

One to Watch

## ECS Botanics

### Meeting with Nan-Maree Schoerie and Alex Keach

2<sup>nd</sup> February 2024

Venn Brown sat down with Nan-Maree Schoerie, Managing Director and Alex Keach, founder of ECS Botanics, to discuss the expansion, new product development, profitability, cost management, market growth and margin expansion.

**Company background:** ECS Botanics is a cultivator and manufacturer of medicinal cannabis products. The group is primarily a wholesaler of flowers and oils and has customers in Australia, New Zealand, the UK and Europe. 95% of its product is white-labelled to suppliers and distributors, and it is one of the largest cultivators and producers in the Australian. ECS currently only sells one compassionate brand through a B2C model but is working on expanding this part of the business.

**Cost management:** ECS's cultivation is 20x less energy-intensive than most other producers. Leveraging the natural climate benefits of its growing region, the group cultivates its product using open acreage and natural greenhouses.

**Market Size:** The Australian market is estimated to generate more than \$590 million a year, with the number of patients growing exponentially from fewer than 20 thousand in late 2019 to more than 105 thousand in early 2022. Local Australian suppliers can't keep up with the growing demand. In Europe, the medicinal cannabis market is currently valued at around \$8 billion a year and is expected to grow to more than \$21 billion by 2027. The UK market is estimated to be around \$2 billion in 2024. These figures represent just the medicinal market. As more countries legalise cannabis for recreational use, these figures will increase by an order of magnitude.

**Production expansion:** ECS is launching a new consumer product in Australia with 4x the absorption rate of existing products on the market. The company announced a \$24 million, five-year supply contract with MediCann Health in October, boosting the more than \$26 million in contracted product at the start of 2023, most of which is for delivery over the next three years.

**Outlook:** Despite producing a premium product, ECS is already the lowest-cost producer that has entered its next phase of growth and profitability. Global demand continues to outpace supply, positioning ECS to continue building on its strong profitable market position.

### ECS Botanics

#### ASX:ECS

Sector	Cannabis Production
Date	1-Feb-24
Share price	\$0.027
52-week range	\$0.02 / \$0.03
Market cap	\$29.9m
Free float	-
Dividend	-
Yield	-

Year-end 30 June	FY20	FY21	FY22	FY23
Revenue	\$1m	\$1m	\$5m	\$15m
EBITDA	-\$4.5m	-\$5.3m	-\$1.1m	-\$2.0m
EBIT	-\$4.5m	-\$5.5m	-\$1.8m	-\$3.0m
Net profit	-\$4.6m	-\$4.3m	\$0.2m	\$0.5m
Earnings per share	-\$0.01	-\$0.01	-\$0.00	\$0.00
Operating cash flow	-\$2.9m	-\$2.3m	-\$4.7m	\$0.4m
Free cash flow	-\$4.4m	-\$5.7m	-\$7.6m	-\$0.7m
Cash & equiv	\$1.9m	\$4.2m	\$1.9m	\$2.5m
Net debt	-\$1.9m	-\$4.2m	-\$1.8m	-\$2.2m
Net debt / EBITDA	0.4	0.8	1.7	1.1
Dividend per share	#N/A	-	-	-
ROA	-83.6%	-21.7%	0.7%	1.9%
ROE	-90.8%	-25.4%	0.7%	2.2%

### 3-year Price Chart



### Analysts

Andrew Wilkinson      awilkinson@vennbrown.com

### Thanks for being with us here today, Nan and Alex. First, can you give us a brief overview of ECS Botanics?

ECS Botanics is a cultivator and manufacturer of medicinal cannabis products. The business as it is today was formed in early 2021 with the merger of ECS Botanics, founded in 2018, and Murray Meds founded in 2019. The driving force behind the company is the philosophy of growing and producing globally competitive medicinal cannabis in Australia.

We're primarily a wholesaler of flowers and oils and have customers in Australia, New Zealand, the UK and Europe. 95% of our product is white-labelled to suppliers and distributors, and we're one of the largest cultivators and producers in the Australian market. We currently only sell one compassionate brand directly to consumers, but we're working on expanding this part of the business.

