GBC AG Investment Research

AGRIOS GLOBAL HOLDINGS LTD.*5a,5b,11

Rating: BUY
Target price: 1.24 USD (1.64 CAD; € 1.12) (previously: 1.04 USD (1.38 CAD; € 0.94))

Current price: 0.1471
Current price: USD
04/12/2019 / FINRA / 16:39
Currency: USD

Key Data:

ISIN: CA00856K1003
WKN: A2N62K
CSE: AGRO
OTCQB: AGGHF
FSE: ØSA - WKN-A2N62K
Number of shares³: 90.64m
Marketcap³: 13.33
EV: 16.52
³ in m / in m USD
Free float: 63.7%

Primary listing: Canada CSE
Secondary listing: Frankfurt

Accounting Standard: IFRS

FY End: 31/03/

Date and time of completion of this research: 09/12/2019 (11:00)

Date and time of first distribution: 09/12/2019 (12:00)

Target price valid until: max. 31/03/2021

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* possible conflicts of interest on page 33

Company Profile

Sector: Agritech

Focus: Cannabis

Headquartered in Vancouver (British Columbia - Canada)

Management: Chris Kennedy (President & CEO, Director), Herrick Lau (CFO, Corp. Secretary, Director), Larry Ellison (Director, CFO (USA))

Agrios Global Holdings is a data analytics-driven agriculture technology and services company advancing the latest innovations in indoor growing science.

The company leases and manages properties and equipment for eco-sustainable agronomy and provides advisory services to support all aspects of aeroponic cultivation in the cannabis sector. Agrios is actively pursuing new opportunities to expand its portfolio of tenant growers and infrastructure assets in strategic licensed jurisdictions.

P&L in USD m FY	31/03/2019	31/03/2020e	31/03/2021e	31/03/2022e
Sales	4,04	8,40	13,50	21,84
EBITDA	-4,24	0,28	2,49	7,24
EBIT	-4,83	-0,43	1,68	5,86
Net income	-4,87	-0,50	1,53	5,71

Key figures in USD m				
EPS	-0,05	-0,01	0,02	0,06
Dividends per share	0,00	0,00	0,00	0,00

Key figures				
EV/Sales	4,08	1,97	1,22	0,76
EV/EBITDA	-3,90	59,10	6,63	2,28
EV/EBIT	-0,29	-0,03	0,10	0,35
PE	-2,74	-26,48	8,70	2,33
PB	0,57			

** Last research by GBC:
Date: publication/target price in USD/rating
06.09.2019: RS / 1.38 CAD; 0.94 € / Buy
01.08.2019: RS / 1.38 CAD; 0.94 € / Buy
** The research studies indicated above may be viewed at www.gbc-ag.de, or requested at GBC AG, Halderstr. 27, D86150 Augsburg

Financial calendar
11/12/2019: MKK – Müchner Kapitalmarkt Konferenz

Note on research as a “minor non-monetary benefit” according to the MiFID II regulation: This research meets the requirements for being classified as a “minor non-monetary benefit”. For more information, see the disclosure under “I. Research under MiFID II”

“Still on track” Target price raised to 1.64 CAD (previously: 1.38 CAD) Buy Rating confirmed. Agrios’ financial results are improving while the company continues to invest in its Shelton facility. By year’s end, the facility should be completed, paving the way for a new growth phase. The company’s expenses have significantly decreased and all metrics have improved.

Washington State cannabis market update

Agrios Global Holdings is a company in the take-off stage, with a strong growth potential. It currently owns one state-of-the-art cultivation growing facility in Wash-ington State that is leased to a licensed Tier 3 cannabis producer and processor. The company provides data-driven aeroponic cultivation equipment rental and growing services to cannabis producers. The company’s technology can also be used for any type of indoor cultiva-tion. The indoor aeroponic market in the USA could reach USD 40 billion annually by 2022. Moreover, the American cannabis market could reach USD 75 billion annually by 2030. Specifically, the Washington State market represented approximately USD 1.371 billion in 2017 and is expected to grow to USD $2.28 billion by 2020.

