Fiscal 2023 Earnings Update & Price Target Increase

Sow Good Inc.

(OTC: SOWG)

Report Date: 03/25/24

12- 24 month Price Target: *$32.00

Allocation: 6

Closing Stock Price at Initiation (Closing Px: 07/17/23): $3.75

Closing Stock Price at Allocation & Price Target Increase (Closing Px: 08/16/23): $5.00

Closing Stock Price at Allocation & Price Target Increase (Closing Px: 11/14/23): $9.00

Closing Stock Price at This Price Target Increase (Closing Px: 01/16/24): $10.19

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

For fiscal 2023 (ended 12/31/23) Sow Good reported revenues of $16.1 million versus $428,132 for fiscal 2022 (ended 12/31/22). What is particularly remarkable about those results is that the Company generated $14.6 million of it in the second half of the year, and *60% of it (9.5 million) in the fourth quarter*. In terms of our estimates, revenues for the year bested our most recent (January 16, 2024) estimate of $13.7 million by $2.4 million. For reference, the revenues of $16.1 million beat the estimate from our initiating coverage (07/17/23) by nearly $6 million. In retrospect, in January, we hesitated to publish our revenue estimate of $10.15 million because we thought it was *a bit out there*. The fact that it was not even close is extraordinary.

As for the call, the Company noted a handful of cogent data points that require review.

First, recall, we noted in prior writings that we have built our model around assumptions regarding the potential of specific customers they have revealed along the way. For instance, we noted that their largest customer at that time, Five Below (Nasdaq: FIVE) has roughly 1300 locations and we understood that they were shipping 4 sku's, so if they sent 4 sku's to each location and those locations turned that product a certain number of times we could arrive at projections that might be close if we got the turns relatively close. In short, we repeated that process with the customers they actually announced and then to a lesser extent extrapolate some additional projections around what we assumed were some additional customers that would not allow them to announce their names, which is not uncommon. Given that approach, they provided some new customer names/guidance on the call that we were unaware of, and we will be working those into our new model. Obviously, that provides a basis for us to expand our revenue expectations. Here are a few of those new customer data points for reference.

- Circle K **-** approximately 2,000 stores. (TSE: ATD.TO and OTC: ANTCF)
- increasing SKU portfolios at Cracker Barrel (NASDAQ: CBRL)
- increasing SKU portfolios at Five Below (NASDAQ: FIVE)
- launching into 300 SESCO convenience stores in February.
- launching four SKUs in Target Corporation (NYSE:TGT) in March and expanding into an anticipated 1,859 Target stores in June.
- Pending launches in Party City
- Pending launches in Kroger (NYSE:KR)
- Pending launches in 7-Eleven
- Pending launches in Dollar General (NYSE: DG)
- Pending launches in Hobby Lobby

Second, our prior modeling was based on 9 sku's. There were others at the time, but we modeled what we believed were those that looked to be the most popular. We believe there are there are 13+ sku's today and they addressed some of those on the call, most notably their new ice cream products. To that end, we periodically drop in on some of the Five Below retail stores that carry their products and we recently tested one of the new ice cream sku's. (By the way, it was outstanding). In our view the Company's ability to add new innovative sku's may be a marked growth driver, as they introduce new sku's into existing customers. We recognize there may be some diminishing returns to that, but again, for the foreseeable future we view new sku's as a highly positive data point. Moreover, we have also noted in the prior research that the Company's founders have demonstrated an ability to develop and commercialize innovative CPG products in the past, and we think that tribal knowledge will prove important here as well.

Third, the Company spent some time on the call discussing their efforts to add contract manufacturing arrangements to increase their capacity. We have discussed this possibility in prior research as well. The call provided some visibility in that regard, and it appears they have added capacity in China and Columbia and are looking at other arrangements as well. More specifically, they also emphasized that they were utilizing in-house production for some of the more difficult sku's, which we think is an important point. for reference, we built our prior models around capacity from the deployment of 6 in-house dryers. We estimated that all of these would be in operation by Q2F24. They indicated on the call that dryers 5 and 6 are now slated for Q3F24. That brings us to our next issue.

