

Ayurcann Holdings Corp.

(CSE: AYUR / OTCQB: AYURF / FSE: 3ZQ0)

BUY

Current Price: C\$0.17

Fair Value: C\$0.56

Risk*: 4

Strong Q2 / Expecting a Shift in Sector Sentiment – FINAL REPORT

Sector/Industry: Cannabis

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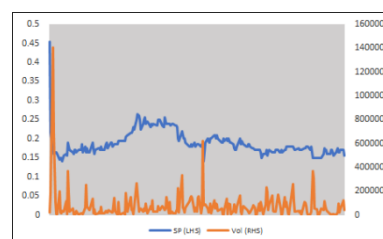
Highlights

- In Q2-FY2022 (quarter ended December 2021), AYUR reported \$3.2M in revenue, up 106% YoY and 73% QoQ, beating our expectations **due to faster than expected roll out** of its 2.0 products.
- AYUR's products are now sold in Ontario, New Brunswick, Saskatchewan, Manitoba, and Alberta (previously only New Brunswick and Saskatchewan).
- Revenue from **white label services** was in-line with expectations, but bulk oil sales fell below expectations due to continued sector-wide declines in product prices **amid rising competition and excess supply**.
- Strong revenue led to improved gross margins and EBITDA in Q2.
- Due to enhanced distribution, we are expecting stronger revenue in Q3-FY2022 (ended March 2022). Management is planning to launch additional 2.0 products.
- The recreational cannabis market in Canada is expected to grow from \$2.6B in 2020, to \$8.6B by 2026 (Statista). We **are expecting a shift in market sentiment towards the sector this year**. The sector was out of favor in the past 12 months. HMMJ (TSX: HMMJ/cannabis index) is down 15% YTD, and 58% YoY. We continue to believe that the market is overlooking fundamentally strong companies, such as AYUR.

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AYUR Price and Volume



*Since shares started trading (April 2021)

	YTD	12M
AYUR	-6%	N/A
CSE	-14%	-54%

Company Data

52-Week Range	\$0.12 - \$0.75
Shares O/S	122M
Market Cap.	\$20M
Current Yield	N/A
P/E (forward)	10.2x
P/B	2.9x

Key Financial Data (C\$)	2021	2022E	2023E
YE June 30			
Cash	725,016	2,212,159	5,107,549
Working Capital	3,859,132	7,444,166	11,878,204
Total Assets	6,677,006	11,700,302	16,914,761
Total Debt	73,359	73,359	73,359
Revenue	7,633,656	12,412,256	20,017,120
Net Income	(278,360)	1,976,716	4,764,902
EPS (basic)	(0.00)	0.02	0.04

*See last page for important disclosures, rating, and risk definitions. All figures in C\$ unless otherwise specified.

Q2 Financials

Statements of Operations (\$)	Q3-2021	Q4-2021	Q1-2022	Q2-2021	Q2-2022	YoY	QoQ
Trade sales - (bulk oil sales)	2,202,484	1,916,862	1,040,186	1,282,907	1,597,925	25%	54%
Processing fees - (white-label sales)	424,032	742,225	825,692	277,166	1,022,057	269%	24%
Product sales - (2.0 product sales)					599,426		
Revenue	2,626,516	2,659,087	1,865,878	1,560,073	3,219,408	106%	73%
Gross Profit	1,842,161	2,302,569	930,994	302,132	1,805,250	498%	94%
EBITDA	1,011,031	1,206,864	168,126	(34,335)	809,021	2456%	381%
*Adjusted Net Income (Net Loss)	(974,617)	1,040,101	124,703	(215,123)	584,667	372%	369%
EPS	(0.009)	0.012	0.001	(0.003)	(0.002)		

*adjusted for non-cash expenses

Margins Analysis	6M-2022	2022E	Q1-2021	Q1-2022	Q2-2021	Q2-2022
Gross	54%	53%	21%	50%	19%	56%
EBITDA	19%	24%	-6%	9%	-2%	25%
EBIT	19%	24%	-6%	9%	-2%	25%
Net	-2%	18%	-27%	7%	-14%	-6%

