

Halo Labs Inc.

(OTC:AGEEF, NEO:HALO, DE:A9KN)

15 August 2019

EARNINGS

Outstanding revenue growth for Halo's JunQ19: we raise our estimates and note that valuation is ridiculously low versus comparables given the size and growth of the Company

Rating: MODERATE RISK
Market Cap: \$53m USD
Price target: \$1.00 USD
Current Price: \$0.32 USD
Currency: USD

Revenues (C\$m)

	CY18	CY19	CY20
Mar	2.17m	8.72m	12.64m
Jun	2.09m	9.55m	13.85m
Sep	3.60m	11.00m	15.95m
Dec	3.04m	14.00m	19.60m

EPS (Diluted)

	CY18	CY19	CY20
Mar	(0.07)	(0.02)	(0.02)
Jun	(0.08)	(0.02)	(0.01)
Sep	(0.19)	(0.02)	(0.01)
Dec	(0.02)	(0.01)	0.00

Summary:

- Halo grew revenues beyond our expectations
 - As we had expected, ramping California sales drove substantially higher revenues
 - Opportunity in Nevada, and pricing stabilizing in Oregon
- We raise our estimates
 - SepQ19 revenues raised from \$8.8m to \$11.0m
 - DecQ19 revenues raised from \$9.1m to \$14.0m
 - CY19 revenues raised from \$38m to \$43m
- Halo is trading at a ridiculously cheap valuation versus its direct comparables:
 - Trading at 1.2x CY19E revenues
 - Average comparable trades at 11.8x CY19E revenues
 - The nearest valued company is CV Sciences at 4.7x CY19E revenues
 - Our \$100 price target is only 2.5x CY19E revenues
- California is the outstanding growth driver
 - This is the key focus for the company
 - California harvest is in late Q4
 - Biomass purchases from the Emerald Triangle – strong relationships with 2-3 farms

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Investment Thesis

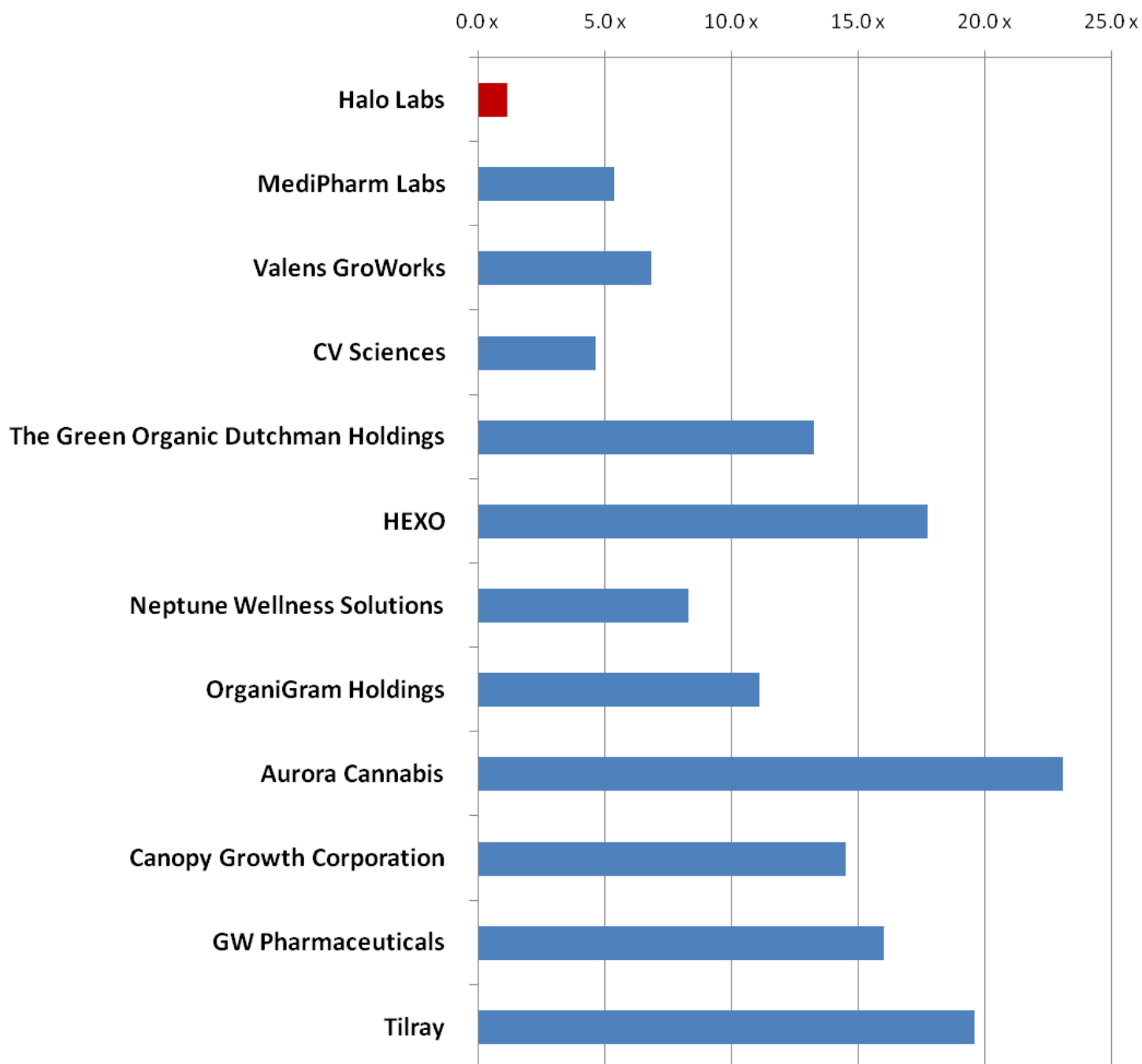
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- The company reiterated their assertion that CY19 can see \$48m in revenues
 - We only project \$43m, but just to be conservative
 - We expect we will continue to raise forecasts from here
 - Management does not give specific quarterly guidance
- Our \$62m CY20 revenue expectations are likely substantially too low
 - Given the ramp they've seen thus far
 - Additional capacity coming online in California and Nevada
 - Stabilization of Oregon pricing
 - We expect to raise these forecasts as we move closer to CY20
 - And we believe our CY19E revenues of \$43m are likely too low as well
- Nevada revenues are slower than hoped -- the company needs its own biomass supply
 - Currently biomass is roughly 2-3x the cost on California
 - Anticipate Clark County is in the approval process
- Ready to expand distribution
 - Plan to work with a small number of top-tier distributors – larger chains and not small stores
- Shatter price may be ready to stabilize
 - Declining price, but declining at a slowing rate
 - MarQ19 price declined 31% Y/Y
 - JunQ19 price declined 17% Y/Y – decline is decelerating
- Bophelo Bioscience (Lesotho) acquisition may add \$4.5m+ revenues in CY20 -- expects to close acquisition in September
 - Expect to generate a minimum of 1,000 kg of usable marijuana per harvest
- We are positive on Halo Labs because:
 - We believe investors may have missed this story
 - Revenue growth is substantial
 - Valuation is ridiculously low versus their peers
 - Company management has substantial experience at name-brand consumer products groups
 - Company management is executing and hitting their targets
 - Extracts are the fastest growing portion of the market
 - Medical- and edible-quality extracts will be a competitive moat protecting the business

