

July 14, 2022

**THE VALENS COMPANY (VLNS-TSX, \$0.85)**

**Q2 FINANCIALS MISS EXPECTATIONS**

**Rating: BUY**  
**New Target Price: \$3.00**  
**Old Target Price: \$4.00**

The Valens Company		VLNS	
<i>(Currency is C\$ unless noted otherwise)</i>			
Last Price (\$)		\$0.85	
12 Month Target Price (\$)		\$3.00	
Return To Target		253%	
52-Week Trading Range (\$)		\$0.76 / \$9.87	
Average Daily Volume (90-Day)		325.5K	
<b>MARKET INFO</b>			
FD ITM Shares (M)		80.2	
Market Capitalization (\$M)		\$68.2	
Enterprise Value (\$M)		\$85.1	
<b>FYE: NOV 30</b>	<b>F2021A</b>	<b>F2022E</b>	<b>F2023E</b>
Revenue (\$M)	\$78.2	\$105.4	\$190.5
Gross Margin (%)	22%	5%	34%
Adj. EBITDA (\$M)	(\$26.7)	(\$44.0)	\$10.1
Adj. EBITDA (%)	NM	NM	5%
<b>MOST RECENT QUARTER</b>			
<b>May-22</b>			
Revenue (\$M)	\$24.0		
Gross Margin (%)	NM		
Adj. EBITDA (\$M)	(\$15.9)		
Adj. EBITDA (%)	NM		
Cash and Equiv. (\$M)	\$26.1		
Debt (\$M)	\$43.1		
<b>VALUATION</b>	<b>F2021A</b>	<b>F2022E</b>	<b>F2023E</b>
EV/Revenue	1.1x	0.8x	0.4x
EV/EBITDA	NM	NM	8.4x
<b>DISCLOSURE CODE:</b>	2, 6		
<i>(Please refer to applicable disclosures on the back page)</i>			
Website: <a href="https://www.thevalenscompany.com/">https://www.thevalenscompany.com/</a>			

Source: M Partners, Capital IQ, Bloomberg, Company Documents



The Valens Company is a cannabinoid-based custom manufacturer and brand company. Valens provides differentiated, proprietary services across core technologies, including product development, formulation and manufacturing of cannabis consumer packaged goods.

**Yesterday after market close, The Valens Company reported Q2/22 financial results that missed our expectations.** The Company reported \$24.0M in revenue (+28% YoY, +4% QoQ), below our estimate of \$26.7M. The provincial sales segment regressed QoQ due to the rebranding of Verse to Versus and revenue timing issues, while the Green Roads and B2B segments remained strong. As such, branded market share declined in May 2022, but management saw a strong rebound in June 2022, posting record monthly revenue. More importantly, management reiterated its objective of reaching positive adjusted EBITDA by Q4/22 and its 2023 guidance of \$225M+ in revenue with 10%+ adjusted EBITDA margins (including future acquisitions).

Additional highlights from the quarter include:

- Revenue of \$24.0M vs. our estimate of \$26.7M and \$23.2M generated last quarter. Provincial revenue came in at \$9.2M (-15% QoQ) due to the factors mentioned above. Green Roads revenue came in at \$5.7M (+12% QoQ), which was attributable to growth in DTC e-commerce sales and international sales. B2B revenue came in at \$7.0M (+11% QoQ) due to higher demand for bulk sales. International revenue came in at \$1.1M and other revenue came in at \$1.0M.
- Adjusted gross profit of \$3.4M (14% margin) vs. our expectations of \$6.1M (23% margin) and \$3.4M (15% margin) posted in Q1/22. Management outlined that it expected improved gross margins in the coming quarters based on optimizing input sourcing and automation
- Adjusted EBITDA of -\$15.9M vs. our estimate of -\$12.0M and -\$17.6M in Q4.
- Valens ended the quarter with \$26.1M in cash and equivalents

Quarterly Financials Summary				
	Q2/22A	MPI Est.	QoQ	YoY
Revenue	\$24.0	\$26.7	+4%	+28%
Adjusted Gross Margin	14%	23%	-60 bps	N/A
Adjusted EBITDA	(\$15.9)	(\$12.0)	N/A	N/A

**Figure 1: Quarterly Financials Summary**

**Market Share:** Following the provincial sales decline, VLNS' market share came in at 3.2% in May compared to highs of 3.4% in April. This included 3.6% in flower, 1.8% in pre-rolls, 3.1% in edibles, 3.7% in vapes and 910.9% in beverages. We are expecting a rebound in market share in Q3 as June was a record month and management has high visibility into July sales.