Summary of Cash Flows (\$)	6M-2021	6M-2022
YE June 30		
Cash Flows from Operations	92,380	(879,712)
Cash Flows from Investing	(240,302)	(192,091)
Cash Flows from Financing	(39,686)	2,233,604
Net Change	(187,608)	1,161,801
FOREX		
Free Cash Flows	(147,922)	(1,071,803)

Liquidity and Capital Structure (\$)	2021	Q1-2022	Q2-2022
YE June 30			
Cash	725,016	976,194	1,886,817
Working Capital	3,859,132	3,963,116	5,850,174
Current Ratio	3.46	3.29	3.16
LT Debt	40,000	40,000	40,000
Total Debt (incl. related party)	73,359	58,900	58,900
Total Debt / Capital	2%	1%	1%
LT Debt / Capital	1%	1%	1%

Source: Company Filings, FRC

Stock Options and Warrants

3.11M options (weighted average exercise price of \$0.17), and 24.92M warrants (weighted average exercise price of \$0.19) are outstanding. 2.41M options and 14.42M warrants are in-the-money, implying a potential to raise up to \$2.32M if exercised.

FRC Projections

	FY2022E (Old)	FY2022E (New)	FY2023E (Old)	FY2023E (New)
Revenue	\$12,075,000	\$12,412,256	\$18,750,000	\$20,017,120
EBITDA	\$3,250,200	\$2,649,188	\$6,232,740	\$6,369,238
Net Income	\$2,385,417	\$1,976,716	\$4,542,763	\$4,764,902
EPS	\$0.03	\$0.02	\$0.04	\$0.04

Source: FRC

Revenue up 106% YoY, and 73% QoQ, to \$3.2M, beating our expectations due to stronger than expected 2.0 product sales

Higher revenue led to stronger gross profit, EBITDA, and adjusted net income (both QoQ and YoY)

SG&A expenses were higher than expected

FCF down in FY2022 (6M) due to inventory build-up, anticipating stronger sales in H2-FY2022

Strong balance sheet with \$5.9M in working capital, and minimal debt

Can raise up to \$2.32M

Lowering our FY2022 EPS forecast (higher SG&A expenses, partially offset by higher revenue), while raising our FY2023 forecast (higher revenue, partially offset by higher SG&A expenses)

DCF valuation of
\$0.72 per share
(previously \$0.70)

DCF Model	2022E (Q3-Q4)	2023E	2024E	2025E	Terminal
EBIT(1-tax)	1,261,045	4,770,404	10,427,819	14,463,612	
Non-Cash Expenses	114,208	169,136	203,680	503,037	
Change in Working Capital	(1,283,065)	(1,538,649)	(2,149,059)	(4,513,255)	
Cash from Operations	92,188	3,400,891	8,482,439	10,453,394	
CAPEX	(500,000)	(500,000)	(500,000)	(500,000)	
Free Cash Flow	(407,812)	2,900,891	7,982,439	9,953,394	
Present Value	(371,061)	2,356,668	5,790,080	6,446,175	73,772,896
Discount Rate	12%				
Terminal Growth	3%				
Present Value	87,994,759				
Cash - Debt	1,827,917				
Fair Value	89,822,676				
Shares O/S (diluted)	124,465,005				
DCF Value per Share (C\$)	\$0.72				

AYUR is trading at
1.5x revenue
(unchanged) vs the
comparables
average of 3.7x
(previously 3.9x),
implying a 59%
discount

Company	EV/R
High Fusion Inc.	13.1
Adastra Holdings	11.4
Radiant Technologies Inc.	9.8
Nextleaf Solutions Ltd.	6.6
Valens	2.2
Neptune	1.6
Ayurcann (forward)	1.5
MediPharm Labs	0.3
Average	3.7
Median	4.4
Fair Value of Ayurcann	\$0.38

Source: FRC, S&P Capital IQ

We are reiterating our BUY rating, and adjusting our fair value estimate from \$0.55 to \$0.56 per share (the average of our DCF and comparables valuations). We are expecting a stronger Q3, and a shift in investor-sentiment this year.

Risks

We believe the company is exposed to the following risks (list is non-exhaustive):

Maintaining a risk
rating of 4

- Operates in a highly regulated industry subject to government intervention.
- **Highly competitive market.**
- No guarantee that the company will continue to attract clients for tolling/white-label services.

