiercevideo.com/video/streaming-services-help-push-content-spending-past-220b-2021>

Overview and Background

Grom Social Enterprises, Inc. is a media, technology, and entertainment company that focuses on delivering content to children under the age of 13 through its five operating subsidiaries:

1. **Grom Social Inc.:** Operates a social media network designed for children under the age of 13.
2. **TD Holdings Limited:** Produces animated films and television series.
3. **Grom Educational Services, Inc.:** Operates web filtering services provided to schools and government agencies.
4. **Grom Nutritional Services, Inc.:** Pre-revenue segment that intends to market and distribute nutritional supplements to children.
5. **Curiosity Ink Media, LLC:** Develops and acquires kids and family entertainment properties and associated business opportunities. Grom purchased 80% of the Curiosity in August of 2021.

Investment Thesis

In our opinion, Grom Social Enterprises is currently at an inflection point. We are initiating on the company with a Buy and price target of \$5 based on a sum-of-the-parts analysis. The company stands to benefit from the race for content by major streaming services through its acquisition of 80% of the assets of Curiosity Ink Media in August of 2021. The acquisition also led to the hiring of Russell Hicks, a long tenured leader within the animation industry who was appointed to Managing Director of Top Draw Animation. Additionally, the company has seen strong growth in key performance indicators within its social media and web filtering segments.

Investment Highlights

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- The team at CIM has a strong incentive to develop successful content due to the earn-out structure from the acquisition. Grom paid roughly \$5.7M for CIM up front, but the selling party has the opportunity to earn up to \$17.5M more upon achieving certain EBITDA targets from 2023 - 2025.
- According to Ampere Research, streaming services spent over \$220B for content in 2021, representing an increase of 14% over 2020. In 2022, Ampere expects investment for content to exceed \$230B, representing an increase of 4.5%.¹

Top Draw Animation Tailwinds. With recent contract wins in 4Q21, we believe the company's backlog is roughly \$8.6M, which represents a 33% increase above the backlog stated at the beginning of FY21 and a 23% increase above the backlog stated at the beginning of FY20.

¹ <https://www.fiercevideo.com/video/streaming-services-help-push-content-spending-past-220b-2021>

- Russell Hicks was appointed as Managing Director of Top Draw Animation in August 2021. The founder of Top Draw Animation, Wayne Dearing, resided in the Philippines and retired in August 2021. The company now has direct access to Hollywood through the connections that Russell Hicks has built over the past 40 years.
- According to former Nickelodeon executive, Paul Ward, who joined the company in March 2021 as President of Grom, many of Russell Hicks' colleagues hold key decision-making roles at major companies such as NBC Universal, Netflix, Hulu, and Amazon.
- As a result, we believe the company's Top Draw Animation business will win new contracts going forward.

Positive Momentum in KPIs and Revenue Trends. Grom boasts a high online usage duration versus some its peers and continues to grow its user base. The company currently has roughly 2.5M total monthly active users, up from 876K in 2019, representing approximately 60% growth per year.

Attractive Valuation. The company's shares trade for 3.2x FY23 revenue, whereas peers trade at roughly 7.5x.

Company History

- **April 14, 2013:** Company is incorporated in the State of Florida as Illumination America, Inc.
- **July 1, 2016:** Grom enters into an agreement to purchase TD Holdings.
- **September 30, 2016:** The company acquires online application and website MamaBear from GeoWaggle, LLC.
- **January 1, 2017:** Company acquires NetSpective web filter from Telemate.net Software, LLC.
- **August 17, 2017:** Company acquires Grom Holdings via the issuance of approximately 3.4M shares to Grom Holdings stockholders and changes name to Grom Social Enterprises.
- **December 27, 2017:** Company acquires Fyoosion LLC, a software company that utilizes a digital automation marketing platform to help with generating sales leads and improving customer retention.
- **May 19, 2021:** Company completes 1-for-32 reverse stock split and begins trading on the OTCQB market.
- **June 17, 2021:** Common stock and registered warrants begin trading on the Nasdaq.
- **August 19, 2021:** Company closes on acquisition of 80% of Curiosity Ink Media, LLC (CIM).

Company Overview

Top Draw Animation

Top Draw Animation is the company's largest segment and generates roughly 90% of the company's revenue. It is involved in the production of animated content and operates through its two wholly owned subsidiaries in the Philippines and Hong Kong.

Figure 1: Top Draw Animation



Source: Grom Social Enterprises 2021 Presentation

Top Draw contracts with third parties to produce animated films and television shows, which are then sent to Top Draw Philippines for production work at its studio in Manila. The company has more than 400 global animation experts who work at its state-of-the-art facility in Manila. The company produces more than 200 half-hour segments of animated content annually, making it one of the largest producers of animation for television globally.

Some notable projects it has worked on in the past include:

Figure 2: Top Draw Notable Projects

Show	Client	Number of Series in Years	Period
My Little Pony	DHX Media	10	2010-2019
My Little Pony - Equestrian Girls	DHX Media	7	2012-2013, 2015-2019
Tom and Jerry	Slap Happy Cartoons	5	2015-2019
Polly Pocket	WildBrain (formerly DHX Media)	3	2017-2020
Glitch Techs	Nickelodeon	1	2018-2019
Carmen Sandiego	WildBrain (formerly DHX Media)	2	2019-2020
Rhyme Time Town	DreamWorks	1	2019-2020
Archibald's Next Big Thing	DreamWorks	1	2020-2021
Polly Pocket S3	DHX Media	3	2021
The Loud House Movie	New Nickelodeon Animation	1	2021
Bionic Max	Gaumont Animation	1	2021
Vikingskool	Samka Production	1	2021

Source: Company Reports

In August 2021, the founder and Managing Director of Top Draw Animation, Wayne Dearing, announced his retirement. Grom appointed Russell Hicks as Managing Director of Top Draw Animation concurrently with Wayne Dearing's retirement.

The success of Top Draw is largely dependent upon the development and production of its animated features. The company generates revenue from contracts with customers for pre-production and production services for developing animated movies and television show.

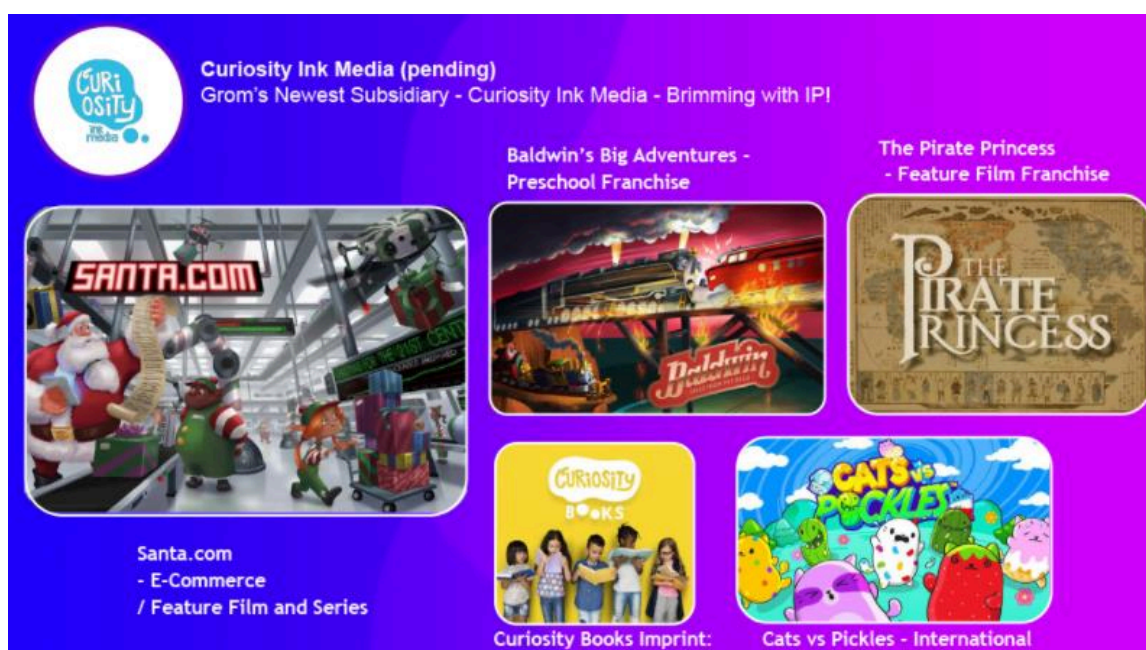
Some of Top Draw's customers include Disney, Nickelodeon, Cartoon Network, and Warner Bros. Pictures. In our opinion, these blue-chip customers speak to the quality of the product that Top Draw produces.

