

Kiaro Holdings Corp.

(TSXV: KO)

BUY

Current Price: C\$0.10

Fair Value: C\$0.23

Risk*: 4

Record Revenue in Q2 / Expecting New Records in Q3

Sector/Industry: Cannabis

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Highlights

- Q2-2022 (quarter ended July 2021) performance was commendable, and inline with expectations.
- Retail sales continued to strengthen amid Kiaro's focus on providing a superior customer experience. **Same store sales grew 21% YoY.**
- The wholesale business also grew significantly (92% YoY), while the new e-commerce business started contributing towards the end of the quarter.
- Despite the strong revenue growth, EBITDA remained flat YoY, and was inline with expectations. **We expect the OPEX to revenue ratio to decline notably in Q3**, once revenue kicks in from the Hemisphere acquisition last month.
- Kiaro's store-count is currently 16 (across B.C., Ontario, Saskatchewan, and Ontario), up from seven at the start of the year, plus two under development.
- Raising \$3M by issuing 8% unsecured debentures.
- We are **maintaining our FY2022E forecasts** as the company is on track to meet our forecasts.
- Kiaro's forward EV/Revenue is 0.6x (unchanged) vs the cannabis retail sector average of 2.2x (previously 2.3x). **We believe Q3 results will be the next major catalyst.**

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Head of Research

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Equity Analyst

KO Price and Volume



	YTD	12M
KO	27%	6%
TSXV	-2%	22%

Company Data

52-Week Range	\$0.06 - \$0.20
Shares O/S	262M
Market Cap.	\$25M
Current Yield	N/A
P/E (forward)	N/A
P/B	1.7x

Key Financial Data YE Jan 31	2020 (13 Months)	2021 (12 Months)	2022E (12 Months)	2023E (12 Months)
Cash	\$1,418,764	\$1,304,829	\$4,307,363	\$5,315,930
Working Capital	\$2,815,847	\$1,108,870	\$4,189,915	\$5,537,286
Total Assets	\$13,992,304	\$9,665,317	\$21,041,072	\$21,818,012
Revenue	\$5,171,836	\$17,071,866	\$29,227,074	\$46,069,882
Net Income	-\$12,503,250	-\$9,337,037	-\$2,646,971	\$1,077,524
EPS	-\$0.25	-\$0.08	-\$0.01	\$0.00

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

Financials

STATEMENTS OF OPERATIONS						
YE January 31, \$	Q1-2021	Q1-2022	YoY%	Q2-2021	Q2-2022	YoY%
Revenue	\$ 2,666,711	\$ 5,167,064	94%	\$ 4,000,102	\$ 6,190,179	55%
Gross Profit	\$ 715,285	\$ 1,557,661	118%	\$ 1,236,246	\$ 1,675,914	36%
Expenses	\$ 1,605,383	\$ 1,923,610	20%	\$ 1,616,831	\$ 2,047,740	27%
EBITDA	\$ -890,098	\$ -365,949		\$ -380,585	\$ -371,826	
Net Loss	\$ -3,810,831	\$ -979,921		\$ -1,443,805	\$ -1,063,598	
EPS	\$ -0.04	\$ -0.01		\$ -0.02	\$ -0.01	

