# Summary of SOCIAL REALITY, INC.

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**16-May-2016**

## Quarterly Report

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion of our financial condition and results of operations for the three month periods ended March 31, 2016 and 2015 should be read in conjunction with the condensed consolidated financial statements and the notes to those statements that are included elsewhere in this report. Our discussion includes forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth under the Item 1A, Risk Factors, Cautionary Notice Regarding Forward-Looking Statements and Business sections in our Annual Report on Form 10-K for the year ended December 31, 2015, this report, and our other filings with the Securities and Exchange Commission. We use words such as "anticipate," "estimate," "plan," "project," "continuing," "ongoing," "expect," "believe," "intend," "may," "will," "should," "could," and similar expressions to identify forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Such statements are based on our current expectations and could be affected by the uncertainties and risk factors described throughout this report.

**Overview**

We are an Internet advertising and platform technology company that provides tools to automate the digital advertising market. We have built technologies and leveraged partner technologies that service social media and the real-time bidding (RTB) markets. Our focus is to provide technology tools that enable both publishers and advertisers to maximize their digital advertising initiatives. We derive our revenues from:

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sales of digital advertising campaigns to advertising agencies and brands;

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sales of media inventory through RTB exchanges;

sale and licensing of our SRAX Social platform and related media; and,

creation of custom platforms for buying media on SRAX for large brands.

The core elements of our business are:

Social Reality Ad Exchange or "SRAX" - Real Time Bidding sell side and buy side representation is our technology which assists publishers in delivering their media inventory to the real time bidding, or RTB, exchanges. The SRAX platform integrates multiple market-leading demand sources. We also build custom platforms that allow our agency partners to launch and manage their own campaigns by enabling them to directly place advertising orders on the platform dashboard and view and analyze results as they occur;

SRAX MD is our ad targeting and data platform for healthcare brands, agencies and medical content publishers. Healthcare and pharmaceutical publishers utilize the platform for yield optimization, audience extension campaigns and re-targeting of their healthcare professional audience. Agencies and brands purchase targeted digital and mobile ad campaigns;

SRAX Social is a social media and loyalty platform that allows brands to launch and manage their social media initiatives. Our team works with customers to identify their needs and then helps them in the creation, deployment and management of their social media presence; and

SRAX APP, a recently launched new product, which is a platform that allows publishers and content owners to launch native mobile applications through our SRAX app platform.

We offer our customers a number of pricing options including cost-per-thousand-impression ("CPM"), whereby our customers pay based on the number of times the target audience is exposed to the advertisement, and cost-per-engagement ("CPE"), whereby payment is triggered only when an individual takes a specific activity.

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In 2015 we completed the technology needed to both operate the buy side of our SRAX platform and the buy side of SRAX MD, and launched our SRAX APP which we expect to begin contributing to our revenues in a meaningful basis during the second half of 2016. The SRAX APP is a free platform that provides online publishers an opportunity to distribute their content via a branded mobile application that updates automatically as they publish new content to their website. The platform also allows publishers the opportunity to bring in influencer feeds from Facebook, Instagram, YouTube and Twitter that are relevant to their content. During 2016 we expect to continue to enhance all of our technology offerings of SRAX, SRAX Social, SRAX MD and SRAX APP. We are now in the marketing and monetization phases of these technologies and our efforts are focused on the continued growth of our sales and marketing efforts of these platforms, with the goal of eliminating the dependence on revenues from a limited number of customers.

Results of operations

**Selected Consolidated Financial Data**

| | Three Months Ended March 31, 2016 | 2015 | change |
|---|---|---|---|
| Revenues | $ 5,469,335 | $ 4,021,284 | 36.0 % |
| Cost of revenue | 3,180,562 | 2,242,475 | 41.8 % |
| Gross margin percentage | 41.8 % | 44.2 % | (2.4 )% |
| Operating expenses | 3,805,101 | 2,910,000 | 30.8 % |
| Operating (loss) | $ (1,516,328 ) | $ (1,131,191 ) | 34.0 % |
| Interest (expense) | (885,327 ) | (923,270 ) | (4.1 )% |
| Net (loss) | $ (2,401,655 ) | $ (2,054,461 ) | 16.9 % |

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**Revenue**

Increases in our revenues during the three months ended March 31, 2016 from the same time in 2015 are due to growth in our buy side clients and the media they are buying. We are also seeing strong adoption of our SRAX MD platform as well as our customized buying platforms. The revenue for this period is also impacted by the seasonality of the media buying from our clients.

Cost of revenue

Cost of revenue consists of certain labor costs, payments to website publishers and others that are directly related to a revenue-generating event and project and application design costs. During the first quarter of 2016 our gross margin declined as a result of an increase in our cost of revenue as a percentage of our revenues. Cost of revenue as a percent of revenue increased to 58.2% for the first quarter of 2016 as compared to 55.8% for the first quarter of 2015. This increase is due to changes in the product mix sales for the period.
Approximately 97% and 99% of cost of revenue was attributable to payments to website publishers and other media providers for the first quarter of 2016 and the first quarter of 2015, respectively. The balance was attributable to labor costs and project and application design costs. As we continue to grow the revenue from our buy-side and sell-side product offerings, we expect that our blended gross margins will remain in the range of 50% to 55% in 2016.