Top Draw competes with other animation businesses from production companies in Korea, Taiwan, Canada, India, China, Malaysia, Singapore, and Thailand. Its competitors located within the Philippines include Toon City Animation, Snipple Animation Studio, and Synergy 88 Digital.

Curiosity Ink Media

Headquartered in Hollywood, CA, Curiosity Ink Media is a creator, developer, and producer of kids' and family entertainment content. Grom purchased an 80% stake in the company in August of 2021. The company was formed by Russell Hicks in 2018, who spent more than two decades in leadership roles at Nickelodeon. The impetus for the acquisition was brought about through the relationship between Grom's recently appointed President, Paul Ward, and Russell Hicks, who spent many years working together at Nickelodeon.

Figure 3: Curiosity Ink Media



Source: Company Website

The company's current productions in development include:

- *Santa.com*: Debuted in early December, Santa.com is a virtual North Pole. The company plans on making a full-length feature film to be shown in theatres, with the plot centered around Santa's

workshop, which has been upgraded with robotic candy cane arms, peppermint drones, and other technology. Santa's workshop gets hacked by Cyber Scrooge and elves work to lure Santa out of retirement to save Christmas.

- *The Pirate Princess*: Tells the story of an infant princess who washes ashore to a remote island that is run by no-nonsense pirates, who band together to raise her. The story will debut initially as a graphic novel in 2022 and the company expects it to be a feature film franchise thereafter.
- *Thunderous*: Expected to be a feature film franchise after the debut of the graphic novel. The story is centered around a teenager who struggles to find the connection between her family's indigenous culture and her life in the modern world. She then gets transported to a Spirit World to learn more about her family's indigenous culture and tries to find her way home.
- *Baldwin's Big Adventures*: This series will be geared towards the company's emerging preschool market and is expected to first be published in book format, arriving on the market in the Spring of 2022. The story is centered around a train who embarks on a journey to be reunited with his father.
- *Cats vs. Pickles*: The company will receive a 2% royalty share from this franchise. The first installment of the book series debuted in 4Q and expects to become an animated series. This concept is already selling merchandise and games. The products on Amazon.com boast strong reviews and ratings.

If these productions find success, we believe the company will be able to generate additional revenue through merchandising opportunities.

Grom Educational Services

The company purchased internet content filtering software called NetSpective Webfilter on January 2, 2017, from Telemate.net. The company's Web Filtering business generates revenue through the sale of hardware and on a subscription basis for its software. Typically, its clients pay in advance for filtering services ranging between 1-5 years. Its clients include thousands of schools with more than 4M children in attendance.

Figure 4: Grom Educational Services

Grom Educational Services, Inc.
Web Filtering for Schools, Federal/Municipal Government and Private Businesses.

Protecting Kids In School
Grom Educational Services, Digital Citizenship Program assist K-12 schools with their CIPA compliance while also providing online safety.

NETSPECTIVE WEBFILTER

- Web filtering
- Digital Citizenship License course
- Exclusive educational content
- Protecting millions of kids online - in thousands of US schools - since 2003

Children's Internet Protection Act (CIPA)
Was enacted by Congress in 2000 to address concerns about children's access to obscene content or harmful content over the internet.

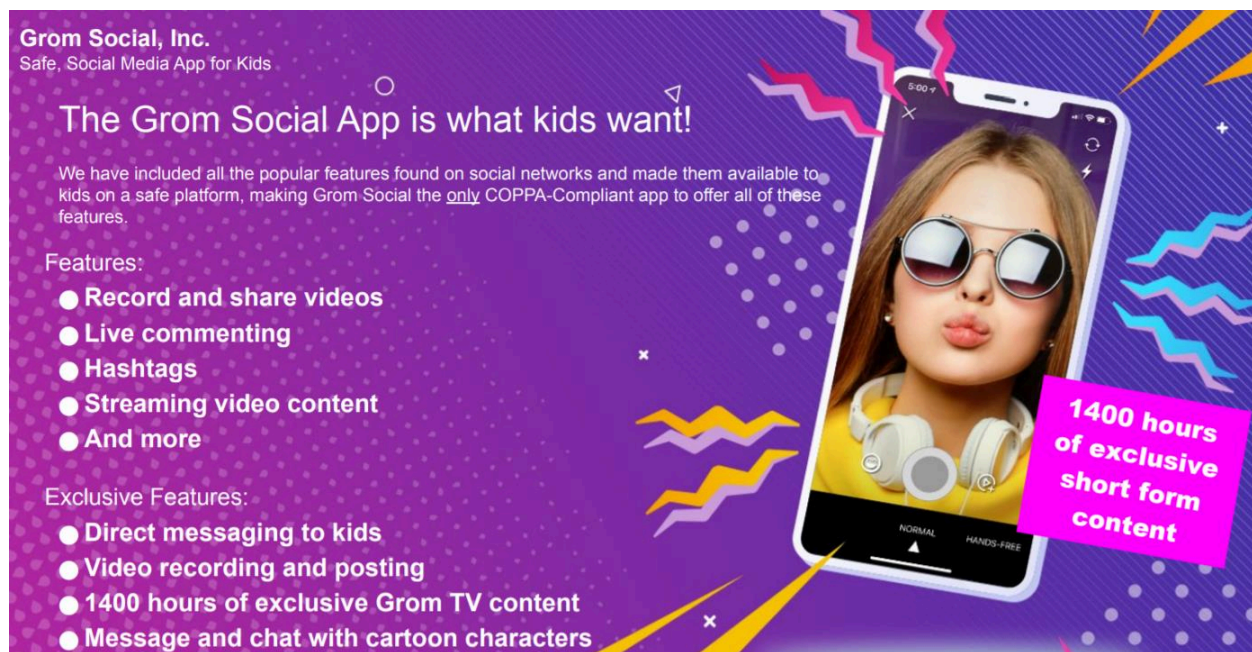
Source: Company Website

The segment competes with other web filtering products and services, such as iBoss, Lightspeed, Go Guardian, and Securly. It also competes with larger companies focused on enterprise solutions, such as Forcepoint (Websense), Bluecoat, Palo Alto Networks, Barracuda, and Cisco.

