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Earnings Review, Price Target Change

Cannabis

Flora Growth Corp. (FLGC, Buy, $11.50)

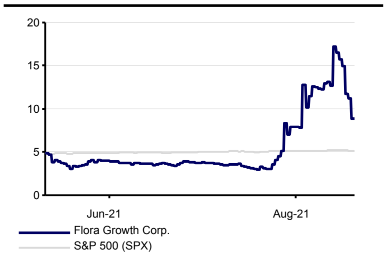
Stage is Set for Multi-Faceted Growth and Quick Profitability

August 20, 2021

Key Data

Rating	Buy
12-Mo Price Target	$11.50
	Prior $6.00
Current Price	$8.81
52-Wk Range	$21.45 - $2.85
Avg. Vol. (3m)	3,245
Shares Out (mn)	42.0
Market Cap (mn)	$370.2
Enterprise Value (mn)	$963.6
Fiscal Year End	Dec.

Price Performance



Source: Factset

1H21 Recap: Flora reported 1H21 revenue of $2mn with a 60% gross margin, generating a net loss of -$4mn (-$1mn adjusted for one-time expenses). Flora guided to 2H21 revenue of $9mn-$11mn exclusive of announced M&A (Heimat and Vessel with combined trailing 12 mo revenue of $14mn) and exclusive of dried flower shipments. This organic guidance is a sharp acceleration led by Kasa Wholefoods/Tropi and Flora Lab/Flora Beauty. Importantly, these organic numbers ($9mn-$11mn) were above our initial estimates ($7.6mn in 2H). When we launched on Flora, our numbers did not include any changes to Colombian legislation, nor did they include contributions from M&A. The deals, which could close shortly, and shipments of dried CBD flower provide further upside to guidance (and our former numbers), setting the stage for run-rate annual revenue of >$40mn as Flora exits 2021. Importantly, it will take very little revenue growth for Flora to become profitable. At a 60% gross margin, Flora would need to generate just another $2mn in organic revenue to become profitable (assuming organic revenue doesn't carry much additional SG&A). We are raising our 2H21 and FY22 estimates for better than expected organic growth (2H21 and FY22) and legislative changes (FY22 forward). We are now modeling $12mn (from $7.6mn) in 2H21 net sales and +$1.8mn in adjusted EBITDA (from $0.7mn). With the higher estimates (incl. legislative changes) our price target is now $11.50 (from $6).

Colombian Legislative Changes: Colombia has replaced the existing quota system and declared the sector a National Project of Interest. Colombian growers now have the ability to: 1) export dry flower; 2) increase uses in Food & Bev and nutraceuticals; 3) increase maximum THC in non-psychoactive exports to 1% (from 0.2%); 4) make cannabinoid-infused derivatives available to medical and industrial sales channels; 5) distribute into the medical cannabis market domestically via pharmacies; 6) receive research grants from the government; and 7) receive incentives from hiring younger employees. This new legislation opens the door for Colombia to become the low-cost cannabis producer the global market so desperately needs. While we expect this legislation to be good for the entire group, it gives Flora's outdoor prowess the opportunity to shine. Flora, with outdoor operations in very favorable Colombia, will have dominant cost advantages over international peers. Given Flora's cost advantages, we believe inefficient growers (like Canadians) would be better-served sourcing from Flora, rather than trying to compete against Flora. While protectionist measures will always limit the true market potential, most agricultural categories eventually evolve into a competitive global sourcing marketplace.

Cost Leadership in Colombia and at Flora: Flora, with one of the world's largest outdoor operations, should be able to grow for as little as $0.20/gram (conservatively and including packaging and transport). This allows Flora to deliver strong margins AND offer product at below-market prices. Flora can offer the market $1.00/gram at ~80% margin, which puts Canadians at a negative gross margin to compete. Instead, we believe the Canadian growers, with some strong European distribution arrangements, should source product from Colombia/Flora. As a group, Canadian LPs have ~35% gross margins, but if they purchase product from Flora (even at $0.50/gram) this may take their gross margins toward 80%. Flora is bringing on 49 acres of 247 in 2021, with the first commercial output beginning shortly. **Valuation:** Our $11.50 price target is DCF-derived based on 1) net sales reaching $69.4mn in 2023; 2) adjusted EBITDA of $25mn (35% margin); 3) strong double-digit growth through 2028; 4) 3% terminal growth; 5) 8% WACC (lowered to reflect cash from warrants).

