Trickle Research

Every raging river, every great lake, every deep blue sea starts … with a trickle

Fiscal 2024 Earnings Update & Allocation Increase

SideChannel

SideChannel, Inc.

(OTCQB: SDCH)

www.sidechannel.com

Report Date: 11/18/24

12- 24 month Price Target: $.23

Allocation: *6

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 Allocation Increase (Closing Px: 12/17/24): $.038

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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 Fiscal 2024 (ended 09/30/24) SideChannel reported revenues of $7.4 million, Net Income of <$904,000>. Those compared to our estimates of $7.66 million and <$772,000> respectively. Overall gross margins were about 60 basis points better than we estimated. In short for the fiscal year and extending back to some of the prior estimates (obviously we adjust that with quarterly results), we have consistently overestimated revenues and underestimated gross margins, with operating expense in line with our estimates. Perhaps most importantly, for the full year, the Company generated positive (and quarterly sequential) cash flow from operations. As we noted in our last update, "*we think management is dialed in to extracting financial performance out of every spot they can. 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*". To that end, in our view, the Company's ability to generate positive operating cash, or more specifically to avoid dilution to finance burn, is especially positive for SideChannel on multiple fronts.

First, cybersecurity threats continue to plague organizations of all sizes, and that trend is rising. (For instance, from a personal perspective over the *past handful of months*, we have received *three letters* from a healthcare organization, our telecom provider, and a state government administration informing us that our data had been breached…). Further, while generative AI will likely be utilized to harden cybersecurity solutions, it will also most certainly be used by attackers to enhance their approaches. From the wide angle, we believe SideChannel is positioned to address some of those growing threats, both through their legacy vCISO business, as well as through their emerging Enclave microsegmentation/zero-trust technology platform.

On a more granular level, while technically, SideChannel launched Enclave on 2HF22, the Company's vCISO business has historically generated the preponderance of the revenues. We submit, adoption of Enclave has been a bit slower than we (and ostensibly the street) had anticipated, but, given the Company's capital constraints, and their focus on rightsizing the business to eliminate burn (a result of the capital constraints), their available resources to market Enclave have been limited. We think that factor aligns the methodical uptake of Enclave customers. That said, they *have been* marketing Enclave, and we believe they are gaining momentum in that regard.

On October 29, 2024, the Company released the following:

> *SideChannel, the creator of the innovative zero-trust network microsegmentation solution Enclave, is proud to announce an initial contract win with a prominent defense research and development organization within the U.S. Department of Defense (DoD). The contract will see the implementation of SideChannel's Enclave solution to ensure secure communications, advanced segmentation, and enhanced network security.*
>
> *The DoD agency had been relying on legacy systems that were increasingly costly, unreliable, and hard to maintain. In search of a modern, more dependable solution to connect various systems and sites securely, the agency selected SideChannel's Enclave for its ability to create secure, isolated environments for sensitive communications and data.*
>
> *Enclave will enable the agency to transition to a zero-trust architecture, ensuring that only verified and authorized systems and users can communicate with one another across their network. Brian Haugli, CEO of SideChannel, commented on this important milestone:*
>
> *"We're thrilled to partner with such a forward-thinking organization within the DoD. This contract reaffirms SideChannel's commitment to delivering cutting-edge, secure communications solutions that reduce risk and improve operational resilience. Enclave is built for organizations that prioritize security, and we look forward to helping this agency achieve their zero-trust objectives."*

Additionally, SideChannel's Enclave solution is now available through the GSA and NASA SEWP contract vehicles, making it easier for government agencies to acquire and deploy the technology. These procurement options streamline the process, allowing federal entities to quickly implement secure, scalable solutions like Enclave to meet their evolving cybersecurity needs.

Clearly, the DoD represents a milestone reference customer for Enclave, but we believe there are other companies in the private sector that are in the process of adopting/implementing the platform as well. Succinctly, we submit, we do not have good visibility with respect to Enclave's adoption, but we remain of the view that the platform provides effective and affordable cybersecurity functionality for a variety of potential organizations and enterprises and announcements like the one above regarding an "*organization within the DoD*", provides validation of that view. Below are some links to videos that may help explain that functionality.