One of the data points we have utilized has been the capacity represented by the 6 dryers. In short, we have a good idea of the general capacity of each dryer (although it depends on the product being dried) and we have operated under the assumption that if they are adding capacity (dryers) it is likely because they are seeing demand increase. However, capacity in that regard has been constrained by a lack of dryers. Recall, that was some of the basis for the two equity raises they completed in the second half of 2023. On the call, management noted that they "*strategically paused the onboarding of new customers in Q3 through Q1"*. We think that is another way of saying they were having trouble drying enough product to meet demand. That said, we assumed the critical path was adding in-house dryers as quickly as possible, but apparently, that problem has been addressed through contract manufacturing arrangements. To that end, the Company provided some guidance around their anticipated capacity through 2024, specifically, *"we are currently aiming to be able to produce 4.25mn units in Q1, growing to 7.2 million units in Q2, 9 million units in Q3 and 9.55 million units in Q4 for a total of approximately 30 million units in 2024"*. Once again, we are building our revenue model around capacity information we are able to glean, that is, ostensibly, we assume they intend to sell what they produce, or from another perspective, we assume they would not plan to ramp capacity from 4 million units in Q1 to closer to 10 million by Q4 if they didn't have a good idea about who they were going to sell it to. For reference, 30 million units should generate something close to $75 million in revenues. We have (conservatively) incorprated that guidance into our new model assumptions.

Again, we have updated our model to include some of the data points we gathered from the filings as well as the corresponding conference call. In terms of Q1F24 they suggested on the call that in conjunction with their pause in onboarding through the quarter, they expect *"deliberately executed smaller sequential expansion relative to the fourth quarter of 2023, laying the groundwork to effectively manage and support much greater growth in Q2 and the second half of this year"*. Our model reflects adjustments around that guidance as well, which in turn aligns with the aforementioned capacity guidance.

To summarize, when we first started doing our due diligence around Sow Good, *they did not have a candy business*. We were introduced to the Company by a Trickle subscriber. After a call with management, we arranged a site visit some time later, and were impressed with some of the opportunities they were looking at pursuing. One of those was candy, but it was in its nascent stages (or at least nascent as we understood it at the time), but their vision therein accelerated very quickly from that point forward. They have been one (or three) steps ahead of us since that time. The trajectory has been remarkable. Consider, 12 months ago, they did not have a candy business, which means *they went from zero to nearly $10 million in quarterly revenue in less than 9 months*.

The above noted, we have had conversations with subscribers as well as others regarding the path forward here and we submit, there are wild cards that remain in the story. For instance, there is one question that is popular namely, is this new candy "category" sustainable, or is it a fad? That is a very good question, and we do not know the answer to that, nor do we know how to assess it with any particular vigor. Clearly, it remains a risk to the story.

The other question we have discussed is, in the event that they have in fact created a new category, how susceptible are they to new competitors? We are a bit more comfortable answering this one. The freeze-dried food business has historically been limited largely to the MRE/emergency rations market, although there are certainly other perhaps emerging verticals. To that end, Sow Good had a line of MREs that they have since discontinued (part of the basis for their impairments for fiscal 2023). Moreover, there are others selling freeze-dried candy. However, our view of the freeze-dried candy market is that it is *highly* fragmented, with very few players that have the ability to manufacture and deliver products at scale and at an attractive price point to big box retailers and/or with the ability to develop new products and in turn effectively market them. We believe Sow Good is one of those, and as we noted in our initiating coverage, we think the founders have considerable history and expertise around running efficient and scalable freeze-dried operations, which includes some proprietary protocols, but emerging competition is certainly a risk. However, we tend to believe that formidable emerging competition is more likely if freeze dried candy does in fact become a new and likely sustainable category. Since Sow Good is at the forefront of that effort, we also tend to think that they will have a marked first mover advantage in that scenario and that position would afford them considerably more value than is currently reflected in the shares. We submit that may be more subjective than some may be comfortable with, but that is our thesis.

Looking ahead, considering their capacity guidance above, and assuming they plan to sell what they produce, it looks to us like they are guiding to F24 revenue in the $75 million range. Granted, they have not specifically guided *in those words*, and maybe we have some assumptions wrong here, but that is how we interpret it. Our model from our most recent update in January (2024) reflects projected revenues of just under $42 million. In the context of the capacity guidance, which again, has been one of the two beacons we have followed to develop what we thought were defensible projections, that conclusion appears to be substantially understated. Further, as we also covered above, the other data point we have built assumptions around is the announced customers base, and the earnings call provided some names we had not modeled before, so that speaks to higher projections as well. On the other hand, while we noted our projections to this point have been consistently a few steps behind, we are (still) inclined to err on the conservative side. As a result, we have provided an updated model around the aforementioned new data points, which has led us to a new 12 – 24 month price target of *$32.00 per share. For reference, that number represents a P/E multiple about 33X the eps run rate implied by the Q4F23 results, about 25X to our pre-tax fully diluted projections for F24, and 12.7X our f/d eps estimates for F25. By the way, if the projections prove relatively accurate, F25 fully diluted eps would represent *a 100% increase over F24*. In short, we have used some heavy discounts to hedge the possibility that our projections will end up measurably inaccurate, either in terms of revenue, expenses, or both. However, from that standpoint, if they do in fact play out as projected, our price target will in our view have markedly understated the intrinsic value of the shares. That is another way of saying we think the story is open-ended beyond our targets.