Revenue (mn)	Q1	Q2	Q3	Q4	Year	Mult
2020A	—	—	—	—	0.1	3,492.7
2021E	1.0E	1.0E	6.0E	6.0E	14.0E	26.4
MKM Prior (E)	*1.1E*	*1.3E*	*3.8E*	*3.8E*	*10.0E*	*12.8*
2022E	8.3E	8.3E	11.5E	11.5E	39.6E	9.3
MKM Prior (E)	*5.9E*	*5.9E*	*8.9E*	*8.9E*	*29.6E*	*4.3*

EBITDA (mn)	Q1	Q2	Q3	Q4	Year	Mult
2020A	—	—	—	—	(9.2)	NM
2021E	0.0E	0.0E	0.9E	0.9E	1.9E	507.2x
MKM Prior (E)	*0.7E*	*0.8E*	*0.4E*	*0.4E*	*2.2E*	*437.0x*
2022E	1.3E	1.4E	3.2E	3.2E	9.0E	107.1x
MKM Prior (E)	*1.4E*	*1.5E*	*1.8E*	*1.9E*	*6.7E*	*144.2x*

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See pages 3-5 for analyst certification and important disclosures.

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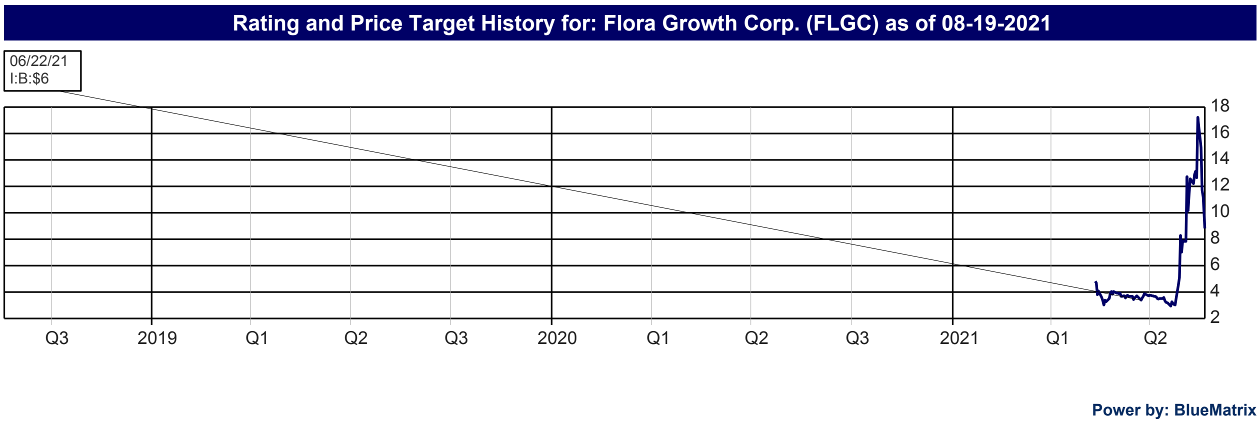
Flora Corporation		2021e					2022e					2023e				
Income Statement ($ 000's)	**2020**	**1Q'21**	**2Q'21**	**3Q'21**	**4Q'21**	**2021e**	**1Q'22**	**2Q'22**	**3Q'22**	**4Q'22**	**2022e**	**1Q'23**	**2Q'23**	**3Q'23**	**4Q'23**	**2023e**
Kilograms Sold	0	0	250	2,250	2,250	4,750	4,500	4,500	6,750	6,750	22,500	10,250	11,250	12,250	10,000	43,750
% Change								*400%*	*150%*	*150%*	*257%*	*100%*	*100%*	*33%*	*33%*	*60%*
$/Gram	0.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
% Change Price / Mix							*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Revenue	106	1,000	1,000	6,000	6,000	14,000	8,290	8,290	11,490	11,490	39,560	16,023	17,023	19,298	17,048	69,392
% Change						*13107.5%*	*729.0%*	*729.0%*	*91.5%*	*91.5%*	*182.6%*	*93.3%*	*105.3%*	*68.0%*	*48.4%*	*75.4%*
COGS	-35	0	(50)	(450)	(450)	-950	(900)	(900)	(1,350)	(1,350)	-4,500	(1,845)	(2,025)	2,205	(1,800)	-3,465
Adjustments	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross Profit (Reported)	71	633	583	4,238	4,238	9,690	6,064	6,064	8,481	8,481	29,089	12,157	12,977	19,036	12,781	56,952
Gross Profit (Adjusted)	71	633	583	4,238	4,238	9,690	6,064	6,064	8,481	8,481	29,089	12,157	12,977	19,036	12,781	56,952
Margin	*67.0%*	*63.3%*	*58.3%*	*70.6%*	*70.6%*	*69.2%*	*73.1%*	*73.1%*	*73.8%*	*73.8%*	*73.5%*	*75.9%*	*76.2%*	*98.6%*	*75.0%*	*82.1%*
Selling & Marketing	0	(170)	(170)	(780)	(780)	-1,900	(912)	(812)	(689)	(689)	-3,103	(801)	(851)	(965)	(852)	-3,470
General & Administrative	-12,486	(800)	(800)	(3,600)	(3,600)	-8,800	(4,974)	(4,974)	(5,745)	(5,745)	-21,438	(7,691)	(8,171)	(9,263)	(8,183)	-33,308
Other	-1,816	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Adjustments	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Operating Income (Reported)	-14,231	-338	-388	-143	-143	-1,010	178	277	2,047	2,047	4,548	3,665	3,955	8,808	3,746	20,175
Margin	*-13425.5%*	*-33.8%*	*-38.8%*	*-2.4%*	*-2.4%*	*-7.2%*	*2.1%*	*3.3%*	*17.8%*	*17.8%*	*11.5%*	*22.9%*	*23.2%*	*45.6%*	*22.0%*	*29.1%*
