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Better Choice Company Inc. (NYSE AM: BTTR)

October 19, 2021

Buy: Reiterate Buy and \$10 Price Target

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We expect a product re-launch and a new distribution strategy, guided by an experienced and deep management team and funded with a strong balance sheet, will enable the company to drive revenue and EBITDA to significantly higher levels. We believe the increase in revenue and EBITDA will result in a higher multiple. Our \$10 target is based on an EV/sales multiple of 4x our 2023 sales estimate of \$82.5 million.

We reiterate our Buy recommendation and \$10 price target on Better Choice. Apart from the pet food market's two mega, mass-market suppliers, Nestlé's Purina and Mars which serve about 45% of the global pet food market, the rest of the market is highly fragmented. We believe this offers opportunities for well-managed and well-financed companies, such as Better Choice, to gain share organically and through acquisitions. We expect the pet food market will grow far in excess of nominal growth in the U.S. driven by increased pet ownership, higher income, and migration to bigger houses, on larger lots. The pandemic has boosted growth as more people work from home and have more opportunity to care for pets.

The company is led by an experienced and deep management team with a history of success in consumer products and pet food. Recent additions include experienced e-commerce and marketing talent. We also believe the company has the financial resources necessary to accomplish its goals, with over \$35 million in cash.

The company plans to re-launch its offering to the brick-and-mortar distribution channel in 2022, has signed an agreement to launch in Pet Supplies Plus in Q1, and expects to be available in 1,500 stores by the end of Q2. This product re-launch is expected to drive revenue growth sharply higher in this channel over our forecast horizon.

Better Choice has signed minimum purchase agreements with its Asian distributors valued at \$100 million over the next 4-5 years. This is a key component of our revenue projections. Demand for pet food and increased pet ownership is increasing in international markets, particularly in China, where household pet ownership is much lower than the level in the U.S.

The company is scheduled to present at the Dawson James conference this week and we expect management to discuss these and other issues.

Valuation: An EV/Sales multiple of 4x applied to our 2023 revenue estimate results in a price target range of \$10 to \$12 per share. The low end of the range assumes exercise of the company's warrants. Our \$10 price target uses the 4x EV/Sales multiple and assumes exercise of the company's warrants.

Risks: Risks to achieving our price target include an interruption in the economic recovery, less expansion in the domestic retail channel than we project, Asian distributors not meeting their minimum purchase obligations, cost increases impacting margins and greater time and resources needed to meet sales objectives.

Current Price	\$4.09		
Price Target	\$10.00		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 42,590	\$ 47,819	\$ 66,000
1Q March	\$ 12,226	\$ 10,830	\$ 15,000
2Q June	\$ 9,941	\$ 10,989	\$ 16,000
3Q September	\$ 11,135	\$ 12,000	\$ 17,000
4Q December	\$ 9,288	\$ 14,000	\$ 18,000
	F2020A	F2021E	F2022E
EBITDA (\$000s)	\$ (1,716)	\$ (6,663)	\$ (740)
1Q March	\$ (94)	\$ (1,131)	\$ (1,155)
2Q June	\$ (627)	\$ (1,798)	\$ (475)
3Q September	\$ (274)	\$ (2,207)	\$ 245
4Q December	\$ (721)	\$ (1,527)	\$ 645
EV/Sales	2.3 x	2.0 x	1.5 x
EV/EBITDA	(56.6) x	(14.6) x	(131.1) x
Stock Data			
52-Week Range	\$2.96 - \$10.80		
Shares Outstanding (mil.)	29.6		
Market Capitalization (mil.)	\$121		
Enterprise Value (mil.)	\$97		
Debt to Capital	29%		
Book Value/Share	\$0.90		
Price/Book	4.5x		
Average Three Months Trading Volume (K)	111		
Insider Ownership	5.7%		
Institutional Ownership	16.0%		
Short interest (mil.)	0.4%		
Dividend / Yield	\$0.00/0.0%		



Financial model

The company's long-term financial model is a gross margin of 40% to 45%, contribution margin of 20% to 25% and long-term EBITDA margin of 10% to 15%. We believe the company can exit 2023 achieving these target ranges. The company was at the low end of the gross margin target range in 2020 but experienced pressure in the first half of this year and will probably experience continued pressure in the second half as costs have increased and the company is prepping for the Halo Elevate product launch.

