Trickle Research

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

Target Decrease and Allocation Increase

Vext Science, Inc.

(symbol: VEXTF)
www.vextscience.com

Report Date: 06/06/23

12- 24 month Price Target: *US$.80

Allocation: **8

Closing Stock Price at Initiation (Closing Px: 01/30/20): US$.55

Closing Stock Price at Allocation Upgrade (Closing Px: 06/02/20): US$.33

Closing Stock Price at Allocation Upgrade (Closing Px: 07/13/21): US$.67

Closing Stock Price at Allocation Upgrade & Target Decrease (Closing Px: 01/11/23): US$.21

Closing Stock Price at Target Decrease (Closing Px: 12/20/23): US$.20

Closing Stock Price at This Target Decrease and Allocation Increase (Closing Px: 06/05/23): US$.17

Prepared By:
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Disclosure: Portions of this report are excerpted from Vext's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text. Unless otherwise noted, all prices in this report are in US Dollars.

We have managed to miss Vext's numbers badly over the past three quarters, which has caused us to go back and reassess our model to try to figure out what we do not seem to be figuring out. In retrospect, some may recall that when we first started covering the stock, Arizona law would not allow for-profit entities to own cannabis enterprises, so the Company used applicable management service agreements to execute the business. That requirement changed when Arizona went recreational. Oddly enough, modeling the old management service configuration was complex and difficult, but we somehow managed to hit numbers better then than today. Further, we tried to pivot the model to address the changes, which ultimately included the layering in and consolidation of the pieces of the Ohio assets. In short, we reached the conclusion that we needed to start over with a new approach which is represented by the model attached herein. That said, the misses in the numbers also went beyond our own shortcomings, and that is worth reviewing as well.

A portion of our misses were the result of trying to model the consolidation of the Ohio pieces, which included two individual dispensaries, as well as the cultivation and processing assets. In that regard, 2QF24 will represent the first full quarter with all of those assets fully consolidated. We submit, we did not have all of *that* timing correct either, for instance, we had the second dispensary consolidated in Q1F24, but as it turned out it was consolidated for only about 1/3rd of the quarter. However, the bulk of the negative surprises are related to the stark compression in the Arizona cannabis market and by extension, the Company's Arizona assets. We have addressed this in prior updates, but the 10,000-foot view is apparently that the market suffers from a glut of cannabis via the excessive production of flower, which has resulted in marked price compression across industry. We will address that below. Further, the Company, via the earnings call as well as the filing, notes that Arizona consumers are essentially feeling the bite of inflationary and associated pressures, which are likely impacting their discretionary spending. We will address that briefly as well.

First, we submit the Company is certainly in a better position to assess the fundamentals of the Arizona cannabis market than we are. Moreover, we do not dispute that the advent of recreational use in Arizona has attracted cultivation that ultimately overestimated demand creating a glut and resulting price compression, which we have illustrated in **Table 1** below. However, we remain of the opinion that Arizona, like some other recreational states, has a black-market problem as well. In our view, this is an important distinction for the future. Succinctly, if Arizona's flower glut is a result of temporary imbalances around the launch/establishment of recreational cannabis in Arizona, then we should expect that glut to eventually wash through the system, prices to find a bottom somewhere in here and ultimately begin to clear and stabilize at higher prices, improving the fortunes of entrenched players like Vext. However, to the degree that our sense that the black market is exacerbating the Arizona weed glut proves accurate, the road back to higher prices could prove longer and more challenging than some are anticipating. On the other hand, we also believe that integrated players like Vext, especially those who have built in some flexibility around their ability to cultivate more or less cannabis, are in a much better position to weather the storm and ultimately overcome the storm.

Table 1.

