

Harborside Inc. (US OTCQX: HBORF: \$0.55): Q3 Results Reflect Execution on Turn-Over; Acquisitions Allow Scaling in CA

Harborside reported Q3/21 earnings results of \$17.9M in revenues and \$1.5M adjusted EBITDA. Revenues came in above our estimate of \$17.3M while adjusted EBITDA was below our \$2.9M forecast as California pricing pressure hindered results particularly in the wholesale channel. With that said, Q3 results reflected continued execution of Harborside's turn-around under new management with the company now having reported seven consecutive quarters of positive adjusted EBITDA results despite challenging conditions after having historically been challenged to do so.

In addition to earnings, management announced two transformative acquisitions (Urbn Leaf and Loudpack) which upon completion and in connection with other recently completed transactions (Sublime brand and cultivation and production assets in Selina, CA in particular) position Harborside to grow revenue capabilities by ~3x and be a top operator in California by just about any measure. With transactions set to close in March, Harborside will change its name to StateHouse Holdings and Urbn Leaf's CEO Ed Schmult's will become the company's CEO with current Harborside Interim CEO Matthew Hawkins retaining his Chairman position. We are confident that the new company is far from done in expanding through near term M&A. Despite challenging market conditions, we remain confident that California is a worthwhile and attractive market for operators based on sheer size and the view that headwinds will eventually subside. We are positive on Harborside's goal to consolidate the market and ultimately, we believe the initiative can translate to outperforming growth and margin expansion.

Additionally, scaled operations make Harborside a more likely takeout candidate in its own right as the acquisitions permit Harborside to be a greater plug-and-play contributor to any MSO looking to enter or expand in California with a meaningful splash. For now, our 2022 forecast is unchanged as we await further color on timing on acquisitions while our Q4 estimate is reduced to reflect lingering pricing pressure. Our price target remains \$1.15 and our rating at Buy.

Announced Acquisitions and Financings Position Harborside to be a Leader in CA

We launched coverage on Harborside in October on the premise that the company would be a consolidator of the fragmented California cannabis market. With its announced acquisitions, Harborside is doing just that. Urbn Leaf owns seven dispensaries with four in Southern California, an area that Harborside had yet to enter. Following the completion of the transaction and Harborside's planned opening of a San Francisco dispensary in the coming months the company will have fifteen dispensaries in California. Loudpack is a leading branded products manufacturer in California and the acquisition furthers Harborside's portfolio of branded products. As we have previously mentioned, in a state with competitive pricing like California branded products are a key differentiator enabling enhanced demand and pricing in both retail and wholesale channels. Furthermore, we expect Harborside to begin licensing brands acquired in the Loudpack transaction and its Sublime brands to operators in other markets as an additional source of revenues.

To fund the acquisitions, Harborside will issue 151.4M subordinate voting shares of stock (\$83M value based on today's close) and 2M in warrants at a strike price of \$2.50. According to management, the combined company on a proforma basis would have generated \$165M through the first nine months of this year with \$58M coming from Harborside, \$61M from Loudpack and \$49M from Urbn Leaf. This compares with \$60M in reported revenues for Harborside in 2020.

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Harborside

Rating: Buy

Price Target: \$1.15

Investment Highlights

- Q3 results impacted by CA pricing but reflect execution.
- Urbn Leaf acquisition expands retail presence particularly in Southern CA. Loudpack enhances production capabilities and brand portfolio.
- Deals follow acquisitions of Sublime brands and cultivation assets in recent months.
- Acquisitions position Harborside to be a CA leader in scale. Longer term likely make Harborside a more viable takeout by MSO.
- Company to rename StateHouse Holdings with Urbn Leaf CEO becoming CEO of consolidated entity.
- Also announced \$55M debt facility and \$10M private placement. Proceeds to fund additional expansion.

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In addition to the acquisitions, Harborside announced a \$77M non-dilutive real estate debt financing (10.25% interest rate) of which we expect ~\$38M will be used to refinance existing debt. The remainder will be used to fund further acquisitions and capital investment needs. The company also announced a \$10M private placement investment to provide additional capital. As previously mentioned, we are confident that additional M&A is forthcoming with Harborside looking to acquire other retailers or producers in the state.

California Consolidation Likely; Harborside a Takeout Candidate

As reflected in the *Viridian Capital Cannabis Deal Tracker*, there has been a meaningful uptick in M&A activity this year and particularly with larger transactions. Acquisition targets increasingly are becoming either established public operators or leading private companies. This is a change from prior year acquisitions as historically cannabis acquisitions have taken the form of licenses and under-developed assets.

We are confident that the trend of larger scale M&A will continue and even accelerate in the near term with the motivation for acquirers being a need to make acquisitions that can immediately contribute to reported results in-order to differentiate from peers and excite investors (at a time when valuations are very much deflated).

Accordingly, we believe that several large and mature markets which have largely been devoid of MSO participation historically are ripe for consolidation. We have highlighted on-going consolidation in Colorado and Michigan as a result of recent M&A and note that a similar dynamic played out in Florida in late 2020 and earlier this year. We are confident that California is a next market to consolidate.

California is the world's largest cannabis market with sales projected to be nearly \$4.5B this year. Despite its size, due to a combination of factors including limited regulatory transparency, high taxes and the large established black market, MSOs and other large operators have mostly avoided California to date.

Of the twelve largest MSOs, only Cresco, Columbia Care, Planet 13, Terrascend and Trulieve (including Harvest assets) have California operations of any scale today and at that not one has an established leadership position or even a position commensurate to Harborside's in scale.

