urban-gro, Inc.

United States / AgTech
Primary: Nasdaq
Secondary: Frankfurt Stock Exchange
Bloomberg: UGRO US
ISIN: US91704K2024

Cannabis rescheduling
& Q1 results

RATING	**BUY**
PRICE TARGET	**$ 4.30**
Return Potential	131.2%
Risk Rating	High

HIGH TIMES FOR U.S. CANNABIS

After months of rumours and market speculation, news broke Tuesday that the DEA (Drug Enforcement Administration) is finally set to sign off on cannabis rescheduling. This historic shift in Federal policy was confirmed by multiple sources close to the situation and sent cannabis stocks soaring. The move to a Schedule 3 drug will result in massive tax savings for cannabis operators, which should in turn stimulate investment across the sector. The news overshadowed UG's Q1 reporting, which showed good sequential improvement, and importantly, hit guidance for the period. Management confirmed their full year targets calling for $84m in sales and a break even AEBITDA. The confirmed guide does not reflect rescheduling. UG will undoubtedly benefit from the loosened restrictions, but it may take months to wrap up the legal process before the upside crystallises. That said, we should see a more stable shift in sector sentiment straight away. We are Buy-rated on UGRO with an unchanged $4.3 TP.

High times for U.S. cannabis The DEA is now expected to nod through the most significant cannabis reform since weed was banned in 1970. Pot will become a Schedule 3 drug (now: Schedule 1), which will allow cannabis operators to bypass punitive tax codes. Currently, the IRS code known as 280E prevents companies trafficking in Schedule 1 substances from writing off expenses on their federal tax returns, meaning any expense unrelated to cost of goods sold is non-deductible. The elimination of the 280E roadblock will clear the way for weed operators to redirect the tax savings into investment for facilities and equipment. While the industry-wide tax windfall won't be captured all at once, we do expect earnings and operating cash flows to start improving incrementally later this year. This is good news for UG and will certainly jumpstart its stagnating high-margin Equipment Systems and Services segments.

Rescheduling could also influence other policy Aside from the aforementioned tax benefits, the shift in Federal policy may help prod other policymakers and voters. Rescheduling could boost support for. . . (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2020	2021	2022	2023	2024E	2025E
Revenue ($m)	25.84	62.11	67.03	71.54	82.87	115.29
Y-o-y growth	6.8%	140.4%	7.9%	6.7%	15.8%	39.1%
AEBITDA ($m)	-0.65	2.68	-3.89	-9.71	0.59	2.20
AEBITDA margin	-2.5%	4.3%	-5.8%	-13.6%	0.7%	1.9%
Net income ($m)	-5.07	-0.88	-15.28	-18.68	-5.36	-2.86
EPS (diluted) ($)	-1.06	-0.09	-1.44	-1.66	-0.44	-0.29
DPS ($)	0.00	0.00	0.00	0.00	0.00	0.00
FCF ($m)	-3.81	-9.90	-17.06	-9.21	0.42	0.22
Net gearing	-83.7%	-71.8%	-23.5%	10.4%	7.6%	10.7%
Liquid assets ($m)	0.18	34.59	12.01	1.11	1.33	1.37

** adjusted EBITDA*

RISKS

Risks include but aren't limited to regulatory, financing and market cyclicality, particularly in the cannabis sector.

COMPANY PROFILE

urban-gro, Inc is a provider of professional turnkey facility services to the CEA (Controlled Environment Agriculture) industry and various commercial sectors. Headquartered in Denver, Colorado, the company now operates six offices across North America and one in Europe. Urban-gro has 140 employees.

MARKET DATA

As of 01 May 2024

Closing Price	$ 1.86
Shares outstanding	12.07m
Market Capitalisation	$ 22.46m
52-week Range	$ 1.00 / 2.82
Avg. Volume (12 Months)	105,302

Multiples	2023	2024E	2025E
P/E	n.a.	n.a.	n.a.
EV/Sales	0.3	0.3	0.2
EV/EBITDA	n.a.	40.8	11.0
Div. Yield	0.0%	0.0%	0.0%

STOCK OVERVIEW

COMPANY DATA

As of 31 Mar 2024

Liquid Assets	$ 0.70m
Current Assets	$ 33.20m
Intangible Assets	$ 4.20m
Total Assets	$ 56.13m
Current Liabilities	$ 35.48m
Shareholders' Equity	$ 18.59m

SHAREHOLDERS

Insiders	28.9%
Institutional Holdings	28.0%
Free Float	43.1%

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. . . the SAFER Banking Act (see note of 27 September 2023), which is still working through the legal process. Plus, recreational marijuana will go before Florida voters this November, but the amendment would have to receive a supermajority or 60% of the vote to be passed. Florida would then become the 25th state to legalise marijuana usage for recreational fun alongside medical purposes.

