Trickle Research

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

Earnings Update – 3QF24

Vext Science, Inc.

(symbol: VEXTF; VEXT.CN)

Report Date: 11/26/24

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

Closing Stock Price at This Update (Closing Px: 11/25/24): US$.14

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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.

For 3QF24, Vext reported revenues of $9 million and a pre-tax loss of $2.74 million and eps of <$.01>. Those numbers compared to our estimates of $9.4 million, pre-tax loss of $3.67 million and eps of <$.01>. On a segment basis, Arizona revenue came in at $5.3 million, and gross profit was $793,000, versus our estimates of $5.8 million and $1.6 million respectively. Clearly, we are still trying to find the bottom in Arizona. Conversely, Ohio revenue was $3.7 million with gross margin of $2.9 million, versus our estimates of $3.5 million and $1.2 million. Obviously, Ohio is picking up the slack for Arizona, especially in terms of margin, which brings us to prices.

As a preface to pricing, the company's 3QF24 MD&A provide the following color regarding the Arizona Cannabis market:

As of September 30, 2024, there were 168 operating dispensaries in Arizona. As of September 30, 2023, there were 156 operating dispensaries. This represents an increase of +7.7%.

Using available data from the State of Arizona, the average dispensary in July 2024 had net sales of $516,858, compared to $725,440 in July 2023. This represents a decrease of (28.8%) on an average per dispensary basis. Due to extreme heat experienced during summer months, Q2 and Q3 are low seasonal periods in Arizona. This seasonality will begin to turn as the population of Arizona begins to rebound toward the beginning of Q4.

Our retail operations comprise two stores in Arizona. We benchmark individual store performance against the respective state's average sales per retail location. Our Central Phoenix store was flat +0.3% in Q3 2024, while our North Phoenix store declined by (2.5%) in Q3 2024, compared to Q2 2024. Available State data indicated the State average per store declined by (20.5%) when comparing July 2024 to April 2024.

Acquisition multiples for dispensaries in Arizona are still relatively high. Acquisitions involving all cash are seeing some easing of price multiples, but they are still high given overall market valuations. Arizona laws capping the number of dispensaries and communities zoning requirements should keep dispensary valuations high for the foreseeable future. There is excess cultivation capacity and concentrate brands and products in Arizona, which will continue to put downward pressure on pricing and increase the proportion of in-house products sold on dispensary shelves as operators work to improve mix and preserve margin.

The wholesale market continues to have an oversupply of cultivators and flower products, which has been impacting wholesale flower pricing. Retail pricing to end consumers has been impacted, but not as dramatically as in the wholesale channel. The majority of dispensary operations are vertically operated and primarily focused on selling their own products in their own retail locations to maximize their margins.

While Arizona licensing is vertical and limited, some license owners have decided to "lease" the right to cultivate to non-license holders. These non-license holding cultivation operators do not have retail operations to sell their own product and are solely reliant on the wholesale channel. This phenomenon has put further downward pressure on wholesale pricing and leaves operators without retail doors, vulnerable to market conditions.

In addition to the above narrative the table below from the MD&A provides additional color:

Significant unobservable inputs	September 30, 2024	December 31, 2023
Average selling price per gram of flower	$ 1.87	$ 2.87
Weighted average yield of flower per plant (in grams)	59.01	54.35
Effect on fair value		
Sensitivity	**September 30, 2024**	**December 31, 2023**
Increase or decrease by $0.50 per gram	$ 248,940	$ 168,388
Increase or decrease by $0.10 per gram	$ 50,335	$ 27,790
Increase or decrease of yield by 10%	$ 241,038	$ 101,784

The Company estimated the harvest yields for the cannabis plants at various stages of growth at the reporting date as follows:

	September 30, 2024	December 31, 2023
Total expected yield (in grams)	2,491,429	954,456

The table above includes two pieces of data that we think are topical. First, as the yellow highlight reflects, the compression in pricing in Arizona has been stark, which again fits with the narrative above from the MD&A. As we have noted along the way in our prior research, we have attempted to project the bottom of the pricing pressure (to no avail), which has largely set up the misses we have experienced in the past. While management is not ready to call the bottom just yet, we did sense that they were a bit more constructive on the prospects for improved results for 4QF24 and 1QF25 largely around the "snowbird" seasonality that Arizona typically enjoys. If there is a bottom out there, then the good news is that by the time we get into the seasonally slower periods again (summer 2025), then ostensibly, we should be closer to that bottom. As the Company frames it in the filing, "*We are anticipating that the AZ margin will continue to be challenged due to excess cultivation capacity, **which we anticipate will eventually decline due to consolidation and capitulation by cultivators faced with shrinking margins***. In the meantime, we have tried to approach the Arizona modeling with more caution. On the other hand, the second notable item from the table (highlighted in green), is the yield improvement the Company has managed to achieve through its cultivation business.