Subsequent to the quarter, VLNS announced that it secured an exclusive cannabis partnership with Coldhaus Distribution to provide integrated logistics solutions for VLNS branded products in ON, AB, and BC. Coldhaus will be responsible for store level representation, brand advocacy, distribution route

July 14, 2022

coverage, and retail staff education. Also subsequent to the quarter, Valens announced the launch of Quebec-exclusive brand, Bon Jak (including the popular BC God Bud dried flower and three seltzer products). The products will be listed on the SQDC on September 12<sup>th</sup>.

**Cost Reduction Initiatives:** Over the last five months, Valens has actioned \$15M in annual cost savings and identified an additional \$5M in cost savings to be implemented in the coming quarters (with potential to exceed the originally planned \$20M). The Company reported that it has realized the initial benefits of its integration initiatives, noting that SG&A as a percent of revenue declined 908 bps QoQ. CEO Tyler Robson highlighted that he expects the cost savings to start taking effect in the coming quarters since most were executed in Q2 and Q3. Management is expecting Q3/22 OCF of -\$9.0M to -\$12.5M, compared to -\$19.8M this quarter. The push for profitability is a key element in our VLNS thesis and once VLNS can start matching the profitability of other top ten LPs, we can expect to see a re-rating in the stock.

**Balance Sheet:** During the quarter, Valens recognized a \$52.9M impairment on its goodwill and a \$67.9M impairment on its intangible assets. Furthermore, the Company had to write down \$4.1M in prepaid deposits, \$2.8M in assets held for sale and \$13.9M in inventory. VLNS does not expect this to impact its future operations, liquidity, cash flow, or debt covenants.

**Governance:** On May 16<sup>th</sup>, Valens announced that it has appointed Andrew Cockwell as Chair of the Board (previously a board director). Tyler Robson has stepped down as Chair but will remain on the board and in the CEO role. The rationale for this is to begin using best governance practices for increased transparency and accountability. Mr. Cockwell is Managing Partner of Ursatour Capital Management and has a background in private equity, consulting, finance, and legal advisory. On June 15<sup>th</sup>, VLNS received notice from the Nasdaq regarding its non-compliance with the minimum \$1.00/share bid requirement; Valens has until December 12<sup>th</sup> to regain compliance with the requirement.

**Valuation:** With VLNS trading at its tangible book value of \$0.90/share, we continue to believe that it is too cheap relative to its market share positioning and peer valuation (VLNS: 0.4x sales vs. mid-cap LPs: 1.2x sales). We think that the discount to its peers is unwarranted since VLNS is now a top ten LP (by market share) and will hit an inflection point later this year where the business can profitably scale. With Valens now trading at 8.4x 2023E EBITDA (even when assuming a heavy discount to the 2023 guidance) and below its tangible book value, we think the risk-reward opportunity is very compelling. **We are maintaining our BUY rating and revising our target price to \$3.00/share based on 1.25x 2023E sales (previously \$4.00/share based on 1.5x 2023E sales).**