Halo is trading at a ridiculously cheap valuation versus its revenues

- Trading at 1.2x CY19E revenues
- Average comparable trades at 11.8x CY19E revenues
- The nearest valued company is CV Sciences at 4.7x CY19E revenues
- Our \$100 price target is only 2.5x CY19E revenues
- If Halo traded at CV Sciences' valuation of 4.7x (the 2nd lowest valuation) it would be \$200m market cap
- If Halo traded at the group's average valuation of 11.8x it would be \$500m market cap
- If Halo traded at the average valuation of the large caps (Tilray, Aurora, GW and Canopy) of 18.3x it would be \$800m market cap
- And we expect we'll need to raise our revenue forecasts for CY19

Price to CY19E Sales



California is the outstanding growth driver

- This is the key focus for the company
- They have 15.5k sq ft
- Operating 1.7k sq ft
- The State has approved another 800 sq ft
- They expect to bring up additional capacity in Cathedral
- Now selling bulk product but plan to start distribution through high-end key dispensaries
- California harvest is in late Q4
- Biomass purchases from the Emerald Triangle – strong relationships with 2-3 farms
- Could formalize their relationship with these farmers to provide seed-to-dispensary

Nevada revenues are slower than hoped

- The Company has 18k sq ft in NV, but is using only 2k sq ft
- It buys oil in bulk and dispenses
- Currently selling into 22 dispensaries

- The company needs its own biomass supply
- Currently biomass is roughly 2-3x the cost on California
- They have an agreement to buy a license for cultivation
- They anticipate Clark County is in the approval process
- The company will leverage operational efficiencies into their Nevada process to drive yields and margins higher – seed to dispensary, and optimized for extraction

Bophelo Bioscience (Lesotho) acquisition may add \$4.5m+ revenues in CY20

- Management expects to close acquisition in September
- Cost is 18m shares
- All internal funding to date has been provided by Bophelo investors
- Expect to generate a minimum of 1,000 kg of usable marijuana per harvest
- Harvest expected in April
- They currently have offtake agreements in Israel and Europe
- Outdoor cannabis cultivation provides product at substantially lower cost
- Current price in Europe is \$4.50/g

- Adding an oil extraction facility for even higher margin production

Financials

Revenues for JunQ19 were up 329% Y/Y, driven by new contributions from Cpastal Harvest and HLO (NV). They also saw 11.8% Y/Y increase in revenues in Oregon (ANM). Revenue was driven by growth in distillate, shatter and live resin (up 262% Y/Y) and an increase in average selling prices (29% Y/Y) due to the company's strategy of providing premium product from its advanced extraction process. Prices in general were higher in California and Nevada and lower in Oregon.

