BEACON Securities Limited

Indus Holdings Inc (INDS – C)

From Going Concern to Green Shoots

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- In a March 15, 2009 interview with 60 Minutes, ex Fed Chairman Ben Bernanke made reference to the analogy of "green shoots" sprouting in the US economy, which was in the midst of the Great Recession. As we know, the S&P 500 had hit a low of 666 on March 9 and rallied to the recent high of 3394, a 17% CAGR over that 11 year period. In other words, turnaround situations can produce powerful results if the market is mis-pricing the future.
- The official "green shoots" at Indus appeared on April 14, 2020 when the company announced the closing of a $15.1 million convertible debenture financing. Prior to this investment, Indus had a market cap of ~$6.5 million (@ $0.20), a clear indication the market was pricing for significant "going concern" risk.
- What "green shoots" did the two investment groups who participated in the financing see and can investors still participate as those "shoots" grow into fully formed cannabis plants? We believe the answer to the first question is infrastructure and the answer to the second question is "yes".
- We believe there were a few facts that attracted Merida Capital Partners and Geronimo Capital to Indus:
  - a) The pre-money value of the company was less than the value of the fixed assets. This is incredibly rare where most cannabis companies still trade at multiples of their book value and even significantly beyond that if one just looks at the P/Fixed Assets (ie BV excluding goodwill and intangibles);
  - b) Indus' fixed assets, and in particular its greenhouse, needed minimal investment (ie. ~$4 million) to increase its annual capacity to ~45,000lbs;
  - c) After its investment in the greenhouse, Indus repaid all of its debt ($3.8 million), leaving the company with a several million dollar buffer to reach cash flow positive, which is expected in 2H20.
- In essence, for a $15 million investment, the new shareholders own ~75% of a debt-free cannabis company, capable of generating ~$80 million from its infrastructure (greenhouse, extraction equipment, kitchen) and operating in the largest cannabis market in the world (California).

Mary, Mary, Quite Contrary, How Does Your Garden Grow? Keeping it Simple

- After almost two years of publicly traded cannabis companies both in Canada and the United States, the industry has proven itself to be long on promises and short on execution. The history of Indus is no exception. Historically, successful companies establish a core competency in one area before moving on to another. For Indus, prior to its recent re-capitalization, the company was clearly trying to do too many things and not doing any of them particularly well. The exception was its home grown flower brand Cypress, which is currently the #6 brand in California according to BDS data (out of 300 brands in the state). In the vein of KISS (Keeping It Simple Stupid), if Indus can grow more cannabis (thanks to the $4m investment for capacity expansion) that has the same attributes as its current crop (high THC, low retail price point), we believe it can sell significantly more. For reference, 45,000 lbs could generate $65 million in revenue and ~$21 million in EBITDA. This run-rate could be achieved by FY20 year-end. With a current EV of $40 million, the stock could be trading at 1.9x EBITDA. We believe this sets-up an excellent risk-return trade. **Buy**

Re-Setting Expectation

BUY (unch)	**C$2.50** (was C$5.00)
Recent/Closing Price (C$)	$0.60
12-month Target Price (C$)	$2.50
Potential Return	317%
52 Week Price Range (C$)	$0.24 - $14.45

Estimates

YE: Dec 31	FY19	FY20e	FY21e
Revenue (US$MM)	$37.0	$36.9	$76.7
Adj EBITDA (US$MM)	($36.0)	($5.4)	$21.0
Adj. EPS (US$)	($1.62)	($0.35)	$0.15

Valuation

	FY19	FY20e	FY21e
EV/Sales	1.1x	1.1x	0.5x
EV/EBITDA	n/a	-7.7x	1.9x
P/E	n/a	-1.3x	2.9x

Stock Data

Shares Outstanding (MM)		
	Basic	108.9
	FD	191.5
Market Cap (C$MM)		
	Basic	$65.4
	FD	$114.9
Net Cash (C$MM)		$9.8
EV (C$MM)		$55.6

About the Company

Indus Holdings, Inc. cultivates, extracts, manufactures, markets and distributes cannabis products. The firm's brands include Cypress and House Weed. The company operates in California.

All prices in US$ unless otherwise stated

Stock Performance

Tenets of Investment Thesis

How to Gain Market Share? Volume and Pricing

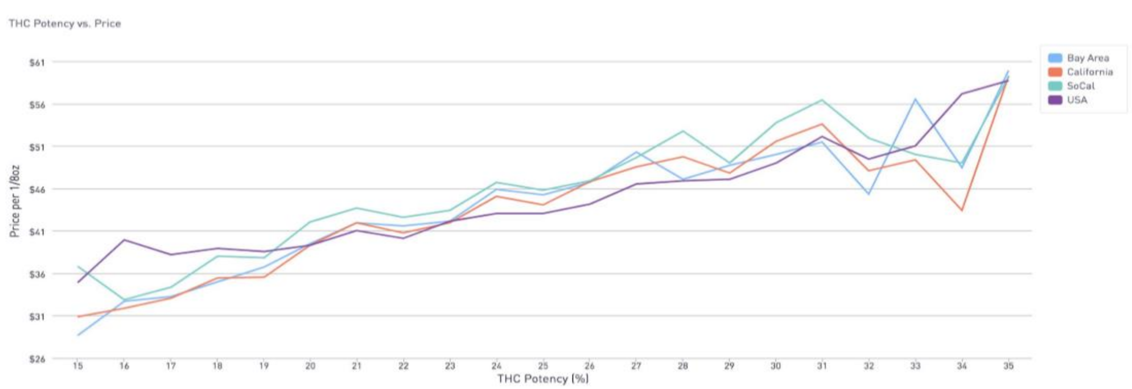
- Indus is not starting from a standing start. Its Cypress flower brand is already the #12 brand in California out of 214 in the state. If its House Weed brand is included, Indus is the #6 brand in California.
- Generally, to gain market share, the product needs to be on the retailers/dispensaries shelves. To get them interested in carrying the product, it needs to:
  - i) Make the retailer money. Management has indicated that the retail mark-up on its flower is 130%. In other words, selling Cypress is very profitable for the retailer.
  - ii) The product needs to have the attributes the consumer wants including high THC level and low price. Cypress is consistently in the mid-to-high 20%-level of THC and is priced at ~$7.25/gram. An excellent value proposition for the consumer
- To date, Cypress flower has sold very quickly. With the above attributes, more volume is better. The question is how quickly can more product come to market and what are the economics.