LeafLink: Wholesale cannabis flower prices, 2023-24

State	1Q23	2Q23	3Q23	4Q23	January 2024	February 2024	March 2024	March 2024 YOY % change
Alaska	$2,300	$2,316	$2,358	$2,293	$2,210	$2,218	$2,207	-4.3%
Arizona	$1,423	$1,647	$1,732	$1,152	$1,168	$1,097	$1,104	-24.1%
Arkansas	$1,320	$1,323	$1,293	$1,361	$1,401	$1,444	$1,490	8.3%
California	$1,335	$1,259	$1,255	$1,137	$1,159	$1,240	$1,227	-10.6%
Colorado	$754	$773	$803	$802	$807	$814	$805	8.9%
Maryland	$1,216	$1,401	$2,441	$2,625	$2,609	$2,558	$2,516	125.2%
Massachusetts	$1,483	$1,382	$1,392	$1,400	$1,381	$1,325	$1,294	-12.5%
Michigan	$797	$902	$981	$977	$904	$916	$915	13.8%
Missouri	$1,838	$2,094	$2,035	$2,110	$2,072	$1,992	$1,880	-7.6%
Nevada	$1,517	$1,784	$1,759	$1,661	$1,740	$1,781	$1,790	5.5%
Oklahoma	$888	$905	$954	$916	$902	$905	$913	5.9%
Oregon	$854	$860	$887	$863	$840	$837	$831	0.2%
Washington	$1,259	$1,268	$1,283	$1,237	$1,292	$1,304	$1,289	11.4%
LL Platform	$1,051	$1,116	$1,175	$1,128	$1,124	$1,140	$1,120	4.9%

Wholesale cannabis prices beating expectations for 2024 (mjbizdaily.com)

As we noted, in addition to pricing, the Company referenced the state of the consumers in the face of higher inflation as well as perhaps their concerns over a slowing economic backdrop. Here again, we have touched on this in the past, but historically, we think many cannabis industry observers have assumed that the industry might prove defensive against macro-economic headwinds. Interestingly enough, Colorado became the first state to legalize recreational marijuana in 2014, and outside of the brief recession of February through April 2020, we have *not had* a recession since the passage of recreation cannabis in any applicable state. That is, cannabis's resilience in the face of a poor economic backdrop has yet to be tested, but we suspect opinions regarding its defensive posture may prove overstated, and some of the Company's narrative seem to support that view as well. We have built some discounting elements into our model around that notion.

To summarize Arizona's cannabis industry, it remains precarious as does visibility around it. However, we think management has done an admirable job of managing through the malaise. That includes reducing its exposure on the cultivation side while maintaining the flexibility to add capacity if/when needed as well as focusing on their storefronts and their branded products therein. That brings us to Ohio.

To reiterate, the Company consolidated its second dispensary in Q1F24, and we believe this is the better of the two current stores. This follows the consolidation of the cultivation and processing pieces in Q4F23, so the current quarter (2QF24) represents the first quarter of the fully integrated Ohio footprint. We believe there are a handful of catalysts around Ohio that will play out through the balance of the year and will markedly improve the Company's performance as well as its working capital liquidity. Here are the major catalysts as we see them.

- It sounds as if Ohio recreational sales will launch within the current month (June 2024). Initially, it was unclear when the start date might actually happen, including some views that it may get kicked down the road. Clearly, for Vext, especially considering that it is just recently fully integrated, that timing could not be better.

- When recreational sales become legal (again, ostensibly this month) the Company addressable market is expected by some to grow from roughly 150,000 medical marijuana patients, to between 1.8 and 2 million recreational users. We assume that will create a marked uptick in average dispensary sales into the foreseeable future, as well as higher pricing/margins for some period of time as the market adjusts to considerably higher demand.

- While it is difficult to try to project retail demand coming out of Ohio's recreational launch, we think Vext is positioned to benefit from what will almost certainly be an extraordinary increase, but we are unsure how that will play out for Vext in terms of sales mix. For instance, their current cultivation and processing capacity is considerably greater than what we are modeling even their post recreational retail demand to be, which means that they should be selling wholesale product into a rising demand and associated pricing environment. From another perspective, that *also means* they should have ample supply to meet their own retail demand, *even if it exceeds* our (or more topically their) expectations. As a result, we believe (in conjunction with their discussion on the call) that over the next 12 months, Vext should begin growing cash markedly and sequentially, which should allow them to complete the acquisition and stand up of dispensaries #3 and #4 (see below) and begin chipping away at the debt, ultimately fortifying the balance sheet and improving the Company's posture as an acquisition target, which we tend to view as the end game here.