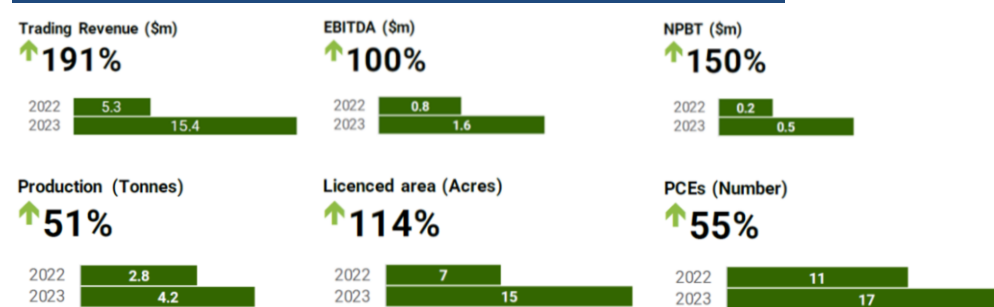
Following the merger, we looked at what the market would look like in five years and at what other companies were doing in Canada, Europe, and the US. We realised that to be successful and to offset our high labour costs, we needed to leverage the three things Australia offered:

1. our climate;
2. world-leading agriculture; and
3. our pharmaceutical industries.

Our analysis led us to use our unique combination of broad-acre growing and low-energy-intensive greenhouse cultivation. Our greenhouses cost hundreds of thousands of dollars to build rather than millions, so we're not saddled with huge infrastructure investments.

As I'm sure we'll talk about, we're already the lowest-cost producer, but we're not stopping there. We're working to drive better efficiencies. We've got the revenue base, and we're profitable. The more cash we can generate, the more we can invest in the business and expand because the market and demand are there.

**Figure 1: ECS is looking to drive both revenue and margin growth**



Source: ECS Botanics

### What is your sales model?

We sell oils, bulk flower and packaged flower, so we have a few different markets. We're mostly a cultivator and wholesaler, so most of our revenue comes from selling to businesses. We currently only have one compassionate brand, RAP, that we sell directly to consumers.

We primarily supply mid to large-sized customers. We sell ninety-five per cent of our product to our white-label customers, several of whom are some of the largest cannabis companies in Australia. We also sell to mid-sized companies, clinics, and suppliers.

### How large are the markets into which you're selling?

We sell products in Australia, New Zealand, Germany, Poland and the UK. We've also just started selling in Switzerland, but it's very small.

The Australian market is estimated to be more than \$594 million a year, with the number of patients growing exponentially from fewer than 20 thousand in late 2019 to more than 105 thousand in early 2022. Local Australian suppliers can't keep up with the growing demand, with 80% of Australian cannabis products imported. We have a fair share of the 20% that's produced locally.

We're not actually competing with Australian companies; we're competing with the imports. The key is for us to have more strains. Patients tend to have a preferred strain, and we need to produce more flower strains to capture a greater market share. We currently have eight strains, but we're expanding this to 15 by the end of the year.

In Europe, the medicinal cannabis market is currently valued at around \$8 billion a year and is expected to grow to more than \$21 billion by 2027. The UK market is estimated to be around \$2 billion in 2024, and we're already a major supplier in the UK.

These figures just represent the medicinal market. As more countries legalise cannabis for recreational use, these figures will increase by an order of magnitude. For instance, Germany is expected to legalise adult-use cannabis in early 2024. Germany's medicinal market is estimated to be around \$1 billion a year, but this compares to the illicit market, which is estimated to be more than \$22 billion annually.

Figure 2: Demand for medicinal cannabis is growing exponentially

### Medical Cannabis

#### a Large and Growing Market.

Approximately 2.5% of Australians have already accessed medicinal cannabis



Source: ECS Botanics

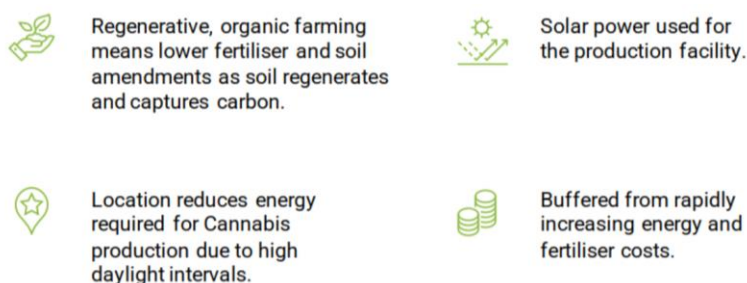
### How have you reduced your cultivation and production costs so far below your competitors?

