Trickle Research

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

Research Update

VEXT SCIENCE

Vext Science, Inc.

(symbol: VEXTF)

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

Report Date: 06/10/21

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: 06/09/21): $.71

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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 been following VEXT for about 16 months now. In the meantime, we think the story has improved markedly, for a handful of reasons we will cover below, but recognizing that progress remains difficult. We will cover some of that as well, but we have attempted to provide a view of the Company from a different angle, which may provide some added clarity. Succinctly, we believe the stock should be higher, but we also believe the complexities of the story are negatively impacting that valuation. However, as we will illustrate, we also think new laws in Arizona are about to remove some of those complexities, which should make the higher valuations we are arguing here more apparent. Obviously, we think there is value in recognizing that before everyone else figures it out.

Specific to the quarter, VEXT recognized revenues of just under $9.2 million versus our estimate of $8 million and After-Tax Net Income of $1.1 million versus our estimate of $1.1 million. As we noted on their conference call, we feel like visibility is improving a bit (as our models are reflecting closer to actual numbers). To that end, for edification, while these actual results tracked well with our estimates, we would have expected a bit better bottom line numbers given the higher revenues, but they recognized $425,000 of share based (non-cash compensation, which we did not see coming. Absent that, the higher revenue numbers would have lined up quite closely to our estimates. That said, here are some things to consider regarding VEXT and its merging opportunities.

To refresh, VEXT manages cannabis cultivation, processing and dispensary enterprises in Arizona. However, Arizona laws require that only not-for-profit entities can **actually own** cannabis related businesses. as a result, VEXT's business amounts to managing those operations, which means charging them for a variety of items that are delineated in the operating statement. The easy way to think about that is, VEXT can never take ownership or carry inventory of cannabis product. (As a specific example, VEXT can sell its customers a vape cartridge, but they cannot sell their customers a vape cartridge full of distillate). As a result of that nuance, again, the Company effectively operates the entire business and then charges various fees to the non-profit entities that own the underlying cannabis licenses. Further, the passing on and/or recognition of costs between VEXT and the licensees, are constrained by specific laws, (Section 280E of the US tax code for instance) that cover what types of expenses cannabis businesses may deduct and by extension, what fees (and how much) VEXT may be allowed/able to pass on. Recognize, those fees are effectively VEXT's revenues. We would add, as private entities, VEXT's not-for-profit licensee customers are not required to file their financial results, which means that those of us trying to analyze VEXT must try to "back into" that number, which is not entirely possible no matter how much we might think we are getting better at it. However, recognize**, the performance of those licensees is ultimately VEXT's business**.

As we have lamented through much of our coverage of VEXT, the aforementioned arrangement makes it difficult to evaluate the Company's performance and even more difficult to model with respect to future performance. On the Company's recent call, they referenced their need to "pulling the levers" to manage and reconcile the recognition of revenues at the not-for-profit level and translating those as completely as possible to VEXT. For instance, notice in Q1, the Company recognized and additional $600,000 for "Management Fees" than they did in prior periods, and they recognized Product Sales of $3.64 million, which we believe is the highest Product Sales figure they have ever posted. However, to be clear, the recognition of those product sales, do not tie directly to sales by their licensees in any given period. In fact, since those product sales cannot include actual THC based product, they tell us even less about the actual activities of the licensees. To be clear, the magnitude of the quarter's product sales number probably tells us that 2Q will likely be a much more modest number. On the other hand, if we look at other line items in the financial statements, we can also find some clues about what "lever" they may be able to "pull" in Q2 to get revenue recognition from the licensees to VEXT. For example, in Q1, property plant and equipment increased by roughly $1.5 million related largely we believe to the upgrades to the processing facility during the quarter. We would expect much of that to be recognized as Equipment Lease revenue in Q2. Again, to clarify, capex and other improvements are generally passed on in their entirety (in the same period) to their not-for-profit licensee customers, in the form of Equipment Leases.

Succinctly, the "lever pulling" required to deal with the not-for-profit licensee customers is exhausting and it is not particularly conducive to visibility, and visibility is typically a key construct to (higher) equity valuations. In fact, the great irony is that the better the associated cannabis business(es) perform, the harder the lever pulling gets. As a result of that difficulty and as a way of trying to help our readers better understand the potential of the business, we are going to take a slightly different approach. Before we get to that new approach, we should cover a couple of items that have come about over the past few months that we think readers should keep in mind.

