

Equity Research: Healthcare - Cannabis
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MEDIPHARM LABS CORP.		TSXV:LABS
<i>(Currency is C\$, unless noted otherwise)</i>		
Last Price (as at close 18-Jan-2018)		\$1.96
Rating		N/R
Target Price		N/R
52 Week High		\$2.36
<i>Current Share Price % 52-week high</i>		83%
52 Week Low		\$1.20
<i>Current Share Price % 52-week low</i>		163%
30-Day Average Daily Volume		200.7K
30-Day VWAP		\$1.72
Company Headquarters	Barrie, ON, Canada	
Company Website	www.medipharmlabs.com	
CAPITALIZATION		Diluted
Shares Outstanding (M)	97.5M	131.6M
Market Capitalization (\$M)		\$191.1
Enterprise Value (\$M)		\$186.7
Cash Balance (\$M)		\$6.4
Total Debt (\$M)		\$2.0
RELATIVE VALUATION	EV/Revenue	EV/Revenue
	2019E	2020E
MediPharm Labs Corp*	1.7x	1.1x
Oil Extractors**	11.4x	5.2x
CAN-Based Major Cultivators	11.5x	8.1x
CAN-US Based Operations	2.8x	1.8x
<i>** (TSX:NEPT & CNSX:CURA)</i>		
MANAGEMENT TEAM		
Patrick McCutcheon	President & CEO	
Christopher Hobbs	CFO	
David Mayers	COO	
Sybil Taylor	CMO	
Keith Strachan	VP Business Development	
MAJOR SHAREHOLDERS		
<i>Management and Insiders (9.5%), Mirae Asset Global Investments (1.1%)</i>		

First \$10M Oil Shipments Gives a Taste of Lucrative Future

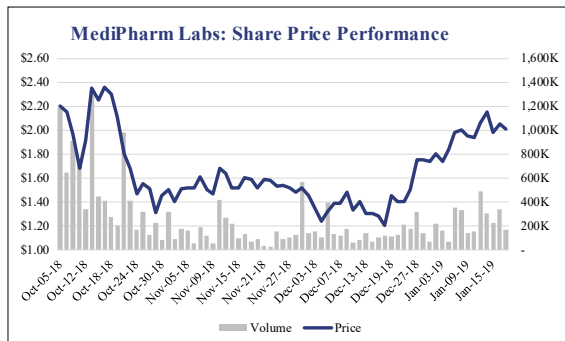
On January 16, 2019, MediPharm Labs Corp. announced that its first oil shipments were sold in December for \$10M. This follows a news release on November 12, 2018, when the Company [announced](#) it had 180 kg of cannabis extract in inventory. As well, on January 10, LABS reported that they had purchased an additional 1,600 kg of dried product, implying quick inventory turnover and material revenue, booked in Q4/18.

Other Recent News

- Solid start for 2019 – MediPharm Labs signs a three-year extraction agreement with TerrAscend Corp (CSE:TER, \$5.96 | N/R).** Under the terms of the agreement, TerrAscend will supply bulk quantities of dried cannabis to MediPharm for processing, on a fee for service basis, into cannabis resin or other premium products, derived from cannabis oil. TerrAscend is currently operating an ~18,000 sq. ft facility in Mississauga, ON, yielding ~1,000 kg annually. TerrAscend is presently in the process of building out an additional 41,000 sq. ft, which is expected to yield between 1,500 – 2,000 kg.
- On December 24, MediPharm completed Phase I of its expansion, increasing annual production capacity to 150,000 kg from 100,000 kg.** With the expansion, the Company has added two additional extraction lines, which can produce up to 6,500 kg of resin annually (equivalent to about 9.7M vape pens), bringing the facility to a total of five extraction lines. The Company is anticipating regulatory approvals from Health Canada to further increase its production capacity to 250,000 kg, which is expected to be completed by Q2/19. The completion of Phase 2 in Q2/19 should further strengthen MediPharm's extraction capacities in Canada and positions the Company to meet the significant demand for cannabis oil in Canada.

Valuation

- Trades at a discount to peers.** Based on our preliminary revenue estimates of ~\$110M for 2019 (25% utilization), the Company trades at a 1.7x EV/revenue multiple, compared with oil extractors, Canadian majors, and U.S. based peer companies, which trade at a consensus average of 11.8x, 11.4x, and 2.8x 2019E, respectively. For the following year, once the expansion is complete, if we assume 25% utilization of 150,000 kg dry flower capacity, this implies potential revenue of \$165M for 2020; once again equating a discount to peers, implying a multiple of 1.1x, (same peers), which trade at 5.4x, 8.2x, and 1.8x 2020E, respectively.