Revenue surged 55% YoY in Q2-2022

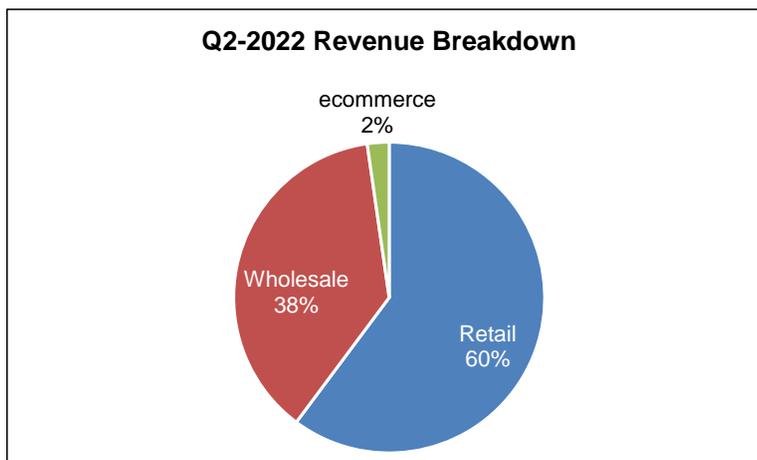
Same-store sales grew 21%

Wholesale revenue increased 92% as the company expanded its distribution network

YE January 31, \$	H1-2021	H1-2022	YoY%
Revenue	\$ 6,666,813	\$ 11,357,243	70%
Gross Profit	\$ 1,951,531	\$ 3,233,575	66%
Expenses	\$ 3,222,214	\$ 3,971,350	23%
EBITDA	\$ -1,270,683	\$ -737,775	
Net Loss	\$ -5,254,636	\$ -2,043,519	
EPS	\$ -0.05	\$ -0.01	

Segment (\$M)	Q2-2021	Q2-2022	YoY%
Retail	\$ 2.79	\$ 3.72	33%
Wholesale	\$ 1.21	\$ 2.32	92%
ecommerce	\$ -	\$ 0.14	
	\$ 4.00	\$ 6.18	55%

Wholesale's contribution increased from 26% in Q1, to 38% in Q2



Source: Company Filings, FRC

Gross margins declined QoQ due to increased revenue contribution from wholesale; we expect margins to increase in Q3 as revenue kicks in from Hemisphere

Margins	Q1-2021	Q1-2022	Q2-2021	Q2-2022	H1-2021	H1-2022
Gross	27%	30%	31%	27%	29%	28%
EBITDA	-33%	-7%	-10%	-6%	-19%	-6%
Net	-143%	-19%	-36%	-17%	-79%	-18%
SGA Expenses	60%	37%	40%	33%	48%	35%

Source: FRC

FCF declined due to store acquisitions but rose excluding acquisitions which we feel is more important

Stable balance sheet at the end of Q2; raising \$3M through a debenture financing to fund marketing expenses and store acquisitions

Maintaining projections as Kiara is on track to meet our FY2022 forecasts

DCF valuation unchanged at \$0.22 per share

Summary of Cash Flows (\$)	Q1-2021		Q1-2022		H1-2021		H1-2022	
Operating	\$	-412,210	\$	-301,123	\$	-787,285	\$	354,355
Investing	\$	539,876	\$	-812,106	\$	207,358	\$	-1,580,933
Financing	\$	-281,445	\$	2,409,687	\$	153,571	\$	2,137,610
Net	\$	1,264,985	\$	2,601,287	\$	992,408	\$	2,215,861
Free Cash Flows to Firm (FCF)	\$	127,666	\$	-1,113,229	\$	-579,927	\$	-1,226,578

Source: Company Filings, FRC

Liquidity and Capital Structure	Q1-2022		Q2-2022	
Cash	\$	2,601,287	\$	2,215,861
Working Capital	\$	2,626,453	\$	935,669
Current Ratio		2.19		1.24
Total Debt	\$	765,493	\$	756,220
Total Debt / Capital		11.5%		11.3%

Source: Company Filings, FRC

Stock Options and Warrants

10.9M options (weighted average exercise price of \$0.20), and 23.82M warrants (\$0.25) outstanding. None of the options/warrants are in-the-money.

FRC Projections and Valuation

STATEMENTS OF OPERATIONS (\$)	YE Jan 31		
	2021	2022E	2023E
Revenue	17,071,866	29,227,074	46,069,882
Total Revenues	17,071,866	29,227,074	46,069,882
COGS	11,957,658	20,416,292	32,248,917
Gross Profit before FV adjustments	5,114,208	8,810,782	13,820,965
FV adjustments	27,094		
Gross Profit	5,087,114	8,810,782	13,820,965
SG&A	5,840,370	8,275,480	10,135,374
Share-based compensation	1,135,961	730,677	1,151,747
EBITDA	(1,889,217)	(195,375)	2,533,843
Depreciation			
Amortization			
D&A	1,866,786	2,392,053	1,193,777
EBIT	(3,756,003)	(2,587,428)	1,340,066
Net financing expense	1,416,010	59,543	49,619
EBT	(5,172,013)	(2,646,971)	1,290,448
Income tax expense		-	212,924
Unusual/Non-recurring expense	4,165,024		
Non-controlling interest			
Net Income / (Net Loss)	(9,337,037)	(2,646,971)	1,077,524
EPS	(0.08)	(0.01)	0.00