Our production costs are so much lower than most other producers because we use two different cultivation methods, and for both, we leverage the natural climate benefits of regional Victoria rather than creating an artificial environment.

Firstly, unlike most growers, we use outdoor agricultural acreage for growing product for medicinal cannabis oils, which is about 50% of the Australian medical market, and we use natural greenhouses to produce our premium-grade flower.

Growing for cannabis oil on acreage has huge cost advantages compared to a lot of oil crops that are grown in greenhouses. We found that the first harvest of the acreage produces high-quality flowers for which we've found a steady and profitable market. We sell that flower as a premium product; the rest goes for extraction and oils.

Figure 3: ECS cultivation is 20 - 50 times less energy intensive compared to typical greenhouse and indoor methods



Source: ECS Botanics

We grow a premium export flower product in the protective cropping enclosures [greenhouses]. The export flower markets don't want anything grown in acreage. They like the idea of having a "sealed environment", so our export product has to come out of the greenhouse, but we still do it differently.

Unlike most growers around the world, we grow our protected crops in soil and use the sun, rather than in pots in an environmentally sealed and artificially controlled indoor environment. This has huge margin and profit advantages as we don't have high electricity costs. Typically, cannabis cultivation is extraordinarily energy-intensive and non-environmentally friendly. People grow cannabis in windowless buildings, using environmental control systems to control temperature, humidity and airflow.

Our cannabis is grown in passive greenhouses with open sides and natural airflow. We have fans and lighting, but the lighting is only there for photo periods to allow the crop to go through its cycle more quickly. These changes mean our cultivation model is probably 20 times less expensive in energy than the other models.

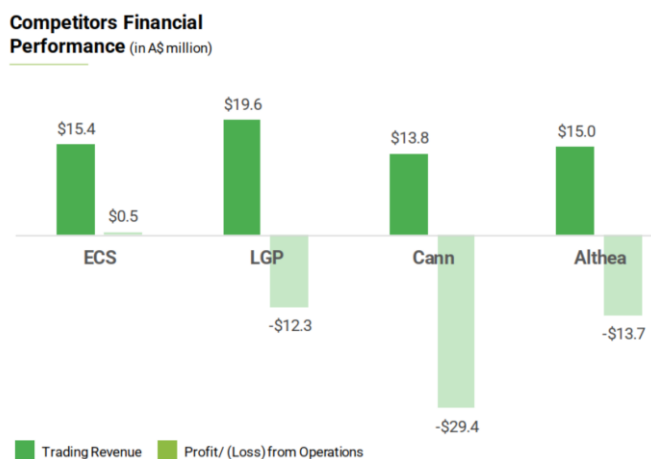
We've recently successfully completed a trial to extend our greenhouse growing season by using floor heating and lights to grow for 12 months of the year. While it will increase our costs, these are more than offset by the benefits. Not only will we achieve higher yields, but it also more than doubles our growing period and smooths out our labour costs across the year.

Overall, we can cultivate premium oils and flowers using methods significantly cheaper than most companies around the developed world. This is evident in our financials as we're profitable on the same revenues that most other cannabis companies are loss making.

On the production side, our partnership with Sun Pharma, the fourth largest generic pharmaceutical manufacturer globally [listed on NASDAQ], has significant capital and operational cost advantages. We bought an oil extractor several years ago but realised it wasn't a business we should be in, given it's a pretty high-tech process. The facilities required to house and operate the extractor were going to be three times the cost of the extractor.

Our collaboration with Sun Pharma gives us extraction services at half the cost compared to other providers. It also meant we didn't need to invest the huge upfront costs to build extraction facilities.