% Change						*-92.9%*	*-106.3%*	*-108.6%*	*-850.0%*	*-850.0%*	*-259.4%*	*967.8%*	*595.2%*	*156.3%*	*23.4%*	*152.9%*
Operating Income (Adjusted)	-14,231	-338	-388	-143	-143	-1,010	178	277	2,047	2,047	4,548	3,665	3,955	8,808	3,746	20,175
Margin	*-13425.5%*	*-33.8%*	*-38.8%*	*-2.4%*	*-2.4%*	*-7.2%*	*2.1%*	*3.3%*	*17.8%*	*17.8%*	*11.5%*	*22.9%*	*23.2%*	*45.6%*	*22.0%*	*29.1%*
% Change						*-92.9%*	*-106.3%*	*-108.6%*	*-850.0%*	*-850.0%*	*-259.4%*	*967.8%*	*595.2%*	*156.3%*	*23.4%*	*152.9%*
Finance Costs	-30	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Income (expense)	-73	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
FX	-16	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Adjustments	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Pre-Tax (Reported)	-14,350	-338	-388	-143	-143	-1,010	178	277	2,047	2,047	4,548	3,665	3,955	8,808	3,746	20,175
Pre-Tax (Adjusted)	-14,350	-338	-388	-143	-143	-1,010	178	277	2,047	2,047	4,548	3,665	3,955	8,808	3,746	20,175
Provision for Income Taxes	0.0	95	109	40	40	282.8	-50	-78	-573	-573	(1273.4)	-1,026	-1,107	-2,466	-1,049	(5648.9)
Tax Rate	*0.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*
Minority Interest	-164	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net Income (Adjusted)	-14,186	-243	-279	-103	-103	-1,293	128	199	1,474	1,474	3,274	2,639	2,848	6,342	2,697	14,526
% Change						*-90.9%*	*-152.6%*	*-171.5%*	*-1536.2%*	*-1536.2%*	*-353.3%*	*1963.8%*	*1327.5%*	*330.4%*	*83.0%*	*343.6%*
EPS (Adjusted)	**-0.16**	**0.00**	**-0.01**	**0.00**	**0.00**	**-0.02**	**0.00**	**0.00**	**0.03**	**0.03**	**0.06**	**0.05**	**0.05**	**0.12**	**0.05**	**0.27**
% Change						*-85.0%*	*-152.6%*	*-171.5%*	*-1536.2%*	*-1536.2%*	*-353.3%*	*1963.8%*	*1327.5%*	*330.4%*	*83.0%*	*343.6%*
Fully Diluted Shares Outstanding	89,704	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400	54,400
EBITDA (Adjusted)	**-9,217**	**43**	**-8**	**938**	**938**	**1,910**	**1,298**	**1,397**	**3,167**	**3,167**	**9,028**	**4,845**	**5,135**	**9,988**	**4,926**	**24,895**
EBITDA margin	-8695.3%	4.3%	-0.8%	15.6%	15.6%	13.6%	15.7%	16.9%	27.6%	27.6%	22.8%	30.2%	30.2%	51.8%	28.9%	35.9%
% Change						-120.7%	268.3%	-2347.0%	76.4%	76.4%	67.3%	93.2%	79.0%	87.8%	4.8%	57.2%
Balance Sheet	**2020**	**1Q'21**	**2Q'21**	**3Q'21**	**4Q'21**	**2021**	**1Q'22**	**2Q'22**	**3Q'22**	**4Q'22**	**2022**	**1Q'23**	**2Q'23**	**3Q'23**	**4Q'23**	**2023**
Cash & Equivalents	15,523	12,297	11,098	4,520	6,830	6,830	451	20	7,308	15,301	15,301	15,154	16,943	21,602	25,966	25,966
Inventory	540	1,111	1,111	6,667	6,667	6,667	9,211	9,211	12,767	12,384	12,384	17,269	18,347	20,799	17,806	17,806
Goodwill/Intangibles	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089
Net PP&E	411	1,331	2,251	3,171	4,091	4,091	4,721	5,351	5,981	6,611	6,611	7,181	7,751	8,321	8,891	8,891