Next steps in the rescheduling process The New York Times reported that Attorney General Merrick Garland was expected to make the rescheduling recommendation to the White House Office of Management and Budget (OMB) on Tuesday, Once reviewed by the White House, the rescheduling proposal will go back to the Justice Department, which will publish a proposed rule in the Federal Register. A public comment period will ensue, along with hearings in front of an administrative law judge, before the rule can become law.

Market watchers caution that proposed rescheduling will almost certainly draw lawsuits, which could drag out the process. The OMB could sit with the decision for as long as three months, while the comment period could also take months. Regardless of the timeline, there is no putting the genie back in the bottle.

We suspect cannabis operators will look to move ahead as quickly as possible with pent up expansion plans. This should lead to discussions with vendors and service providers, such as urban-gro. We will reassess our forecasts, once the rescheduling timeline becomes clearer.

FIRST QUARTER HIGHLIGHTS

Table 1: First quarter results vs FBe and prior year

All figures in USDm	Q1/24	Q1/24E	*variance*	Q1/23	*variance*
Revenue	15.5	15.2	*2%*	16.8	*-8%*
Gross profit	3.1	2.4	*31%*	2.8	*11%*
Margin	*20.0%*	*15.5%*	-	*16.7%*	-
AEBITDA	-0.3	-0.5	-	-3.4	-
Margin	-	-	-	-	-

Source: First Berlin Equity Research; urban-gro

Sequential improvements urban-gro notched roughly $15.5m in revenues for the quarter, which was in line with our target. The 4% Q/Q uptick in sales owes to a $0.6m rise in Services revenue and a $0.4m increase in Equipment Systems turnover. This was partially negated by a $0.4m decline in Construction Design-build sales (table 2).

Table 2: Revenue by segment

All figures in USDm	Q1/24	Q1/24E	*variance*	Q1/23	*variance*
Equipment systems	2.5	2.2	*14%*	2.9	*-14%*
Services	3.1	2.6	*19%*	3.5	*-11%*
Construction Design-build	9.8	10.2	*-4%*	10.2	*-4%*
Other	0.1	0.2	*-50%*	0.2	*-50%*
Total revenue	**15.5**	**15.2**	***2%***	**16.8**	***-8%***

Source: First Berlin Equity Research; urban-gro

AEBITDA loss pared down to $-0.3m Gross profit increased to $3.1m equal to a 20% margin and topped the prior year comp of $1.7m thanks to margin expansion to 52% for the Services segment (2024: 39%). The showing reflects improved productivity by UGRO’s architects and engineers alongside increased construction margins. Operating expenses were trimmed down to $5.2m vs $6.4m in the October-to-December period and equated to 33% of sales (Q4/23: 42%). The sequential decrease stems from the ~$8m in cost cutting measures communicated in H2/23.

