Trickle Research

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

Q2-F20 Earnings Update

VEXT SCIENCE

Vext Science, Inc.

(symbol: VEXTF)

(http://www.vapenmj.com/)

Report Date: 09/14/20

12- 24 month Price Target: $1.60

Allocation: 5

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

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

Closing Stock Price at This Report Date (Closing Px: 09/14/20): $.37

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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. All prices in this report are in US Dollars.

Our prior update on VEXT was fairly extensive so we will try to stay on point here. Briefly, VEXT reported revenues of $6.74 million and adjusted EBITDA of $1.65 million. Those number compared quite favorably to Q1 which, as we noted in the prior update was an anomalous quarter on a handful of levels including but not limited to Covid19. We missed some revenue numbers most notably in Professional Fees, but we think our general understanding of (and ability to successfully model) revenue recognition is improving. Recall, the trick to the analysis of VEXT lies in the accounting challenges for the Company in terms of recognizing revenues from its *non-profit customers* in Arizona (HWC and now Organica). Succinctly, the Company essentially manages the entire operations of their customer(s), and in exchange for that, they recognize a handful of fees associated with that management. Those fees include the basic revenue line items of VEXT; Management Fees, Professional Fees, Product Sales and equipment and facility leasing. The challenge is that some of these line items, at least for particular periods of time, consist of fixed amounts. For instance, Management Fees are set at a static rate until they are reevaluated/changed at future dates. Professional Fees are generally accounted for on a margin basis. For example, VEXT hires employees to operate various portions of their customers businesses (cultivation, processing and retail). VEXT then marks these services up and charges their customers for those services. Product Sales are handled in much the same manner. Recall, VEXT is not allowed to own any cannabis-based products, but it does sell non-cannabis related items that ultimately become part of their customers' retail SKU's. Again, by way of example, VEXT will purchase vape hardware and packaging that includes a markup not unlike any other product soled by a wholesaler to a retailer. In its simplest form, VEXT incurs all of the expenses of its *customers'* operations, while its *customers* collect all of the revenues from the sale of the products generated by those operations. The difference between those two items is profit/(loss), and/or in the case of unsold product, inventory. We will unpack that again.

We think HWC's operation generates revenues in the range of $2 million to $2.5 million per month. Recognize, that number includes the contributions of the cultivation and processing side. In turn, HWC sells much of that product through the dispensary with the balance being sold at wholesale to other dispensaries largely as Vapen branded sku's. We estimate, that the blended gross margin of that product is in the range of 40% to 45%, and the store level net margin is likely in the 30% to 35% range. As a private non-profit entity, those numbers are not reported, but we believe our numbers are consistent with other similar operations we have encountered in other research. Clearly, that estimate could prove different from actual numbers, but we think we are in the ballpark. In conjunction, we are estimating that Organica, is operating at a fraction of that number, but we expect that number to grow as Oranica hits full stride.

As we extrapolate the above numbers, we think fiscal 2021 sales of HWC and Organica combined will be in the $45-$50 million million range. If we apply the 30% store level gross margin to that number, it implies that those stores would generate annual store level gross profit of $13 million to $14 million. By extension, that would mean that in order for VEXT to "capture" that number, they would have to bill fees and product sales in the amount of roughly $3.5 million per quarter *above and beyond the actual costs associated with the operations* and for reference, *that* number is effectively VEXT's "Cost of Goods Sold". Given that train of thought, for instance in Q4F21, we are estimating that if the management fees and other associated rates charged to those customers (which essentially equates to VEXT's revenues) remain static, VEXT will still have not "billed in" all of that profit from its customers. That is, they are going to have to raise the rates they charge the customers in order to capture the balance of the profit. To put this another way, the more successful HWC and Organica are, the more *creative* VEXT has to be in order to bill away the profit from those enterprises. Succinctly, while that creates some challenges, and we are still trying to get our arms around the whole process, it is a far better problem to have than having customers that are not successful.

