

*Tormont50: Identifying timely topics and trends in the sub-\$300 million market.*

Research Type: **Emerging**

Timeliness: **Current**

Date: **May 30, 2018**

## Cannex Capital Holdings, Inc.



**CNNX \$0.92**

Canadian Securities Exchange | Market Cap \$80.2M

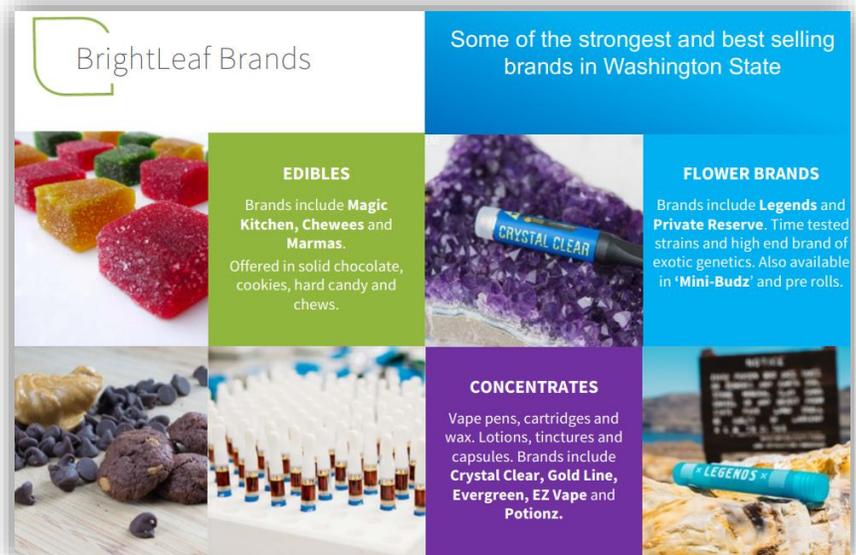
**Description:** Cannex Capital Holdings may be the new kid on the Cannabis Industry block, with its public debut on March 14, 2018, but a late start should not be considered a sign of inexperience. The company boasts a seasoned management team that includes COO Leo Gontmahker, the co-founder of Northwest Cannabis Solutions (NCWS), the #1 producer/processor in the State of Washington with over US\$25.7M in sales in 2017. Importantly, NCWS now represents the core operation in the Cannex portfolio, as the company’s leading strategic tenant. Cannex’s strong start can be traced to an important attribute – **it is currently more advantageous to raise money and run a U.S-centric cannabis company if the headquarters is outside of the U.S.** That will continue to be the case as long as marijuana is legal at the state level, but illegal at the Federal level – a condition with an indeterminate future.



**A Strong Start:** The Vancouver-based company raised \$48M in conjunction with its listing, the largest to date for a U.S.-oriented operator in the space. With the financing originally planned for \$25M, this strong showing at nearly double the original goal was a great indicator of investor demand for entry into a U.S.-centric cannabis play. Interest was also spurred by the metrics, as **Cannex at the time claimed the highest trailing revenue of any publicly-traded U.S.-focused cannabis company.**

Cannex has the feel of an emerging conglomerate in the space. The company’s primary asset is BrightLeaf Development LLC which holds real estate assets, property leases, brands and intellectual property, and material supply agreements with NCWS, the largest cannabis producer and processor in the Pacific Northwest; in addition to an agreement with 7Point Holdings LLC, another Washington State licensed cannabis producer/processor. Through its wholly-owned subsidiaries, Cannex has created a turn-key operation, offering a comprehensive range of services including real estate and financial management, branding and IP to licensed cannabis business operators domestically and internationally. Unlike narrowly focused operators who are now attempting to branch out, Cannex started with a wide-ranging business plan covering many of the verticals, leaving mostly infill and geography to complete the plan. That strategy has positioned the company as a near perfect partner, with just a few more areas to fully round out its coverage of the space.

