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Better Choice Company Inc. (NYSE AM: BTTR)

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Buy: Reiterate Buy and \$10 Price Target

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We reiterate our \$10 target based on an EV/sales multiple of 4x our 2023 sales estimate. We expect that growth in the company's e-commerce, brick and mortar and international segments will result in top-line growth of over 40% this year, as well as rapidly expanding margins.

We reiterate our Buy recommendation and \$10 price target of Better Choice. The company is in the early stages of expansion in the U.S. brick and mortar segment, is on track to exceed its \$100 million in aggregate contract minimums through 2025 from international distributors and has completed the integration of its TruDog brand into the Halo product portfolio. The shares have been buffeted by the decline in small-cap stocks and offer substantial value at current levels.

The company has completed the integration of its TruDog brand into the Halo product portfolio. TruDog was a direct-to-consumer brand generating an estimated \$8.5 million in sales in the past twelve months. We have assumed a modest decline for the rest of the year as the brand is re-launched. Coincident with the integration of TruDog, Better Choice launched a Halo-branded freeze-dried raw meals, treats and toppers for the legacy TruDog customers. With the integration of TruDog, the company will now endeavor to grow the product category, aided by recent launch of a media campaign and re-designed website.

Halo Elevate is officially on the shelf in more than 1,500 pet specialty stores. Elevate is expected to be available in 1,000 Petco stores by early Q3, is available at 600 Pet Supplies Plus outlets and additional stores will be added in the coming months. This is expected to result in sales growth to brick and mortar outlets this year of 150%+ and 20% growth in 2023.

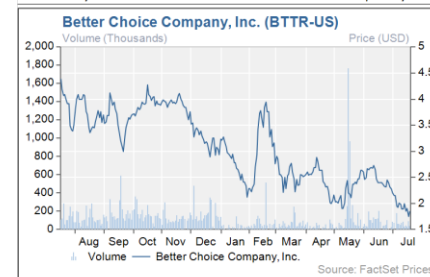
The company is on track to exceed its \$100 million in aggregate contract minimums through 2025 from international distributors. We expect international sales will exceed \$25 million this year. Sales to China has been a key to the company's results. In 2021, sales to China were over \$9 million, over 60% of total international sales. Increased geographic distribution, including to Mexico and Australia, should sustain the strong international results in the coming quarters.

We believe pet food sales will be less impacted than other major consumer expenditures by the Fed's tighter monetary policy. The pandemic has changed work-from-home habits for a generation and increased the number of pets and demand for pet food, particularly demand for premium food. We believe a mix shift to premium food is driven by the humanization of pets, greater time at home, lower birth rates and substantial cash balances on consumer's balance sheets.

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 | \$1.85 | | |
| Price Target | \$10.00 | | |
| Estimates | F2021A | F2022E | F2023E |
| Revenues (\$000s) | \$ 46,006 | \$ 65,148 E | \$ 83,266 |
| 1Q March | \$ 10,830 | \$ 17,014 A | \$ 21,054 |
| 2Q June | \$ 10,989 | \$ 16,234 E | \$ 20,525 |
| 3Q September | \$ 13,200 | \$ 15,900 E | \$ 21,125 |
| 4Q December | \$ 10,987 | \$ 16,000 E | \$ 20,563 |
| | F2021A | F2022E | F2023E |
| EBITDA (\$000s) | \$ (11,475) | \$ (7,434)E | \$ 3,017 |
| 1Q March | \$ (2,183) | \$ (2,461)A | \$ 533 |
| 2Q June | \$ (2,471) | \$ (2,131)E | \$ 538 |
| 3Q September | \$ (2,876) | \$ (1,758)E | \$ 983 |
| 4Q December | \$ (3,945) | \$ (1,084)E | \$ 964 |
| EV/Sales | 0.9 x | 0.7 x | 0.5 x |
| EV/EBITDA | (3.8) x | (5.9) x | 14.4 x |
| Stock Data | | | |
| 52-Week Range | \$1.70 - \$4.30 | | |
| Shares Outstanding (mil.) | 29.4 | | |
| Market Capitalization (mil.) | \$54 | | |
| Enterprise Value (mil.) | \$44 | | |
| Debt to Capital | 19% | | |
| Cash (mil.) | \$23 | | |
| Cash/Share | \$0.80 | | |
| Average Three Months Trading Volume (K) | 9 | | |
| Insider Ownership | 35.8% | | |
| Institutional Ownership | 31.1% | | |
| Short interest (mil.) | 0.7% | | |
| Dividend / Yield | \$0.00/0.0% | | |



We think the company has significant growth potential. 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 GDP 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 \$23 million in cash.