Operating expense

Our operating expenses are comprised of salaries, commissions, marketing and general overhead expenses. Overall, our operating expense increased 30.8% for the first quarter of 2016 from the comparable period in 2015. The increase is primarily attributable to salaries, commissions and payroll expenses. We expect that our operating expense will continue to increase in future quarters commensurate with the expected growth of our business.

Interest income (expense)

Interest expense represents primarily interest under notes issued pursuant to the Financing Agreement together with the costs associated with the note issued to Mr. Steel as partial consideration for the purchase of Steel Media

described elsewhere in this report. The expense also includes amortization of debt costs and the accretion of contingent consideration and the put liability associated with the Steel Media acquisition. The decrease in interest expense in the first quarter of 2016 reflects the satisfaction of the note to Mr. Steel in October 2015, offset by interest associated with increased borrowings under the Financing Agreement during 2015 and the first quarter of 2016. Our interest expense may continue to increase during the balance of 2016 if we draw additional amounts under the Financing Agreement.

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Non-GAAP financial measures

We use Adjusted net (loss) to measure our overall results because we believe it better reflects our net results by excluding the impact of non-cash equity based compensation. We use Adjusted EBITDA to measure our operations by excluding interest and certain additional non-cash expenses. We believe the presentation of Adjusted net (loss) and Adjusted EBITDA enhances our investors' overall understanding of the financial performance of our business.

You should not consider Adjusted net (loss) and Adjusted EBITDA as an alternative to net income (loss), determined in accordance with GAAP, as an indicator of operating performance. A directly comparable GAAP measure to Adjusted net (loss) and Adjusted EBITDA is net (loss). The following is a reconciliation of net (loss) to Adjusted net (loss) and Adjusted EBITDA for the periods presented:

| | For the Three Months Ended March 31, | |
|---|---|---|
| (unaudited, in thousands) | 2016 | 2015 |
| Net (loss) | $ (2,402 ) | $ (2,054 ) |
| plus: | | |
| Equity based compensation | 436 | 417 |
| Adjusted net (loss) | $ (1,966 ) | $ (1,637 ) |
| Interest expense | 885 | 923 |
| Depreciation and amortization | 99 | 5 |
| Adjusted EBITDA | $ (982 ) | $ (709 ) |

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Liquidity and capital resources

Liquidity is the ability of a company to generate sufficient cash to satisfy its needs for cash. As of March 31, 2016 we had approximately $1,600,000 in cash and cash equivalents and a deficit in working capital of $5,184,901 as compared to $1,100,000 in cash and cash equivalents and a deficit in working capital of $7,047,176 at December 31, 2015. Our current assets decreased 18.6% at March 31, 2016 as compared to December 31, 2015 which is primarily attributable to a decrease in accounts receivable and prepaid expenses, offset by an increase in cash. Our current liabilities decreased 22.1% at March 31, 2016 as compared to December 31, 2015 which is the result of several factors, including the decrease in accounts payable and accrued expenses together with a decrease in contingent consideration, which represents the payment of the 2015 earn out Mr. Steel received in January 2016, offset by an increase in the current portion of notes payable, which reflects additional borrowings under the Financing Agreement and scheduled increases in payment under the terms of the agreement.

Our principal sources of operating capital have historically been equity and debt financing. During the fourth quarter

of 2014 we entered into the Financing Agreement with Victory Park Management, LLC, as administrative agent and collateral agent for the lenders which is described below. In May 2015 we entered into the First Amendment to Financing Agreement with Victory Park Management, LLC, as administrative agent and collateral agent for the lenders. Under the terms of the amendment, the leverage ratio, senior leverage ratio, fixed charge coverage ratio and interest coverage ratio under the Financing Agreement were all modified, and the minimum current ratio was reduced. The amendment also modified our obligations with respect to the delivery of certain reports, certain representations by us as well as clarifying other additional terms by which the loan is administered.

The Financing Agreement provides for borrowings of up to $20 million. As of March 31, 2016 we have drawn a total of $14.0 million under the Financing Agreement, of which $9 million was used in connection with the initial acquisition of Steel Media in 2014, an additional $1.4 million was used in the payment of the Steel Note at its maturity in October 2015 and $1.6 million was used for the cash portion of the first year earn out payment to Mr. Steel in January 2016. The balance of the funds we have drawn under the Financing Agreement have been used for working capital. In 2015, we made payments to Victory Park Management, LLC against the draws aggregating $1.9 million. During the three months ended March 31, 2016, we also made payments to Victory Park Management, LLC against the draws aggregating $0.4 million.