Total Assets	19,452	17,906	17,627	23,080	22,977	22,977	25,650	25,849	40,878	42,352	42,352	50,028	53,986	62,856	63,053	63,053
Short Term Debt	251	251	251	251	251	251	251	251	251	251	251	251	251	251	251	251
Accounts Payable	2,414	1,111	1,111	6,667	6,667	6,667	9,211	9,211	12,767	12,767	12,767	17,803	18,914	21,442	18,942	18,942
Total Current Liabilities	2,743	1,440	1,440	6,996	6,996	6,996	9,540	9,540	13,096	13,096	13,096	18,132	19,243	21,771	19,271	19,271
Long Term Debt	69	69	69	69	69	69	69	69	10,069	10,069	10,069	10,069	10,069	10,069	10,069	10,069
Total Liabilities	3,202	1,899	1,899	7,455	7,455	7,455	9,999	9,999	23,555	23,555	23,555	28,591	29,702	32,230	29,730	29,730
Minority Interest	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113	-113
Stockholders' Equity	16,250	16,007	15,728	15,625	15,523	15,523	15,651	15,850	17,324	18,797	18,797	21,436	24,284	30,626	33,323	33,323
Total Liabilities & Equity	19,452	17,906	17,627	23,080	22,977	22,977	25,650	25,849	40,878	42,352	42,352	50,028	53,986	62,856	63,053	63,053
Cash Flow Statement	**2020**	**1Q'21**	**2Q'21**	**3Q'21**	**4Q'21**	**2021**	**1Q'22**	**2Q'22**	**3Q'22**	**4Q'22**	**2022**	**1Q'23**	**2Q'23**	**3Q'23**	**4Q'23**	**2023**
Net Income	-14,186	-243	-279	-103	-103	-1,293	128	199	1,474	1,474	3,274	2,639	2,848	6,342	2,697	14,526
Depreciation & Amortization	113	80	80	80	80	320	120	120	120	120	480	180	180	180	180	720
Other	1,698	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Change in WC	-947	-2,063	0	-5,556	3,333	-4,285	-5,878	0	-3,556	7,149	-2,284	-2,216	-489	-1,112	2,237	-1,581
Operating Cash Flow	-8,421	-2,226	-199	-5,578	3,311	-4,693	-5,630	319	-1,962	8,743	1,470	603	2,539	5,410	5,113	13,665
Capital Expenditures	-234	-1,000	-1,000	-1,000	-1,000	-4,000	-750	-750	-750	-750	-3,000	-750	-750	-750	-750	-3,000
Acquisitions	-730	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash Flow from Investing	-2,164	-1,000	-1,000	-1,000	-1,000	-4,000	-750	-750	-750	-750	-3,000	-750	-750	-750	-750	-3,000
Short Term Debt	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Long Term Debt	-1,043	0	0	0	0	0	0	0	10,000	0	10,000	0	0	0	0	0
Repurchases/Issuance	26,893	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Dividends	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash Flow from Financing	25,816	0	0	0	0	0	0	0	10,000	0	10,000	0	0	0	0	0
Change in Cash	15,383	-3,226	-1,199	-6,578	2,311	-8,693	-6,380	-431	7,288	7,993	8,470	-147	1,789	4,660	4,363	10,665
Beginning Cash	140	15,523	12,297	11,098	4,520	15,523	6,830	451	20	7,308	6,830	15,301	15,154	16,943	21,602	15,301
Ending Cash	15,523	12,297	11,098	4,520	6,830	6,830	451	20	7,308	15,301	15,301	15,154	16,943	21,602	25,966	25,966