As we have also noted several times along the way, we believe management has done an admirable job navigating the market challenges in Arizona, and despite the continued travails, we think some of the data points noted above support that view. For instance, while they may not be able to control market prices, they have continued to drive cultivation yields as well as other operating efficiencies. As they also noted, Vext appears to be performing better than many of its Arizona peers. For example, the state industry statistics suggest the *average dispensary in July 2024 had net sales of $516,858.* With two dispensaries, Vext reflected retail sales of $5.08 million for the quarter, or approximately $847,000 per store per month. Further, while the Company's sequential results were largely flat, the state industry collectively saw a sequential decline of 20.5% at least for the months of April to July (2024). Our point is, while the Arizona market may still remain out of balance, some of Arizona's operators may find *their own* "bottoms" sooner than others. At the risk of getting it wrong again, it appears to us that Vext may be beginning to see some wind at its back in Arizona.

In contrast to the Arizona market, Ohio saw its first recreational sales in early August, consequently the current quarter (Q4F24) will be the Company's first with the Ohio operations fully consolidated and subject to recreational sales for the entire quarter. That said, the early returns from Ohio have been a bit of a mixed bag.

On the retail side, the Company's two dispensaries reflected 14% sequential growth, but that comp was made from recreational sales for only 60% of the quarter. They indicated that the relative 90-day comp into Q4F24 "continues to grow". They also noted that the two dispensaries in the Big Perm acquisition they are hoping to close (and we are modeling) in 2QF25 "*grew in excess of +200% in Q3 2024 vs. Q2 2024 as a result of the beginning of adult use sales*". That said, it sounds as if some observers of the Ohio market viewed the initial sales as somewhat below their expectations. In that regard, apparently some potential customers have continued to travel across the state line to Michigan ostensibly out of habit or lack of information regarding legal alternatives within Ohio. Based on proximity, it seems likely to us that most Ohio residents will ultimately seek closer/local dispensaries.

While retail operations experienced a clear bump from the August 6 recreational launch, sales at the wholesale level experienced a sequential decline of 38% from 2QF24. That has largely been attributed to retailers stocking product ahead of the launch, which makes sense. The Company anticipates wholesales demand to “normalize” and grow going forward, which we think is a reasonable assumption. Clearly, the Ohio market is just beginning to find its footing. Ultimately, our belief around the Ohio market is much like that of most of the other cannabis markets, which is that good integrated operators will eventually rise to the top. We expect Vext to be among those.

As a result of the new data provided by the filings and subsequent call, we have made some adjustments to our model. In general, we expect Arizona pricing challenges to continue, offset in part by the Company’s efforts to control overall operating costs, leverage their integrated footprint by focusing on the promotion and sell through of their own products at retail, and continued initiatives to drive cultivation yields to help maintain overall margins. However, as we noted above, there are some reasons to believe that there may be light at the end of the tunnel in Arizona, which could provide some upside surprises. On the other hand, Ohio is clearly the growth driver here as recreational use begins to take shape. In that regard, in our view the Company is well positioned in terms of its established integrated footprint, which includes good visibility to its goal of 8 retail locations as provided by law. As we have seen in Arizona, there are clear risks associated with the trajectory of any/all highly regulated cannabis markets and Ohio is no exception. Further, those risks include a host of issues that industry participants may have little control over, including the general economic back drop. While those risks could collectively negatively impact our assessments, we remain of the view that Ohio is clearly the growth driver here as recreational use begins to take shape, and the Company is well positioned in terms of its established integrated footprint in the state. As a result, we expect the Company to post markedly improving comparative operating results, and to begin building cash, both of which should provide a basis for much better valuations.

We reiterate our 12-24 price target of $.80, as well as our elevated allocation of 8. with the view that coming results will vindicate each.