	2020	1H 2021	Target
Annual sales (\$M)	\$42.6	\$43.6	\$85 net/\$100 gross
Gross margin	40%	37%	40%-45%
EBITDA margin	-4.0%	-13.4%	10%-15%

Source: Better Choice

The company also has a goal of achieving \$100 million in gross annual sales within the next 3 years. This would equate to about \$85 million in net sales (gross sales less allowances and discounts), or a 25% CAGR from 2020. As mentioned above, higher growth is expected from the brick-and-mortar and international channels, with still strong growth from e-commerce and DTC.

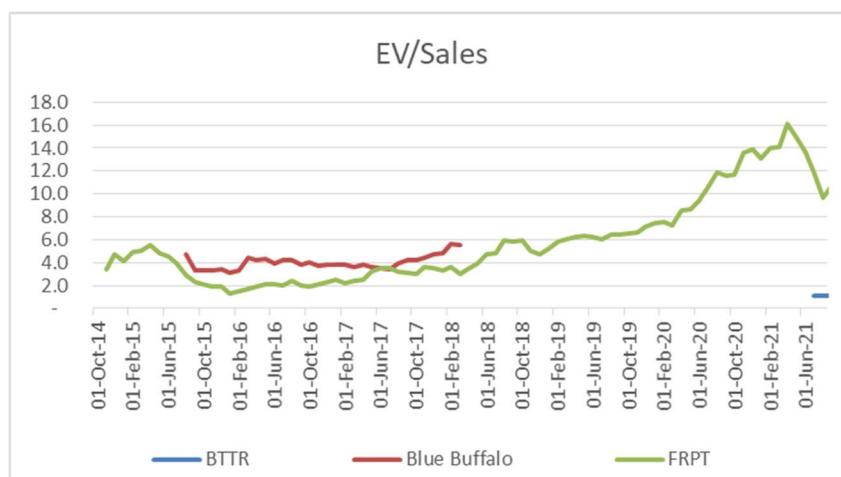
Valuation

Freshpet is the closest and most relevant comp to Better Choice. There are retailers in the pet business, but their margin and growth profiles are much different from Better Choice's. The pet food business of J.M. Smucker, General Mills, Colgate, Spectrum Brands and Nestlé are parts of larger businesses and have much lower expected growth relative to Better Choice.

The chart below shows historical EV/Sales data for Freshpet, Blue Buffalo (while it was public) and Better Choice. Blue Buffalo had a similar growth, margin and market focus to Better Choice, so we believe its multiple history is relevant to where we believe Better Choice's shares could trade.

From August 2015 through March of 2018, the average EV/Sales based on forward-12-month sales estimates for Blue Buffalo was 4.0x. During this same period, Freshpet's shares traded at an average EV/Sales of 2.5x. From March 2018, when Blue Buffalo was acquired, through February 2020, when the pandemic began to have an impact on the market, Freshpet's shares traded at an average EV/Sales of 5.9x, and since March 2020, have traded at an average of 12.0x.

We believe the Blue Buffalo and Freshpet pre-pandemic average multiples are the most relevant for Better Choice's valuation. Growth is similar, as are margins. An EV/Sales multiple of 4x applied to our 2023 Better Choice revenue estimate results in a price target range of \$10 to \$12 per share. The low end of the range assumes exercise of the company's warrants. Our \$10 price target uses the 4x EV/Sales multiple and assumes exercise of the company's warrants.



Source: FactSet and Dawson James Securities estimates

Risk Analysis

Risks to achieving our price target include an interruption in the economic recovery, less expansion in the domestic retail channel than we project, Asian distributors not meeting their minimum purchase obligations, cost increases impacting margins and greater time and resources needed to meet sales objectives.