Appendix

STATEMENTS OF OPERATIONS (\$)			
YE June 30	2021	2022E	2023E
Revenue			
Trade sales - (bulk oil sales)	5,788,603	\$6,300,000	\$10,800,000
Processing fees - (white-label sales)	1,845,053	\$4,200,000	\$5,250,000
Product sales (In-house brands)		\$1,912,256	\$3,967,120
Total Revenues	7,633,656	12,412,256	20,017,120
COGS	3,006,939	5,795,515	9,270,204
Gross Profit	4,626,717	6,616,741	10,746,916
SG&A	2,323,549	3,833,856	4,217,241
Share-based compensation	133,697	133,697	160,436
EBITDA	2,169,471	2,649,188	6,369,238
D&A	10,162	6,231	8,700
EBIT	2,159,309	2,642,957	6,360,538
Net financing expense	315,182	7,336	7,336
Transaction costs	1,888,434		
Other income	101,394		
EBT	57,087	2,635,621	6,353,203
Income tax expense	335,447	658,905	1,588,301
Unusual/Non-recurring expense			
Net Income (Net Loss)	(278,360)	1,976,716	4,764,902
EPS	(0.003)	0.02	0.04
BALANCE SHEET (\$)			
YE June 30	2021	2022E	2023E
Assets			
Cash	725,016	2,212,159	5,107,549
Prepays	308,467	277,620	305,382
Receivables	2,059,491	3,103,064	6,005,136
Harmonized sales tax recoverable	20,880	20,880	20,880
Inventory	2,316,979	4,346,636	3,244,571
Current Assets	5,430,833	9,960,360	14,683,518
PP&E and ROU assets	1,246,173	1,739,942	2,231,242
Total Assets	6,677,006	11,700,302	16,914,761
Liabilities & Shareholders' Equity			
Trade and other payables	1,083,938	2,028,430	2,317,551
Due to related parties	33,359	33,359	33,359
Income tax payable	335,447	335,447	335,447
Current portion of lease liabilities	118,957	118,957	118,957
Current Liabilities	1,571,701	2,516,193	2,805,314
Lease liabilities	316,083	284,475	284,475
Long term debt	40,000	40,000	40,000
Total Liabilities	1,927,784	2,840,668	3,129,789
Equity	5,914,022	7,914,022	7,914,022
Contributed surplus	851,454	985,151	1,145,587
Deficit and AOCI	(2,016,254)	(39,539)	4,725,363
Total Liabilities and Shareholder's Equity	6,677,006	11,700,302	16,914,761

STATEMENTS OF CASH FLOWS (\$)	2021	2022E	2023E
YE June 30			
Operating Activities			
Net loss for the period	(278,360)	1,976,716	4,764,902
Items not involving cash			
D&A	271,644	6,231	8,700
Accrued interest			
Accretion of finance costs	292,410		
Shares issued for advertising services			
Interest on right-of-use assets	48,162		
Transaction costs -RTO	2,113,792		
Amortization of deferred lease inducement			
Shares for services			
Share-based compensation	133,697	133,697	160,436
FFO	2,581,345	2,116,644	4,934,038
Prepaid expenses	(297,144)	30,847	(27,762)
Accounts receivable and other receivables	(1,709,124)	(1,043,573)	(2,902,072)
Harmonized sales tax recoverable	(23,209)	-	-
Income taxes	335,447		
Inventory	(2,035,034)	(2,029,657)	1,102,065
Accounts payable and accrued liabilities	949,152	944,492	289,121
Changes in WC	(2,779,907)	(2,097,891)	(1,538,649)
Cash from (used in) Operations	(198,562)	18,752	3,395,389
Financing activities			
Equity	672,476	2,000,000	
Debt	(134,589)	-	-
Lease		(31,608)	-
Cash provided by Financing Activities	537,887	1,968,392	-
Investing activities			
Cash acquired on RTO	872,232		
PP&E	(508,986)	(500,000)	(500,000)
Cash used in Investing Activities	363,246	(500,000)	(500,000)

Fundamental Research Corp. Equity Rating Scale:

Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

Hold – Annual expected rate of return is between 5% and 12%

Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:

1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues and may rely on external funding. These stocks are considered highly speculative.

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