Grom Social

Grom Social is a media platform that is focused on delivering to content to children under the age of 13 and allows parents or guardians to monitor their kids' activities. The platform allows its users to chat with friends, view original content, and/or play games that are created by the company. Its business model is focused on providing a safe environment for children under the age of 13. As such, each child is required to receive parental approval to gain full access to the platform.

Figure 5: Grom Social



Source: Grom Social Enterprises 2020 Presentation

In May of 2019, the company's Grom Social mobile application was approved on the Apple Store and Google Play Store.

The company has established several safeguards and procedures to make the platform a safe place for children:

1. **Account Approval:** The company sends an email to the parents or guardian of the child who requests an account opening that requests approval.
2. **Parental Involvement:** Through the approval process, the company strives to ensure that the parents or guardians are aware and involved with their child's activity on the website. Additionally, the company is able to market products and services to parents this way as well.
3. **Digital Citizenship Educational Content:** The company incentivizes children to take and pass an internet safety course in order to gain access to more features on the platform.
4. **Limited Data Collection of Child and Parent:** The information the company collects is limited to parent email, birthdate, gender, and country locations.

5. **Content Monitoring:** The company uses keyword monitoring to seek out inappropriate behavior on the site. The user will receive a warning if the company flags any activity that it deems inappropriate and will be banned from the platform if the problems persist.
6. **Anti-Bullying:** The company also monitors the platform for bullying and posts messages that emphasize anti-bullying and responsible digital citizenship.
7. **Use of “Gromatars”:** Each user has their own “Gromatar”, which is an animated picture that the user creates to represent themselves, rather than using a real photograph.

Grom acquired an app called MamaBear in September of 2016, whereby parents can use the app to monitor their child’s online presence on various platforms such as Facebook, Instagram, Twitter, and YouTube.

The company’s strategy is to:

1. Increase its user base to attract advertisers to the platform.
 - a. Grom has partnered with SuperAwesome, one of the largest COPPA (Children’s Online Privacy Protection Act) compliant kid advertising companies in the world. A number of SuperAwesome’s clients are already advertising on the Grom Platform, including Disney, Nickelodeon, and McDonalds.
2. Add a subscription based premium content tier, whereby premium users will pay a monthly subscription fee in order to have enhanced features. The company has yet to roll this out this feature.
3. Add exclusive premium games and/or add in-game upgrades that users would need to pay for.
4. Create Grom Social apparel to be purchased.

The Grom Social platform generates minimal revenue currently, but we believe monetization opportunities will be realized as the userbase continues to expand. Additionally, we believe there are some synergies the platform has with Curiosity Ink Media, whereby we foresee the company offering its users

1. Premium upgrades based on characters from the content developed through CIM, and
2. Premium games and features based on content developed through CIM.

Grom Social operates in highly competitive markets and competes with Facebook, YouTube, Twitter, Google, TikTok, SnapChat, Video Star, Zoomerang, Yoursphere, Fanlala, Franktown Rock, and Sweetie High.

- Grom Social is the only COPPA compliant platform for children under the age of 13 that allows them to record and share videos, which we believe gives it a competitive advantage.
- Children under the age of 13 are not eligible to use certain platforms, such as Facebook and Instagram.

Customers

Grom has added more than 24M users located in over 200 countries and territories since the company’s inception in 2012 and has 2.3M active users across its platforms. The users include children under the age of 13, parents who register or download the MamaBear app, and any student or faculty member that uses its NetSpective web filtering platform. The company acquires customers through organic and purchased search results on internet search websites such as Google.com, Bing.com, and Yahoo.com. The company reported that its number one source of growth comes from parent to parent and child to child referrals.

The company generates the majority of its revenue from Top Draw Animation, which has significant customer concentration. Four of Top Draw's accounted for 81% of its revenue in the 9 months ended September 30, 2021.

Management

Darren Marks, Chief Executive Officer, President, Director

Darren Marks has been the company's Chief Executive Officer and a Director since June of 2012 and previously was Chairman of the Board from July, 2015 to August, 2017. From January, 2011, to February, 2016, he was the president of DNA Brands, a publicly traded beverage distributor. He also co-founded and served as Vice President of Sims Communications, a telecommunications company that used to trade on the Nasdaq.

Jason Williams, Chief Financial Officer, Secretary, Treasurer

Jason Williams has been the company's Chief Financial Officer, Secretary, and Treasurer since June 26, 2021. Prior to joining Grom, he was the President of WM Consulting from 2016 – 2021. He also served as Chief Financial Officer of Protective Products of America and ForceField Energy (OTCPK:FNRG).

Melvin Leiner, Executive Vice President, Chief Operating Officer, Director

Melvin Leiner has been the company's Executive Vice President since December of 2012 and Chief Operating Officer as of August 17, 2017. From December 2012 to June 2021, he also served as the company's Chief Financial Officer and Secretary. Prior to Grom, he co-founded DNA Brands, where he was the Executive Vice President and a Director from January 2011 to February 2016. He also co-founded Sims Communications and served as Chairman, President, and Chief Executive Officer from 1991 to 1997.

The company has reserved a total of approximately 1.9M shares for its 2020 Equity Incentive Plan, representing approximately 12% of shares outstanding. Additionally, all Officers and Directors as a group have approximately 62.3% of the combined voting power of the company, mostly derived through the ownership of the company's Series C Convertible Preferred Stock.

Figure 6: Top 5 Holders of Common Stock

Name	% Common
Denis Kerasotes	18%
Condor Equities, LLC	17%
Darren Marks	6%
Russell Hicks	5%
Brent Watts	5%