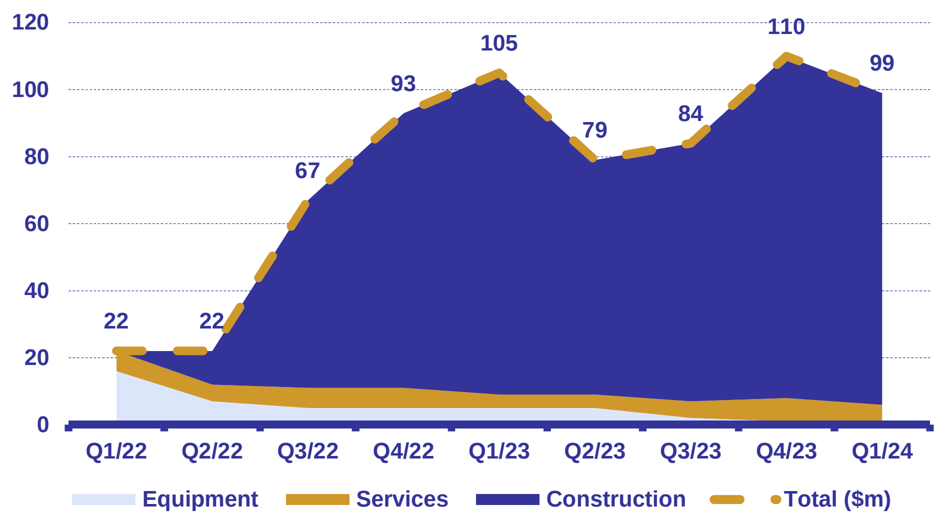
Table 3: Updated order backlog

in $m	CEA	Commercial	Total	*Ratio*
Equipment Systems	1	-	1	*1%*
Services	2	3	5	*5%*
Construction Design-Build	72	21	93	*85%*
Total backlog	**75**	**24**	**99**	***90%***
Ratio	*76%*	*24%*	*100%*	

Source: First Berlin Equity Research; urban-gro

The order backlog stood at $99m (table 3) giving the company good visibility to meet its full year revenue target of $84m. Commercial projects for the Construction design-build segment were converted to sales leading to a 10% sequential decline in the backlog, but, with a number of new projects in the discussion phase we do not expect this to dip further.

Figure 1: Order backlog developments



Source: First Berlin Equity Research; urban-gro

Table 4: Financial highlights

All figures in USDm	Q1/24	2023	*variance*
Cash & liquid assets	0.7	1.1	*-36%*
Financial debt (short- and long-term)	2.5	3.2	*-22%*
Net debt / (net cash)	1.8	2.1	*-14%*
Total assets	56.1	64.4	*-13%*
Shareholders' equity	18.6	20.1	*-7%*
Equity ratio	*33%*	*31%*	-

Source: First Berlin Equity Research; urban-gro

urban-gro exited the quarter with cash and liquid assets of $0.7m vs $1.1m at the end of 2023. The 36% Q/Q drop-off stems from a decrease in contract liabilities traced to billing timing of construction projects. The company has only drawn down around $2m of its RCF and will continue to lean on this to cover working capital when needed. UG's financial boss, Dick Akright, reiterated on the earnings call that the company does not need to consider a cap hike.

It should also be noted that a pickup in Equipment Systems sales will help ease WC needs, since orders are coupled with deposits. Segment activity has been at rock bottom levels, but will likely be the first to benefit from the rescheduling.

Table 5: Changes to FBe and TP

	old	new	*revision*	*upside*	*dividend yield*	*total return*
Price target ($)	**4.3**	**4.3**	***0%***	***131%***	***0.0%***	***131%***
		2024E			2025E	
All figures in USD '000	**old**	**new**	***revision***	**old**	**new**	***revision***
Revenue	82,503	82,870	*0.4%*	114,784	115,290	*0.4%*
Gross profit	12,075	12,826	*6.2%*	17,215	17,496	*1.6%*
Margin (%)	*14.6%*	*15.5%*	-	*15.0%*	*15.2%*	-
AEBITDA	242	595	*145.7%*	1,998	2,203	*10.3%*
Margin (%)	*0.3%*	*0.7%*	-	*1.7%*	*1.9%*	-

Source: First Berlin Equity Research estimates

Maintaining Buy rating and $4.3 TP Updated forecasts factor in first quarter results leading to only minor changes. We will wait for the discussed rescheduling process to play out before fully reassessing our estimates and target price. That said we see upside to confirmed revenue guidance of $84m, which does account for the expected upswing in cannabis.

VALUATION MODEL

Table 6: DCF model

In USD '000	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
Sales	**82,870**	**115,290**	**146,419**	**178,631**	**208,998**	**234,078**	**257,485**	**280,659**
NOPLAT	**-5,157**	**-2,679**	**256**	**3,463**	**7,493**	**9,111**	**10,768**	**12,506**
(+) depreciation & amortisation	580	576	586	536	627	632	630	625
Net operating cash flow	-4,577	-2,103	842	3,999	8,120	9,743	11,397	13,132
(-) Total investments (CAPEX and WC)	-137	-1,119	-1,953	-1,887	-2,093	-1,385	-1,414	-1,480
(-) Capital expenditures	*-671*	*-703*	*-747*	*-732*	*-648*	*-726*	*-798*	*-870*
(-) Working capital	*534*	*-416*	*-1,206*	*-1,154*	*-1,445*	*-660*	*-616*	*-609*
Free cash flows (FCF)	-4,714	-3,222	-1,111	2,112	6,028	8,357	9,983	11,652
PV of FCF's	**-4,319**	**-2,587**	**-782**	**1,303**	**3,260**	**3,963**	**4,150**	**4,246**