Lastly, we have made some modifications to our model in part because of our own (better) understanding of the business. However, we have also lowered some of our expectations for the CBD side of the business because of what we think are systemic competitive pressures in those markets. We will continue to adapt our model to new data points as they become available.

All of that said, here is the bigger picture as we see it. As we have noted along the way in various pieces of research, we did not participate in the front end of the cannabis fury for several reasons. In retrospect, that was right and wrong depending on one's timing. However, as we have also noted, from an investment perspective, we think the general visibility (and frankly the aggregate valuation) of the space is improving. At the same time, this industry has managed to grow through pandemics and the ensuing economic slowdown, and the industry continues to grow, albeit perhaps slower than some of the original estimates, but growing more than most. Succinctly, the cannabis industry is not going away, and we think well positioned players will prosper. More specifically, we think VEXT has spent the past 12 months or so positioning the Company for growth in a handful of new markets. Perhaps more importantly, they have also worked to further bolster their presence in Arizona via the Organica arrangement. As our attached model indicates, we expect the coming quarters to reflect the fruits of those efforts, which in turn should translate into higher intrinsic valuations for VEXT.

Further, it looks to us like Arizona will likely pass recreational use this time around. In our view, that scenario will likely be *quite positive* for entrenched players in the Arizona market such as VEXT, especially given their integrated profile in the state. At this point, we are not sure how to evaluate the potential of that outcome, but our sense is that it should make VEXT more valuable the day after the election than the day before. That is, we think a favorable outcome in Arizona could provide a marked catalyst for VEXT's valuation as well.

We remain positive on VEXT and we reiterate both our allocation and our targets of the shares.