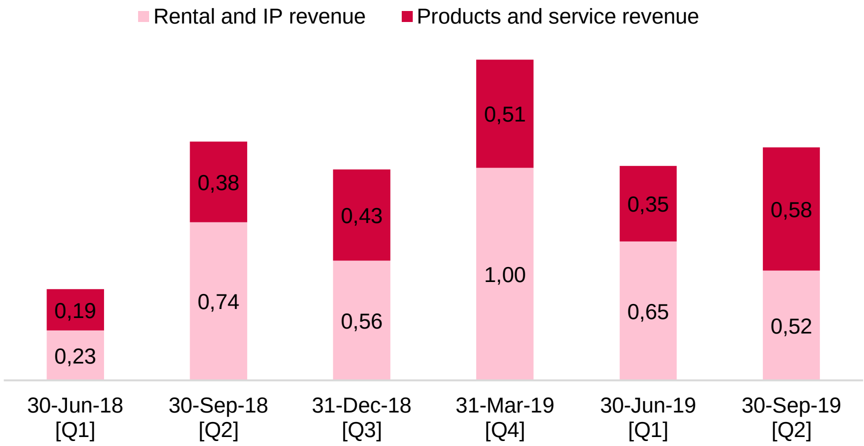
The cannabis landscape in Washington State continues to show signs of recovery and we believe that the company can profit from this positive trend. However, legislation continues to be an important unknown as the state has just banned flavored cannabis vaping products. We expect such regulations to come and go given that the industry is still at a very early stage and since cannabis is still illegal on the federal level.

An interesting case occurred in Washington State where a man sued producers over an illness due to the poor quality of a cannabis product. This increases our confidence in Agrios’ approach of quality over quantity and ensuring perfect reproducibility of their products. We continue to believe that their digitalized and automated growing facilities represent the inevitable solution to many of the current and future issues for cannabis producers.

Q2 2020 Results

Agrios Holdings has seen an increase in their products and service revenues and a small increase in their rental and IP revenues, aggregating to a total increase of 11.53% com-pared to the previous quarter, up to USD 1.093M from USD 1.007M. The revenues will have to grow significantly in Q3 and Q4 2020 in order to reach our year-end projection.

Revenue by fee structure

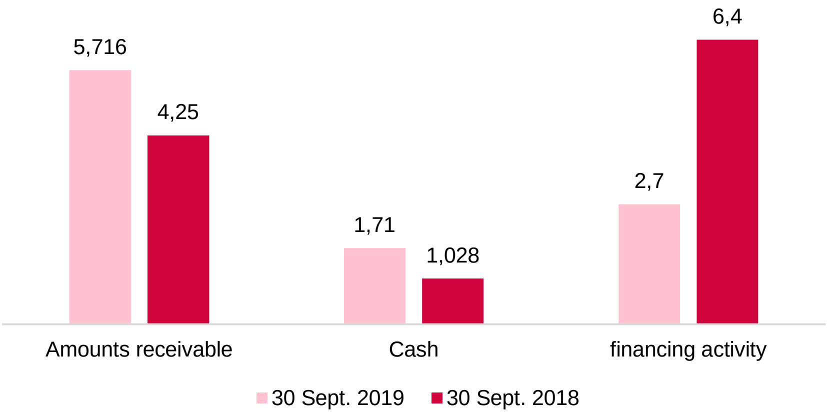


Source: GBC AG

We had, however, accounted that most of the sales would be registered in Q4. With amounts receivable reaching a high of USD 5.72M this quarter compared to USD 4.25M in the last one, it is clear that the company posted strong sales growth numbers. As discussed in our initial coverage, it is important for Agrios Holdings to focus on reducing the amount receivables given that the company currently has only one large client. If they can achieve this objective, we consider it reasonable to project that Agrios Holdings will reach our projected year end sales numbers.

The company's overall financial position has greatly improved year on year. As seen in the chart, amounts receivable have grown, while cash position has increased and financing activities have been greatly reduced. As we expected, with the Shelton facility being near completion, investment in new equipment and development will now be replaced by free cash flow.

Development of key financials



Source: GBC-AG

We estimated the 2020 accounting year to generate a small deficit of USD 1.5m. We predicted that the company would post negative cash flow in Q1 and Q2 and turn cash flow positive in Q3 2020. The company seems well on track to achieve this result.