Source: FRC

Kiario is trading at just 0.6x forward revenue (unchanged) vs the retailers' sector average of 2.2x (previously 2.3x)

Kiario's forward EV/EBITDA is 11.6x (unchanged) vs the sector average of 16.7x (previously 15.9x)

Fair value unchanged at \$0.23 per share

Maintaining our risk rating of 4

Comparable Companies	EV/Rev	EV/EBITDA
Kiario (based on PV of 2023E)	0.6x	11.6x
Nextleaf Solutions Ltd.	13.1x	NM
Adastra Holdings	18.7x	NM
The Valens Company	5.6x	NM
Nutritional High International Inc.	3.6x	NM
Radiant Technologies Inc.	11.8x	NM
Ayurcann	3.7x	13.9x
High Tide	2.6x	38.0x
Choom Holdings	2.6x	NM
Neptune	2.4x	NM
MediPharm Labs	1.2x	NM
Fire & Flower	1.9x	21.7x
Nova Cannabis	3.2x	NM
Delta 9	1.3x	57.6x
Average Market Multiples (retailers)	2.2x	16.7x
Average Market Multiples (excluding outliers)	3.4x	15.7x
Median Market Multiples	2.9x	21.7x
Kiario's Premium/(Discount) to Retailers	-71%	-30%

Valuation Method	Fair Value per share (\$)	Weight
DCF Valuation	\$0.22	50.0%
Fair value per share (\$) - Average EV/R Multiple (2023E)	\$0.34	25.0%
Fair value per share (\$) - Average EV/EBITDA Multiple (2023E)	\$0.14	25.0%
Fair Value Estimate (\$)		\$0.23
Current Price (\$)		\$0.10

Source: FRC / S&P Capital IQ

We are maintaining our BUY rating, and fair value estimate of \$0.23 per share. We expect consolidation in the retail sector due to potential synergies. Inner Spirit Holdings was acquired earlier this year for 2.7x revenue by Sundial Growers (NASDAQ: SNDL). **Kiario's high revenue per store, and favorable customer reviews, make them an attractive M&A candidate.**

Risks

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

- **Yet to generate profits.**
- Store expansion may not be successful.
- **Cannabis retailers' margins are shrinking due to rising competition.**
- Future store acquisitions have to be very selective, with heavy customer traffic taken into consideration.

Appendix

Income Statement (YE January 31, \$)	2020	2021	2022E	2023E
Total Revenue	5,171,836	17,071,866	29,227,074	46,069,882
Cost of goods sold	3,829,871	11,957,658	20,416,292	32,248,917
Fair value adjustments	2,408,198	27,094	0	0
Gross Profit	-1,066,233	5,087,114	8,810,782	13,820,965
SG&A expense	6,940,737	5,840,370	8,275,480	10,135,374
Research & development	798,174	1,135,961	730,677	1,151,747
EBIT	-10,793,480	-3,756,003	-2,587,428	1,340,066
Depreciation and amortization	1,988,336	1,866,786	2,392,053	1,193,777
EBITDA (calculated)	-8,805,144	-1,889,217	-195,375	2,533,843
Net financing expense	1,257,395	1,416,010	59,543	49,619
EBT	-12,050,875	-5,172,013	-2,646,971	1,290,448
Provision for income taxes	0	0	0	212,924
Non-recurring expense	452,375	4,165,024	0	0
Net Income	-12,503,250	-9,337,037	-2,646,971	1,077,524