- Enclave - Simple Deployment of Microsegmentation | SideChannel
- Enclave Demo by SideChannel | VPN Replacement | Vulnerability Scanning | Microsegmentation
- Enclave Video | ZTNA | Zero Trust

To summarize, recall, the Company has been wrestling with some outstanding ratcheting warrants that have effectively prohibited them from seeking additional capital to grow (market) both their vCISO business and perhaps more importantly, their Enclave platform. They have been successful in exchanging some of those warrants for shares, but for reasons that are not clear to us, some of the warrant holders have chosen not to accept that exchange, which in our view has negatively impacted the Company's growth. However, again, despite limited resources, management has been able to position the business to generate modest operating cash largely around the legacy vCISO segment, which means that traction with Enclave could provide an additional (and higher margin) layer of business that should provide sequentially growing results in revenue with expanding net margins and profitability. Again, we submit visibility around that dynamic remains elusive, but we believe it is emerging, and with a small market cap (currently under $9 million), even modest Enclave traction should lead to extraordinary increases in the intrinsic value of the shares. As a result, we remain steadfast in our view that SideChannel shares represent compelling risk/reward potential from current levels. We think that view is supported by management's ability to achieve positive operating cash flow from modest revenues thus reducing the risk profile of the operation, as well as by recent announcements reflecting the commercial validation of Enclave by notable early adopters. **We also believe there are more of those to come**. That said, we have adjusted our model to more acutely reflect the "lack of visibility of Enclave sales" mantra we noted above. To translate, we have assumed slower adoption, which may or may not be the case, but still reflects our target, which is several multiples of the current stock price. Succinctly, we believe we can defend achievable scenarios that could reflect intrinsic values of 10X+ the current price of SideChannel shares.

As a result of the above, we increasing our allocation from 5 to *6 as well as reiterating our 12-24 month price target of $.23 as we continue to believe the next 12 months should provide improving positive visibility. We will revisit both of these as that visibility improves.

Projected Operating Model

SideChannel, Inc.						
Projected operating Model						
Prepared By: Trickle Research						
	(Estimate)	(Estimate)	(Estimate)	(Estimate)	(Estimate)	(Estimate)
	12/31/2024	**3/31/2025**	**6/30/2025**	**9/30/2025**	**Fiscal 2025**	**Fiscal 2026**
Income Statement						
Revenues	$ 2,110,947	$ 2,235,586	$ 2,328,220	$ 2,451,228	$ 9,125,981	$ 11,289,260
Cost of revenues	$ 1,121,726	$ 1,186,721	$ 1,234,252	$ 1,291,081	$ 4,833,780	$ 5,862,949
Gross profit	**$ 989,221**	**$ 1,048,865**	**$ 1,093,968**	**$ 1,160,148**	**$ 4,292,202**	**$ 5,426,311**
Operating expenses						
General and administrative	$ 747,766	$ 756,491	$ 762,975	$ 771,586	$ 3,038,819	$ 3,190,248
Selling and marketing	$ 219,847	$ 223,537	$ 228,156	$ 233,223	$ 904,762	$ 973,581
Research and development	$ 115,000	$ 115,000	$ 125,000	$ 130,000	$ 485,000	$ 520,000
Acquisition costs	$ -	$ -	$ -	$ -	$ -	$ -
Goodwill impairment	$ -	$ -	$ -	$ -	$ -	$ -
Other Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total operating expenses	**$ 1,082,613**	**$ 1,095,028**	**$ 1,116,131**	**$ 1,134,809**	**$ 4,428,581**	**$ 4,683,830**
Operating income (loss)	**$ (93,392)**	**$ (46,163)**	**$ (22,163)**	**$ 25,339**	**$ (136,379)**	**$ 742,482**
Other income:						
Other Income	$ -	$ -	$ -	$ -	$ -	$ -
Miscellaneous income	$ -	$ -	$ -	$ -	$ -	$ -
Interest expense	$ -	$ -	$ -	$ -	$ -	$ -
Total Other Income (Expense)	$ -	$ -	$ -	$ -	$ -	$ -
Net income (loss) Before Tax	**$ (93,392)**	**$ (46,163)**	**$ (22,163)**	**$ 25,339**	**$ (136,379)**	**$ 742,482**
Income Tax Expense	$ -	$ -	$ -	$ -	$ -	$ -
Net Income	**$ (93,392)**	**$ (46,163)**	**$ (22,163)**	**$ 25,339**	**$ (136,379)**	**$ 742,482**
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	**226,175,131**	**286,375,131**	**286,375,131**	**286,375,131**	**271,325,131**	**286,375,131**
Weighted average common shares outstanding – diluted	**226,175,131**	**286,375,131**	**287,139,020**	**287,902,909**	**271,898,048**	**289,812,631**

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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.