In addition, given the difference between that target and the current share price, we are also inclined to raise our allocation (again). We are going to refrain from that for now because of two primary reasons. First, as we often suggest in our research, we do not tend to publish many allocations above 6 (see our "Rating System Overview" at the end of this report). Moreover, it is rare for us to increase allocations as the stock is appreciating and there are several reasons for that, which we are happy to discuss with whomever. To edify, we tend to increase allocations more often when we think specific names get oversold because *we think* the street has perhaps misunderstood or otherwise missed something along the way. Second, Sow Good is very thinly traded, which frankly, is a challenging part of the story, and we think has likely frustrated many investors trying to buy the shares. That noted, the stock does seem to catch a seller once in a while, which sometimes creates some measurable compression in the stock. We view those events as opportunities for those paying attention. We will reassess our allocation, and our price targets for that matter, as visibility improves.

Projected Operating Model

Sow Good Inc.						
Projected Operating Model						
By: Trickle Research						
	(Estimate)	(Estimate)	(Estimate)	(Estimate)	(Estimate)	(Estimate)
	3/31/2024	**6/30/2024**	**9/30/2024**	**12/31/2024**	**Fiscal 2024**	**Fiscal 2025**
Revenues	$ 9,827,259	$ 11,982,576	$ 14,784,160	$ 18,051,236	**$ 54,645,231**	**$ 93,194,962**
Cost of goods sold	$ 5,743,480	$ 7,003,141	$ 8,640,509	$ 10,549,932	**$ 31,937,063**	**$ 54,467,211**
Gross profit	$ 4,083,779	$ 4,979,434	$ 6,143,650	$ 7,501,304	**$ 22,708,168**	**$ 38,727,751**
General and administrative expenses:	$ 0	$ 0	$ 0	$ 0	$ 1	$ -
Salaries and benefits	$ 1,482,726	$ 1,698,258	$ 1,978,416	$ 2,305,124	$ 7,464,523	$ 11,319,496
Professional services	$ 346,545	$ 389,652	$ 445,683	$ 511,025	$ 1,692,905	$ 2,463,899
Other general and administrative expenses	$ 547,409	$ 579,739	$ 621,762	$ 670,769	$ 2,419,678	$ 2,997,924
Intangible Asset Impairments	$ -	$ -	$ -	$ -	$ -	$ -
Goodwill impairment	$ -	$ -	$ -	$ -	$ -	$ -
Total general and administrative expenses	$ 2,376,680	$ 2,667,648	$ 3,045,862	$ 3,486,917	**$ 11,577,106**	**$ 16,781,320**
Depreciation and amortization	$ 50,000	$ 50,800	$ 51,613	$ 52,439	$ 204,851	$ 218,280
Total operating expenses	$ 2,426,680	$ 2,718,448	$ 3,097,474	$ 3,539,355	**$ 11,781,958**	**$ 16,999,600**
Net operating loss	$ 1,657,099	$ 2,260,987	$ 3,046,176	$ 3,961,949	**$ 10,926,211**	**$ 21,728,151**
Other income (expense):	$ -	$ -	$ -	$ -	$ -	$ -
Interest expense,	$ (171,880)	$ (161,880)	$ (151,880)	$ (141,880)	$ (627,520)	$ (467,520)
Other income	$ -	$ -	$ -	$ -	$ -	$ -
Gain on disposal of property and equipment	$ -	$ -	$ -	$ -	$ -	$ -
Gain on early extinguishment of debt	$ -	$ -	$ -	$ -	$ -	$ -
Gain on investment in Allied Esports Entertainment, Inc.	$ -	$ -	$ -	$ -	$ -	$ -
Total other income (expense)	$ (171,880)	$ (161,880)	$ (151,880)	$ (141,880)	**$ (627,520)**	**$ (467,520)**
Net Income (Loss)	$ 1,485,219	$ 2,099,107	$ 2,894,296	$ 3,820,069	**$ 10,298,691**	**$ 21,260,631**
Weighted Average Number of Shares Outstanding, Basic	6,033,852	6,033,852	6,033,852	6,033,852	**6,033,852**	**6,033,852**
Weighted Average Number of Shares Outstanding, Diluted	8,117,386	8,209,360	8,291,479	8,364,801	**8,245,756**	**8,434,158**
Earnings Per Share, Basic	$ 0.25	$ 0.35	$ 0.48	$ 0.63	**$ 1.71**	**$ 3.52**
Earnings Per Share, Diluted	$ 0.18	$ 0.26	$ 0.35	$ 0.46	**$ 1.25**	**$ 2.52**

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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.