EBITDA from operations were \$544k, driven by very strong EBITDA at Coastal Harvest. Both ANM and HLO saw EBITDA losses.

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Quarterly Income Statement (C\$000s)



	MarQ19	JunQ19	SepQ19E	DecQ19E	MarQ20E	JunQ20E	SepQ20E	DecQ20E
Revenue	8,718,503	9,552,012	11,000,000	14,000,000	12,640,000	13,850,000	15,950,000	19,600,000
Cost of Inventory Sold	6,273,930	8,005,913	8,960,000	10,840,000	10,100,000	10,680,000	11,600,000	13,040,000
Change in Value of Biological Assets	267,758	24,884	30,000	40,000	40,000	40,000	40,000	50,000
<u>Total COGS</u>	<u>6,541,688</u>	<u>8,030,797</u>	<u>8,990,000</u>	<u>10,880,000</u>	<u>10,140,000</u>	<u>10,720,000</u>	<u>11,640,000</u>	<u>13,090,000</u>
Gross Profit	2,176,815	1,521,215	2,010,000	3,120,000	2,500,000	3,130,000	4,310,000	6,510,000
G&A	751,415	1,044,550	1,100,000	1,200,000	1,160,000	1,200,000	1,260,000	1,360,000
Salaries	895,213	1,285,771	1,360,000	1,490,000	1,450,000	1,510,000	1,600,000	1,730,000
Professional Fees	530,979	523,429	550,000	600,000	580,000	600,000	630,000	680,000
S&M	529,900	657,023	690,000	760,000	740,000	770,000	810,000	880,000
Investor Relations	478,247	747,463	500,000	500,000	500,000	500,000	500,000	500,000
Share Based Compensation	629,125	689,547	730,000	800,000	780,000	810,000	860,000	930,000
R&D	-	-	-	-	-	-	-	-
<u>Other Operating Expenses</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Operating Expenses	3,814,879	4,947,783	4,930,000	5,350,000	5,210,000	5,390,000	5,660,000	6,080,000
Operating Income	(1,638,064)	(3,426,568)	(2,920,000)	(2,230,000)	(2,710,000)	(2,260,000)	(1,350,000)	430,000
Net Interest Expense	155,603	349,440	200,000	150,000	130,000	110,000	100,000	90,000
Other Income	(466,663)	69,765	(250,000)	(200,000)	(180,000)	(160,000)	(140,000)	(120,000)
Pre-Tax Income	(2,260,330)	(3,706,243)	(3,370,000)	(2,580,000)	(3,020,000)	(2,530,000)	(1,590,000)	220,000
Tax Provision	718,964	410,134	100,000	100,000	100,000	120,000	130,000	80,000
Net Income (Continuing Operations)	(2,979,294)	(4,116,377)	(3,470,000)	(2,680,000)	(3,120,000)	(2,650,000)	(1,720,000)	140,000
Non-Recurring Items	(58,308)	-	-	-	-	-	-	-
Net Income	(3,037,602)	(4,116,377)	(3,470,000)	(2,680,000)	(3,120,000)	(2,650,000)	(1,720,000)	140,000
EPS (Basic)	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.01)	\$ (0.02)	\$ (0.01)	\$ (0.01)	\$ 0.00
EPS (Diluted)	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.01)	\$ (0.02)	\$ (0.01)	\$ (0.01)	\$ 0.00
Shares Outstanding	160,386,434	182,418,186	184,242,368	186,084,792	187,945,639	189,825,096	191,723,347	193,640,580
Gross Margin %	25.0%	15.9%	18.3%	22.3%	19.8%	22.6%	27.0%	33.2%
Operating Margin %	-18.8%	-35.9%	-26.5%	-15.9%	-21.4%	-16.3%	-8.5%	2.2%
Tax Rate %	-31.8%	-11.1%	-3.0%	-3.9%	-3.3%	-4.7%	-8.2%	36.4%
Net Margin %	-34.8%	-43.1%	-31.5%	-19.1%	-24.7%	-19.1%	-10.8%	0.7%
Y/Y Growth								
Revenues	302%	356%	206%	361%	45%	45%	45%	40%
Operating Income	90%	51%	94%	140%	60%	152%	216%	119%
Net Income	60%	51%	155%	111%	97%	155%	202%	105%
Q/Q Growth								
Revenues	187%	10%	15%	27%	-10%	10%	15%	23%
Operating Income	191%	48%	117%	131%	82%	120%	167%	132%
Net Income	98%	74%	119%	129%	86%	118%	154%	108%

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