BALANCE SHEET (\$)	2020	2021	2022E	2023E
YE Jan 31				
Assets				
Cash	1,418,764	1,304,829	4,307,363	5,315,930
Receivables	162,460	142,083	240,223	378,657
Inventories	841,829	1,744,244	1,398,376	2,208,830
Investment in Marketable Securities	2,986,518	-		
Prepays and other current assets	207,912	181,454	185,083	188,785
Loan Receivable	297,382			
Net Investment in Finance Lease	130,483	156,915	160,053	163,254
Current Assets	6,045,348	3,529,525	6,291,098	8,255,456
Property and equipment	1,749,072	1,597,630	9,510,577	8,316,800
Right of use assets	4,944,646	3,617,822	3,617,822	3,617,822
Investments and Lease Deposits	644,650	311,752	317,987	324,347
Intangibles and Goodwill	608,588	608,588	1,303,588	1,303,588
Total Assets	13,992,304	9,665,317	21,041,072	21,818,012
Liabilities & Shareholders' Equity				
Payables and accrued liabilities	1,462,426	1,325,421	1,064,564	1,681,551
Due to shareholders	18,861	147,817	119,049	119,049
Current portion of loan from related parties			-	-
Current portion of purchase liabilities	370,180	103,230		
Current portion of lease liabilities	683,979	723,904	793,523	793,523
Current portion of borrowings	694,055	120,283	124,047	124,047
Current Liabilities	3,229,501	2,420,655	2,101,183	2,718,170
Loan from related parties				
Long term portion of purchase liabilities	103,230			
Lease liabilities	2,487,121	1,587,046	1,624,244	830,721
Borrowings	5,836,712	620,236	3,620,236	3,496,189
Embedded Derivative Liabilities	1,285,000	208,386	208,386	208,386
Total Liabilities	12,941,564	4,836,323	7,554,049	7,253,466
Share Capital	14,987,041	26,386,873	37,691,873	37,691,873
Reserves	1,186,081	2,901,540	2,901,540	2,901,540
Deficit and AOCI	(15,122,382)	(24,459,419)	(27,106,390)	(26,028,866)
Total Liabilities and Shareholder's Equity	13,992,304	9,665,317	21,041,072	21,818,012

Cash Flow (YE January 31, \$)	2020	2021	2022E	2023E
Net income	-12,503,250	-9,337,037	-2,646,971	1,077,524
Depreciation, amortization, and other	7,456,352	8,550,720	2,392,053	1,193,777
Changes in operating assets and liabilities:				
Receivables	-124,847	40,920	-98,140	-138,434
Inventories	-894,769	-921,602	345,868	-810,454
Prepays and other current assets	-155,887	60,019	-3,629	-3,702
Net investment in finance lease	0	0	-3,138	-3,201
Payables and accrued liabilities	410,526	63,245	-260,857	616,987
Due from directors and officers	-219,276	128,955	-28,768	0
Current portion of purchase liabilities	0	0	-103,230	0
Current portion of lease liabilities	0	0	69,619	0
Net cash from operations	-984,253	-628,463	-82,275	-338,804
Investing				
Additions to property and equipment	-1,306,321	-636,491	-1,500,000	0
Right of use assets	0	0	0	0
Investments and others	-2,028,017	2,440,189	-6,235	-6,360
Intangibles and goodwill	0	0	-695,000	0
Net cash used in investing	-3,334,338	1,803,698	-2,201,235	-6,360
Financing				
Proceeds from equity issue	0	0	2,500,000	0
Debt	6,051,500	585,000	3,003,764	-124,047
Lease liabilities	-1,479,766	-900,839	37,198	-793,523
Others	109,165	-187,014	0	0
Net cash from (used in) financing	4,680,899	-502,853	5,540,962	-917,570
Net change in cash and cash equivalents	-4,684,590	-113,935	3,002,534	1,008,567
Cash and cash equivalents, beginning of period	6,103,354	1,418,764	1,304,829	4,307,363
Cash and cash equivalents, end of period	1,418,764	1,304,829	4,307,363	5,315,930

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.

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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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