Source: Company Reports

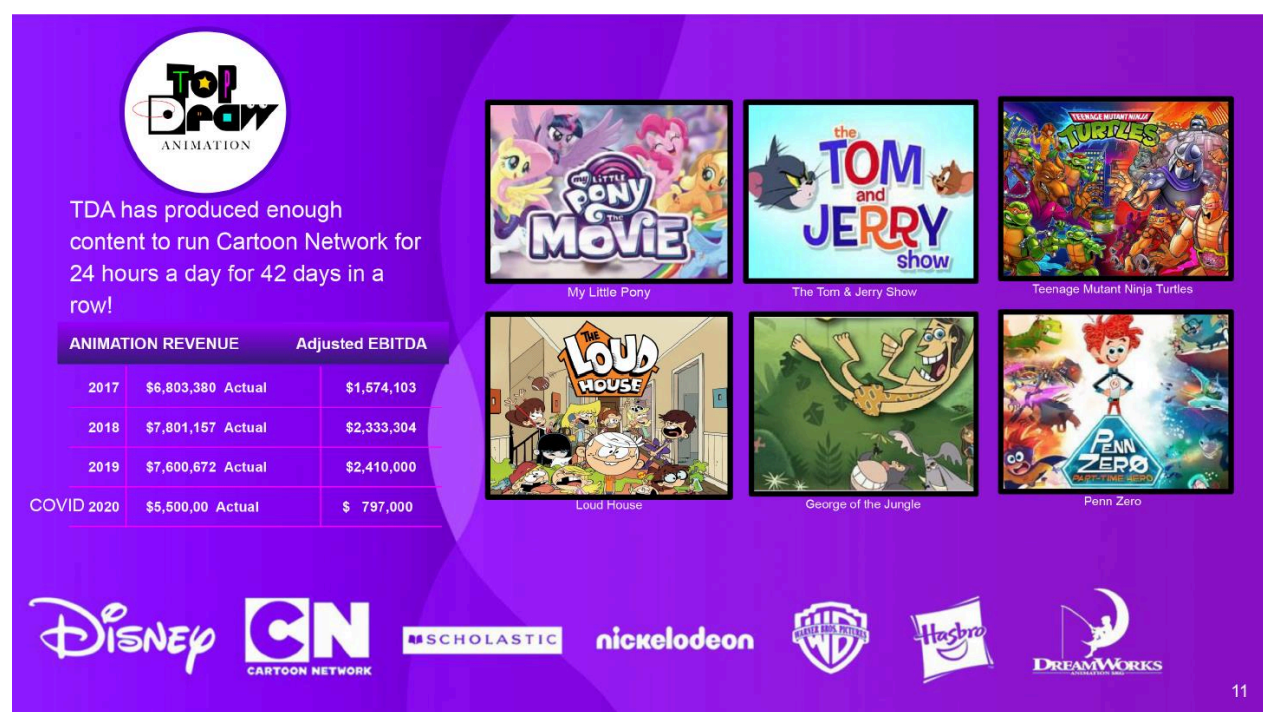
Financial Analysis and Outlook

Top Draw Animation

In our opinion, the appointment of Russell Hicks as Managing Director of Top Draw Animation in August 2021 marks an inflection point for the company.

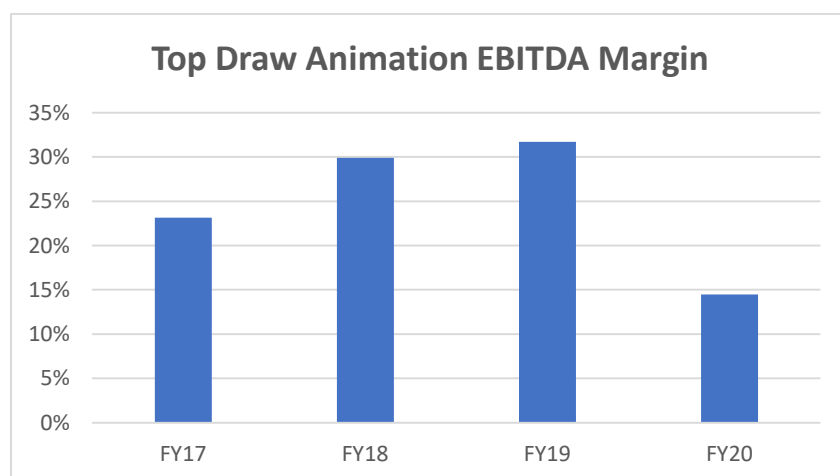
Top Draw Animation's growth was significantly affected by COVID-19 in FY20 due to the temporary closure of its animation studio in Manila but has historically produced strong EBITDA margins. The business historically realizes gross profit margins between 45-55%.

Figure 7: Top Draw Animation Financial Snap Shot



Source: Grom Social Enterprises 2021 Presentation

Figure 8: Top Draw Animation EBITDA Margin



Source: Grom Social Enterprises 2021 Presentation

Russell Hicks has more than 40 years of experience working within the creation and animation industry, starting at Hanna-Barbera then going on to work for Turner Broadcasting, Disney, and Nickelodeon. Wayne Dearing, who retired in August of 2021, was based out of the Philippines. According to Grom President, Paul Ward, the colleagues Russell Hicks has made over his career are now head decision makers at major companies such as NBC Universal, Netflix, Hulu, and Amazon.² Given Russell Hicks' strong connections within Hollywood, we believe the company will generate strong revenue growth from his connections within the industry going forward.

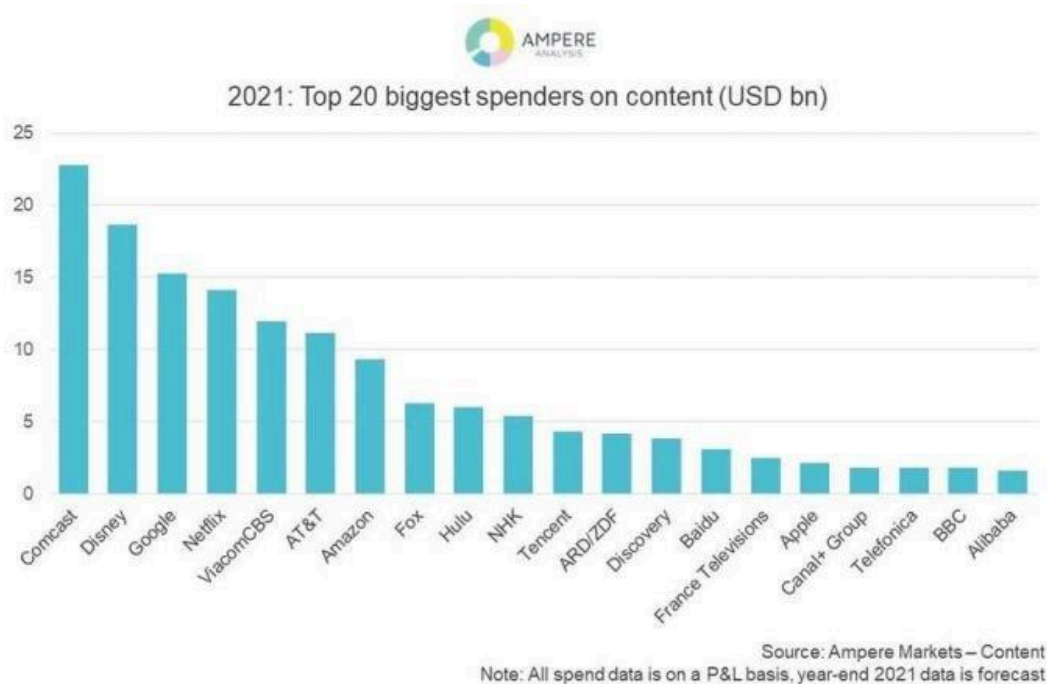
Curiosity Ink Media

In our opinion, Curiosity Ink Media is poised to take advantage of the race for content from major streaming services. In addition, we believe that Russell Hicks' past history of producing hits is repeatable.

Major content providers such as Disney, Comcast, Netflix, and Viacom have spent a tremendous amount of resources on content over the past few years. In our opinion, Curiosity Ink Media's intellectual property development is well positioned to capture these trends in spending for content.

According to Ampere Research, streaming services spent over \$220B for content in 2021, representing an increase of 14% over 2020. In 2022, Ampere expects investment for content to exceed \$230B, representing an increase of 4.5%.³

Figure 9: Content Spend



Source: <https://www.fiercevideo.com/video/streaming-services-help-push-content-spending-past-220b-2021>

On top of the projects that are already in production, the company also has several content properties in development:

² <https://www.youtube.com/watch?v=1VHLNSL-EgI>

³ <https://www.fiercevideo.com/video/streaming-services-help-push-content-spending-past-220b-2021>

- *Aloha Hoku*: Animated musical series centered around a Hawaiian girl's adventures with her magical ukulele. The company is partnering with YouTube sensation Honoka Katayama, who has over 56.3K subscribers on YouTube and millions of views.
- *Odd Jobs*: A comedic story of three young friends who take on a variety of odd jobs in order to purchase the latest electric scooter. Along the way, the friends cut corners, resulting in disastrous outcomes for their community.
- *The Forgettable Supervillains*: This story revolves around superheroes who can't quite cut it as superheroes and then decide to test their luck being villains. Upon doing so, they realize that the successful superheroes that they once admired are actually evil and attempt to save the day.
- *Oothar the Blue*: Oother the barbarian decides to quit his monster slaying job and move to the suburbs for a desk job. In turn, the same creatures he once fought in his past decide to show up in his neighborhood, where he is forced to fend them off.