- The Company is awaiting regulatory approval and eligibility to apply for license transfers of dispensaries #3 and #4, which are already specifically identified. They are anticipating a late 3QF24 approval and a potential consolidation of those facilities in late 2024. We are modeling their consolidation(s) through 1HF25.

We would add, there are some nuances in the accounting that readers should keep in mind. For instance, while the financials reflect separate line items for amortization and depreciation, they also allocate (significant) additional portions of these expenses to COGS and to other operating line items. For instance, in Q1F24, they recognized a separate depreciation line item of $124,862, however, they also allocated $1,590,012 of depreciation to cost of sales. To edify, because of the substantial investments in acquired and constructed assets along the way, the Company realizes marked non-cash expenses, which is why their analysis often focuses on their prospects to build cash as opposed to generating GAAP earnings. We suspect most are aware of that dynamic, but we do feel like it is worth reinforcing.

To summarize, over the past three years cannabis valuations have substantially discounted, although certain publicly traded cannabis stocks have managed to claw some of that valuation back over the past year or so. Unfortunately, that has not been the case for Vext … yet. In retrospect, we have noted several times along the path of our Vext coverage that, hailing from Colorado, we have had a front row seat to rollout of what is now one of the more seasoned recreational marijuana markets. In its nascent state, we saw more cannabis deal flow than we care to remember. As we have noted, despite being at ground zero, we have only provided coverage of two (sort of three) cannabis related enterprises. Part of that reluctance stemmed from concerns about the industry that again in retrospect, turned out the way we feared they might. Specifically, setting aside the lofty valuations that sometimes accompany manic emerging industries, our concerns have always focused on the challenges that come with letting governments regulate markets. We believe those concerns remain today and are the genesis of many of the *legitimate* industry's challenges.

In addition, the industry also continues to suffer from the disconnect between federal and state laws around cannabis, which as those who are familiar with the space even on a cursory basis know, impacts banking and other business processes. Moreover, there remains considerable uncertainty around various postures the federal government might ultimately adopt (or not) and how each of those iterations might impact individual states and the entrenched legitimate players within them, most of whom have paid considerable fees and taxes to be able to participate. In short, the industry is not, nor has it ever been, ideal.

The above said, *we think* the industry, certainly in some markets, is beginning to settle in and look more like a lot of industries driven by supply and demand and all of those traditional economic metrics. Again, we think, that may be another way of suggesting that visibility may be improving at least on some fronts, and from another perspective, the winners and losers will likely be determined the old-fashioned way, good fundamental operators will survive, and not-so-good operators will not. We continue to believe Vext's management is in the "good operators" camp and that brings us to our final point.

In the face of and/or despite the struggles in Arizona, the Company has managed to keep its hand on the rudder (and its foot on the peddle) to establish a fully integrated and visibly scalable platform in Ohio. Again, in our view, their timing in getting all the pieces together in lockstep with the passage and now ostensibly the launch of recreational cannabis in Ohio has been spot on. To reiterate, as a result of that preparation, we think the Company is poised for a marked breakout in operating performance. We submit, that "breakout" will depend on Ohio's recreational launch looking like most of the recreational launches that have occurred around the country (a huge influx of recreational cannabis buyers generating extraordinary industry growth), as well as Vext's ability to successfully compete and "hold its own" in that environment. Obviously, we are constructive on both, and we expect the Company's resulting improvements in financial performance to provide a basis for improving share valuations as well.

As result of our updated model assumptions including higher relative share counts, we are lowering our price target for VEXT shares from US$1.00 to *US$.80. However, given the coming catalysts we noted above, we are also increasing our allocation from 7 to **8 based on what *we believe* are becoming more tangible valuation disconnects. To be clear, allocations of 7+ are not typical for us, and as with Vext, they tend to come about as a result of continued valuation compression that we view as oversold. Regardless, we are willing to throw caution to the wind, as we believe at these levels, Vext represents a compelling risk/reward value proposition.

