GB Sciences, Inc. (OTCQB: GBLX), a Speculative Buy Ahead of Shareholder Meeting

The silver lining is that GBLX is transparent and we give it a speculative buy with a price target of $1.2 in the short-to-mid-term

MIAMI, FLORIDA, USA, January 18, 2018 /EINPresswire.com/ -- Emerging Growth Newswire - On March 7, 2018, medical cannabis player GB Sciences, Inc. (OTCQB: GBLX) will hold a special shareholder meeting, in line with its recent Form DEF 14A filing with the SEC. Shareholders will vote on two issues that will materially impact the long-term success of the company.

The two key issues that shareholders will vote on are: a proposal to re-domicile the Corporation from the State of Delaware to the State of Nevada; and a proposal to approve an amendment to the company's certificate of incorporation to increase the number of authorized shares from 250 million shares to 400 million shares.

The company has been the subject of heightened investor interest since late November 2017, when it announced approximately $200,000 in revenues from its Las Vegas-based cultivation facility for the six months ended September 30, 2017, compared to zero revenue in the same period the prior year. As will be discussed later in the article, the facility has the potential to generate $10 million annually when operating at full capacity, explaining why news that the facility had produced its first revenue was received positively.

Investor sentiment has been positive since November 2017

GBLX describes itself as a company that "seeks to be an innovative technology and solution company that converts cannabis plants into medicines, therapies and treatments for a variety of ailments." As the wording suggests, the company is still in the process of product development and does not have an end product in the market. In view of this, the proposed change in domicile from Delaware to Nevada is timely as it will help accelerate the process of bringing the product to market—Nevada has more progressive marijuana laws in comparison to Delaware.

In Delaware, access to cannabis for medical reasons was legalized in 2011 under Democrat Governor, Jack Markel. The first medical marijuana clinic opened in 2015, four years after legislation paved way for use of medical marijuana. In contrast, medical use of marijuana in Nevada has been legal since 2000 while recreational use has been legal since January 2017. Nevada also licenses marijuana growers and distributors, explaining why GBLX's built its cultivation facility in Nevada and not in Delaware.

Since GBLX is still not profitable, and it can't access conventional financing from banks due to the federal status of marijuana as an illegal substance, its financing strategy largely depends on issuances of common stock, convertible notes and warrants. All of these tend to lead to an increase in outstanding shares, introducing the need for the company to have a high number of authorized shares.

These points summarize why it is requesting shareholders to approve proposals to change the corporate domocile and increase the number of authorized shares.

Operational alignment

GBLX’s core operations are currently in Nevada, where it has a 28,000 square feet cultivation facility in Las Vegas that is operational but still requires additional work. This facility is the company’s “top priority,” according to notes in its quarterly report for the period ended September 30, 2017. Tellingly, the company’s CEO, John Poss, who also doubles up as the board chairman, runs the business from his Teco Avenue office in Las Vegas.

From an operational point of view, GBLX’s core business is in Nevada. But from a legal standpoint, the company’s corporate address is Delaware. Though this does not hinder it from doing its business, it adds layers of complexity in administration due to the disparity in state laws regarding the legality of cannabis.

According to the aforementioned quarterly report, the Las Vegas-based cultivation facility has the potential to generate $10 million annually when all phases of construction are completed. However, successful completion of construction requires additional financing, which the company will need to source externally.

Convincing a financier to put money in a business is easier when operations are aligned, explaining why the shift in corporate address from Delaware to Nevada is essential for GBLX’s long-term success.

In May 2017, the cultivation facility harvested its first cannabis. As a result of the harvest, GBLX recorded net revenue of $190,745 for the six months ended September 30, 2017. This illustrates that the company’s revenues are directly tied to the success of its Las Vegas operations, underlining the importance of domiciling the business in Nevada.

Company’s revenue tied to Las Vegas operations

GBLX has a production license in Nevada that allows it to convert cannabis plants from its cultivation facility into oils and extracts that are suitable for creating medical compounds. However, with revenues of just under $200,000, the company is not in a position to fund the end-to-end production and marketing of cannabis-based medicine using cash from operations. It needs a robust financing strategy, explaining why its request to shareholders to approve the increase of authorized shares from 250 million to 400 million is consequential for long-term success.