In our opinion, the Curiosity Ink Media team are highly incentivized to produce meaningful EBITDA in 2023, 2024, and 2025 based on the contingent earn-outs associated with the acquisition. The company paid the selling group roughly \$5.7M in total consideration in August of 2021. However, the selling group has a contingent earn out of roughly \$17.5M based on meeting certain EBITDA levels in FY23, FY24, and FY25.⁴

Figure 10: Curiosity Ink Media Earn Out Incentives

TTM Ending 12/31/2023	
Payout	EBITDA Target
\$ 833,333	\$ 2,625,000
\$ 1,666,667	\$ 5,250,000
\$ 2,500,000	\$ 7,875,000

TTM Ending 12/31/2024	
Payout	EBITDA Target
\$ 2,500,000	\$ 7,000,000
\$ 5,000,000	\$ 14,000,000
\$ 7,500,000	\$ 21,000,000

TTM Ending 12/31/2025	
Payout	EBITDA Target
\$ 2,500,000	\$ 7,000,000
\$ 5,000,000	\$ 14,000,000
\$ 7,500,000	\$ 21,000,000

Source: Company Reports

With a total enterprise value of roughly \$26.4M, we believe that there could be meaningful upside if these EBITDA targets are achieved.

⁴ https://www.sec.gov/Archives/edgar/data/0001662574/000168316821001289/grom_ex1001.htm

Grom Social & Grom Educational Services

The company's strategy is to expand its Grom Social user base through the acquisition of synergistic companies, products, or intellectual property and through increased marketing initiatives with the goal of growing a user base large enough to attract advertisers and paid users for its premium content. Its web filtering business typically realizes gross profits between 75-80%. However, the web filtering business competes with larger companies that offer similar products within a bundle, making it difficult for the company's product to compete on a standalone basis.

The company's goal for its Grom Social platforms is to grow to 50M active users.⁵ In our opinion, this will attract advertisers and generate a stronger stream of revenue for this business segment.

This segment has shown strong user growth since its inception in 2012 and boasts an average online duration that competes with some of the top social media platforms. In our opinion, the relatively long average duration speaks to the stickiness of the platform's content, including but not limited to games, chatting with friends, and short form animated series. To date, the company has had over 24M users on its platform.

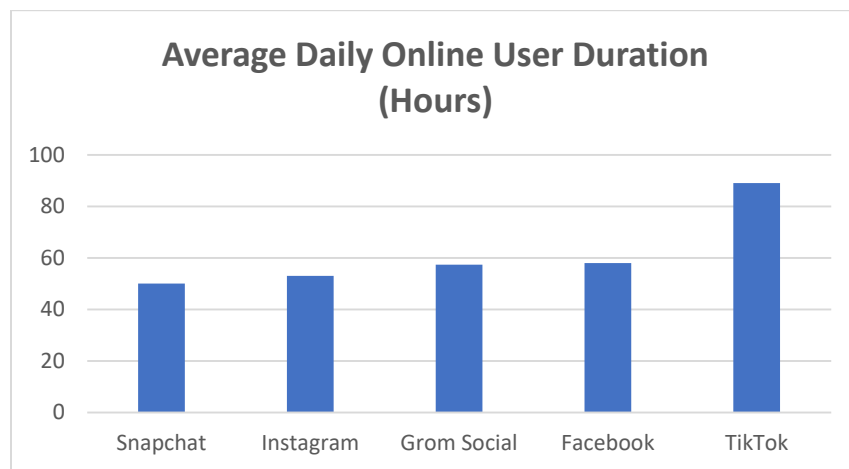
Figure 11: Grom Social & From Educational Services User Data

User Data	
Total Users ⁽¹⁾	24,239,083
Total Monthly Active Users ⁽²⁾	2,509,562
Average Child Online Duration ⁽³⁾	57.3 Minutes
Average Parent Online Duration ⁽³⁾	2.5 Minutes
Bounce Rate ⁽⁵⁾	29.7%

Source: Grom Social Enterprises 2021 Presentation

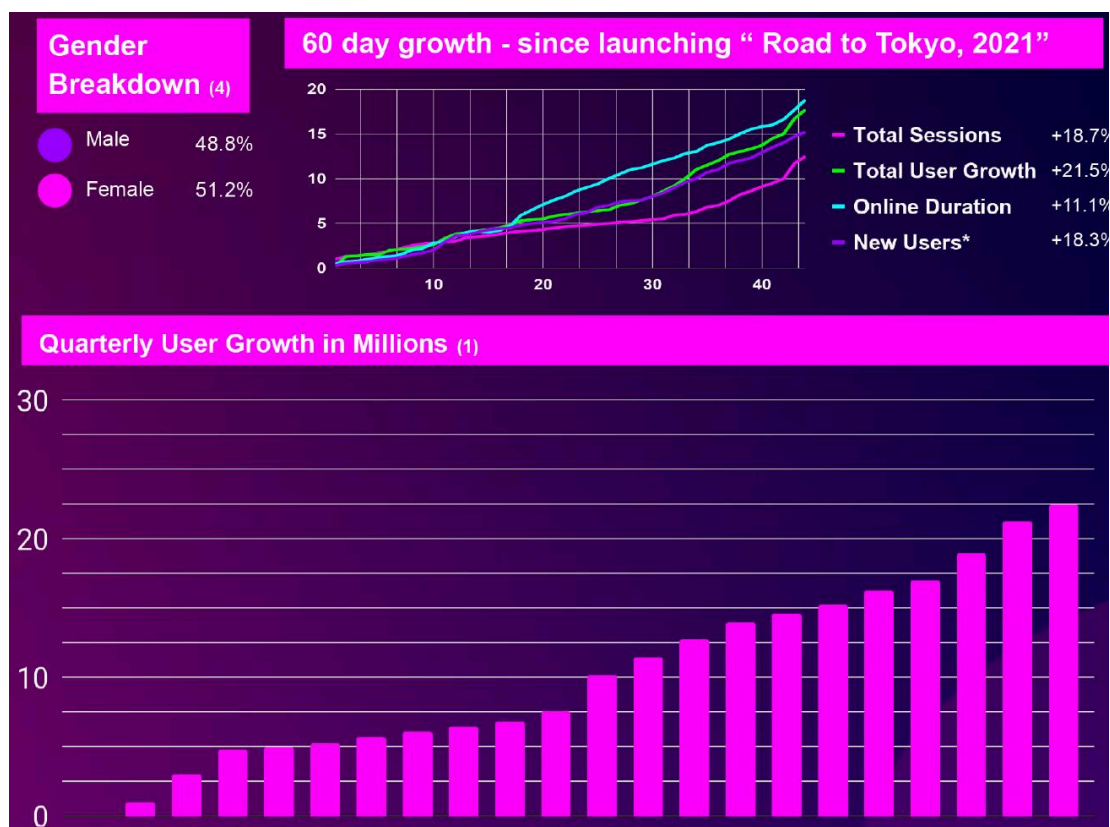
⁵ <https://www.youtube.com/watch?v=m65MPH5co2U>

Figure 12: Average Daily Online User Duration (Hours) vs. Peers



Source: Grom Social Enterprises 2021 Presentation; <https://www.nme.com/news/tiktok-users-watch-app-for-average-of-89-minutes-per-day-2923460>; <https://www.forbes.com/sites/petersuciu/2021/06/24/americans-spent-more-than-1300-hours-on-social-media/?sh=795d52cf2547>

Figure 13: Quarterly User Growth (Millions)



Source: Grom Social Enterprises 2021 Presentation

Recent Results

Grom reported its 3Q21 results on November 22, 2021. Total revenue grew 5.3% versus 3Q20.

