3QF24 Earnings Update

SideChannel, Inc.

(OTCQB: SDCH)

www.sidechannel.com

Report Date: 08/22/24

12- 24 month Price Target: $.23

Allocation: 5

Closing Stock Price at Initiation (Closing Px: 10/09/23): $.045

Closing Stock Price at Allocation and Target Increase (Closing Px: 05/08/24): $.06

Closing Stock Price at This Update (Closing Px: 08/21/24): $.05

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Disclosure: Portions of this report are excerpted from SideChannel's website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

For 3QF24 (ended 06/30/24) SideChannel reported revenues of $1.85 million, Net Income of <$146,000>. Those compared to our estimates of $2 million and <$208,000> respectively. Those numbers included a gross margin of 48.8% versus our estimate of 46.6%. We mention that specifically because last quarter, they reflected better gross margins than we projected, and they managed to outrun our estimates again. We think that fits into one of the cornerstones to our overall thesis here, which is that we think management is dialed in to extracting financial performance out of every spot they can. To that end we would add, this represents the Company's *"second consecutive quarter of positive cash flow from operations"*. Given the current environment where capital for small emerging companies is becoming more scarce and more expensive, we cannot emphasize enough the need for those companies to reduce burn and in turn their reliance on equity markets to fund working capital.

The above noted, we submit, the YoY revenue growth remains modest (about 5%), but we think the story continues to address some macro themes that may ultimately play out here. We addressed those in our last update, but some are worth reiterating here.

The Company's most recent 10Q provides some color from industry sources that indicate the growing role that Chief Information Security Officers ("CISO") are occupying in today's enterprises. The filing also touches on the recent Verizon data breach to illustrate the growth and breadth of cybercrime incidents, but frankly, anyone paying attention will recognize that breaches into large companies, small companies, government installations and everywhere in between are becoming more frequent. Further, as these industry insights also note, SideChannel's market, *virtual* CISOs ("vCISO"), are becoming particularly topical as small and midmarket companies are also victims of cybercrimes. In fact, as we addressed in the initiating coverage, cybercrimes may be more acute for smaller companies because they may lack the resources to wholly recover from those events. That being the case, part of our thesis here is that demand for vCISOs is poised to grow, and SideChannel is positioned to benefit from that growth.

As some of our readers will recognize, as a matter of identifying potential research coverage candidates, we prefer companies that have established and growing legacy businesses, with an additional business, technology or assets that provide blue sky opportunities that could be markedly additive to the Company's results. To that end, our view is that SideChannel's vCISO business represents that legacy business that we believe will continue to grow into profitability. However, we also recognize that scaling the vCISO business will take time and will continue to include challenges. On the other hand, the Company has developed an additional cybersecurity platform, that can be layered on to the vCISO business and provide an opening to much higher levels of business.

The Company's new technology platform is referred to as "Enclave", which again, we covered in detail in the initiating coverage so we will not rehash that here. However, we will provide a few refresher points to consider.

First, Enclave, addresses several vulnerabilities that are emerging from new technology approaches. For instance, Enclave is particularly suited to address edge computing, and its "microsegmentation" and "zero trust" protocols are quite topical to today's challenges.

Second, our sense is that the Company will have opportunities to upsell Enclave to its existing and future vCISO client base, as well as to other enterprises looking to fortify their systems. As a SaaS solution, we think even modest success from Enclave could have an outsized impact on SideChannel's results.

Third, as we understand it, the Company is gathering some momentum around Enclave, and we think they will be able to demonstrate Enclave traction through the balance of calendar 2024 and into 2025. In that regard, we believe improved positive visibility around Enclave would provide a marked catalyst for the valuation of the shares.

