

Lowell Farms (US OTCQX: LOWLF: \$1.25): Q2/21 Results Benefit from Capacity Expansion and Branded Offering; Challenges with CA Flower Pricing Dampen 2H Outlook

August 17, 2021

LOWLF reported in line Q2/21 results of \$15.2M in revenues and \$740K adjusted EBITDA. Results for the quarter reflected the benefits of the cultivation capacity expansion completed 2020 with the company exceeding cultivation targets of 8.5K-9K lbs. (harvested 9.7K lbs.). Importantly, higher production levels provide both a top and bottom line impact with enhanced scale eliminating any reliance on third party supply demand. Additionally, Q2 results highlighted LOWLF's continued shift to greater branded products production with branded product sales accounting for nearly \$6M in revenues and providing a nice gross margin bump. We expect the branded products focus to expand in future quarters as LOWLF looks to offset bulk flower pricing headwinds in California with its sought-after pre-rolls offering. We expect additional color on this initiative as well as insight on contributions from LOWLF's processing service offering to come within the next few quarters. Both offer likely upside to our forecasts.

Pricing pressure hinders 2H outlook; Brand acquisition a difference maker

Revenue and gross margin guidance for Q3/21 were disappointing (revenues at \$14M-\$16M vs. our estimate of \$26M and margins to be down Q/Q from Q2) as the company deals with pricing challenges as meaningful new flower supply comes online in California. Flower prices have dropped 20%-30% in recent months and we expect the pressure to persist through the remainder of this year leading to a slower than expected 2H ramp. The pricing challenges only add credence to our positive view of the Lowell Herb Co. acquisition made earlier this year as the company's pre-roll brand gives retailers a reason to carry LOWLF products and at solid pricing. As we have previously mentioned, the brand also gives LOWLF an additional revenue stream through licensing into other markets. We note that Q3 will see initial contributions from the Ascend partnership with Illinois sales beginning this month and Massachusetts sales expected before the end of this quarter. Meanwhile we believe eventually the brand and licensing partnerships with MSOs could make LOWLF a viable takeover candidate longer term.

Lower 2H estimates and reduce price target

For now, we reduce our estimates to reflect guidance and persistent California headwinds in general. Additionally, we lower our price target from \$2.35 to \$1.60 on the estimates change and to reflect the valuation pullback in cannabis stocks over the past few months. Never-the-less our target offers significant room for upside and we believe there are numerous catalysts to prompt a positive revision. We remain positive on LOWLF despite headwinds and believe the company is as well positioned as any operator to consolidate the California flower production market particularly following the recent processing facility acquisition. Along with branding, we believe LOWLF's new processing service business can be a difference maker for the company and eventually be a sizable contributor to results (capable of generating >\$54M in standalone revenues).

Upcoming participant in Cannabis Expert Series

We plan to host LOWLF Chairman George Allen as a participant in the **Viridian Capital Cannabis Expert Series** with an investor call schedule for September 8th at 11 AM EST. With the call, we plan to discuss the California cannabis market and LOWLF's unique position in the state as well as cannabis brand building in general.

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Lowell Farms

Rating: Buy

Price Target: \$1.60 (was \$2.35)

Investment Highlights

- In line Q2 as LOWLF benefit from cultivation expansion and branded offering.
- Q3/21 Top Line Guidance Reflects Pricing Pressure on Bulk Flower. Reduce Estimates.
- Reduce Estimates and Price Target.
- Branded products offering to drive demand and offsets some pricing pressure.
- New growth drivers coming online with licensing revenues and services business coming online in Q3.
- Remain confident that LOWLF is well positioned in California.
- Participant in Viridian Cannabis Expert Series with Investor call scheduled for 9/8.

Click the Link to Subscribe to the [Viridian Cannabis Deal Tracker](#)

Revise our estimates and reduce price target

- Revenues: Q3/21 from \$26M to \$15.2M; 2021E from \$76M to \$61M; 2022E from \$106M to \$84M.
- EBITDA: Q3/21 from \$7.7M to \$1.1M; 2021E from \$10.7M to \$0.9M; 2022E from \$31.9M to \$18.6M.
- Price Target: from \$2.35 to \$1.60.

Our \$1.65 price target reflects an EV/EBITDA multiple of 21.6x our 2022 estimate.

FY Income Statement (\$M)

	2020	2021					2022				
	2020	Q1 '21	Q2 '21	Q3 '21E	Q4 '21E	2021	Q1 '22E	Q2 '22E	Q3 '22E	Q4 '22E	2022
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Dec-22
Revenue	42.7	11.0	15.2	15.0	20.0	61.2	18.0	23.0	23.0	20.0	84.0
COGS	38.1	12.5	9.4	9.5	12.2	43.6	10.6	13.1	13.1	11.4	48.2
Gross Profit	19.1	(1.5)	5.7	5.6	7.8	17.6	7.4	9.9	9.9	8.6	35.8
G&A	11.8	2.5	3.8	3.2	3.2	12.7	3.2	3.2	3.2	3.2	12.8
Sales & Marketing	5.2	1.4	2.2	2.2	2.3	8.2	2.5	2.5	2.5	2.5	10.0
Depreciation	3.7	0.3	0.2	0.2	0.3	1.0	0.3	0.3	0.3	0.3	1.2
Opex	20.6	4.2	6.2	5.6	5.8	21.8	6.0	6.0	6.0	6.0	24.0
Income from operati	(1.5)	(5.7)	(0.5)	(0.1)	2.0	(4.2)	1.4	3.9	3.9	2.6	11.8
Total Other Expense	7.2	(1.0)	1.3	(0.8)	(0.8)	(1.3)	(0.8)	(0.8)	(0.8)	(0.8)	(3.1)
Pre-tax Income	(8.8)	(6.7)	0.8	(0.9)	1.2	(5.5)	0.6	3.1	3.1	1.8	8.7
Taxes	0.2	0.1	0.1	(0.1)	0.2	0.2	0.1	0.5	0.5	0.3	1.3
Net Income	(9.0)	(6.7)	0.7	(0.7)	1.0	(5.7)	0.5	2.7	2.6	1.5	7.4
EPS	(0.3)	(0.1)	0.0	(0.0)	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0
Shares	33.4	53.6	201.3	202.3	203.3	165.1	204.3	205.3	206.4	207.4	205.8
Adjusted EBITDA	(9.8)	(4.6)	0.7	1.1	3.6	0.9	2.8	5.7	5.8	4.3	18.6
<u>% Revenues</u>											
Gross Margin	45%	-13%	38%	37%	39%	29%	41%	43%	43%	43%	43%
Opex	48%	38%	41%	37%	29%	36%	33%	26%	26%	30%	29%
Operating Income	-4%	-52%	-3%	0%	10%	-7%	8%	17%	17%	13%	14%
Net Income	-21%	-61%	5%	-5%	5%	-9%	3%	12%	11%	8%	9%
Adjusted EBITDA		-41%	5%	7%	18%	1%	16%	25%	25%	21%	22%
<u>Growth Rates</u>											
Revenues											
Y/Y	15%	17%	53%	6%	117%	43%	63%	52%	53%	0%	37%
Q/Q		20%	37%	-1%	33%		-10%	28%	0%	-13%	

Source: Company Reports, Viridian Capital Estimates

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			Count	Percent
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Not Rated (NR)	0	0%	0	0%

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