Exhibit 1. Income Statement

(\$ in 000's) (except per share data)	31-Dec-19 2019 A	31-Dec-20 2020 A	31-Mar-21 Q1 21 A	30-Jun-21 Q2 21 A	30-Sep-21 Q3 21 E	31-Dec-21 Q4 21 E	31-Dec-21 2021 E	31-Dec-22 2022 E	31-Dec-23 2023 E
Revenue	15,577	42,590	10,830	10,989	12,000	14,000	47,819	66,000	82,500
COGS	9,717	26,491	6,556	7,089	7,920	9,240	30,805	40,520	47,850
Gross Profit	5,860	16,099	4,274	3,900	4,080	4,760	17,014	25,480	34,650
Gross margin	38%	40%	39%	35%	34%	34%	36%	39%	42%
G&A	19,782	25,966	4,551	3,530	3,500	3,500	15,081	14,560	15,142
Share-based comp	10,280	8,940	2,525	332	332	332	3,521	2,000	2,400
Sales and marketing	10,138	7,892	2,336	3,235	3,200	3,200	11,971	13,312	13,844
Other	1,097	623	0	0	0	0	0	0	0
Impairment	889	0	0	0	0	0	0	0	0
Opex	42,186	43,421	9,412	7,097	7,032	7,032	30,573	29,872	31,387
Operating Income	(36,326)	(27,322)	(5,138)	(3,197)	(2,952)	(2,272)	(13,559)	(4,392)	3,263
Interest Expense	670	9,247	835	2,234	251	251	3,570	1,002	1,002
Loss on extinguishment of debt	0	88	394	(851)	0	0	(457)	0	0
Loss on acquisitions	147,376	0	0	0	0	0	0	0	0
Change in fair value of warrant liability	90	22,678	6,483	(29,356)	0	0	(22,873)	0	0
Net Income	(184,462)	(59,335)	(12,850)	24,776	(3,203)	(2,523)	6,201	(5,394)	2,261
Preferred dividends	109	103	0	0	0	0	0	0	0
Net to common	(184,571)	(59,438)	(12,850)	24,776	(3,203)	(2,523)	6,201	(5,394)	2,261
Basic Shares	5,540	8,181	9,588	11,127	29,600	29,836	20,038	31,086	33,086
Diluted Shares	5,540	8,181	9,588	21,389	29,600	29,836	22,603	31,086	33,086
Basic EPS	\$ (33.32)	\$ (7.27)	\$ (0.22)	\$ 2.23	\$ (0.11)	\$ (0.08)	\$ 0.31	\$ (0.17)	\$ 0.07
Diluted EPS	\$ (33.32)	\$ (7.27)	\$ (0.22)	\$ 1.16	\$ (0.11)	\$ (0.08)	\$ 0.27	\$ (0.17)	\$ 0.07
Depreciation and Amortization	171	1,748	411	413	413	413	1,650	1,652	1,652
Stock Comp	10,280	8,940	2,544	313	332	332	3,521	2,000	2,400
Other	10,989	14,918	1,052	673	0	0	1,725	0	0
EBITDA	(14,886)	(1,716)	(1,131)	(1,798)	(2,207)	(1,527)	(6,663)	(740)	7,315
Margin	NM	-4.0%	-10.4%	-16.4%	-18.4%	-10.9%	-13.9%	-1.1%	8.9%