- Animation revenue grew 4.2% in the quarter versus 3Q20 due to an increase in the overall number of contracts completed.
- Web filtering revenue grew 18% in the quarter versus 3Q20 due to an increase in organic sales growth.

The company's gross profit decreased to 51.1% in 3Q21, versus 60.2% in 3Q20 due to increased fixed overhead costs and animation projects going over budget.

Operating expenses increased to \$2.9M in 3Q21 from \$1.6M in 3Q20 due to stock-based compensation and increased costs associated with the acquisition of Curiosity Ink Media.

On August 19, 2021, the company acquired an 80% interest in Curiosity Ink Media, LLC through the issuance of roughly 1.8M shares at a \$2.82 per share valuation. The company also paid down a \$400K convertible promissory note and issued \$278K of an 8% 18-month convertible promissory note in connection with the acquisition. Additionally, the sellers of CIM have the ability to earn \$17.5M, payable 50% in cash and 50% in stock, upon achievement of certain performance milestones from the acquisition date until December 31, 2025. Total consideration at the time of the acquisition was roughly \$5.7M.

Figure 14: Curiosity Ink Media, LLC Total Consideration

Consideration Paid:	
Cash and cash equivalents	\$ 400,000
Common stock	5,000,000
Convertible notes	278,000
Fair value of total consideration	<u>\$ 5,678,000</u>

Source: Company Reports

Forecast

On July 15, 2021, the company secured an additional \$1.7M in new business and noted that its backlog position at that time was \$8M. Since the appointment of Russell Hicks in August, the company added \$2M in backlog. We estimate that the company's current backlog is roughly \$8.6M.

- Revenue generated in FY20 represented roughly 78% of its reported backlog in FY20 due to the pandemic. Given the uncertain backdrop as it relates to new variants, we expect the company to generate roughly 80% of its backlog in FY22 and 85% in FY23.
- With Russell Hicks leading Top Draw Animation, we believe the company will be able to reach pre-pandemic level revenue by FY23. We expect the company to be able to generate \$7.1M and \$7.9M of animation revenue in FY22 and FY23, respectively.
- With the increased focus on development of content, we expect the company's focus to decrease from its web filtering segment and expect declines in revenue to continue. We project web filtering revenue to be \$477K in FY22, representing a decrease of roughly 9% from our FY21 estimate and 16% per year from FY20.
- We expect the company's revenue derived from its social media platforms will continue to be minimal in the near term, with revenue growth tracking expected social media advertising spend.
- We assumed 45% and 75% gross margins for the Animation and Web Filtering businesses going forward, at the lower end of management's stated range.

- We expect CAPEX to be low relative to historical standards given recent improvements to the company's Manila operation.
 - The company's weighted average lease term at the end of 3Q21 stood at 1.7 years, so we expect depreciation expense to decrease significantly going forward. However, due to the acquisition, amortization expense will be higher going forward.
- Our forecast assumes that selling and marketing expense will continue to be 4% of total revenue.
- Due to the acquisition of CIM, the company's general and administrative expenses have increased significantly.
 - Typically, expenses are generated for the production and development of content prior to any revenue being realized, which is why we expect G&A cost to be higher than normal going forward.
- We assumed normalized professional fees to be roughly \$1M per year going forward.
- The company granted 141,250 stock options to Brent Watts and Russell Hicks in connection with the CIM acquisition. The options vest over three years, which we have included in stock-based compensation.
- The company's largest interest expense comes from the accrual of the 10% Senior Secured Convertible Notes, due in March of 2023. The loan is payable in 18 installments in cash or stock. The discount is amortized over the life of the loan, along with the fair value of the warrants issued in connection with the loan.
 - The company also had:
 - 8% Unsecured Convertible Notes due in January of 2023.
 - Notes are convertible into shares of common stock at \$2.38 per share.
 - 10% Secured Convertible Notes that are not accruing interest.
 - The notes were due in December of 2019, but no notices of default or demands for payment have been received by the company.
 - 12% Senior Secured Convertible Notes due in March of 2024.
 - 12% Additional Senior Secured Convertible Notes due in March of 2024.
 - We arrive at interest expense of approximately \$395K per quarter.

Balance Sheet

As of late November, the company had approximately 12.6M shares of common stock outstanding and 9.4M of 8% Series C Preferred Stock outstanding.

- Holders of common stock are entitled to one vote per share.
- Holders of Series C Preferred Stock are entitled to 1.5625 votes per share.
 - Series C Preferred Stockholders also have the ability to convert shares into common stock at a conversion rate of \$1.92 per share.

On June 21, 2021, the company raised capital through the sale of 2.4M units, which consist of one share of common stock and one warrant to purchase one share of common stock with an exercise price of \$4.565. The warrants have an expiration date of five years after the issuance date. As of September 30, 2021, the company had approximately 4.4M warrants outstanding with a weighted average exercise price of \$4.36 and a weighted average contractual life of 1.82 years.

As of September 30, 2021 the company had \$9.1M in cash and cash equivalents, \$3.2M in debt, and \$9.4M in series C preferred stock. The company's convertible notes consist of the following:

Figure 15: Convertible Notes Table

	September 30, 2021	December 31, 2020
8% Unsecured Convertible Notes (Curiosity)	\$ 278,000	\$ –
8% - 12% Convertible Promissory Notes (Bridge Notes)	–	373,587
10% Unsecured Convertible Redeemable Notes – Variable Conversion Price	–	265,000
10% Senior Secured Convertible Note with Original Issuance Discount (L1 Capital Global Master Fund or “L1”)	4,400,000	–
10% Secured Convertible Notes with Original Issuance Discounts (OID Notes)	75,000	153,250
12% Senior Secured Convertible Notes (Newbridge)	–	52,572
12% Senior Secured Convertible Notes (Original TDH Notes)	–	882,175
12% Senior Secured Convertible Notes (TDH Secured Notes)	359,056	1,645,393
12% Senior Secured Convertible Notes (Additional Secured Notes)	68,221	260,315
Loan discounts	(1,988,089)	(385,266)
Total convertible notes, net	3,192,188	3,247,026
Less: current portion of convertible notes, net	(1,879,853)	(2,349,677)
Convertible notes, net	\$ 1,312,335	\$ 897,349