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 at or near these target ranges. The company was at the low end of the gross margin target range in 2020 but experienced cost pressure, supply constraints and shortfalls by its manufacturing partner. However, price increases and new manufacturing partners should alleviate much of the issues faced recently.

| | 2021A | 2022E | Target |
|--------------------|----------|---------|----------------------|
| Annual sales (\$M) | \$46.0 | \$65.1 | \$85 net/\$100 gross |
| Gross margin | 33% | 33% | 40%-45% |
| EBITDA (\$M) | \$(11.5) | \$(7.4) | 10%-15% |

Source: Better Choice and Dawson James Securities estimates

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.

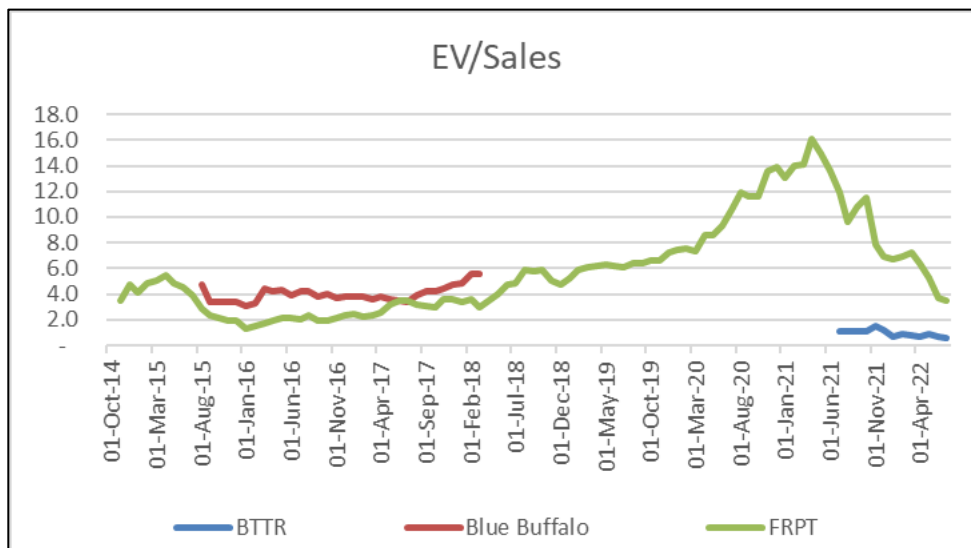
Valuation

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 businesses 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 10.0x and currently trades at 3.5x FTM sales.

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-Dec-21 2021 A | 31-Mar-22 Q1 22 A | 30-Jun-22 Q2 22 E | 30-Sep-22 Q3 22 E | 31-Dec-22 Q4 22 E | 31-Dec-22 2022 E | 31-Dec-23 2023 E |
|---|---------------------|---------------------|---------------------|----------------------|----------------------|----------------------|----------------------|---------------------|---------------------|
| Revenue | 15,577 | 42,590 | 46,006 | 17,014 | 16,234 | 15,900 | 16,000 | 65,148 | 83,266 |
| COGS | 9,717 | 26,485 | 30,638 | 12,307 | 11,201 | 10,494 | 9,920 | 43,922 | 50,380 |
| Gross Profit | 5,860 | 16,105 | 15,368 | 4,707 | 5,033 | 5,406 | 6,080 | 21,226 | 32,886 |
| Gross margin | 38% | 38% | 33% | 28% | 31% | 34% | 38% | 33% | 39% |
| SG&A | 34,487 | 34,487 | 28,507 | 7,577 | 7,577 | 7,577 | 7,577 | 30,308 | 31,520 |
| Share-based comp | 10,280 | 8,940 | 4,140 | 1,091 | 1,091 | 1,091 | 1,091 | 4,364 | 2,400 |
| Impairment | 889 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Opex | 45,656 | 43,427 | 32,647 | 8,668 | 8,668 | 8,668 | 8,668 | 34,672 | 33,920 |
| Operating Income | (39,796) | (27,322) | (17,279) | (3,961) | (3,635) | (3,262) | (2,588) | (13,446) | (1,035) |
| Interest Expense | 670 | 9,247 | 3,217 | 76 | 76 | 76 | 76 | 304 | 304 |
| Loss on extinguishment of debt | 0 | 88 | (457) | 0 | 0 | 0 | 0 | 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 | (23,463) | 0 | 0 | 0 | 0 | 0 | 0 |
| Net Income | (184,462) | (59,335) | 3,387 | (4,040) | (3,711) | (3,338) | (2,664) | (13,753) | (1,339) |
| Preferred dividends | 109 | 103 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net to common | (184,571) | (59,438) | 3,387 | (4,040) | (3,711) | (3,338) | (2,664) | (13,753) | (1,339) |
| Basic Shares | 5,540 | 8,181 | 19,844 | 29,290 | 29,365 | 29,615 | 30,115 | 29,596 | 31,365 |
| Diluted Shares | 5,540 | 8,181 | 22,409 | 29,290 | 29,365 | 29,615 | 30,115 | 29,596 | 31,365 |
| Basic EPS | \$ (33.32) | \$ (7.27) | \$ 0.17 | \$ (0.14) | \$ (0.13) | \$ (0.11) | \$ (0.09) | \$ (0.46) | \$ (0.04) |
| Diluted EPS | \$ (33.32) | \$ (7.27) | \$ 0.15 | \$ (0.14) | \$ (0.13) | \$ (0.11) | \$ (0.09) | \$ (0.46) | \$ (0.04) |
| Depreciation and Amortization | 171 | 1,748 | 1,664 | 409 | 413 | 413 | 413 | 1,648 | 1,652 |
| Stock Comp | 10,280 | 8,940 | 4,140 | 1,091 | 1,091 | 1,091 | 1,091 | 4,364 | 2,400 |
| EBITDA | (29,345) | (16,634) | (11,475) | (2,461) | (2,131) | (1,758) | (1,084) | (7,434) | 3,017 |
| Margin | NM | -39.1% | -24.9% | -14.5% | -13.1% | -11.1% | -6.8% | -11.4% | 3.6% |