Many of the challenges of the past are finally waning and at some point, the sheer scale of sales in California will motivate entry.

Furthermore, the belief that eventually interstate sales could come and the understanding that California is where the best cannabis is produced should make cultivation and production assets in the state attractive to potential acquirers. As such, the acquisition of an established California operator can meaningfully impact near term results and thus excite investors with both near and long-term potential.

As MSOs enter the market, they will do so by acquiring existing operators in the state which can provide immediate "plug and play" contributions. We believe Harborside of any operator in California, makes for an attractive takeout partner particularly upon completion of the Urbn Leaf and Loudpack acquisitions. The company has sizable existing revenues and profitable results which will scale in the near term, a portfolio of leading brands to leverage and be sold in additional markets, vertical integration, a name that investors will recognize and a valuation well below that of each of the most likely acquirers.

We believe an acquisition price would likely offer significant upside for the stock from current levels.

Largest MSOs Exposure to CA

Curaleaf	Small Manufacturing and Production
Green Thumb	1 Dispensary
Trulieve	5 Dispensaries (following Harvest Acquisition)
Verano	1 Dispensary
Cresco	Cultivation and Production
Ascend	Nothing
Terrascend	5 Dispensaries
AYR	Nothing
Columbia Care	6 Dispensaries
Jushi	2 Dispensaries
Planet 13	1 Dispensary
4Front	Manufacturing and Production

Source: Company Reports

Significant upside in Price Target

Harborside's stock was down meaningfully following the acquisition news and earnings report. Our \$1.15 price target reflects >100% upside from current levels and represents an EV/EBITDA multiple of 5.0x our 2022 estimate before considering dilution from the outstanding transactions. This valuation level represents a significant discount to the valuations of the broader peer group.

We plan to factor in dilution from outstanding transactions and the financings as we gain better clarity on timing of the transactions and scale of contributions. With that said, in adding all the additional shares and no contributions from the acquired assets, our price target would reflect an EV/EBITDA multiple of 11.2x our 2022 estimate. While this valuation is above that of the broader peer group (8.3x) it remains significantly below the multiples of many of the largest MSOs or the companies that would be most likely to acquire Harborside.

FY Income Statement (\$M)

	2020	2021					2022				
	2020 Dec-20	Q1 '21 Mar-21	Q2 '21 Jun-21	Q3 '21 Sep-21	Q4 '21E Dec-21	2021 Dec-21	Q1 '22E Mar-22	Q2 '22E Jun-22	Q3 '22E Sep-22	Q4 '22E Dec-22	2022 Dec-22
Revenues	60.0	12.4	15.4	17.4	21.6	66.8	23.2	26.1	29.5	30.4	109.2
COGS	31.9	6.6	8.4	9.0	11.9	35.8	11.8	11.8	13.0	13.4	49.9
Gross Profit	29.6	4.6	8.7	6.8	9.7	29.8	11.4	14.4	16.5	17.0	59.2
G&A	18.2	4.3	5.4	6.5	6.3	22.5	6.2	6.1	6.2	6.2	24.7
D&A	1.0	0.2	0.2	0.7	0.3	1.4	0.3	0.3	0.3	0.3	1.0
Opex	33.3	7.8	9.0	11.1	10.1	38.0	10.2	10.1	10.2	10.3	40.6
Operating Income	(3.7)	(3.2)	(0.3)	(4.3)	(0.4)	(8.2)	1.2	4.3	6.3	6.8	18.6
Interest	(4.7)	(0.9)	(0.9)	(0.7)	(0.9)	(3.4)	(0.9)	(1.0)	(1.0)	(1.0)	(3.9)
Other Income	(2.1)	1.4	3.6	8.8	(0.9)	12.9	(0.9)	(1.0)	(1.0)	(1.0)	(3.9)
Pre-tax Income	(5.8)	(1.8)	3.3	4.5	0.5	6.5	2.1	5.3	7.3	7.8	22.5
Taxes	6.1	1.1	1.7	1.8	1.8	6.4	2.0	2.0	2.0	2.0	8.0
Net Income	(11.95)	(2.9)	1.8	2.7	(1.3)	0.3	0.1	3.3	5.3	5.8	14.5
EPS	(0.3)	(0.1)	0.0	0.0	(0.0)	(0.0)	0.0	0.0	0.1	0.1	0.2
Shares	42.5	51.0	61.5	81.4	81.8	68.9	82.2	82.6	83.0	83.5	82.8
Adjusted EBITDA	7.4	0.96	1.1	1.5	1.9	5.5	3.5	6.8	8.8	9.2	28.2
% Revenues											
Gross Margin	49%	37%	57%	39%	45%	45%	49%	55%	56%	56%	54%
Opex	56%	63%	59%	64%	47%	57%	44%	38%	34%	34%	37%
Operating Income	-107%	-621%	-37%	-986%	-35%	-281%	99%	314%	409%	423%	325%
Net Income	-20%	-23%	11%	16%	-6%	0%	0%	13%	18%	19%	13%
Adjusted EBITDA	12%	8%	7%	9%	9%	8%	15%	26%	30%	30%	26%
Growth Rates											
Revenues											
Y/Y		-9%	0%	-5%	146%	11%	136%	63%	253%	41%	96%
Q/Q		12%	63%	-48%	158%		7%	13%	13%	3%	

Source: Company Reports, Viridian Capital Estimates

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			IB Services in Past 12 months	
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Buy (Buy)	11	92%	0	0%
Hold (Hold)	1	8%	0	0%
Sell (Sell)	0	0%	0	0%
Not Rated (NR)	0	0%	0	0%

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