Trickle Research

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

Q2-F23Earnings Update

Vext Science, Inc.

(symbol: VEXTF)

www.vextscience.com

Report Date: 08/30/23

12- 24 month Price Target: US$1.35

Allocation: 7

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 This Update (Closing Px: 08/30/23): US$.18

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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 2QF23 VEXT reported revenues of $9.2 million and earnings of $535,454 versus our estimates of $9.3 million and earnings of <$34,615> respectively. While those numbers reflect a largely positive comp, inside the numbers the quarter was a bit more challenging than the comp reflects. For instance, they realized a tax benefit of $1,141,064, so the actual pre-tax loss was <$605,610>, versus our estimate of <$48,077>. That miss requires some narrative.

As our largely flat sequential revenue estimate and net *loss* earnings estimate reflect, we were expecting a continuation of the difficult cannabis environment, specifically in Arizona, which we anticipated would be further complicated by seasonal issues, which as it turned out included particularly warm weather. In short, the "perfect storm" for Arizona cannabis enterprises continued through Q2.

More specifically, the starkest operating item was gross margin which totaled $2.8 million or roughly 30% of revenues. For reference, that number is 350 basis points lower than the comparable year-over-year quarter, and 210 basis points lower than the sequential (Q1F23) quarter. That was particularly disconcerting since the Q1F23 quarter also reflected some of the aforementioned challenges. Succinctly, as Management noted on the call, setting aside some of the demand (seasonality) issues we noted above, the industry in Arizona continues to fight through excess flower supply and its cascading effects downstream. We addressed that last quarter, and to refresh the notion, we still believe a portion of the problem stems from the state's inability to reign in illegal participants, but regardless of the reason(s), there is too much flower around and it continues to negatively impact pricing. Generally speaking, when an industry is experiencing pricing pressure, participants can choose to try to either maintain their prices or maintain their market share, but they cannot typically do both. VEXT chose the latter, and we will not argue with that.

On the other hand, as we have opined along the way, we think Management has proven to be adept at weathering the storm better than many, and we think they demonstrated that again in 2Q23. Along those lines, we would encourage people to read the Company's MD&A for the quarter, as it provides a constructive overview of the challenges and their strategies around mitigating them, as well as a good overview of the path forward. Most imminently, that means the emerging pieces in Ohio including the consolidation of the cultivation operation in the current quarter, as well as the approval/addition of the second dispensary (Columbus) in the first half of 2024.

Looking ahead there are a few major items the Company discussed in the MD&A and/or the earnings call that we think are quite topical.

First, part of the Company's approach in managing their way through the problems in Arizona has been to focus on the portions of the business where they have more control. That includes a greater focus on their branded products and by extension, the dispensaries they operate as well. From the MD&A:

> *Marketing and advertising will continue to be targeted on attracting customers into our retail locations with tailored offers that meet their individual profile, and balancing marketing spend with returns on that spend. We are focused on increasing the traffic to our stores and have initiated some programs that we expect will achieve this objective, specifically at the Deer Valley store. These programs are in the early stages of being rolled out.*

That approach also includes a *lesser* focus on the cultivation (re: commodity) portions of the business. To that point the MD&A notes:

> *The 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. 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.*

As an extension of that strategy, they suspended the outdoor grow and are commencing the addition of the Eloy canopy in the current quarter. The approach in that regard is to "*produce almost exclusively for its own needs, with a goal of minimizing any wholesale flower sales, and matching any expansion to the requirements of its own retail storefronts. This results in better profit margins.* We think this is the basis for the Company's guidance that despite the environment and they are anticipating that *"the margin profile will move toward historical levels in the third quarter and going forward"*. Given the challenging landscape in Arizona, we find that constructive, in part because we think Management has historically been straightforward (good or bad) in terms of their guidance around the environment. That by the way does not mean margins will definitely improve in the near term, but their sense that they will is more encouraging than if they were telling us that they did not expect them to improve. Clearly, the margin compression was the headline for the quarter and ostensibly the continued weakness in the shares, so presumably, improvement in that regard should in turn help the share price.

Again, beyond Arizona, the story is pivoting to now include Ohio. That transition will be augmented by the addition of the cultivation business in the current quarter, and the addition of the second dispensary in the first half of 2024, hopefully sooner rather than later. The Company noted on the call that they are "*about 6 weeks behind*" on fully integrating the Ohio operations, and we think that is largely related to administrative issues at the state level. Regardless, in our view the Ohio integration is a watershed event for the Company and will provide a marked boost in both revenues and earnings over the coming quarters. The street apparently does not see it that way or just does not recognize it. As we see it, the Company has spent considerable resources getting Ohio on board, and now with that heavy lifting predominantly behind them, we expect them to start realizing the fruits of that labor, which should result in them building cash, and perhaps setting the stage for the next valuation piece (Kentucky, Oklahoma… ?).