Projected Operating Model

Vext Science, Inc.						
Projected Operating Model						
By: Trickle Research LLC						
	(actual)	(estimate)	(estimate)	(estimate)	(estimate)	(estimate)
	3/31/2020	6/30/2020	9/30/2020	12/31/2020	Fiscal 2020	Fiscal 2021
REVENUES						
Management Fees	$ 600,000	$ 1,100,000	$ 1,100,000	$ 1,100,000	$ 3,900,000	$ 4,800,000
Professional Fees	$ 1,402,839	$ 2,283,822	$ 2,221,843	$ 2,252,180	$ 8,160,685	$ 11,010,264
Product Sales	$ 2,005,085	$ 3,029,180	$ 4,034,719	$ 4,164,674	$ 13,233,659	$ 17,852,243
Equipment Leasing	$ 20,752	$ 200,861	$ 200,000	$ 200,000	$ 621,613	$ 800,000
Property Leasing	$ 67,422	$ 122,859	$ 130,000	$ 130,000	$ 450,281	$ 520,000
Total Revenues	**$ 4,096,098**	**$ 6,736,723**	**$ 7,686,562**	**$ 7,846,854**	**$ 26,366,237**	**$ 34,982,507**
COST OF SALES						
Cost of Goods	$ 1,494,285	$ 2,066,532	$ 2,636,895	$ 2,734,355	$ 8,932,067	$ 12,341,000
Salaries Wages and Contractors	$ 1,160,271	$ 1,718,434	$ 1,960,495	$ 2,011,271	$ 6,850,471	$ 8,825,016
Property & Equipment Leasing, Utilities and Property Tax	$ 23,636	$ 31,082	$ 52,563	$ 52,563	$ 159,843	$ 210,250
Amortization	$ 212,115	$ 368,684	$ 356,415	$ 356,415	$ 1,293,629	$ 1,425,659
Total Cost of Goods Sold	**$ 2,890,307**	**$ 4,184,732**	**$ 5,006,367**	**$ 5,154,603**	**$ 17,236,009**	**$ 22,801,925**
Gross Profit	**$ 1,205,791**	**$ 2,551,991**	**$ 2,680,195**	**$ 2,692,251**	**$ 9,130,228**	**$ 12,180,582**
OPERATING EXPENSES						
Advertising & Promotion	$ 117,497	$ 152,631	$ 163,790	$ 171,149	$ 605,067	$ 753,170
Amortization	$ 56,983	$ 57,340	$ 89,104	$ 89,104	$ 292,530	$ 356,415
Bank Charges and Interest	$ 182,512	$ 177,040	$ 170,174	$ 170,823	$ 700,549	$ 689,261
Consulting	$ 280,591	$ 49,896	$ 50,096	$ 50,296	$ 430,879	$ 203,204
Insurance	$ 6,588	$ 10,186	$ 24,035	$ 24,165	$ 64,973	$ 97,852
Office and General	$ 796,665	$ 222,975	$ 285,868	$ 289,117	$ 1,594,625	$ 1,186,306
Professional Fees	$ 264,166	$ 103,081	$ 170,694	$ 181,293	$ 719,235	$ 749,045
Rent, Property Tax asnd Utilities	$ 27,069	$ 8,148	$ 44,208	$ 44,988	$ 124,413	$ 187,113
Repairs and Maintenance	$ 19,952	$ 167,672	$ 57,347	$ 58,647	$ 303,618	$ 246,522
Research and Development	$ 30,098	$ 38,728	$ 38,243	$ 39,153	$ 146,222	$ 164,966
Shared Based Compensation	$ 87,406	$ 461,926	$ 30,000	$ 30,000	$ 609,332	$ 120,000
Salaries, Wages and Commissions	$ 330,590	$ 200,000	$ 376,389	$ 391,587	$ 1,298,566	$ 1,614,090
Travel, Entertainment & Training	$ 110,811	$ 48,955	$ 231,042	$ 246,940	$ 637,748	$ 1,023,567
Total SG&A	**$ 2,310,928**	**$ 1,698,578**	**$ 1,730,989**	**$ 1,787,262**	**$ 7,527,757**	**$ 7,391,512**
Operating Income (Loss)	**$ (1,105,137)**	**$ 853,413**	**$ 949,206**	**$ 904,990**	**$ 1,602,471**	**$ 4,789,071**
Loss on Acquisition						
Interest Income (Expense)	$ 71,056	$ 97,508	$ (92,500)	$ (97,500)	$ (21,436)	$ (440,000)
Contribution from Joint Ventures	$ (62,520)	$ (253,908)	$ 302,877	$ 447,434	$ 433,884	$ 3,124,478
Investment Income	$ -	$ -	$ 57,538	$ 120,719	$ 178,257	$ 970,704
Other					$ -	$ -
Income Before Tax	**$ (971,020)**	**$ 201,018**	**$ 1,217,121**	**$ 1,375,643**	**$ 1,822,762**	**$ 8,444,253**
Income Tax	**$ -**	**$ -**	**$ 304,280**	**$ 343,911**	**$ 648,191**	**$ 2,111,063**
Net Income - After Tax	**$ (971,020)**	**$ 201,018**	**$ 912,841**	**$ 1,031,732**	**$ 1,174,571**	**$ 6,333,190**
					$ -	$ -
Other Comprehensive Income (Loss)	**$ 344,794**	**$ -**	**$ -**	**$ -**	**$ 344,794**	**$ -**
Less: Non-Controling Interests	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Totla Comprehensive Income (Loss)	**$ (626,226)**	**$ 201,018**	**$ 912,841**	**$ 1,031,732**	**$ 1,519,365**	**$ 6,333,190**
Basic Earnings per Share	**$ (0.01)**	**$ 0.00**	**$ 0.01**	**$ 0.01**	**$ 0.02**	**$ 0.07**
Weighted Average Earnings per Share	**$ (0.01)**	**$ 0.00**	**$ 0.01**	**$ 0.01**	**$ 0.02**	**$ 0.07**
Basic Shares Outstanding	**$ 84,363,326**	**$ 89,811,678**	**$ 89,811,678**	**$ 89,811,678**	**88,449,590**	**89,811,678**
Weighted Average Shares Outstanding	**$ 84,363,326**	**$ 84,363,326**	**$ 84,363,326**	**$ 84,363,326**	**84,363,326**	**85,874,931**

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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.