**Figure 4: Unlike most competitors, ECS is profitable and is nearing cash-flow positive**

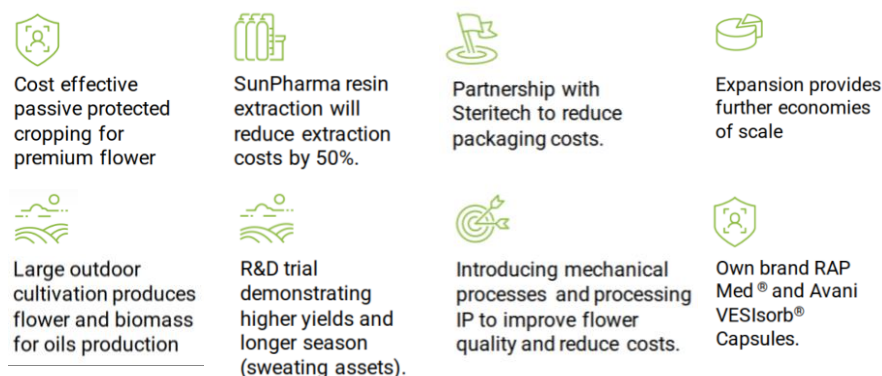


Source: ECS Botanics

#### Are there further cost improvements you can make?

We believe there are still significant improvements we can make to our cost base. Firstly, there are simple economies of scale. Secondly, we're continuously improving our processes. Every year, we're learning more, finding better and more efficient ways of processing the flower and bringing in more automation. We focus on generating higher crop yields while lowering production and processing costs.

**Figure 5: Despite being the lowest-cost producer, ECS believes it can realise more efficiencies**



Source: ECS Botanics

### **How do you respond to claims that you can't maintain product consistency without better environmental controls?**

The claim is that if you have a room where everything's controlled, you will always grow the same flower. Well, the reality is this isn't the case. Some corners are cooler than others; some areas are directly under the light, while others have light to the side. No one gets a hundred per cent consistency. Instead, we've worked on stabilising the genetics as we've discovered that genetics has the single biggest influence on consistency. If you have stable genetics, they produce the same flower.

We meet Germany's specifications, which require consistency of plus or minus 10%, and we achieve that. There is no point in getting higher consistency than that because you won't be paid more and the market doesn't demand it.

What's also important to realise is that we have the highest standard of flower in Australia. We export our product to Europe, so we must meet the EU GMP standard<sup>1</sup>. The European standard for cannabis is higher than the Australian TGA standard. Many Australian producers don't meet that standard and can't export. So even though we're lower cost, we meet the highest pharmaceutical standard in the world.

### **Can you tell us more about your latest product development?**

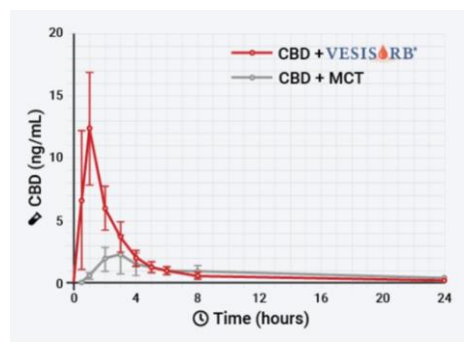
We've acquired a licence for VESIsorb, a patented technology that improves the absorption of ingredients into the body. 80% of the cannabis oil someone consumes isn't absorbed but passes through their system. VESIsorb increases the bioavailability of cannabis oil so that the body absorbs four times more cannabinoids. One of the big problems with cannabis is that it's expensive. With this technology, patients who'd typically take 4ml will only need 1ml, making it far more affordable. VESIsorb will also make our oils more effective. Rather than taking the oil two hours before sleeping or waiting two hours for pain relief, our product will work far faster.

<sup>1</sup> GMP is the medicine manufacturing standard set by the European Medicines Agency.

We will launch this product under our own brand as a premium consumer product as there is a significant difference in the efficacy of this product compared to what's currently in the market.

We have an exclusive ten-year licence for VESIsorb covering New Zealand, the UK and Europe for products we're already selling. In Australia, it's a broader licence, giving us more options for new products.

**Figure 6: VESIsorb increases absorption by up to four times**



Journal: Molecules, 2019 Volume: 24 Number: 2967

**Source:** ECS Botanics

### What are your largest growth opportunities?

In October we signed a \$24 million, five-year supply contract with MediCann Health which commenced in January. This significantly boosts the more than \$26 million in supply contracts we had at the start of 2023, most of which is for delivery over the next three years.

In August last year, we received a license to double the size of our facility. This expansion involved building six new greenhouses or protective cropping enclosures (PCE), which we completed in March. Based on current pricing, based on two cycles, each PCE will generate up to \$700,000 a year of product sales. With the completion of these enclosures, we now have a full complement for the upcoming season.