To summarize, in our view, management has done yeoman's work driving down the expenses of the business to preserve cash and avoid added dilution. Recall, the Company is in the midst of trying to replace the last portions of some existing toxic warrants, that are effectively keeping them from considering additional capital to grow the business. From that perspective, their cost cutting measures have perhaps been a matter of necessity, but regardless, the fact that they have managed to continue to grow revenues and commercialize Enclave in the face of driving down expenses is impressive. As an aside to the notion, it remains a mystery to us why the last warrant holders are determined to slow the progress here, but absent a change of heart by those investors, management will have to continue to grind their way to growth. Regardless, we think they will get there one way or the other, as we remain constructive on what we view as management's considerable experience and knowledge of the cybersecurity space, as well as its ability to manage the business. As such we reiterate our allocation of 5 as well as our 12-24 month price target of $.23 as we think the next 12 months should provide improving positive visibility.

Projected Operating Model

SideChannel, Inc.						
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Prepared By: Trickle Research						
	(Actual)	(Actual)	(Actual)	(Estimate)	(Estimate)	(Estimate)
	12/31/2023	**3/31/2024**	**6/30/2024**	**9/30/2024**	**Fiscal 2024**	**Fiscal 2025**
Income Statement						
Revenues	$ 1,736,000	$ 1,927,007	$ 1,846,004	$ 2,149,503	$ 7,658,513	$ 11,467,867
Cost of revenues	$ 891,000	$ 1,059,007	$ 944,002	$ 1,149,329	$ 4,043,337	$ 6,084,943
Gross profit	**$ 845,001**	**$ 868,000**	**$ 902,002**	**$ 1,000,173**	**$ 3,615,176**	**$ 5,382,923**
Operating expenses						
General and administrative	$ 709,000	$ 849,000	$ 778,000	$ 750,465	$ 3,086,465	$ 3,202,751
Selling and marketing	$ 269,000	$ 156,000	$ 137,000	$ 231,509	$ 793,509	$ 1,010,468
Research and development	$ 126,000	$ 123,000	$ 141,000	$ 145,000	$ 535,000	$ 685,000
Acquisition costs	$ -	$ -	$ -	$ -	$ -	$ -
Goodwill impairment	$ -	$ -	$ -	$ -	$ -	$ -
Other Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total operating expenses	**$ 1,104,000**	**$ 1,128,000**	**$ 1,056,000**	**$ 1,126,974**	**$ 4,414,974**	**$ 4,898,219**
Operating income (loss)	**$ (258,999)**	**$ (260,000)**	**$ (153,998)**	**$ (126,801)**	**$ (799,798)**	**$ 484,704**
Other income:						
Other Income	$ 13,000	$ 8,000	$ -	$ -	$ 21,000	$ -
Miscellaneous income	$ -	$ -	$ -	$ -	$ -	$ -
Interest expense	$ -	$ -	$ 8,000	$ -	$ 8,000.00	$ -
Total Other Income (Expense)	$ 13,000	$ 8,000	$ 8,000	$ -	$ 29,000	$ -
Net income (loss) Before Tax	**$ (245,999)**	**$ (252,000)**	**$ (145,998)**	**$ (126,801)**	**$ (770,798)**	**$ 484,704**
Income Tax Expense	**$ -**	**$ 1,000**	**$ -**	**$ -**	**$ 1,000**	**$ 1,000**
Net Income	**$ (245,999)**	**$ (253,000)**	**$ (145,998)**	**$ (126,801)**	**$ (771,798)**	**$ 483,704**
Net income (loss) per common share – basic	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**	**$ 0.00**
Net income (loss) per common share – Diluted	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**	**$ 0.00**
Weighted average common shares outstanding – basic	**221,645,310**	**222,773,052**	**225,032,119**	**225,232,119**	**223,670,650**	**270,582,119**
Weighted average common shares outstanding – diluted	**221,645,310**	**222,773,052**	**225,032,119**	**225,232,119**	**223,670,650**	**271,155,036**

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Portions of this publication excerpted from company filings or other sources are noted in *italics* and referenced throughout the report.

Rating System Overview:

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for my performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that I favor the stock (at respective/current levels) more than a stock with a rating of 1. As a guideline, here is a suggestion on how to use the allocation system.

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

For those attached to more traditional rating systems (Buy, Sell, Hold) we would submit the following guidelines.

A Trickle rating of 1 thru 3 would best correspond to a "Hold" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.

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

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