Projected Operating Model

Vext Science, Inc.						
Projected Operating Model						
By: Trickle Research LLC						
	(actual)	(estimate)	(estimate)	(estimate)	(estimate)	(estimate)
	3/31/2024	**6/30/2024**	**9/30/2024**	**12/31/2024**	**Fiscal 2024**	**Fiscal 2025**
Sales	$ 8,390,023	$ 9,087,584	$ 9,412,221	$ 9,810,865	$ 36,700,693	$ 48,087,902
Cost of Goods	$ 6,451,226	$ 6,453,446	$ 6,461,555	$ 6,466,818	$ 25,833,044	$ 25,914,104
Gross Profit Before Fair Value Adjustments	$ 1,938,797	$ 2,634,138	$ 2,950,666	$ 3,344,047	$ 10,867,649	$ 22,173,798
Unrealized Change in Fair Value of Biological Assets	$ (773,855)	$ (870,959)	$ (910,095)	$ (921,767)	$ (3,476,676)	$ (3,855,082)
Realized Change in Fair Value of Inventory Sold	$ 1,378,837	$ 1,359,295	$ 1,437,477	$ 1,456,152	$ 5,631,761	$ 6,006,093
Gross Profit	$ 1,333,815	$ 2,145,802	$ 2,423,285	$ 2,809,662	$ 8,712,564	$ 20,022,788
Operating Expenses:						
Accretion	$ -	$ -	$ -	$ -	$ -	$ -
Amortization	$ 1,872,534	$ 2,074,352	$ 2,074,352	$ 2,074,352	$ 8,095,589	$ 8,297,406
Depreciation	$ 124,862	$ 256,475	$ 256,475	$ 256,475	$ 894,286	$ 1,025,898
Interest	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 13,065	$ 13,134	$ 13,204	$ 13,274	$ 52,677	$ 53,803
Salaries, Wages and Commissions	$ 1,221,632	$ 1,257,065	$ 1,322,428	$ 1,333,380	$ 5,134,505	$ 5,487,077
General and Administrative Expense	$ 1,338,594	$ 1,342,602	$ 1,354,841	$ 1,369,870	$ 5,405,906	$ 5,812,914
Other	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expense	$ 4,570,687	$ 4,943,628	$ 5,021,298	$ 5,047,350	$ 19,582,963	$ 20,677,097
Other Expenses /Gains:						
Share of Profit/Loss of Joint Ventures	$ 162,916	$ (50,000)	$ (50,000)	$ (50,000)	$ 12,916	$ (200,000)
Foreign Exchange (Gain) Loss	$ (559)	$ -	$ -	$ -	$ (559)	$ -
Interest (Income) Expense	$ 800,680	$ 810,000	$ 810,000	$ 810,000	$ 3,230,680	$ 3,136,500
Other	$ 2,474,025	$ -	$ -	$ -	$ 2,474,025	$ -
Total Other Expenses	$ 3,437,062	$ 760,000	$ 760,000	$ 760,000	$ 5,717,062	$ 2,936,500
Net Income Before Taxes	$ (6,673,934)	$ (3,557,826)	$ (3,358,014)	$ (2,997,687)	$ (16,587,461)	$ (3,590,809)
Income Tax Expense	$ (340,522)	$ (996,191)	$ (940,244)	$ (839,352)	$ (3,116,310)	$ (1,005,427)
Net Income After Taxes	$ (6,333,412)	$ (2,561,635)	$ (2,417,770)	$ (2,158,335)	$ (13,471,151)	$ (2,585,383)
Unrealized Gain (Loss) on Foreign Exchange Translation	$ -	$ -	$ -	$ -	$ -	$ -
Total Comprehensive Income	$ (6,333,412)	$ (2,611,635)	$ (2,467,770)	$ (2,208,335)	$ (13,621,151)	$ (2,785,383)
Basic Earnings per Common Share	$ (0.03)	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.06)	$ (0.01)
Diluted Earnings per Common Share	$ (0.03)	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.06)	$ (0.01)
Weighted Average Common Shares Outstanding	225,131,309	229,364,284	229,364,284	229,364,284	228,306,040	229,364,284
Weighted Average Diluted Shares Outstanding	225,359,459	229,364,284	230,150,215	233,612,054	229,621,503	235,926,702

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, Inc.

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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 "Speculative Buy" 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.