In EUR '000	
PV of FCFs in explicit period	24,256
(+) PV of FCFs in terminal period	29,664
Enterprise value (EV)	53,920
(+) Net cash / (-) net debt	-2,092
(+) Investments / minority interests	0
Shareholder value	51,828
Fair value per share ($)	4.3

Terminal EBIT margin

WACC	5.8%	6.3%	6.8%	7.3%	7.8%	8.3%	8.8%
11.1%	5.6	6.0	6.5	7.0	7.4	7.9	8.4
12.1%	4.8	5.1	5.5	5.9	6.2	6.6	7.0
13.1%	4.1	4.4	**4.7**	**5.0**	**5.3**	5.6	5.9
14.1%	3.5	3.8	**4.0**	**4.3**	**4.5**	4.8	5.0
15.1%	3.1	3.3	**3.5**	**3.7**	**3.9**	4.1	4.3
16.1%	2.7	2.9	3.0	3.2	3.4	3.6	3.7
17.1%	2.4	2.5	2.7	2.8	3.0	3.1	3.3

Cost of equity	15.5%
Pre-tax cost of debt	9.0%
Tax rate	30.0%
After-tax cost of debt	6.3%
Share of equity capital	85.0%
Share of debt capital	15.0%
WACC	14.1%

Terminal growth rate

WACC	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
11.1%	6.2	6.5	6.7	7.0	7.3	7.6	8.0
12.1%	5.3	5.5	5.7	5.9	6.1	6.3	6.6
13.1%	4.6	4.7	**4.9**	**5.0**	**5.2**	5.3	5.5
14.1%	4.0	4.1	**4.2**	**4.3**	**4.4**	4.6	4.7
15.1%	3.5	3.5	**3.6**	**3.7**	**3.8**	3.9	4.0
16.1%	3.0	3.1	3.2	3.2	3.3	3.4	3.5
17.1%	2.7	2.7	2.8	2.8	2.9	2.9	3.0

**Please note our model runs through 2035 and we have only shown the abbreviated version for formatting purposes*

INCOME STATEMENT

All figures in USD '000	2020	2021	2022	2023	2024E	2025E
Revenues	**25,838**	**62,113**	**67,030**	**71,543**	**82,870**	**115,290**
Cost of goods sold	-20,122	-47,353	-52,824	-61,251	-70,045	-97,794
Gross profit	**5,716**	**14,760**	**14,206**	**10,292**	**12,826**	**17,496**
SG&A	-6,658	-13,124	-24,271	-24,770	-15,911	-17,870
Stock-based compensation	-1,803	-1,841	-2,572	-2,199	-2,072	-2,306
Operating income (EBIT)	**-2,746**	**-205**	**-12,637**	**-16,677**	**-5,157**	**-2,679**
Net financial result	-1,498	-334	274	-98	-200	-180
Other non-operating result	-831	-337	-577	-1,863	0	0
Impairment loss	0	0	-2,661	-259	0	0
Pre-tax income (EBT)	**-5,074**	**-876**	**-15,600**	**-18,897**	**-5,357**	**-2,859**
Income taxes	0	0	322	216	0	0
Minority interests	0	0	0	0	0	0
Net income / loss	**-5,074**	**-876**	**-15,278**	**-18,681**	**-5,357**	**-2,859**
Diluted EPS (in $)	**-1.06**	**-0.09**	**-1.44**	**-1.66**	**-0.44**	**-0.29**
AEBITDA	**-652**	**2,679**	**-3,888**	**-9,712**	**595**	**2,203**
Ratios						
Gross margin	22.1%	23.8%	21.2%	14.4%	15.5%	15.2%
EBIT margin	-10.6%	-0.3%	-18.9%	-23.3%	-6.2%	-2.3%
AEBITDA margin	-2.5%	4.3%	-5.8%	-13.6%	0.7%	1.9%
Net margin	-19.6%	-1.4%	-22.8%	-26.1%	-6.5%	-2.5%
Tax rate	15.0%	21.0%	21.0%	21.0%	21.0%	21.0%
Expenses as % of revenues						
SG&A	25.8%	21.1%	36.2%	34.6%	19.2%	15.5%
Stock-based compensation	7.0%	3.0%	3.8%	3.1%	2.5%	2.0%
Y-Y Growth						
Revenues	6.8%	140.4%	7.9%	6.7%	15.8%	39.1%
Operating income	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.
Net income/ loss	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.