Source: Company Reports

Figure 17: GROM P&L

	Fiscal Year 2020					Fiscal Year 2021E					Fiscal Year 2022E						
	FY 2019	Q1 Mar	Q2 June	Q3 Sep	Q4 Dec	FY 2020	Q1 Mar	Q2 June	Q3 Sep	Q4 Dec	FY 2021E	Q1E Mar	Q2E June	Q3E Sep	Q4E Dec	FY 2022E	FY 2023E
Total Revenue	8,296.997	1,292.239	1,746.979	1,439.155	1,681.158	6,159.531	1,875.284	1,388.551	1,514.692	1,714.362	6,492.889	1,866.033	1,886.370	1,906.979	1,927.863	7,587.245	8,392.583
% change (sequential)	nm	-36%	35%	-18%	17%	nm	12%	-77%	-19%	23%	nm	9%	-71%	2%	2%	nm	nm
% change (year over year)	-4%	-34%	-16%	-36%	-17%	-26%	45%	-21%	5%	2%	5%	0%	36%	26%	12%	17%	11%
Cost of Revenue	4,610.961	612.093	661.180	573.455	1,505.912	3,352.640	800.434	833.681	741.436	905.975	3,281.526	989.720	1,001.227	1,012.880	1,024.683	4,028.510	4,476.328
% of total revenue	56%	47%	38%	40%	90%	54%	43%	60%	49%	53%	51%	53%	53%	53%	53%	53%	53%
Gross Profit	3,686.036	680.146	1,085.799	865.700	175.246	2,806.891	1,074.850	554.870	773.256	808.387	3,211.363	876.314	885.143	894.098	903.180	3,558.735	3,916.255
Gross margin %	44%	53%	62%	60%	10%	46%	57%	40%	51%	47%	49%	47%	47%	47%	47%	47%	47%
Depreciation and Amortization	435.649	195.965	193.234	234.461	(174.281)	449.379	217.515	206.983	196.168	334.382	955.048	283.621	234.060	143.734	130.894	792.309	477.901
% of total revenue	5%	15%	11%	16%	-10%	7%	12%	15%	13%	20%	15%	15%	12%	8%	7%	10%	6%
Selling and Marketing	116.291	34.317	21.960	35.420	27.147	118.844	30.276	48.635	51.256	68.574	198.741	74.641	75.455	76.279	77.115	303.490	335.703
% of total revenue	1%	3%	1%	2%	2%	2%	2%	4%	3%	4%	3%	4%	4%	4%	4%	4%	4%
General and Administrative	5,140.100	1,449.348	1,093.880	1,009.162	909.705	4,462.095	1,350.799	1,440.355	1,892.327	2,364.843	7,048.324	2,388.145	2,388.145	2,388.145	2,388.145	9,552.580	9,646.705
% of total revenue	62%	112%	63%	70%	54%	72%	72%	104%	125%	138%	109%	128%	127%	125%	124%	126%	115%
Professional Fees	908.093	52.718	54.760	311.813	203.723	623.014	187.109	325.922	326.800	260.889	1,100.720	266.106	266.106	266.106	266.106	1,064.425	1,085.714
% of total revenue	11%	4%	3%	22%	12%	10%	10%	23%	22%	15%	17%	14%	14%	14%	14%	14%	13%
Stock based compensation	64.800	16.200	46.400	-	-	62.600	-	-	460.146	-	460.146	-	-	140.000	-	140.000	140.000
% of total revenue	1%	1%	3%	0%	0%	1%	0%	0%	30%	0%	7%	0%	0%	7%	0%	2%	2%
Impairment Charge	-	-	-	472.757	-	472.757	-	-	-	-	-	-	-	-	-	-	-
% of total revenue	0%	0%	0%	28%	8%	8%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Operating Income	(2,978.897)	(1,068.402)	(324.435)	(725.156)	(1,263.805)	(3,381.798)	(710.849)	(1,467.025)	(2,153.441)	(2,220.301)	(6,551.616)	(2,136.200)	(2,078.622)	(2,120.166)	(1,959.080)	(8,294.068)	(7,769.768)
Operating margin %	-36%	-83%	-19%	-50%	-75%	-55%	-38%	-106%	-142%	-130%	-101%	-114%	-110%	-111%	-102%	-109%	-93%
EBITDA	(2,543.248)	(872.437)	(131.201)	(490.695)	(965.329)	(2,459.662)	(493.334)	(1,260.042)	(1,957.273)	(1,885.919)	(5,596.568)	(1,852.579)	(1,844.563)	(1,976.432)	(1,828.186)	(7,501.759)	(7,291.867)
EBITDA margin %	-31%	-68%	-8%	-34%	-57%	-40%	-26%	-91%	-129%	-110%	-86%	-99%	-98%	-104%	-95%	-99%	-87%
Interest Expense, Net	(1,705.123)	(277.763)	(612.379)	(330.006)	(178.583)	(1,398.731)	(648.846)	(1,094.916)	(492.783)	(395.201)	(2,631.746)	(395.201)	(395.201)	(395.201)	(395.201)	(1,580.803)	(284.858)
% of total revenue	-21%	-21%	-35%	-23%	-11%	-23%	-35%	-79%	-33%	-23%	-41%	-21%	-21%	-21%	-20%	-21%	-3%
Other	128.121	(0.669)	(16.294)	(1,165.858)	(4.110)	(1,186.931)	(955.880)	57.436	313.787	-	(584.657)	-	-	-	-	-	-
% of total revenue	2%	0%	-1%	-81%	0%	-19%	-51%	4%	21%	0%	-9%	0%	0%	0%	0%	0%	0%
Pre-Tax Income	(4,555.899)	(1,346.834)	(953.108)	(2,221.020)	(1,446.498)	(5,967.460)	(2,315.575)	(2,504.505)	(2,332.437)	(2,615.502)	(9,768.019)	(2,531.401)	(2,473.823)	(2,515.367)	(2,354.280)	(9,874.871)	(8,054.626)
Pre-tax margin %	-55%	-104%	-55%	-154%	-86%	-97%	-123%	-180%	-154%	-153%	-150%	-136%	-131%	-132%	-122%	-130%	-96%
Income taxes	35.375	-	-	(224.027)	(224.027)	(224.027)	-	-	-	-	-	-	-	-	-	-	-
Effective rate %	-1%	0%	0%	0%	15%	4%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
GAAP Net Income/(Loss)	(4,591.274)	(1,346.834)	(953.108)	(2,221.020)	(1,222.471)	(5,743.433)	(2,315.575)	(2,504.505)	(2,332.437)	(2,615.502)	(9,768.019)	(2,531.401)	(2,473.823)	(2,515.367)	(2,354.280)	(9,874.871)	(8,054.626)
Net margin %	-55%	-104%	-55%	-154%	-73%	-93%	-123%	-180%	-154%	-153%	-150%	-136%	-131%	-132%	-122%	-130%	-96%
Loss Attributable to Noncontrolling Interest	-	-	-	-	-	-	-	(23.576)	(47.152)	(70.728)	(70.728)	(49.038)	(49.038)	(49.038)	(49.038)	(196.152)	(203.998)
% of total revenue	0%	0%	0%	0%	0%	0%	0%	0%	-2%	-3%	-1%	-3%	-3%	-3%	-3%	-3%	-2%
Net Income (Loss) Attributable to Grom	(4,591.274)	(1,346.834)	(953.108)	(2,221.020)	(1,222.471)	(5,743.433)	(2,315.575)	(2,504.505)	(2,308.861)	(2,568.350)	(9,697.291)	(2,482.363)	(2,424.785)	(2,466.328)	(2,305.242)	(9,678.719)	(7,850.628)
Net margin %	-55%	-104%	-55%	-154%	-73%	-93%	-123%	-180%	-152%	-150%	-149%	-133%	-129%	-129%	-120%	-128%	-94%
Preferred Dividend	(740.899)	-	-	(277.500)	-	(277.500)	-	-	(752.042)	(752.042)	(752.042)	-	-	-	(752.042)	(752.042)	(752.042)
% of total revenue	-9%	0%	0%	-19%	0%	-5%	0%	0%	44%	44%	12%	0%	0%	0%	0%	-10%	-9%
Net Income (Loss) Attributable to Grom Shareholders	(5,332.173)	(1,346.834)	(953.108)	(2,498.520)	(1,222.471)	(6,020.933)	(2,315.575)	(2,504.505)	(2,308.861)	(3,320.392)	(10,449.333)	(2,482.363)	(2,424.785)	(2,466.328)	(3,057.285)	(10,430.761)	(8,602.670)
Net margin %	-64%	-104%	-55%	-174%	-73%	-98%	-123%	-180%	-152%	-194%	-161%	-133%	-129%	-129%	-159%	-137%	-103%
GAAP Earnings per Share	(1.157)	(0.256)	(0.176)	(0.451)	(0.194)	(1.069)	(0.390)	(0.422)	(0.208)	(0.252)	(1.156)	(0.183)	(0.174)	(0.171)	(0.201)	(0.731)	(0.547)
Diluted Shares	4,607.552	5,270.286	5,400.415	5,540.233	6,311.864	5,630.699	5,932.105	5,936.750	11,118.290	13,158.387	9,036.383	13,554.783	13,951.179	14,394.659	15,197.567	14,274.547	15,719.130
Gross Margin	44%	53%	62%	60%	10%	46%	57%	40%	51%	47%	49%	47%	47%	47%	47%	47%	47%
EBITDA Margin	-31%	-68%	-8%	-34%	-57%	-40%	-26%	-91%	-129%	-110%	-86%	-99%	-98%	-104%	-95%	-99%	-87%
Operating Margin	-36%	-83%	-19%	-50%	-75%	-55%	-38%	-106%	-142%	-130%	-101%	-114%	-110%	-111%	-102%	-109%	-93%
Net Margin	-64%	-104%	-55%	-174%	-73%	-98%	-123%	-180%	-152%	-194%	-161%	-133%	-129%	-129%	-159%	-137%	-103%