To summarize, we understand the struggles in Arizona, and as we have suggested in prior research, we think many of those problems stem from the imperfections of the cannabis markets in general vis-à-vis governments trying to create and regulate markets. That includes by the way, their inability, or their lack of conviction, to protect legal players from black market/illegal players, and the impact that has on supply and resulting prices. While we understand some of the (legal) cultivation nuances that have likely impacted the over-supply issues in Arizona, we continue to believe that imperfections around the regulation of these markets will remain an overriding theme. More specifically, when the dust settles, whether in Arizona or elsewhere, we think the last players standing will be successful mostly because we think those will include the best operators and we believe VEXT management has demonstrated their aptitudes in that regard. In our view, they have aligned the (integrated) business in a way that provides them with some levers to emphasize (or deemphasize) the most promising portions of the business as those ebb and flow. By extension Ohio, should provide them additional flexibility in that regard. In short, we fully expect the cannabis industry to continue to face headwinds because of the imperfections we have been arguing, and those headwinds will be more acute in some places than they are in others. That said, we would reiterate, "*when the dust settles, whether in Arizona or elsewhere, we think the last players standing will be successful mostly because we think those will include the best operators."*

To conclude, we recognize the challenges VEXT faces, but we continue to view the shares as deeply discounted relative to their operating posture and future opportunities that are largely now in place in Ohio. As a result, we reiterate our allocation of 7 and our 12-24 month price target of US$1.35. we submit, our target *may be* a bit stretched since visibility in Arizona continues to be elusive, however, given the current price of the shares relative to the target, does it really matter if its $1.35 or $1.00? Again, we continue to view the shares as markedly oversold.

Projected Operating Model

	(actual)	(actual)	(estimate)	(estimate)	(estimate)	(estimate)
Vext Science, Inc.						
Projected Operating Model						
By: Trickle Research LLC						
	3/31/2023	**6/30/2023**	**9/30/2023**	**12/31/2023**	**Fiscal 2023**	**Fiscal 2024**
Sales	$ 9,110,651	$ 9,187,122	$ 12,130,346	$ 14,331,038	$ 44,759,158	$ 70,411,924
Cost of Goods	$ 4,468,558	$ 6,397,600	$ 6,354,832	$ 6,899,302	$ 24,120,292	$ 32,967,740
Gross Profit Before Fair Value Adjustments	$ 4,642,093	$ 2,789,522	$ 5,775,514	$ 7,431,736	$ 20,638,866	$ 37,444,185
Unrealized Change in Fair Value of Biological Assets	$ (1,063,916)	$ (1,049,856)	$ -	$ -	$ (2,113,772)	$ -
Realized Change in Fair Value of Inventory Sold	$ 1,004,293	$ 1,169,658	$ -	$ -	$ 2,173,951	$ -
Gross Profit	$ 4,701,716	$ 2,669,720	$ 5,775,514	$ 7,431,736	$ 20,578,687	$ 37,444,185
Operating Expenses:						
Accretion	$ -	$ -	$ -	$ -	$ -	$ -
Amortization	$ 981,070	$ 981,070	$ 979,753	$ 976,066	$ 3,917,959	$ 3,867,770
Depreciation	$ 108,034	$ 110,907	$ 124,714	$ 124,090	$ 467,745	$ 490,187
Interest	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 130,332	$ 68,862	$ 130,332	$ 130,332	$ 459,858	$ 486,394
Salaries, Wages and Commissions	$ 1,617,844	$ (289,993)	$ 2,000,897	$ 2,372,676	$ 5,701,424	$ 11,652,166
General and Administrative Expense	$ 1,050,538	$ 1,121,683	$ 1,163,910	$ 1,229,931	$ 4,566,063	$ 5,312,358
Other	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expense	$ 3,887,818	$ 1,992,529	$ 4,399,606	$ 4,833,096	$ 15,113,048	$ 21,808,875
Other Expenses /Gains:						
Share of Profit/Loss of Joint Ventures	$ 91,205	$ 13,854	$ (50,000)	$ (50,000)	$ 5,059	$ (200,000)
Foreign Exchange (Gain) Loss	$ 2,726	$ 310	$ -	$ -	$ 3,036	$ -
Interest (Income) Expense	$ 860,979	$ 1,004,808	$ 1,249,571	$ 1,240,971	$ 4,356,329	$ 4,850,981
Other	$ 926,994	$ 263,829	$ -	$ -	$ 1,190,823	$ -
Total Other Expenses	$ 1,881,904	$ 1,282,801	$ 1,199,571	$ 1,190,971	$ 5,555,247	$ 4,650,981
Net Income Before Taxes	$ (1,068,006)	$ (605,610)	$ 176,337	$ 1,407,669	$ (89,609)	$ 10,984,329
Income Tax Expense	$ 1,141,064	$ (1,141,064)	$ 49,374	$ 394,147	$ 443,522	$ 3,075,612
Net Income After Taxes	$ 73,058	$ 535,454	$ 126,963	$ 1,013,522	$ 1,748,997	$ 7,908,717
Unrealized Gain (Loss) on Foreign Exchange Translation	$ -	$ -	$ -	$ -	$ -	$ -
Total Comprehensive Income	$ 164,263	$ 535,454	$ 76,963	$ 963,522	$ 1,740,202	$ 7,708,717
Basic Earnings per Common Share	$ 0.00	$ 0.00	$ 0.00	$ 0.01	$ 0.01	$ 0.05
Diluted Earnings per Common Share	$ 0.00	$ 0.00	$ 0.00	$ 0.01	$ 0.01	$ 0.05
Weighted Average Common Shares Outstanding	149,514,914	149,729,061	149,729,061	149,729,061	149,675,524	149,729,061
Weighted Average Diluted Shares Outstanding	149,744,008	150,098,719	151,345,833	154,669,199	151,464,440	160,769,494

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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.