Volume *- Growing Production in Expanded Greenhouse*

- We believe the greenhouse, at least in the short-term, should be the focus of investors' attention;
- Currently, there are 18 active grow rooms (5,500 SF each) with 10 having been activated in 2020 and with the expectation that with the recent investment, it will reach up to 30 rooms (full capacity) by Q3/FY20;
- Six cycles per year at ~250 lbs per room per cycle would produce 45,000 lbs of flower. Such production represents a yield of ~93 grams/SF equivalent, which is in-line with other greenhouse producers we track;
- If the 30 grow rooms are operational by Q3/FY20, the company could be on that run-rate of 45,000 lbs by the end of this calendar year.

Pricing *– Good Value to Consumers is Great Value to Shareholders in Terms of EBITDA*

- We noted above that Cypress is priced as a "value" brand. Given its high THC level and value pricing, it is not surprising that it is a strong seller for the retailer.
- In fact, there is a clear relationship between pricing and THC level – the higher the level of THC, the higher the price/gram as demonstrated in the chart below.



Source: Indus Holdings

- If we draw a line up from 26-27% THC on the x-axis, the market pricing from the y-axis is ~$46 for an 1/8th oz or $13.15/gram. Therefore, Cypress' retail selling price of $7.25 is a 45%

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discount to the average pricing for similar levels of THC. Not only is it the cheapest brand for that level of THC, but is was the 3rd cheapest brand period, with the cheapest brand (Pacific Stone at $5.00/gram) being cultivated outdoors.

- Working backwards to arrive at Indus' selling price to the retailer, if we assume a 130% mark-up, that would imply its selling price of $3.15/gram or ~$1,450/lbs.
- If Indus can sell 45,000 lbs at $1,450/lbs, that would generate $65 million in revenue.
- Growing costs, including cultivation taxes, are estimated to be $500/lbs with an additional $150/lbs in packaging and distribution costs.
- That would leave $800/lbs of contribution profit or $36 million before corporate overhead.
- If we assume $15 million of corporate overhead (ie. G&A and sales and marketing),that would leave $21 million of EBITDA or a 32% margin.
- Such an analysis does not include the revenue potential from the trim that comes from the greenhouse flower.
- For the purposes of our model, our FY21 revenue includes a small contribution of such incremental revenue but it does not add to the $21 million EBITDA noted above.

Financial Model – Re-Setting Expectations

- Indus has pre-announced its Q1/FY20 EBITDA loss of ~$5 million. We anticipate its quarterly loss to narrow in Q2 with break-even in Q3 and EBITDA positive in Q4. Overall in FY20, we are modeling $37 million in revenue and an EBITDA loss of $5 million.
- As we noted above, we expect the greenhouse to be operating at its stated capacity by the end of FY20 and thus we forecast Indus to sell 45,000 lbs of flower in FY21 at $1,450/lbs generating EBITDA of $21 million.

Valuation and Share Price Potential

- Based on the current price of C$0.60, the company has a market cap of $40 million and trades at an EV/EBITDA of 1.9x.
- At 10-15x EBITDA, the stock could reach C$2.00 - C$3.00 based on a FD share count of 193 million, albeit we do not think 20x is out of the question if the scenario noted above proves out. At 20x, that would be a share price of ~C$3.50.
- Note that if one uses the FD share count, one must also consider the company would have ~$35 million in cash or ~C$0.25 per share predominantly from the exercise of the US$0.28 warrants (75 million) as well as FCF.

Maintain Buy Recommendation with C$2.50 Target Price

- Based on its new management, recent cash infusion, minimal cap-ex to complete the greenhouse to reach its capacity of 45,000 lbs, the value proposition that its Cypress brand offers both retailers and consumers and the current market cap, we believe the shares of Indus offer an excellent risk-return proposition as we potentially watch the "green shoots" turn into the giant California sequoia.
- We maintain our Buy recommendation with a C$2.50 target price (was C$5.00) based on 15x our FY21 EBITDA forecast of $21 million.

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As at April 30th, 2020	#Stocks	Distribution		
BUY	56	69.1%	BUY	Total 12-month return expected to be > 15%
Speculative Buy	8	9.9%	Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
Hold	4	4.9%	Hold	Total 12-month return is expected to be between 0% and 15%
Sell	0	0.0%	Sell	Total 12-month return is expected to be negative
Under Review	13	16.0%	Under Review	
Tender	0	0.0%	Tender	Clients are advised to tender their shares to a takeover bid or similar offer
Total	81	100%		

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