Financing strategy

Whether or not GBLX will produce and sell cannabis-based medicine depends to a great extent on shareholders’ approval of the proposal to increase authorized shares.

The company heavily depends on convertible notes and warrants. Though this strategy allows it to generate capital for its near-term cash flow needs, it leads to the creation of new shares and an increase in outstanding shares, which dilutes existing shareholders.

A convertible note is a financial instrument through which a lender gives money to a company with the option to convert the debt into shares of common stock at any time. On the other hand, a warrant offers investors the right but not the obligation to acquire stock in the company at a set price by a given date.

Before explaining how warrants and convertible notes dilute shareholders, it is first important to illustrate the central role that these instruments play in GBLX's financing strategy.

In March 2017, the Company issued short-term promissory notes to various holders with combined face value of $965,500. The notes were convertible into 3,862,000 shares. The Company also issued 3,862,000 common stock warrants to the Note holders.

During the three months ended June 30, 2017, the Company issued short-term promissory notes to various holders with combined face value of $1,034,500. The notes were convertible into 4,138,000 shares of the Company's common stock. The Company also issued 4,138,000 common stock warrants to the Note holders.

These two examples—though there several others that are outlined in detail in the quarterly report—demonstrate that GBLX's financing strategy has the net effect of increasing outstanding shares.

An increase in the outstanding shares tends to dilute existing shareholders. Imagine you had to share one pie with three of your friends; each of you would get a quarter. If four more friends joined the party and you now totaled eight; each would get an eighth of the pie. While the size and value of the pie stays the same, the size and price of each piece will become smaller

This simple analogy demonstrates the impact that increasing outstanding shares has on existing shareholders.

GBLX currently has outstanding shares of 131 million against authorized shares of 250 million. This means that debt holders still have considerable room to convert their debt to shares. However, the company is not taking any chances, hence its request to shareholders to increase authorized shares to 400 million.

If shareholders approve this proposal, they will demonstrate that they are comfortable with GBLX's financing strategy, despite its dilutive effect on shareholders. It could also be an indicator that they believe that GBLX will at some point be able to access conventional financing, particularly when medical cannabis laws are streamlined at a federal level and banks get the green light to put money in medical cannabis companies.

Transparency

Admittedly, GBLX's financing strategy is not the best way to raise money. Nevertheless, it is a necessary compromise as most cannabis companies cannot access conventional bank finance due to the classification of marijuana as an illegal substance under federal law.

The silver lining is that GBLX is transparent as far as acknowledging its dependence on financial instruments such as convertible notes is concerned. In SEC filings, the company admits that: "If unable to raise the necessary capital at the times required, the Company may have to materially change the business plan, including delaying implementation of aspects of the business plan or curtailing or abandoning the business plan."

The admission by GBLX's management that it could change its business plan if things don't pan out is bold. It shows that the company is candid about the risks in the medical cannabis field. Despite the hype about medical cannabis, approval of medicines is still a lengthy process.

Market leader GW Pharmaceuticals (NASDAQ: GWPH) was granted market approval for its Sativex drug in the U.K. in 2011, despite beginning research in the late 90s. Approvals for drugs is a lengthy and complex process, especially for a company with limited finances. GBLX has factored this risk into its outlook, as illustrated by its admission that it may change its plans in case things don't work out. This transparency is a welcome departure from the overzealousness that characterizes many cannabis players.

Terra Tech Corp (OTCQX: TRTC), which also heavily relies on convertible notes and other financing instruments that dilute shareholders, has not been candid about its prospects. It has outstanding shares of 903.17 million against shares authorized of 990 million, leaving limited room for debt holders to convert existing debt to stock. However, the company has not issued any definitive guidance on how it intends to address this issue. On the contrary, it has consistently portrayed an image of strength and avoided conversations about financing, despite massive insider selling by the CEO Derek Peterson as recently as January this year.

GBLX does not have the best of financing strategies, but at least it is candid about it. The company is also not trying to do to many things at once and management is exclusively focused on Nevada at the moment. It should be able to win shareholders' approval for its proposals to shift its corporate address to Nevada and increase authorized shares. In view of this, it is a speculative buy with a price target of $1.2 in the short-to-mid-term.

Emerging Growth Staff
EmergingGrowth.com
305-323-5687
email us here