Thus far, Cannex has focused on premium indoor cultivation and brands in the edible and derivative products categories. Washington State does not allow for vertical integration, so currently the company is strictly a wholesale business distributing to approximately 80% of the dispensaries in the state. With its funding

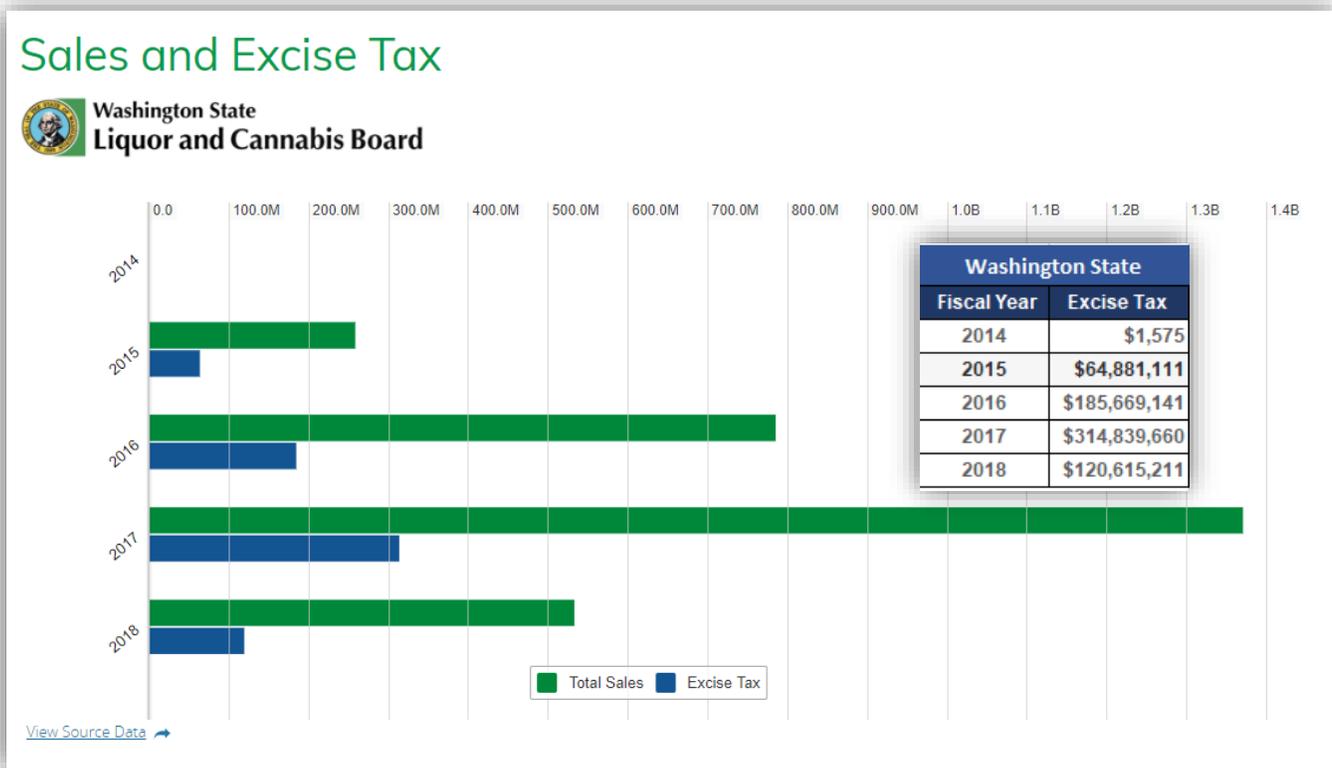


in hand, Cannex has announced plans to develop and acquire assets in additional legal medical and recreational cannabis markets, along with potential international expansion.

**Operational Excellence:** In April 2018, the company unveiled its second state-of-the-art, turnkey indoor cannabis production facility, located in Elma, Washington. The Elma facility is considered one of the world's most efficient indoor cannabis operations and features advanced technology including individualized HVAC units, auto-watering systems, and a proprietary lighting design utilizing over 2,100 flowering lights. The company believes that this new facility is one of the most cost competitive and advanced indoor facilities in the cannabis industry.

As proof of that claim the facility just announced results from its first harvest, which exceeded the prior benchmark annualized yields in excess of 500 grams/ft<sup>2</sup> set at Cannex's Tumwater, Washington facility. Remarkably, the facility's yield from its first crops may be the highest yet reported by any public cannabis company, putting Cannex on the map in terms of operational expertise. As competition increases, the best operators will clearly have a distinct advantage and yield and cost management will become an increasingly central theme in the competitive discussion.

**Positive Trends:** Government risk in the U.S., at least at the state level, became a non-issue when the coffers began to fill with cannabis-generated tax dollars. This chart, from the Washington State Liquor and Cannabis Board, shows cannabis sales passing the \$1.0 billion mark at US\$1.37 billion for fiscal year 2017, up from US\$786 million in 2016. With an annual excise tax already passing the \$300 million range in the State of Washington, government officials will almost certainly push for expansion, while politicians in other states eye those revenues with increasing envy. Washington State is the 13<sup>th</sup> most populous state in the U.S. with about 7.4 million residents, putting some perspective on the crown jewel of the state markets, California, which is more than five times larger at 39.4 million residents.