P&L (in m $)	HY 2018	HY 2019	FY 2019/20e	FY 2020/21e	FY 2021/22e
Total Revenue	1,55	2,10	8.4	13.5	21.84
EBITDA	-2,42	-1,17	0.28	2.49	7.24
EBITDA-Margin	neg.	neg.	3.30%	18.50%	33.20%
EBIT	-2,49	-1,36	-0.43	1.68	5.86
EBIT-Margin	neg.	neg.	neg.	12.40%	26.80%
Net income	-2,52	-1,33	-0.5	1.53	5.71
Net-Margin	neg.	neg.	neg.	11.30%	26.20%

Sources: Agrios Global Holdings Ltd., GBC AG

As can be seen, the current EBITDA is USD -0.524m, greatly improved from USD -1.789m in September 2019. EBIT has also improved, from USD -1.843. to USD -0.615m. Additionally, both EBIT and EBITDA margins have consequently risen, and the net profit resulted in a loss reduction of 68% compared to last year.

The next big step for the company is the refinancing of their USD 4.27m loan, which is coming due. The company has already disclosed that they are in negotiations to convert their loan from short-term to long-term debt.

In the next few quarters, we expect the company to develop new income verticals, continue to improve their financials and post their first cash flow positive quarter.

As the cannabis industry matures in the USA, moving from quantity to quality, Agrios will be positioned in a niche market where their production costs will rival the lowest in the sector while their quality will be the best amongst their peers. Agrios' focus on the duplication of the unique cannabinoids mix generated in each strain could be the key to unlocking pharmaceutical partnerships. This evolution of the cannabis market into a more educated and mature sector will most definitely provide Agrios with growth opportunities.

VALUATION

Model assumptions

We rated Agrios Global Holdings Ltd. using a three-stage DCF model. Starting with the concrete estimations for 2019/20, 2020/21, and 2021/22 in phase 1, in the second phase, from 2022/23 to 2026/27, our forecast uses value drivers. Here we expect a sales increase of 25.0 %. We have assumed an EBITDA margin target of 35.0%. We have taken into account average tax rates of 12.0 %. Additionally, a residual value is determined in the third phase by using the perpetual annuity by the end of the forecast horizon. As the final value, we assume a growth rate of 2.0%.

Determination of capital costs

The weighted average cost of capital (WACC) of Agrios Global Holdings Ltd. is calculated using equity costs and debt costs. The market premium, the company-specific beta, as well as the risk-free interest rate have to be determined in order to determine the equity cost. The risk-free interest rate is derived in accordance with the recommendations of the expert committee for company valuations and business administration (FAUB) of the IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.) from the current interest rate yield curves for risk-free bonds. The zero bond interest rates according to the Svensson method published by the German Federal Bank form the underlying basis. To smooth out short-term market fluctuations, we use the average yields over the previous three months and round up the result to 0.25 basis points.

The value of the currently used risk-free interest rate is 1.00%.

We set **the historical market premium of 5.50%** as a reasonable expectation of the market premium. This is supported by historical analyses of stock market returns. The market premium reflects the percentage by which the stock market is expected to be more profitable than low-risk government bonds. According to GBC estimates, we have determined a beta of 1.93.

Based on these assumptions, the calculated equity costs amount to 11.6% (beta multiplied by the risk premium plus the risk-free interest rate). Since we assume a sustainable weighting of the equity costs of 95 % (target ratio), the resulting weighted average costs of capital (WACC) amount to 11.2%.

We have valued the outstanding options and warrants according to Black Scholes and value them as a liability with a total value of USD 4.31 million. Therefore we assume an undiluted number of shares of 90.64 million.

Evaluation result

The discounting of future cash flows is based on the entity approach. In our calculation, the result for the corresponding weighted average costs of capital (WACC) is 11.2%. The resulting fair value per share at the end of the 2020/21 financial year corresponds to the target price of USD 1.24 (1.64 CAD, 1.12 €). This target price is valid until 31/03/2021 or until a previous change or update of the valuation model.

USD to CAD Conversion: 1 USD = 1.32082 CAD (2019-12-04 17:06 UTC)
USD to EUR Conversion: 1 USD = 0.902778 EUR (2019-12-04 17:06 UTC)

DCF-Modell

Agrios Global Holdings Ltd. - Discounted Cashflow (DCF) model

Value driver of the DCF model after the estimate phase:

consistency - phase	
Sales growth rate	25.0%
EBITDA-Margin	35.0%
Depreciation to fixed assets	3.0%
Working Capital to Sales ratio	25.0%

final - phase	
Eternal growth rate	2.0%
Eternal EBITDA-Margin	32.7%
Eternal effective tax rate	12.0%

Three phases - Model:

Phase	**estimate**			**consistency**					**final**
in m USD	FY 20e	FY 21e	FY 22e	FY 23e	FY 24e	FY 25e	FY 26e	FY 27e	Terminal value
Sales	8.40	13.50	21.84	27.30	34.13	42.66	53.32	66.65	
Sales changes	107.7%	60.7%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	2.0%
Sales to fixed assets	0.37	0.31	0.49	0.59	0.71	0.86	1.05	1.27	
EBITDA	0.28	2.49	7.24	9.56	11.94	14.93	18.66	23.33	
EBITDA-Margin	3.3%	18.5%	33.2%	35.0%	35.0%	35.0%	35.0%	35.0%	
EBITA	-0.43	1.68	5.86	8.21	10.55	13.49	17.18	21.80	
EBITA-Margin	-5.1%	12.4%	26.8%	30.1%	30.9%	31.6%	32.2%	32.7%	32.7%
Taxes on EBITA	0.05	-0.20	-0.70	-0.98	-1.27	-1.62	-2.06	-2.62	
Taxes to EBITA	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%
EBI (NOPLAT)	-0.38	1.48	5.15	7.22	9.28	11.87	15.12	19.18	
Return on capital	-1.5%	5.7%	10.6%	14.3%	17.4%	21.0%	25.1%	29.8%	28.3%
Working Capital (WC)	3.00	4.50	1.00	6.83	8.53	10.66	13.33	16.66	
WC to Sales	35.7%	33.3%	25.2%	25.0%	25.0%	25.0%	25.0%	25.0%	
Investment in WC	-0.85	-1.50	-1.00	-1.33	-1.71	-2.13	-2.67	-3.33	
Operating fixed assets (OAV)	23.00	44.00	45.00	46.50	48.00	49.50	51.00	52.50	
Depreciation on OAV	-0.71	-0.81	-1.38	-1.35	-1.40	-1.44	-1.49	-1.53	
Depreciation to OAV	3.1%	1.9%	3.1%	3.0%	3.0%	3.0%	3.0%	3.0%	
Investment in OAV	-1.00	-21.81	-2.38	-2.85	-2.90	-2.94	-2.99	-3.03	
Capital employed	26.00	48.50	50.50	53.33	56.53	60.16	64.33	69.16	
EBITDA	0.28	2.49	7.24	9.56	11.94	14.93	18.66	23.33	
Taxes on EBITA	0.05	-0.20	-0.70	-0.98	-1.27	-1.62	-2.06	-2.62	
Total investment	-1.85	-23.31	-3.38	-4.18	-4.60	-5.07	-5.65	-6.36	
Investment in OAV	-1.00	-21.81	-2.38	-2.85	-2.90	-2.94	-2.99	-3.03	
Investment in WC	-0.85	-1.50	-1.00	-1.33	-1.71	-2.13	-2.67	-3.33	
Investment in Goodwill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
other effects	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Free cash flows	-1.52	-21.02	3.15	4.40	6.08	8.24	10.95	14.35	197.33

Value operating business (due date)	102.03	134.50
Net present value explicit free cash flows	8.26	30.21
Net present value of terminal value	93.77	104.28
Net debt	-1.68	22.18
Value of equity	103.72	112.32
Minority interests	0.00	0.00
Value of share capital	103.72	112.32
Outstanding shares in m (fully diluted)	90.64	90.64
Fair value per share in USD	1.14	**1.24**
Fair value per share in CAD	1.51	1.64
Fair value per share in EUR	1.03	1.12

Cost of Capital:	
Risk free rate	1.0%
Market risk premium	5.5%
Beta	1.93
Cost of Equity	11.6%
Target weight	95.0%
Cost of Debt	5.0%
Target weight	5.0%
Taxshield	25.0%
WACC	**11.2%**

Return on capital	**WACC in USD**				
	10.2%	**10.7%**	**11.2%**	**11.7%**	**12.2%**
27.3%	1.40	1.29	1.20	1.11	1.03
27.8%	1.43	1.31	1.22	1.13	1.05
28.3%	1.45	1.34	**1.24**	1.15	1.07
28.8%	1.48	1.36	1.26	1.17	1.09
29.3%	1.50	1.39	1.28	1.19	1.11

ANNEX

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BUY	The expected return, based on the derived target price, incl. dividend payments within the rel 10%.
HOLD	The expected return, based on the derived target price, incl. dividend payments within the rel 10% and < + 10%.
SELL	The expected return, based on the calculated target price, incl. dividend payments within the <= - 10%.

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