Source: Capital IQ

Company Description LABS focuses on cannabis oil extraction. The Company operates a cGMP facility and ISO-9000-rated laboratory clean rooms in Barrie, Ontario. Due to its differentiated-focused extracts-only business strategy, MediPharm acts as a strategic partner to any LP, providing both white-label production and contract processing. LABS is expanding globally and is currently developing an extraction facility in Australia, expected to be completed in 2H/2019.

Figure 1: Milling Dried Flower


Source: Company Reports

Figure 2: Cannabis Extract


Source: Company Reports

About MediPharm & Recent Developments in the Market

- **LABS is focused exclusively on the extraction of cannabis oil, a high-margin, high-growth segment of the cannabis industry.** Cannabis oils have emerged as a preferred basis for consumption due to their safety, precise dosing, and lasting shelf-life, compared to dried flower. These advantages have been driving strong growth of cannabis oils within Canada and globally.
- **According to a [report](#) from BDS Analytics and ArcView Research, retail THC/CBD concentrate sales are projected to reach US\$8B annually by 2022.** Based on data provided by [Health Canada](#), medical extract sales grew 32% from 3,374 kg sold in April 2018, to 4,455 kg sold in September 2018. We believe once recreational edibles sales begin on October 17, 2019, the growth of extract sales should significantly increase.
- **MediPharm has multiple sales agreements including the largest wholesale transaction for cannabis oil with Canopy Growth Corporation (TSX:WEED, \$57.80 | N/R).** Canopy Growth has committed to purchase a minimum of 450 kg of cannabis oil with an option to acquire an additional 450 kg over 18 months. The Supreme Cannabis Company (TSXV:FIRE, \$1.72) has also committed to supply LABS with 1,000 kg trim annually for extraction and production of cannabis oil. The Company will retain a processing fee for extracting the oil.

Figure 3: Overview of MediPharm Supply Agreements

Company	Ticker	Duration	Commitment (kg)	Announcement Date
TerrAscend Corp	CSE:TER	3-years	<i>Not disclosed</i>	10-Jan-19
Canopy Growth	TSX:WEED	1.5-years	450 kg + 450 kg option (extract)	29-Nov-18
Supreme Cannabis	TSXV:FIRE	3-years	1,000 kg annually (dried biomass)	14-Nov-18
Emerald Therapeutics Inc.	TSXV:EMH	3-years	<i>Not disclosed</i>	10-Oct-18
UP Cannabis Inc.	TSXV:HIP	<i>Not disclosed</i>	1,200 kg (dried biomass)	24-Sep-18
INDIVA Limited	TSXV:NDVA	3-years	<i>Not disclosed</i>	04-Sep-18
Bonify (6779264 Manitoba Inc.)	Private	1-year	<i>Not disclosed</i>	02-Aug-18
James E. Wagner Cultivation	TSXV:JWCA	3-years	<i>Not disclosed</i>	31-Jul-18