BALANCE SHEET

All figures in USD '000	2020	2021	2022	2023	2024E	2025E
Assets						
Current assets, total	**5,245**	**59,480**	**34,558**	**40,952**	**29,341**	**36,705**
Cash and equivalents	185	34,591	12,008	1,113	1,330	1,370
Trade receivables	915	13,126	15,380	26,992	18,163	25,269
Inventories	537	515	320	229	384	536
Other ST assets	3,609	11,248	6,849	12,618	9,464	9,530
Non-current assets, total	**2,915**	**14,675**	**27,508**	**23,427**	**23,539**	**23,686**
Property, plant & equipment	129	208	1,307	1,419	1,428	1,439
Goodwill & other intangibles	991	9,568	21,023	19,967	20,049	20,165
Financial assets	1,710	4,210	2,559	0	0	0
Other LT assets	85	690	2,619	2,041	2,062	2,082
Total assets	**8,161**	**74,155**	**62,066**	**64,379**	**52,880**	**60,391**
Shareholders' equity & debt						
Current liabilities, total	**14,546**	**25,005**	**24,256**	**42,110**	**33,800**	**41,765**
Trade payables	654	6,067	9,960	25,411	17,271	24,114
ST debt	5,360	0	3,833	3,205	2,600	3,100
Customer deposits	4,879	13,345	2,571	603	698	972
Provisions	1,799	3,878	3,197	4,071	4,234	4,403
Other current liabilities	1,855	1,716	4,695	8,820	8,997	9,176
Long-term liabilities, total	**1,021**	**983**	**3,078**	**2,198**	**2,294**	**2,394**
Long-term debt	1,021	0	0	0	0	0
Deferred tax liabilities	0	441	1,033	817	858	901
Other non-current liabilities	0	542	2,045	1,380	1,436	1,493
Shareholders' equity	**-7,406**	**48,167**	**34,732**	**20,071**	**16,786**	**16,232**
Total consolidated equity and debt	**8,161**	**74,155**	**62,066**	**64,379**	**52,880**	**60,391**
Ratios						
Current ratio (x)	0.4	2.4	1.4	1.0	0.9	0.9
Quick ratio (x)	0.3	2.4	1.4	1.0	0.9	0.9
Equity ratio	-91%	65%	56%	31%	32%	27%
Net debt	6,197	-34,591	-8,175	2,092	1,270	1,730
Net debt / EBITDA (x)	-9.5	-12.9	2.1	-0.2	2.1	0.8
Net gearing	-84%	-72%	-24%	10%	8%	11%
Return on equity (ROE)	69%	-2%	-44%	-93%	-32%	-18%
Capital employed (CE)	1,016	9,357	12,498	7,624	7,181	7,723
Return on capital employed (ROCE)	-270%	1%	-93%	-205%	-64%	-27%