We do not have any commitments for capital expenditures. The terms of the Financing Agreement require us to allocate a significant portion of our expected future cash flow to satisfying obligations under that agreements. Under the terms of the Financing Agreement, we are obligated to make:

monthly interest payments, inclusive of payment-in-kind, or PIK interest, of approximately $140,000,

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quarterly amortization payments of 2.5% of principal in year one of the loan, resulting in principal payments of approximately $225,000 per quarter in the first year of the loan, increasing to 5% of principal in year two of the loan and further increasing to 10% of principal in year three of the loan;

quarterly mandatory prepayments on the loan, in an amount calculated as 50% of excess cash flow as defined in the Financing Agreement, of EBITDA less amortization and interest payments, plus associated prepayment penalties;

payments of proceeds from asset sales, proceeds of debt or equity financings, certain extraordinary receipts (including tax refunds and indemnification payments received in connection with any acquisition), and the proceeds of any taking or destruction of collateral; and

other selected cash outlays, such as late charges, yield maintenance premiums, costs and expenses

Additionally, under the terms of the Stock Purchase Agreement for the acquisition of Steel Media, we agreed to pay Mr. Steel up to two $4 million annual earn out payments based upon the satisfaction of certain targets generated by Steel Media operations for the periods ending October 31, 2015 and October 31, 2016. The EBITDA target for the first earn out period ended October 31, 2015 was achieved, and in January 2016 we paid Mr. Steel $4 million, of which $1.6 million was paid in cash and the balance was paid through the issuance of shares of our Class A common stock in accordance with the terms of the Stock Purchase Agreement. The adjusted EBITDA target which

must be met in order for Mr. Steel to earn the second earn out payment is approximately $4.9 million for the 2016 period. If the 2016 earn out target is met, the cash payment we will need to make to Mr. Steel will reduce the funds which may be used for our debt service obligations and for working capital needs. Any failure on our part to make any earn out payment which may be due Mr. Steel could result in an event of default under the Financing Agreement.

The net effect of the required payments under the Financing Agreement, and the possible earn out payment to Mr. Steel, is anticipated to equal the majority of the cash flow generated from Steel Media's operations. To the extent that we are able to increase the earnings attributable to Steel Media, we are paying down the notes issued under the Financing Agreement.

Other than cash generated from operations and the Financing Agreement, we do not have any external sources of liquidity. While the Financing Agreement provides that we can borrow up to $20 million in total, at March 31, 2016 we have $12.3 million outstanding under the Financing Agreement and our ability to access any additional funds under it is at the discretion of the lender. There can be no assurance the lender will agree to lend us any additional amounts. In the event of a default by us under the terms of the Financing Agreement, remedies for the lender range from notice and cure, to acceleration of both principal and interest. Our operations may not generate sufficient cash to enable us to service our debt. Upon an event of default under the Financing Agreement, if we were unable to cure the default within the prescribed periods, if at all, the lender could increase our interest rates or accelerate all amounts then due. If we were unable to repay these obligations, the lender could foreclose on our assets and collateral, in which case our ability to continue our business and operations as then conducted would be in jeopardy. If the lender should foreclose on our assets, it is likely you would lose your entire investment in our company.

If we are able to significantly increase our revenues and cash flows from operations, we should have sufficient internally generated working capital to satisfy these obligations and fund our ongoing business. If, however, we are not successful in these efforts and we are not able to access additional funding under the Financing Agreement, it is possible we will need to delay or scale back our growth plans.

**Net Cash Used in Operating Activities**

Net cash used in operating activities was $124,775 during the three months ended March 31, 2016 compared to net cash used in operating activities of $831,488 for the comparable period in 2015. The period to period change was primarily attributable to decrease in accounts receivable partially offset by an increase in net loss (after adjusting for non-cash expenses) and a decrease in our accounts payable.

**Net Cash Provided Used in Investing Activities**

We did not use or generate any cash from investing activities in either period.

**Net Cash Provided Used by Financing Activities**

During the three months ended March 31, 2016 net cash provided by financing activities was $633,945 which represented the proceeds from draws under the Financing Agreement, net of costs and repayments and the cash portion of the payment to Mr. Steel of the first year earn out. During the comparable period in 2015, we used $308,880 of cash in financing activities which is primarily attributable to the repayment of amounts due under the Financing Agreement.

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Critical accounting policies

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the reported periods. The more critical

accounting estimates include estimates related to revenue recognition and accounts receivable allowances. We also have other key accounting policies, which involve the use of estimates, judgments and assumptions that are significant to understanding our results, which are described in Note 1 to our condensed consolidated financial statements appearing elsewhere in this report.

Recent accounting pronouncements

The recent accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on our financial statements upon adoption.

Off balance sheet arrangements

As of the date of this report, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The term "off-balance sheet arrangement" generally means any transaction, agreement or other contractual arrangement to which an entity unconsolidated with us is a party, under which we have any obligation arising under a guarantee contract, derivative instrument or variable interest or a retained or contingent interest in assets transferred to such entity or similar arrangement that serves as credit, liquidity or market risk support for such assets.

**ITEM 3.**


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