Projected Operating Model

Vext Science, Inc.						
Projected Operating Model ($USD)						
By: Trickle Research LLC						
	(actual)	(actual)	(actual)	(estimate)	(estimate)	(estimate)
	3/31/2024	6/30/2024	9/30/2024	12/31/2024	Fiscal 2024	Fiscal 2025
Sales	$ 8,459,029	$ 8,506,213	$ 8,986,909	$ 10,293,725	$ 36,245,876	$ 52,597,068
Cost of Goods	$ 6,463,229	$ 6,711,709	$ 5,242,326	$ 6,270,214	$ 24,687,479	$ 25,289,997
Gross Profit Before Fair Value Adjustments	$ 1,995,800	$ 1,794,503	$ 3,744,583	$ 4,023,511	$ 11,558,397	$ 27,307,071
Unrealized Change in Fair Value of Biological Assets	$ (773,855)	$ (1,106,438)	$ (2,723,340)	$ (931,977)	$ (5,535,610)	$ (3,760,797)
Realized Change in Fair Value of Inventory Sold	$ 1,378,837	$ 1,333,941	$ 2,499,609	$ 1,491,163	$ 6,703,550	$ 5,990,965
Gross Profit	$ 1,390,818	$ 1,567,000	$ 3,968,314	$ 3,464,324	$ 10,390,457	$ 25,076,903
Operating Expenses:						
Accretion	$ -	$ -	$ -	$ -	$ -	$ -
Amortization	$ 1,872,534	$ 2,169,066	$ 2,115,569	$ 2,074,352	$ 8,231,520	$ 8,297,406
Depreciation	$ 124,862	$ 130,954	$ 131,373	$ 132,163	$ 519,352	$ 528,651
Interest	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 13,065	$ 233,868	$ 392,912	$ 100,000	$ 739,845	$ 400,000
Salaries, Wages and Commissions	$ 1,221,632	$ 1,214,730	$ 1,220,052	$ 1,300,280	$ 4,956,694	$ 5,423,907
General and Administrative Expense	$ 1,338,594	$ 1,565,261	$ 1,399,284	$ 1,488,073	$ 5,791,212	$ 6,382,909
Other	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expense	$ 4,570,687	$ 5,313,879	$ 5,259,190	$ 5,094,868	$ 20,238,623	$ 21,032,873
Other Expenses /Gains:						
Share of Profit/Loss of Joint Ventures	$ 162,916	$ 118,370	$ 121,335	$ (50,000)	$ 352,621	$ (200,000)
Foreign Exchange (Gain) Loss	$ (559)	$ (910)	$ (445)	$ -	$ (1,914)	$ -
Interest (Income) Expense	$ 800,680	$ 801,832	$ 826,598	$ 839,233	$ 3,268,343	$ 3,250,556
Other	$ 2,474,025	$ (161,900)	$ 497,248	$ -	$ 2,809,373	$ -
Total Other Expenses	$ 3,437,062	$ 757,392	$ 1,444,736	$ 789,233	$ 6,428,423	$ 3,050,556
Net Income Before Taxes	$ (6,616,931)	$ (4,504,271)	$ (2,735,612)	$ (2,419,776)	$ (16,276,590)	$ 993,474
Income Tax Expense	$ (340,522)	$ (127,244)	$ (238,844)	$ (677,537)	$ (1,384,147)	$ 278,173
Net Income After Taxes	$ (6,276,409)	$ (4,377,027)	$ (2,496,768)	$ (1,742,239)	$ (14,892,442)	$ 715,302
Unrealized Gain (Loss) on Foreign Exchange Translation	$ -	$ -	$ -	$ -	$ -	$ -
Total Comprehensive Income	$ (6,276,409)	$ (1,883,956)	$ (2,496,768)	$ (1,792,239)	$ (12,449,371)	$ 515,302
Basic Earnings per Common Share	$ (0.03)	$ (0.02)	$ (0.01)	$ (0.01)	$ (0.06)	$ 0.00
Diluted Earnings per Common Share	$ (0.03)	$ (0.02)	$ (0.01)	$ (0.01)	$ (0.06)	$ 0.00
Weighted Average Common Shares Outstanding	225,131,309	245,450,577	245,450,577	245,553,505	240,396,492	245,553,505
Weighted Average Diluted Shares Outstanding	225,359,459	245,450,577	246,236,508	245,553,505	240,650,012	245,553,505

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, Inc.

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VEXT has paid fees to present at Trickle's Co-Sponsored Investor Conference.

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.