Income Statement Summary												
	FY20	1Q21A	2Q21A	3Q21A	4Q21A	FY21A	1Q22A	2Q22A	3Q22E	4Q22E	FY22E	FY23E
<b>Revenue</b>	<b>83.8</b>	<b>20.0</b>	<b>18.8</b>	<b>21.0</b>	<b>18.4</b>	<b>78.2</b>	<b>23.2</b>	<b>24.0</b>	<b>27.0</b>	<b>31.2</b>	<b>105.4</b>	<b>190.5</b>
Cost of sales	58.1	15.2	14.6	15.4	15.7	60.9	21.1	34.5	21.0	23.4	100.1	126.2
<b>Gross Profit</b>	<b>25.7</b>	<b>4.8</b>	<b>4.1</b>	<b>5.6</b>	<b>2.7</b>	<b>17.2</b>	<b>2.0</b>	<b>(10.5)</b>	<b>5.9</b>	<b>7.8</b>	<b>5.3</b>	<b>64.3</b>
<i>Gross Margin</i>	<i>31%</i>	<i>24%</i>	<i>22%</i>	<i>27%</i>	<i>15%</i>	<i>22%</i>	<i>9%</i>	<i>-44%</i>	<i>22%</i>	<i>25%</i>	<i>5%</i>	<i>34%</i>
<b>Operating Expenses</b>												
SG&A	26.4	7.7	11.0	14.9	20.6	54.2	23.2	28.6	14.8	9.4	75.9	54.3
Share-Based Compensation	9.8	1.7	1.2	1.1	0.6	4.6	1.8	2.3	2.2	2.5	8.7	15.2
Depreciation and Amortization	10.2	2.5	2.7	3.6	2.8	11.6	3.2	2.9	1.8	1.8	9.8	7.3
<b>Operating Income (Loss)</b>	<b>(20.7)</b>	<b>(7.1)</b>	<b>(10.8)</b>	<b>(13.9)</b>	<b>(21.3)</b>	<b>(53.2)</b>	<b>(26.1)</b>	<b>(44.3)</b>	<b>(12.9)</b>	<b>(5.9)</b>	<b>(89.1)</b>	<b>(12.5)</b>
<b>Adj. EBITDA</b>	<b>14.1</b>	<b>(2.2)</b>	<b>(5.0)</b>	<b>(6.2)</b>	<b>(13.3)</b>	<b>(26.7)</b>	<b>(17.6)</b>	<b>(15.9)</b>	<b>(8.9)</b>	<b>(1.6)</b>	<b>(44.0)</b>	<b>10.1</b>
<i>Adj. EBITDA Margin</i>	<i>17%</i>	<i>-11%</i>	<i>-26%</i>	<i>-29%</i>	<i>-73%</i>	<i>-34%</i>	<i>-76%</i>	<i>-66%</i>	<i>-33%</i>	<i>-5%</i>	<i>-42%</i>	<i>5%</i>

Figure 2: Projected Income Statement

Disclosure Code: 2, 6

**Disclosure**

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein. Disclosure codes are used in accordance with IIROC Rules 3608, 3609, and 3616.

**Description of Possible Disclosure Codes**

1. M Partners or its affiliates collectively beneficially own 1% or more of any class of equity securities of the company which is the subject of the research report.
2. The analyst or any associate of the analyst responsible for the report or public comment has a long or short position in the company.
3. M Partners or a director or officer of M Partners or any analyst provided services to the company for remuneration other than normal investment advisory or trade execution services within the preceding 12 months, (may seek compensation for investment banking services from the company herein within the next 3 months).
4. The director, officer, employee or research analyst is an officer, director or employee of the company, or serves in an advisory capacity to the company.
5. The analyst has viewed the material operations of the company. We define material operations as an issuer's corporate head office and its main production facility or a satellite facility that is representative of the company's operations. Unless otherwise disclosed herein, the analyst's travel expenses were not paid for or reimbursed by the company.
6. M Partners provided investment banking services for the company during the 12 months preceding the publication of the research report.
7. The analyst preparing the report received compensation based upon M Partners investment banking revenues for this issuer.

**Dissemination**

M Partners has no further disclosures to make for any issuers mentioned in this report for which disclosures are not provided above. All final research reports and morning outlooks are disseminated to institutional clients of M Partners simultaneously in electronic form. Hard copies will be disseminated to any client that has requested to be on the distribution list of M Partners. Reproduction of this report in whole or in part without permission is prohibited.

**Research Analysts**

The Research Analyst(s) who prepare this report certify that their respective report accurately reflects his/her personal opinion and that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views as to the securities or companies. M Partners compensates its research analysts from a variety of sources and research analysts may or may not receive compensation based upon M Partners investment banking revenue.

Member of the Investment Industry Regulatory Organization of Canada and the Canadian Investor Protection Fund  
Participating organization of the Toronto Stock Exchange and the TSX Venture Exchange

[http://www.mpartners.ca/email\\_disclaimer.html](http://www.mpartners.ca/email_disclaimer.html)

Rating System	
Buy:	Price expected to rise
Speculative Buy:	Buy rating with increased risk
Hold:	Properly priced
Sell:	Price is inflated and expected to decrease
Under Review (U/R):	Under review
Not Rated (N/R):	Not currently rated

Summary of Recommendations	
Buy	17
Speculative Buy	1
Hold	0
Sell	0
U/R	1
<b>Total</b>	<b>19</b>