We also received approval to grow the facility to 15 acres<sup>2</sup>, which can cultivate up to 13 tons compared to the 4 tons we produced in FY23. And the demand is there for it. Also, in July last year, the regulator made it more difficult for importers, requiring them to have the same approvals as local producers. A strange outcome of the Australian demand was that the regulator lowered the requirements for importers. They've now wound back some of those concessions, so it is closer to a level playing field.

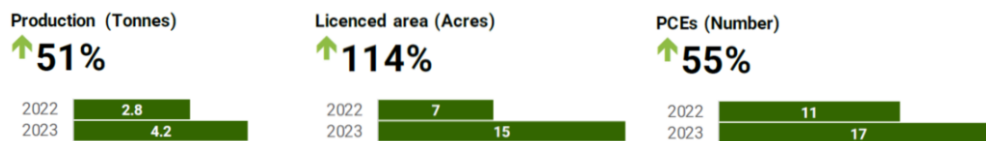
This expansion allows us to produce more flower, directly increasing revenue. Additionally, we are actively working on reducing our costs, which should significantly increase EBITDA. We intend to reinvest most of these profits back into the business, focusing on growing production and improving efficiencies.

As I mentioned, we're also launching our new consumer brand, which we think has huge potential. We'll initially launch it here in Australia, but eventually, we'll probably take it to Europe. We don't have the sales operations to sell to European consumers for now.

<sup>2</sup> ECS Botanics has a total of 179 acres available for cultivation



Figure 7: ECS has the capacity to more than triple its production



Source: ECS Botanics

**You've mentioned a few times that demand is far outstripping supply, which is why 80% of Australian cannabis is imported, so what's stopping you from expanding?**

The primary constraint for our expansion is cash. It's a challenging time to raise funds given the low share price, which, in my view, is undervalued but reflects the broader market sentiment. Additionally, in the past, the cannabis sector has burnt investors, leading to a general lack of trust and caution in investing in this space.

Despite these challenges, we believe ECS stands out. We have been operationally cash flow positive for several quarters and profitable for the year, which should begin to shift perceptions. These positive indicators demonstrate that the issues in the industry aren't universal. Our performance should reassure investors that we have a strong and viable business model.

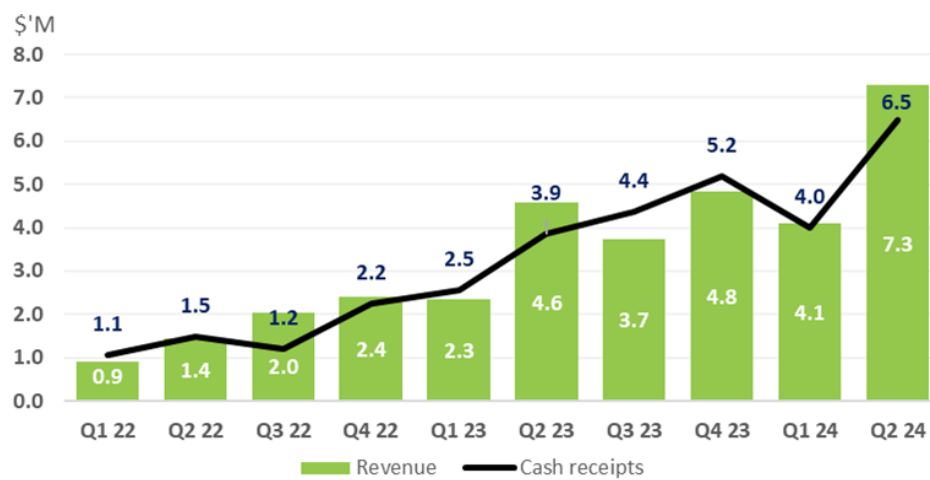
**What is it that shareholders are missing?**

Shareholders might be overlooking the fact that we are a legitimate, trustworthy business in a high-growth industry. Our company isn't just about potential anymore; it's about real, tangible results. We've transitioned from a speculative phase with no revenue to a revenue-generating and margin-expansion phase. Our goal is to be the most respected and trusted cannabis company in Australia, and this message is a key part of our current outreach.

Our track record over the past couple of years should instil confidence in our shareholders and potential investors. We've consistently met our commitments and followed through on our plans. This reliability and execution demonstrate that we are a solid business, not just in the cannabis sector but in any industry. Despite any negative market sentiment towards the cannabis sector, we stand out for our achievements and the pace of our growth. Our success to date and our potential going forward should give investors confidence in our ability to continue delivering results.