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

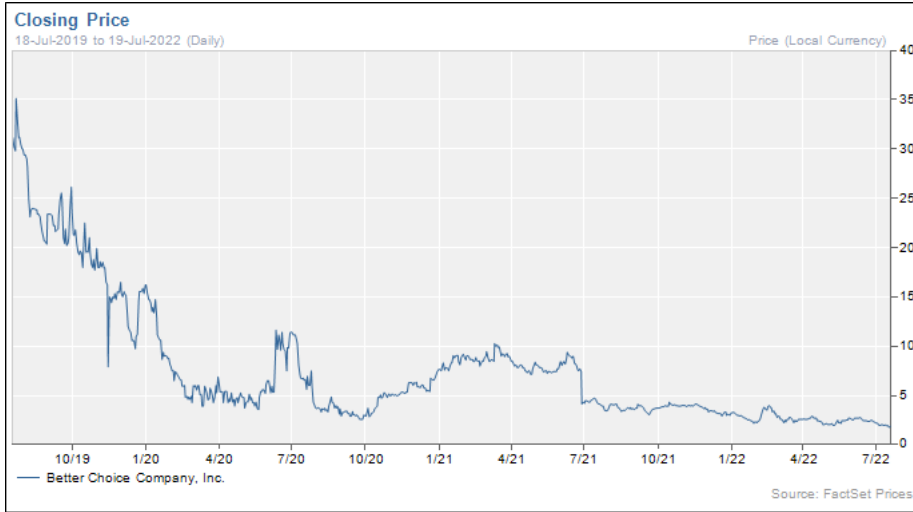
Exhibit 2. Balance Sheet and Cash Flow Statement