**Cannex Eyes California:** With coverage and leadership in the recreational and medical markets in Washington through its two facilities in that state, it was only natural that Cannex should set its sights farther down the west coast to the emerging market in California. While medical use has been legal in California for more than a decade, recreational marijuana sales only began as of January 1, 2018. While off to a somewhat choppy start, as municipalities and city councils grapple with setting local regulations, sales growth is expected to mirror that of other progressive states.

To gain a foothold in this enormous and strategically important market, on April 9<sup>th</sup>, 2018 Cannex initiated an important acquisition of a manufacturing extraction, branding and distribution platform in California. In its first foray into the state, Cannex agreed to acquire 100% of Oakland, California-based Jetty Extracts (Ametrine Wellness Inc.). Founded in 2013, Jetty operates a leading cannabis extraction and processing facility and has established itself as one of the most trusted cannabis extract brands, with distribution in over 600 California dispensaries in 2017.

Jetty operates a licensed 12,000 sq. ft facility in Oakland's "Green Zone" where it performs extraction, manufacturing, product development and administration.

The company is known for its innovation and is currently working with Stone Brewing Company and Thorn Brewing to develop proprietary cannabis-derived terpene-infused beverages. Armed with a cannabis distribution license, Jetty is able to distribute its own brands along with other products throughout the state without a need for a third-party distributor. Most estimates for California put 2020 sales of all cannabis products north of \$6.0 billion, making this the #1 cannabis market in the United States.

**The Future:** Because the medical marijuana market in California developed rather gradually over such a long period, it would be accurate to describe that market as "quasi-medical," as clearly some recreational users took the medical route to purchase legal cannabis. Now that the recreational and medicinal are side by side, the market will undoubtedly feature both rapid expansion and consolidation. The Cannex/Jetty partnership is uniquely positioned in terms of operator expertise and creative merchandising. The coming months should feature a number of new partnerships, distribution agreements, and possible participation in consolidating this highly fragmented market. Simply put, Cannex has the potential to become one of the leading players in the California market.



This corporate slide shows management's goal to create a strong western U.S. presence.

Jetty - Small Batch Handcrafted Extracts

High quality extracts and applicators. Recognized brands.

- Vape Juice
- CO<sub>2</sub> Wax
- Pure blend
- Gold blend
- CBD blends
- Dablicator™ oil dispensers
- Vape Pens
- PAX vaporizer blends

Pesticide, Filler & Chemical Free

**Conclusion:** Cannex has a leadership position in Washington State, a strong start in California, and a multi-state strategy to replicate its systems in any geography. Utilizing BrightLeaf-designed and developed turnkey growing facilities, the company can replicate the success it achieved with NWCS in many other venues. So, the blueprint is ready to achieve similar yield and production results, along with the organizational expertise to support regional vertical markets. Based on managements' statements, 2018 should feature more acquisitions, partnerships, and expansion. Finally, to put the size of the potential opportunity in perspective, last week CIBC published estimates that the entire Canadian cannabis market would reach \$6.5B in 2020, roughly equal to estimates for California during the same time frame. So, for investors seeking a public company in the U.S. (and California, in particular), Cannex represents one of the best positioned firms in the western U.S. markets.



*Tormont50 is a venue for highlighting timely ideas and trends in individual stocks and the market. Tormont50 is not an advisory service, and does not offer buy, sell, or any other rating on the securities we discuss. The stocks we select for commentary are derived from our own research or via suggestions from Tormont50 members. We encourage participants to submit stocks or topics for discussion. Our goal for this project is to create an exclusive, “concierge” research platform that will serve both management teams and portfolio managers within the Tormont50 universe.*

This message is intended only for the personal and confidential use of the designated recipient(s) members of the Tormont50. If you are not the intended recipient of this message you are hereby notified that any review, dissemination, distribution or copying of this message is strictly prohibited. This communication is for information purposes only and should not be regarded as an offer to sell or as a solicitation. This material is based upon information which we consider reliable, but we do not represent that such information is accurate or complete, and it should not be relied upon as such. This information is current and is subject to change. Past performance is not an indicator of future results and the value of the holdings and the income derived from them can go down as well as up.