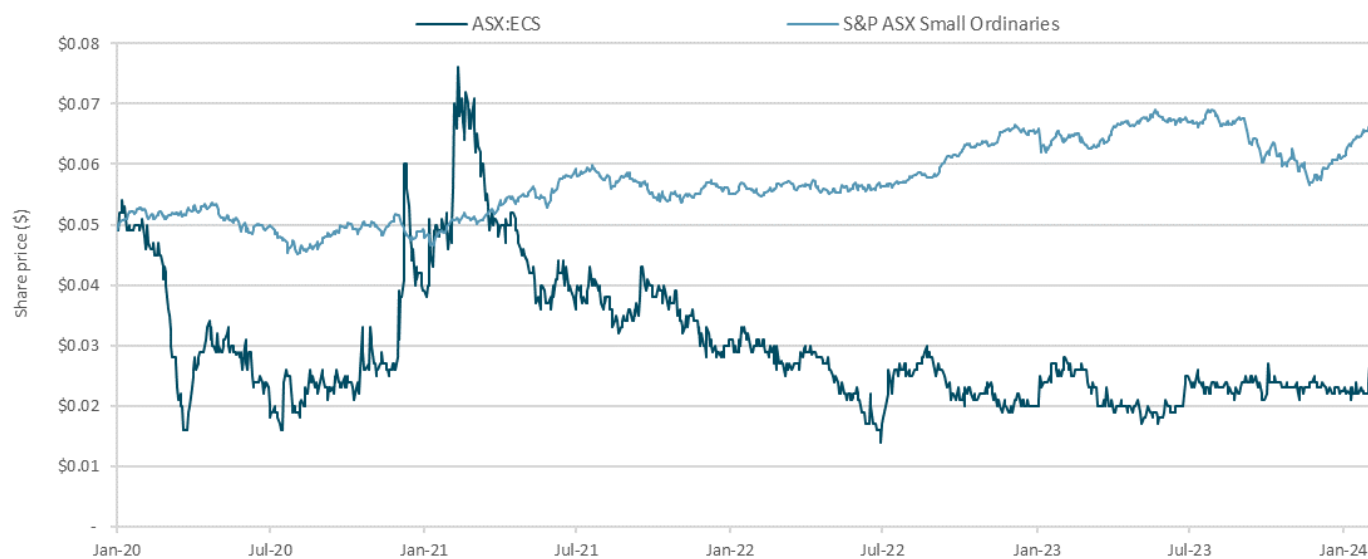


Figure 8: ECS has generated several quarters of positive operating cash flow



Source: ECS Botanics

## Share price performance



Source: Factset

# Disclaimers

## Disclaimer

Venn Brown Pty Ltd (“Venn Brown” ABN 24 665 561 900, AFS Representative No. 001305730) is a Corporate Authorised Representative of True Oak Investments Ltd (ABN 81 002558 956, AFSL 238184). The information, opinions and commentary provided by Venn Brown (“Content”) is prepared by Venn Brown. Any person receiving the Content represents, warrants and confirms that it accepts the qualifications, limitations and disclaimers set out in this Disclaimer.

All Content is only available for distribution within Australia.

All Content is intended to reflect a summary of the matters described with respect to a particular company that is covered by the Content (Investment) at a specific point in time. The Content is general only and is not intended to constitute an opinion or recommendation with respect to the Investment. Anyone viewing the Content must obtain and rely upon their own independent advice and inquiries.

Past performance is not a reliable indicator of future performance. Any reference to past performance is intended to be for general illustrative purposes only.

The Content does not purport to be complete, accurate or contain all of the information that a person may reasonably require to make an informed assessment with respect to a particular Investment. The Content may contain forward looking statements in relation to future matters which are subject to known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Investment to be materially different from those expressed or implied by the Content.

The Content has been prepared based on information available to Venn Brown at the date the Content is published. All information is believed to be reliable. However, none of Venn Brown or its related entities (as defined in the Corporations Act 2001 (Cth)) nor any of their respective directors, officers, employees, advisers or representatives (together “Beneficiaries”) make any express or implied representation or warranty as to the fairness, accuracy, completeness or correctness of the information in the Content (including, but not limited to, the accuracy, likelihood of achievement or reasonableness of any forecast milestones, returns, yields, future income or other statements in relation to future matters). Nothing contained in the Content can be relied upon as a promise or representation by any Beneficiary.