CASH FLOW STATEMENT

All figures in USD '000	2020	2021	2022	2023	2024E	2025E
Net income	**-5,074**	**-876**	**-15,278**	**-18,681**	**-5,357**	**-2,859**
Depreciation and amortisation	258	495	1,483	1,637	580	576
Amortisation of financing instruments	558	104	0	0	0	0
Stock-based compensation	1,803	1,841	2,572	2,199	2,072	2,306
Other non-cash items	1,016	500	3,427	1,155	0	0
Tax result	0	0	-322	-216	0	0
Net interest expense	0	0	-274	98	200	180
Operating cash flow	**-1,438**	**2,064**	**-8,393**	**-13,808**	**-2,505**	**203**
Change in working capital	-2,195	-3,628	-4,220	2,714	3,594	721
Tax paid	0	0	0	0	0	0
Net operating cash flow	**-3,633**	**-1,564**	**-12,613**	**-11,094**	**1,088**	**923**
Cash flow from investing	**-176**	**-8,337**	**-4,452**	**1,885**	**-671**	**-703**
Free cash flow (FCF)	**-3,809**	**-9,901**	**-17,065**	**-9,209**	**417**	**220**
Equity inflow, net	0	57,747	30	0	0	0
Debt inflow, net	4,183	-5,756	0	-758	0	0
Interest expenses paid	-638	0	0	-272	-200	-180
Stock buyback	0	-7,684	-4,362	0	0	0
Other adjustments	0	0	-1,186	-656	0	0
Cash flow from financing	**3,545**	**44,308**	**-5,518**	**-1,686**	**-200**	**-180**
Net cash flows	**-264**	**34,407**	**-22,583**	**-10,895**	**217**	**40**
Cash, start of the year	449	184	34,591	12,008	1,113	1,330
Cash, end of the year	**184**	**34,591**	**12,008**	**1,113**	**1,330**	**1,370**
EBITDA/share (in $)	**-0.14**	**0.27**	**-0.37**	**-0.86**	**0.05**	**0.22**
Y-Y Growth						
Operating cash flow	n.m.	n.m.	n.m.	n.m.	n.m.	-15.2%
Free cash flow	n.m.	n.m.	n.m.	n.m.	n.m.	-47.2%
AEBITDA / share	n.m.	n.m.	n.m.	n.m.	n.m.	346%

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PRICE TARGET DATES

Unless otherwise indicated, current prices refer to the closing prices of the previous trading day.

AGREEMENT WITH THE ANALYSED COMPANY AND MAINTENANCE OF OBJECTIVITY

The present financial analysis is based on the author's own knowledge and research. The author prepared this study without any direct or indirect influence exerted on the part of the analysed company. Parts of the financial analysis were possibly provided to the analysed company prior to publication in order to avoid inaccuracies in the representation of facts. However, no substantial changes were made at the request of the analysed company following any such provision.

ASSET VALUATION SYSTEM

First Berlin's system for asset valuation is divided into an asset recommendation and a risk assessment.

ASSET RECOMMENDATION

The recommendations determined in accordance with the share price trend anticipated by First Berlin in the respectively indicated investment period are as follows:

Category		1	2
Current market capitalisation (in €)		0 - 2 billion	> 2 billion
Strong Buy[1]	An expected favourable price trend of:	> 50%	> 30%
Buy	An expected favourable price trend of:	> 25%	> 15%
Add	An expected favourable price trend of:	0% to 25%	0% to 15%
Reduce	An expected negative price trend of:	0% to -15%	0% to -10%
Sell	An expected negative price trend of:	< -15%	< -10%

[1] The expected price trend is in combination with sizable confidence in the quality and forecast security of management.

Our recommendation system places each company into one of two market capitalisation categories. Category 1 companies have a market capitalisation of €0 – €2 billion, and Category 2 companies have a market capitalisation of > €2 billion. The expected return thresholds underlying our recommendation system are lower for Category 2 companies than for Category 1 companies. This reflects the generally lower level of risk associated with higher market capitalisation companies.

RISK ASSESSMENT

The First Berlin categories for risk assessment are low, average, high and speculative. They are determined by ten factors: Corporate governance, quality of earnings, management strength, balance sheet and financial risk, competitive position, standard of financial disclosure, regulatory and political uncertainty, strength of brandname, market capitalisation and free float. These risk factors are incorporated into the First Berlin valuation models and are thus included in the target prices. First Berlin customers may request the models.

RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target
Initial Report	27 June 2023	$1.21	Buy	$7.00
2...1	↓	↓	↓	↓
2	17 August 2023	$1.11	Buy	$6.40
3	27 September 2023	$1.40	Buy	$6.40
4	17 November 2023	$1.18	Buy	$4.70
5	16 January 2024	$1.47	Buy	$4.70
6	4 April 2024	$1.91	Buy	$4.30
7	Today	$1.86	Buy	$4.30

INVESTMENT HORIZON

Unless otherwise stated in the financial analysis, the ratings refer to an investment period of twelve months.

UPDATES

At the time of publication of this financial analysis it is not certain whether, when and on what occasion an update will be provided. In general First Berlin strives to review the financial analysis for its topicality and, if required, to update it in a very timely manner in connection with the reporting obligations of the analysed company or on the occasion of ad hoc notifications.

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Legally required information regarding

- **key sources of information in the preparation of this research report**
- **valuation methods and principles**
- **sensitivity of valuation parameters**

can be accessed through the following internet link: https://firstberlin.com/disclaimer-english-link/

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