Source: Better Choice Company Inc. and Dawson James Securities estimates

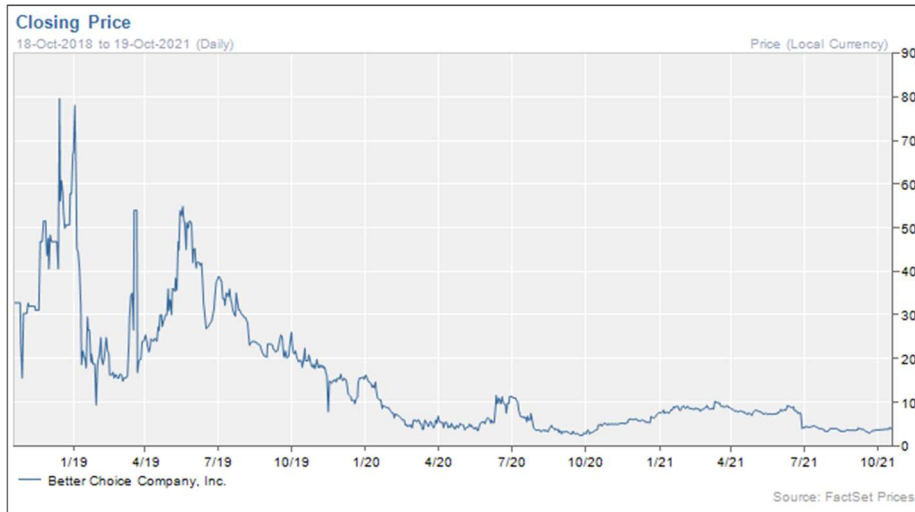
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	31-Dec-19 2019	31-Dec-20 2020	31-Dec-21 2021 E	31-Dec-22 2022 E	31-Dec-23 2023 E
Cash	2,361	3,926	30,611	27,196	31,106
Restricted Cash	173	63	63	63	63
A/R	5,824	4,631	7,000	9,000	11,250
Inventory	6,580	4,869	7,700	9,000	10,875
Prepaid expenses and other	2,641	4,074	6,271	8,062	10,078
Current Assets	\$ 17,579	\$ 17,563	\$ 51,644	\$ 53,321	\$ 63,372
PP&E	417	252	149	149	149
Right-of-use assets	951	345	94	94	94
Intangible assets	14,641	13,115	11,587	10,060	8,533
Goodwill	18,614	18,614	18,614	18,614	18,614
Other assets	1,330	1,364	114	114	114
Total Assets	\$ 53,532	\$ 51,253	\$ 82,202	\$ 82,352	\$ 90,875
Short term loan	16,061	7,826	704	704	5,703
Line of credit	4,819	0	222	222	5,157
PPP loans	0	190	0	0	0
Other liabilities	500	47	0	0	0
A/P	4,049	3,137	6,062	7,794	9,742
Accrued liabilities	4,721	3,003	2,842	3,654	4,568
Deferred revenue	311	350	0	0	0
Operating lease	345	173	56	56	56
Warrant derivative liab.	2,220	39,850	16,977	16,977	16,977
Current Liabilities	\$ 33,026	\$ 54,576	\$ 26,863	\$ 29,407	\$ 42,203
Notes payable	16,370	18,910	0	0	0
Term loans	0	0	4,999	4,999	0
Line of credit	0	5,023	4,935	4,935	0
PPP loans	0	662	0	0	0
Operating lease liab.	641	184	38	38	38
Series E Cv. Preferred	10,566	0	0	0	0
Total Stockholders' Equity	(7,071)	(28,102)	45,367	42,973	48,634
Total Liabilities & Equity	\$ 53,532	\$ 51,253	\$ 82,202	\$ 82,352	\$ 90,875
	31-Dec-19 2019	31-Dec-20 2020	31-Dec-21 2021 E	31-Dec-22 2022 E	31-Dec-23 2023 E
Net Income	(184,571)	(59,438)	6,201	(5,394)	2,261
Depreciation and amort.	171	1,748	1,650	1,652	1,652
Share-based comp.	10,280	8,940	3,521	2,000	2,400
Working Capital and other	153,151	41,245	(24,013)	(2,548)	(3,279)
Operating CF	\$ (20,969)	\$ (7,505)	\$ (12,641)	\$ (4,290)	\$ 3,035
Capex	(110)	(151)	(117)	(125)	(125)
Acquisitions	(20,097)	0	0	0	0
Investing Activities	\$ (20,207)	\$ (151)	\$ (117)	\$ (125)	\$ (125)
Equity	20,333	19,101	41,846	1,000	1,000
Debt	19,431	(9,990)	(2,404)	0	0
Financing	\$ 39,764	\$ 9,111	\$ 39,442	\$ 1,000	\$ 1,000
Change in Cash	\$ (1,412)	\$ 1,455	\$ 26,685	\$ (3,415)	\$ 3,910

Source: Better Choice Company Inc. and Dawson James Securities estimates

Important Disclosures:

Price Chart:



Price target and ratings changes over the past three years:

Initiated – Buy – August 31, 2021 – Price Target \$10.00

Update – Buy – October 19, 2021 – Price Target \$10.00

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	# of Companies	% of Total	# of Companies	% of Totals
Ratings Distribution				
Market Outperform (Buy)	25	69%	4	16%
Market Perform (Neutral)	11	31%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	36	100%	4	11%

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