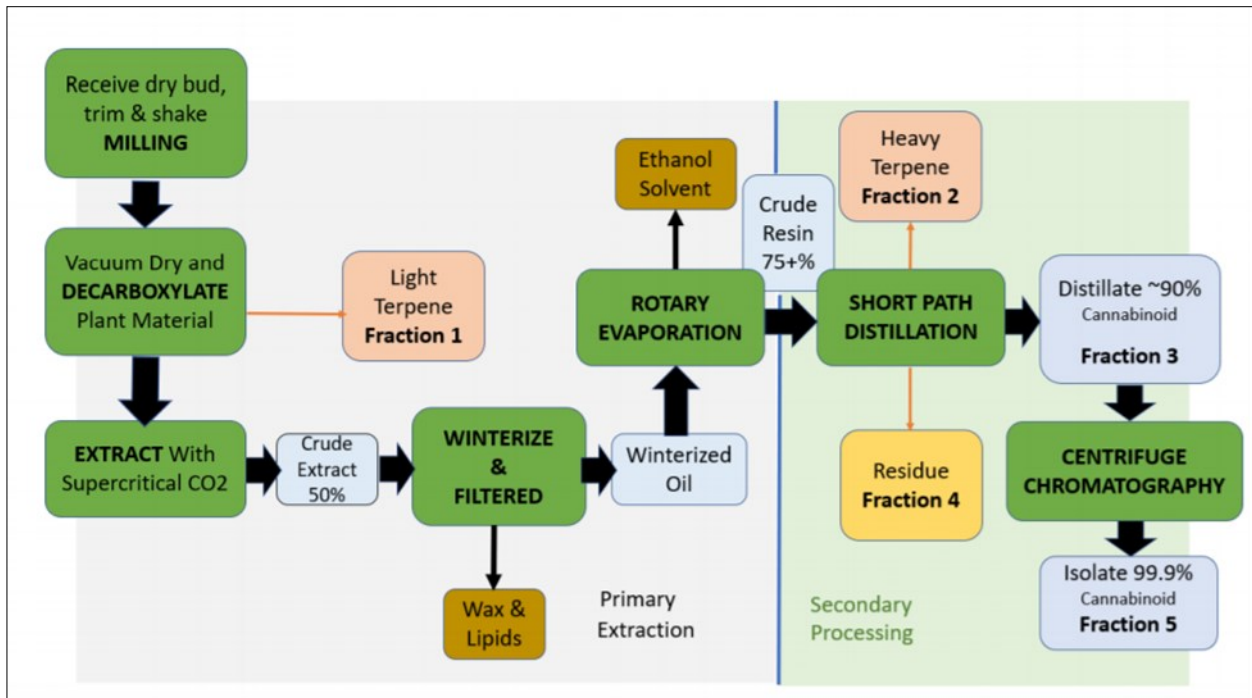
Source: Company Reports

Weak Canadian cannabis roll-out a positive for cGMP's widely shown in publications, such as the [Globe and Mail](#), [Washington Post](#), and [CTV News](#), there remains many shortfalls in the Ontario Government's cannabis rollout plans for Ontario.

- Firstly, all cannabis products in Ontario were bottlenecked through one government entity that acted as a supply and distribution centre, the Ontario Cannabis Store (OCS). The result since legalization was that it proved to be just inconvenient as one could imagine. Aside from a poorly functioning website, customers have been commonly complaining of poor-quality product (old & dry bud, faint smell, bad taste), a lack of transparency (where the cannabis is sourced from & THC strength levels with wide ranges – such as 10-15% THC), and issues with delivery. In our view, by comparison, the likelihood of these negative by-products occurring in a medical-licensed facility (licensed producer) is far lower. A medical patient has significantly more choice for different licensed producers & product.
- Secondly, in terms of retail store distribution, the Ontario government recently confirmed plans for 25 initial stores in the province using a lottery system for communities with populations of 50,000 or more. As of January 14, 2019, the first five cannabis retail locations have been [awarded](#) in the Ontario east region, with an additional 20 in the rest of Ontario. For reference, the companies/individuals selected have five days to start an application for a retail operator license. In our opinion, the main takeaways from this are;
 - 1) These applications are early stage and it should take several months for anything to be built/converted/start up, and;
 - 2) There is a high likelihood, unless the federal and provincial government change their plans, we believe that it could potentially take another 1-2 years before supply meets demand, primarily due to lack of distribution and sluggish retail store rollout For reference, California, a State with a population ~2.8x Ontario, has [815](#) retail and distribution licenses, which implies that Ontario could support 291 retail and distribution licenses.
- Importantly, Health Canada [reported](#) that as at September 2018, there is 101,720 kg of cannabis stored in vaults across Canada. As such, there is plenty of opportunity for more supply agreements to MediPharm, as licensed producers continue to look for creative ways to sell their growing inventories.

- Although we expect sales to increase once Ontario begins retail operations on April 1, 2019, we anticipate the impact on overall distribution to be minimal in the near term. As a result, MediPharm should continue to benefit from these shortfalls in the procrastinated rollout of retail stores by the Ontario government which has resulted in weak distribution, primarily since the Company manufactures and distributes medical-only product using white-labelling and contract processing. Regardless, once the legalization of edibles occurs (set for October 17, 2019), MediPharm is ready and already many steps ahead.

Figure 4: Overview of MediPharm’s Supercritical CO₂ Extraction Technology



Source: Company Reports

Figure 5: MediPharm Extraction Clean Room



Source: Company Reports

Figure 6: Left: Keith Strach (VP Business Development, Right: Patrick McCutcheon (President and CEO)



Source: Company Reports

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