| (\$ in 000's) | 31-Dec-19 2019 | 31-Dec-20 2020 | 31-Dec-21 2021 | 31-Dec-22 2022 E | 31-Dec-23 2023 E |
|---------------------------------------|--------------------|--------------------|--------------------|---------------------|---------------------|
| Cash | \$ 2,361 | \$ 3,926 | \$ 21,729 | \$ 13,106 | \$ 13,550 |
| Restricted Cash | 173 | 63 | 7,213 | 6,963 | 6,963 |
| A/R | 5,824 | 4,631 | 6,792 | 9,778 | 12,566 |
| Inventory | 6,580 | 4,869 | 5,245 | 6,770 | 8,280 |
| Prepaid expenses and other | 2,641 | 4,074 | 2,940 | 2,703 | 3,473 |
| Current Assets | \$ 17,579 | \$ 17,563 | \$ 43,919 | \$ 39,319 | \$ 44,832 |
| PP&E | 417 | 252 | 369 | 490 | 490 |
| Right-of-use assets | 951 | 345 | 56 | 44 | 44 |
| Intangible assets | 14,641 | 13,115 | 11,586 | 10,060 | 8,533 |
| Goodwill | 18,614 | 18,614 | 18,614 | 18,614 | 18,614 |
| Other assets | 1,330 | 1,364 | 116 | 101 | 101 |
| Total Assets | \$ 53,532 | \$ 51,253 | \$ 74,660 | \$ 68,628 | \$ 72,613 |
| Short term loan | \$ 16,061 | \$ 7,826 | \$ 855 | \$ 979 | \$ 5,216 |
| Line of credit | 4,819 | 0 | 0 | 0 | 7,360 |
| PPP loans | 0 | 190 | 0 | 0 | 0 |
| Other liabilities | 500 | 47 | 0 | 0 | 0 |
| A/P | 4,049 | 3,137 | 4,553 | 5,385 | 6,920 |
| Accrued liabilities | 4,721 | 3,003 | 1,879 | 1,362 | 1,750 |
| Deferred revenue | 311 | 350 | 0 | 0 | 0 |
| Operating lease | 345 | 173 | 54 | 46 | 46 |
| Warrant derivative liab. | 2,220 | 39,850 | 0 | 0 | 0 |
| Current Liabilities | \$ 33,026 | \$ 54,576 | \$ 7,341 | \$ 7,771 | \$ 21,292 |
| Notes payable | 16,370 | 18,910 | 0 | 0 | 0 |
| Term loans | 0 | 0 | 4,559 | 4,237 | 0 |
| Line of credit | 0 | 5,023 | 4,856 | 7,360 | 0 |
| PPP loans | 0 | 662 | 0 | 0 | 0 |
| Deferred Tax | 0 | 0 | 24 | 24 | 24 |
| Operating lease liab. | 641 | 184 | 5 | 0 | 0 |
| Series E Cv. Preferred | 10,566 | 0 | 0 | 0 | 0 |
| Total Stockholders' Equity | \$ (7,071) | \$ (28,102) | \$ 57,875 | \$ 49,236 | \$ 51,297 |
| Total Liabilities & Equity | \$ 53,532 | \$ 51,253 | \$ 74,660 | \$ 68,628 | \$ 72,613 |
| | | | | | |
| | 31-Dec-19 2019 | 31-Dec-20 2020 | 31-Dec-21 2021 | 31-Dec-22 2022 E | 31-Dec-23 2023 E |
| Net Income | (184,571) | (59,438) | 3,387 | (13,753) | (1,339) |
| Depreciation and amort. | 171 | 1,748 | 1,664 | 1,648 | 1,652 |
| Share-based comp. | 10,280 | 8,940 | 4,140 | 4,364 | 2,400 |
| Working Capital and other | 153,151 | 41,245 | (21,049) | (3,931) | (3,145) |
| Operating CF | \$ (20,969) | \$ (7,505) | \$ (11,858) | \$ (11,673) | \$ (431) |
| Capex | (110) | (151) | (353) | (244) | (125) |
| Acquisitions | (20,097) | 0 | 0 | 0 | 0 |
| Investing Activities | \$ (20,207) | \$ (151) | \$ (353) | \$ (244) | \$ (125) |
| Equity | 20,333 | 19,101 | 40,181 | 750 | 1,000 |
| Debt | 19,431 | (9,990) | (3,017) | 2,293 | 0 |
| Financing | \$ 39,764 | \$ 9,111 | \$ 37,164 | \$ 3,043 | \$ 1,000 |
| Change in Cash | \$ (1,412) | \$ 1,455 | \$ 24,953 | \$ (8,873) | \$ 444 |

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
 Update – Buy – November 11, 2021 – Price Target \$10.00
 Update – Buy – February 11, 2022 – Price Target \$10.00
 Update – Buy – March 23, 2022 – Price Target \$10.00
 Update – Buy – March 30, 2022 – Price Target \$10.00
 Update – Buy – May 13, 2022 – Price Target \$10.00
 Update – Buy – July 20, 2022 – Price Target \$10.00

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Information about valuation methods and risks can be found in the "Valuation" and "Risk Analysis" sections of this report.

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Ratings Definitions:

- 1) **Buy:** the analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months;
- 2) **Neutral:** the analyst believes the price of the stock is fairly valued for the next 12-18 months;
- 3) **Sell:** the analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

The following chart reflects the range of current research report ratings for all companies, followed by the analysts of the Firm. The chart also reflects the research report ratings relating to those companies for which the Firm has performed investment banking services.

Current as of 18-Jul-22

| | Company Coverage | | Investment Banking | |
|-----------------------------|-------------------------|-------------------|---------------------------|--------------------|
| Ratings Distribution | # of Companies | % of Total | # of Companies | % of Totals |
| Market Outperform (Buy) | 29 | 67% | 4 | 14% |
| Market Perform (Neutral) | 14 | 33% | 0 | 0% |
| Market Underperform (Sell) | 0 | 0% | 0 | 0% |
| Total | 43 | 100% | 4 | 9% |

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