Source: Company Reports and MKM estimates



Valuation Methodology:
FLGC: Our $6 price target is DCF-derived based on 1) net sales reaching $52mn in 2023; 2) adjusted EBITDA of $15.8mn (30% margin); 3) strong double-digit growth through 2028; 4) 3% terminal growth; 5) 9.1% WACC (highest in our coverage). Our target implies 19x our 2023 EBITDA expectation, which is in line with CPG multiples on the current year. Our target implies 26x our 2023 EBITDA expectation, which is the high-end of CPG multiples in the current year.

Risks:
FLGC: There are always risks that the target price for any security will not be realized. In addition to general market and macroeconomic risks, for KR, these risks include, among other things: 1) Access to Europe is very reliant on GMP certified facilities. Flora does not own such a facility, but has partnered with Hoshi, which expects GMP certification shortly. The risk would be if Flora is unable to get GACP product through an EU-GMP facility in Malta. Not all the licensing is in place, which presents a timing and uncertainty risk. Without such an avenue, the route-to-market to access Europe becomes much more difficult. 2) European/International markets open slower or to growers that are not Flora. Europe is among Flora's largest opportunities. While Flora should be able to supply markets at a cost advantage, current quota system limitations (amounts and flower form factors) prevent Flora from fully capturing the opportunity. 3) Capital market access has been very volatile for cannabis companies. Should funding needs arise before a profitability path has been demonstrated, Flora could be reliant on the status of the sector's capital markets. Flora is likely to continue its M&A strategy to develop points of distribution. The focus for now, until the quota system changes, is to move branded CBD product, but more M&A is likely to develop those avenues/marketplaces.

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"Buy" Security is expected to appreciate 15% or more on an absolute basis in the next 12 months.

"Neutral" Security is not expected to significantly appreciate or depreciate in value in the next 12 months.

"Sell" Security is expected to depreciate 15% or more on an absolute basis in the next 12 months.

Investment Risks: Risks associated with the achievement of revenue and earnings projections and price targets include, but are not limited to, unforeseen macroeconomic and/or industry events that weaken demand for the subject company's products or services, product obsolescence, changes in investor sentiment regarding the company or industry, the company's ability to retain or recruit competent personnel and market conditions. For a complete discussion of risk factors that could affect the market price of the securities, refer to the most recent 10-Q or 10-K filed with the SEC.

Distribution of Ratings
MKM Partners, Equity Research

			Investment Banking Serv./Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
BUY [BUY]	104	70.75	2	1.36
HOLD [NEUTRAL]	40	27.21	0	0

SELL [SELL]	3	2.04	0	0

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MKM Partners expects to receive compensation for investment banking and/or advisory services from Flora Growth Corp. within the next 3 months.

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