First, to reiterate, Arizona approved recreational marijuana use in November (2020) and that process is in motion. Moreover, just recently it was announced that Trulieve, one of the nation's largest cannabis companies is acquiring Arizona's largest cannabis player, Harvest. We are comfortable suggesting that the passage of recreational measures likely enabled the transaction and part of that is likely related to some of the other associated adjuncts to the new law. Specifically, as we noted above, Arizona has historically required cannabis operators to be non-for -profit entities, but the new recreational paradigm will be changing that requirement. To circle back, *without the passage of recreational* cannabis in Arizona, we do not think the above transaction occurs, but *with the passage of recreational* in Arizona including changes in some of the legacy operator oversights, we do not suspect it will be the last. In the context of the "levers" and the lack of visibility we addressed above, VEXT's opportunity to transition the operation out of the not-for-profit theatre and begin reflecting the whole operation as their own is in our view a watershed event for the Company. The expectation is that they may be able to make that transition within the current calendar year.

Second, as we alluded to above, the Company recently received *"approval from the State of Arizona to begin operations in its recently expanded, dedicated extraction and manufacturing facility located at 4215 N 40th Avenue, in Phoenix. The expansion includes: additional extract and concentrates production space; a tripling of the Company's kitchen capacity in order to meet growing demand for edibles as the Arizona adult-use market develops; a re-designed finished goods area to support increased efficiency and throughput; and a dedicated product development lab, which the Company will utilize to continue innovating the Vapen line of branded products"*.

In addition, just prior to the above approval, VEXT received another approval from the City of Eloy to *"build and operate a state-of-the-art medical cannabis cultivation facility. As announced on April 7, 2021, Vext has entered into a purchase and sale agreement to acquire a vacant 72,000 square foot industrial facility (~34,000 square feet of future canopy) located in the city"*. To put this into perspective, the Company's two existing facilities operate (collectively) under about 20,000 square feet of canopy, although they have some additional capacity in hoop houses at Organica. Collectively, we think this new cultivation addition should ultimately increase their production by approximately 140%. The Company suggests they can get the facility into operation by the end of 2021. We are modeling Q1 2022. The point is, the new cultivation and processing capacity represented by these two new additions are emerging as Arizona's recreational market begins to gather steam, that ostensibly, should drive demand. Here again, this new piece to the story is significant.

Third, the Company completed two capital raises in Q1F21, collecting net proceeds of roughly $17.5 million. Obviously, some of that capital has been/will be used on the initiatives above, but we think that capital will also help support other growth initiatives both inside and outside of Arizona. To that point, while we believe the focus through 2021 will largely remain on Arizona expansion, we expect additional visibility with respect to non-Arizona assets to improve as we move forward. Moreover, the fresh capital should provide some opportunities that certainly would not exist without it.

To summarize, we think VEXT is forging a larger footprint in a jurisdiction (Arizona) that just opened the door to recreational cannabis. As we have discussed prior, we believe that paradigm will prove to be most beneficial for entrenched players. Incidentally, the Trulieve/Harvest transaction may validate that view. In that regard, VEXT is clearly an "entrenched player" and that includes additional assets they put into play in anticipation of recreational passage that should come online over the next 6 to 12 months.

The above said, we will revisit our initial thought which is that we believe having to evaluate VEXT's performance in the context of the not-for-profit nuances of Arizona's current cannabis laws, is complicating and negatively impacting that valuation and as such, we are offering "a view of the Company from a different angle". In short, we have attempted to provide a pro forma of what we believe VEXT's performance might look for fiscal 2021 and 2022, if it were out from under the not-for-profit nuance it currently operates under. Keep in mind, we expect them to get to this point before the end of 2021 (which is predicated on the state of Arizona modifying its not-for-profit stance, which is apparently in process). That said, here is what we have come up with:

VEXT Sciences, Inc.						
Projected Pro Forma of Arizona Operations on a For Profit Basis						
Trickle Research						
	Fiscal 2021	**Fiscal 2022**	**Fiscal 2023**	**Fiscal 2024**	**Fiscal 2025**	**Fiscal 2026**
Revenues	$ 39,973,793	$ 53,332,133	$ 64,004,628	$ 68,925,652	$ 72,580,531	$ 76,324,977
Net Income	$ 8,862,315	$ 15,942,712	$ 23,067,989	$ 28,480,718	$ 32,440,933	$ 36,251,586
Taxes	$ 2,304,202	$ 4,145,105	$ 5,997,677	$ 7,404,987	$ 8,434,642	$ 9,425,412
After Tax Net Income	$ 6,558,113	$ 11,797,607	$ 17,070,312	$ 21,075,731	$ 24,006,290	$ 26,826,174
Basic Earnings Per Share	$ 0.05	$ 0.09	$ 0.10	$ 0.12	$ 0.14	$ 0.15
Weighted Average Earnings Per Share	$ 0.05	$ 0.07	$ 0.10	$ 0.12	$ 0.14	$ 0.15
Basic Shares Outstanding	127,642,818	137,383,087	174,783,557	175,009,519	175,150,692	175,238,016
Weighted Average Shares Outstanding	129,308,130	161,969,201	174,783,557	175,009,519	175,150,692	175,238,016
EBITDA	$ 9,552,397	$ 17,156,468	$ 22,591,196	$ 25,513,556	$ 28,731,205	$ 32,387,450

Again, the above is our best guess with respect to how we think VEXT's reporting would look if they were able to own the Arizona operations outright (as opposed to the current requirement that they be "owned" by not-for-profit entities). To reiterate, our expectation is that state is preparing to release that requirement, which will provide much better visibility in terms of VEXT's ongoing performance (ala the above pro forma/estimates). We would reiterate, we do not have direct data from the dispensaries because they have no reason to report it, so this has been derived from our own extrapolation of the things *we do know* or can estimate from the filings. The point is, we are confident that the Arizona assets are entrenched, growing and profitable, and while we have not modeled as such in either our existing model, or this pro forma, we believe the chances of the Company adding assets in Arizona is more likely than not. Frankly, we think the Company's beachhead in the state may afford them some opportunities that others may not be able to approach.

Lastly, while the Company has suggested that Arizona is likely to remain the focus through the balance of the year, we also think their much-improved balance sheet via the Q1 raises (cash at 03/231/21 was $16.4 million), will also provide added flexibility to advance some of the non-Arizona arrangements they have assembled. To be clear, the Company has been capital constrained for much of its existence to this point, and we think these raises will provide them some runway to finally play some offense. To that end, they recently hired new CFO Vahan Ajamian, who has an extensive cannabis background, which we think may signal a more aggressive growth posture. By the way, we have had an opportunity to speak with Mr. Ajamian, and we think this addition is highly positive. As an extension to that thought, we have noted before that we believe VEXT CEO, Eric Offenberger has done yeoman's work here, and we think his contribution here has been extraordinary. Frankly, we highly doubt they would be in this position without him. As we noted above, managing a public company around the nuances of Arizona cannabis laws has been no easy task. On the downside, his retention/loss is in our view becoming a more telling risk for the Company. To be clear, we do not expect that, we just think it is important to note that in our view, he is an important cog in this wheel.

The above said, we remain very constructive on VEXT. The stars are clearly beginning to align in Arizona, which is a function of both Company related initiatives and efforts, as well as new recreational laws in the state. Moreover, as we noted, the capital raise should provide added opportunities/flexibility as well, which we think will include advances over at least some of the non-Arizona initiatives in the coming quarters. We think those opportunities could provide added valuation legs. That said, we continue to view the stock as substantially undervalued and as such, we reiterate our allocation of 5 and out 12-24 month price target $1.60. Incidentally, our efforts developing the above proforma model has further validated (in our view) our targets.