The Content does not constitute an invitation, recommendation or offer by any Beneficiary in relation to the Investment. The Content is not a prospectus, product disclosure statement or other disclosure document (as each of those terms are defined in the Corporations Act 2001 (Cth)) and does not contain all of the information that would be contained in a prospectus or other disclosure document prepared under the Corporations Act 2001 (Cth).

To the maximum extent permitted by law, the Beneficiaries will have no liability for any loss or liability of any kind: (i) arising in respect of information contained or not contained in the Content; or (ii) arising from a person relying on any information or statement contained herein.

## General Advice Warning

The Content may contain general advice, which is prepared without taking your personal objectives, financial situation or needs into account. Before acting on any general advice, you should consider the appropriateness of it having regard to your personal objectives, financial situation and needs. You should obtain and read any prospectus, product disclosure statement or other disclosure document (as each of those terms are defined in the Corporations Act 2001 (Cth)) before making any decision to acquire a financial product referred to in the Content. We suggest you seek independent professional advice if in doubt. Please refer to our Financial Services Guide (available at [www.vennbrown.com/disclaimer](http://www.vennbrown.com/disclaimer)) for contact information and information about remuneration and associations with product issuers.

Investing in small and medium-cap companies carries inherent risks, with companies being affected by events that may be unforeseeable and out of management’s control. As an investor, you are solely responsible for your investment decisions.

Financial products are complex and involve a risk of loss, may rise and fall, and are subject to a range of market and economic factors. It is recommended that you seek professional advice to ensure that trading or investing in such products is suitable for your specific circumstances and that you obtain, read and understand any applicable prospectus, product disclosure statement or other disclosure document (as each of those terms are defined in the Corporations Act 2001 (Cth)).

## Disclosures

Venn Brown may be engaged and compensated by the companies featured in its Content for ongoing research coverage. In such instances, Venn Brown receives fees from the company mentioned in the Content for research services and other financial services or advice it may provide to that company. Venn Brown does not receive commissions or other performance based-fees from companies. Please refer to our Financial Services Guide for information about remuneration we may receive in relation to our services. The company has facilitated communication with senior management and provided information on the company and industry. As part of our due diligence, we have independently and critically reviewed the assistance and information provided by the company to form the opinions expressed in the report. Diligent care has been taken by the analyst to maintain an honest and fair objectivity in authoring this report and making any recommendations.

Beneficiaries may, from time to time, hold interests, transact or hold directorships in, or perform paid services for companies mentioned herein. Beneficiaries may hold securities in the companies mentioned herein and may trade in those securities as principal, potentially contrary to recommendations mentioned in the Content.

## Privacy Policy

Venn Brown takes your privacy seriously. This Privacy Policy outlines the types of personal information we collect, how we use it, and how we protect your privacy.

We collect personal information such as your name and email address when you subscribe to our financial research service. We may also collect information about your browsing behaviour and IP address when you visit our website.

We use the personal information we collect to provide you with financial research and market analysis that we believe will be of interest to you. We do not share your personal information with any third parties. We may use your email address to send you updates about our services and promotional offers.

We take appropriate technical and organisational measures to protect your personal information from unauthorised access, disclosure, alteration, or destruction. We limit access to your personal information to authorised personnel who need to know the information in order to provide our services to you. You have the right to access, correct, or delete your personal information at any time. You may also object to the processing of your personal information or request that we restrict the processing of your personal information. To exercise any of these rights, please contact us.

We may update this Privacy Policy from time to time to reflect changes in our practices or for other operational, legal, or regulatory reasons. We will notify you of any material changes to this Privacy Policy by posting the revised policy on our website.

## Terms of Service

By using our website and services, you agree to the following terms and conditions. Venn Brown provides issuer sponsored Content on an as is basis. This Content is intended for informational purposes only and should not be considered as a recommendation or advice to invest. The research provided by Venn Brown should be read in conjunction with our Disclaimers and Privacy Policy.

You are solely responsible for any investment decisions you make based on the information provided by Venn Brown. All content provided by Venn Brown is the property of Venn Brown and may not be reproduced or distributed without our permission. Venn Brown may modify or update these terms and conditions at any time without notice.