Balance sheet as of 09/30/2021

Cash/Investments	9,102.73	Accounts Payable	639.47
Accounts Receivable	472.06	Other Current Liab	3,199.27
Inventory	127.63	Long-Term Liabilities	1,872.56
Other Current Assets	714.28	Total Liabilities	5,711.31
Long-Term Assets	20,776.94	Stockholders' Equity	25,482.33

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 Source: Company reports, EFH estimates
 1/11/2022

Calendar Year Data

Year	Revenue	Operating Margin	EPS	Y/Y Change
2021E	\$ 6,492.89	-101%	\$ (1.16)	nm
2022E	\$ 7,587.24	-109%	\$ (0.73)	nm
2023E	\$ 8,392.58	-93%	\$ (0.55)	nm

Source: Company Reports, EF Hutton Estimates, S&P Capital IQ

Valuation and Investment Conclusion

Valuation

We used a relative valuation to value GROM shares.

- We assumed a value of \$5.7M for CIM, which is what the company paid for it in August of 2021.
- We used a relative valuation for Top Draw Animation using public and private peers.
 - Toei Animation Co (JASDAQ:4816 – Not Rated)) is an animation studio based out of Japan that has produced a number of shows, including Dragon Ball, Sailor Moon, and Transformers.
 - Pencilish Animation Studio is a new animation studio created by former Disney employees.⁶ According to S&P Capital IQ, the company raised \$5M in December 2020,

⁶ <https://wefunder.com/pencilish/details>

leading to a post-money valuation of \$9.5M. The company expects to generate \$1M in 2022.⁷

Figure 18: Valuation

Company	FY23 Revenue	EV	EV/FY22 Revenue
Toeï Animation Co	59,739.90	373,220.45	6.25
Pencilish Animation	1,000.00	9,534.50	9.53
Harmonic Mean			7.55

FY23 Revenue	7,929.36
Multiple	7.55
Top Draw EV	59,855.91
CIM EV	5,678.00
Total EV	65,533.91
Cash	9,102.73
Debt	3,343.49
Preferred	9,400.26
Implied Market Value	61,892.89
S/O	12,601.69
Fair Value	\$ 4.91

Source: Company Reports, S&P Capital IQ,

https://www.sec.gov/Archives/edgar/data/1835666/000167025421000550/document_1.pdf

Using this methodology, we arrive at a fair value of roughly \$5 per share.

The company's CIM segment does not currently produce any revenue and generates a significant amount of expenses. In our opinion, there could be meaningful upside if the company is able to develop a hit, which we have not projected within our model. CIM's FY24 earn-out EBITDA targets range from \$7M to \$21M. Using our fair value enterprise value for these figures combined with a normalized EBITDA margin of 25% for Top Draw Animation puts the implied EV/FY24 EBITDA between 5.3x – 11.8x, which we believe is in line with other content development companies (WildBrain (TSX: WILD) and Thunderbird Entertainment Group (TSVX: TBRD) trade at 10.8x and 7.8x FY24 EBITDA, respectively).

When performing the same exercise on Grom's current EV, we arrive at an EV/FY24 EBITDA multiple between 2.4x -5.7x, which we believe is cheap. Therefore, we believe the market is assigning a low probability on meaningful content creation from CIM. However, given Russell Hicks' history of success, we believe this is incorrect.

Conclusion

We believe that the company's shares are a BUY at current levels and provide investors with potential upside of 173%. Additionally, we don't believe the market is ascribing any probability to the potential for the company to produce a hit show in the future, which we believe Russell Hicks is capable of doing. Additional upside may be seen if the company is able to grow its social media user base to a level that attracts more advertisers.

⁷ https://www.sec.gov/Archives/edgar/data/1835666/000167025421000550/document_1.pdf

Risks

In addition to the below risks, we strongly encourage investors to review regulatory filings for additional risk factors.

- The company's shares are extremely illiquid.
- The company has generated losses and will do so for the foreseeable future, in our opinion.
- The company has stated that it will need to raise additional financing.
- Auditors have express concern over the company's ability to remain a going concern.
- The company competes with companies that are much larger than it.
- One of the company's wholly owned subsidiaries, Top Draw Animation, is located in the Philippines. Any unfavorable economic or political development that occurs in the Philippines may affect the company's results of operations.
- The company has past due notes. No notices of default or demands for payment have been received by the company.
- The company may be unable to produce content that grasps the attention of its core audience.

Important Disclosures

Analyst Certification

I, Edward Reilly, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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The Firm or its affiliates did receive compensation from Grom Social Enterprises, Inc for investment banking services within the past twelve months, and will seek compensation from the companies mentioned in this report for investment banking services within three months following publication of the research report.

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BUY (B) - Total return expected to exceed S&P 500 by at least 10%

HOLD (H) - Total return expected to be in-line with S&P 500

SELL (S) - Total return expected to underperform S&P 500 by at least 10%

Distribution of Ratings/IB Services

EF Hutton

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent

BUY	32	100.00	15	46.88
HOLD	0	0.00	0	0.00
SELL	0	0.00	0	0.00

Grom Social Enterprises, Inc. Rating History as of 01/12/2022



The Firm or its affiliates did receive compensation from Grom Social Enterprises, Inc for investment banking services within the past twelve months, and will seek compensation from the companies mentioned in this report for investment banking services within three months following publication of the research report.