Projected Operating Model

Vext Science, Inc.					
Projected Operating Model					
By: Trickle Research LLC					
	(actual)	(estimate)	(estimate)	(estimate)	(estimate)
	3/31/2021	**6/30/2021**	**9/30/2021**	**12/31/2021**	**Fiscal 2021**
REVENUES					
Management Fees	$ 1,800,000	$ 1,800,000	$ 1,800,000	$ 1,800,000	$ 7,200,000
Professional Fees	$ 3,122,053	$ 3,441,472	$ 3,441,472	$ 3,441,472	$ 13,446,469
Product Sales	$ 3,641,085	$ 1,464,715	$ 2,246,482	$ 3,628,678	$ 10,980,960
Equipment Leasing	$ 554,907	$ 1,500,000	$ 1,500,000	$ 1,500,000	$ 5,054,907
Property Leasing	$ 42,246	$ 100,000	$ 100,000	$ 100,000	$ 342,246
Total Revenues	**$ 9,160,291**	**$ 8,306,187**	**$ 9,087,954**	**$ 10,470,150**	**$ 37,024,582**
COST OF SALES					
Cost of Goods	$ 2,472,081	$ 1,254,014	$ 1,902,428	$ 2,923,998	$ 8,552,521
Salaries Wages and Contractors	$ 2,064,835	$ 2,092,112	$ 2,198,677	$ 2,225,513	$ 8,581,138
Property & Equipment Leasing, Utilities and Property Tax	$ 19,655	$ 36,657	$ 36,657	$ 36,657	$ 129,626
Amortization	$ 443,833	$ 437,496	$ 437,496	$ 437,496	$ 1,756,321
Total Cost of Goods Sold	**$ 5,000,404**	**$ 3,820,279**	**$ 4,575,258**	**$ 5,623,665**	**$ 19,019,606**
Gross Profit	**$ 4,159,887**	**$ 4,485,909**	**$ 4,512,695**	**$ 4,846,485**	**$ 18,004,975**
OPERATING EXPENSES					
Advertising & Promotion	$ 134,513	$ 122,508	$ 135,313	$ 150,358	$ 542,691
Amortization & Accretion	$ 332,960	$ 375,759	$ 375,759	$ 375,759	$ 1,460,237
Bank Charges and Interest	$ 158,840	$ 157,324	$ 161,232	$ 168,143	$ 645,539
Consulting	$ 139,743	$ 140,302	$ 140,863	$ 141,427	$ 562,335
Insurance	$ 42,208	$ 41,465	$ 42,246	$ 43,629	$ 169,548
Office and General	$ 355,872	$ 329,897	$ 306,162	$ 340,717	$ 1,332,648
Professional Fees	$ 325,025	$ 264,294	$ 287,930	$ 290,574	$ 1,167,822
Rent, Property Tax and Utilities	$ 53,847	$ 28,788	$ 33,479	$ 41,772	$ 157,886
Repairs and Maintenance	$ 113,231	$ 84,900	$ 98,190	$ 121,688	$ 418,009
Research and Development	$ 42,883	$ 20,920	$ 29,197	$ 36,866	$ 129,866
Shared Based Compensation	$ 424,953	$ 137,404	$ 124,593	$ 136,319	$ 823,269
Salaries, Wages and Commissions	$ 294,596	$ 293,589	$ 334,859	$ 390,147	$ 1,313,191
Travel, Entertainment & Training	$ 55,709	$ 62,147	$ 70,465	$ 84,287	$ 272,608
Total SG&A	**$ 2,474,380**	**$ 2,059,297**	**$ 2,140,289**	**$ 2,321,685**	**$ 8,995,650**
Operating Income (Loss)	**$ 1,685,507**	**$ 2,426,611**	**$ 2,372,407**	**$ 2,524,800**	**$ 9,009,325**
Loss on Acquisition/disposal					
Interest Income (Expense)	$ 160,767	$ (52,000)	$ (57,000)	$ (62,000)	$ (10,233)
Contribution from Joint Ventures	$ -	$ (22,450)	$ (76,093)	$ (156,540)	$ (255,083)
Investment Income	$ (303,157)	$ 60,188	$ 38,936	$ 17,684	$ (186,350)
Other					$ -
Income Before Tax	**$ 1,537,977**	**$ 2,412,349**	**$ 2,278,249**	**$ 2,323,944**	**$ 8,552,519**
Income Tax	**$ 398,900**	**$ 603,087**	**$ 569,562**	**$ 580,986**	**$ 2,152,536**
Net Income - After Tax	**$ 1,139,077**	**$ 1,809,262**	**$ 1,708,687**	**$ 1,742,958**	**$ 6,399,983**
					$ -
Other Comprehensive Income (Loss)	**$ 265,803**	**$ -**	**$ -**	**$ -**	**$ 265,803**
Less: Non-Controling Interests	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Total Comprehensive Income (Loss)	**$ 1,404,880**	**$ 1,809,262**	**$ 1,708,687**	**$ 1,742,958**	**$ 6,665,786**
Basic Earnings per Share	**$ 0.01**	**$ 0.01**	**$ 0.01**	**$ 0.01**	**$ 0.05**
Weighted Average Earnings per Share	**$ 0.01**	**$ 0.01**	**$ 0.01**	**$ 0.01**	**$ 0.05**
Basic Shares Outstanding	**99,951,301**	**136,712,134**	**136,875,978**	**137,031,860**	**127,642,818**
Weighted Average Shares Outstanding	**99,951,301**	**136,712,134**	**137,391,217**	**143,177,867**	**129,308,130**

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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.