

Equity Research: Healthcare - Cannabis

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NEXTLEAF SOLUTIONS LTD.		CSE:OILS
<i>(Currency is C\$, unless noted otherwise)</i>		
Last Price (April 1, 2019)		\$0.34
Rating		N/R
Target Price		N/R
Average Daily Volume		1.8M
Company Headquarters	Vancouver, BC, Canada	
Company Website	www.nextleafsolutions.com	
CAPITALIZATION		
	Basic	Diluted
Shares Outstanding (M)	96.6	125.6
Market Capitalization (C\$M)		\$32.9
Enterprise Value (\$M)		\$27.9
Cash Balance (\$M)		\$5.0
Total Debt (\$M)		\$0.0
RELATIVE VALUATION		
	EV/Revenue	EV/EBITDA
	2020E	2020E
Nextleaf Solutions	0.3x	1.2x
Extraction Companies	1.7x	5.4x
CAN-Based Major Cultivators	12.7x	67.4x
US-Based Operations	4.1x	14.1x
MANAGEMENT TEAM		
Paul Pedersen	CEO, Co-Founder, and Director	
Charles Ackerman	CFO, Director	
Ryan Ko	CTO, Co-Founder	
MAJOR SHAREHOLDERS		
<i>Management and Insiders (17%), 5 Largest Shareholders (30%), Legion (4%)</i>		
DISCLOSURE CODE: 2		
<i>(Please refer to the applicable disclosures listed on the back page)</i>		

Source: Ubika, Capital IQ

Nextleaf Solutions: Share-Price Performance


Source: TMX Group

TRANSFORMING LOW-VALUE CANNABIS INTO SIGNIFICANT CASH FLOW
COMPANY DESCRIPTION

- Nextleaf Solutions Ltd. is a Canadian extraction technology company that has developed a portfolio of issued and pending patents pertaining to the Company's unique, industrial-scale process of producing purified cannabinoid distillate, a tasteless, odourless cannabis concentrate best suited for infusing premium value-added products.** As of March 14, the Company closed its reverse takeover (RTO) financing of \$5.0M, which will be used to complete the build out of its 6,540 sq. ft. processing facility located in the Greater Vancouver Area, B.C. Based on one shift per day, OILS expects the Phase One buildout of its facility to have an estimated annual processing capacity of 100,000 kg of dried cannabis biomass. All parts and components of the ethanol-based system are designed to run 24 hours a day, 7 days a week. Thus, the Company could theoretically increase output by more than double by operating around the clock. Nextleaf expects its purpose-built facility to be completed and licensed by Q3/19. The Company currently has an issued U.S. patent on the entire end-to-end process (from biomass preparation to molecular distillation), and to our knowledge, is currently the only publicly-traded cannabis company to have a cannabis-specific extraction patent granted by the U.S. Patent Agency.

INVESTMENT THESIS

- Nextleaf's focus on ethanol allows the Company to effectively process large amounts of biomass, leading to lower CAPEX and operating costs, and higher efficiencies than its direct competitors.** The difference in scaling between using ethanol and supercritical CO₂ for primary cannabis extraction appears very significant. According to management, with Nextleaf's patented ethanol technology, the Company estimates a processing capacity of ~60 kg/hour, compared to ~2-5 kg/hour using supercritical CO₂ extraction technology that utilizes a similarly-sized system with a much higher CAPEX. As legal cannabis production in Canada continues to increase, cost-efficient, scalable, cannabis extraction and processing technology is likely going to be required to support a rapidly-growing demand for value-added cannabis products, such as vape pens, edibles, beverages, and topicals.

VALUATION

- Undervalued compared with peers.** Based on our preliminary revenue estimates of \$80.4M for 2020E, Nextleaf trades at 0.3x sales, compared with other cannabis extractors, Canadian majors, and U.S.-based operations, which trade at a consensus average of 1.7x, 12.7x, and 4.1x, respectively. We note that in our initial analysis, we only assumed one shift per day (Nextleaf can do more than two) and modelled ~17% utilization of Nextleaf's Phase 1 (100,000 kg/year) in 2019E. As a result, we believe there is plenty of room to exceed our estimates. If we increase utilization to 50%, we believe Nextleaf could reach revenue of \$113.5M in 2021E.

COMPANY HIGHLIGHTS

Figure 1: Company Logo



Source: Company Website

Figure 2: Refinement and Purification



Source: Nextleaf Solutions

Figure 3: Formulations and R&D Room



Source: Nextleaf Solutions

- **There is an estimated 9M sq. ft of proposed and licensed cannabis greenhouse cultivation space within a one-hour drive of Nextleaf's facility that is anticipated to produce more than 300,000 kg of dried cannabis and an additional 100,000 kg of trim and waste per year.** Based on recent announcements by other extraction-focused publicly-traded companies, such as MediPharm Labs (TSXV:LABS) and Valens GroWorks Corp (CSE:VGW), we believe the top licensed Canadian cannabis companies are not well-equipped to adequately process their own biomass, as a result of deploying the majority of their capital and resources over the last five years into expanding their cultivation capacity. In our opinion, these large cultivators are now beginning to realize that processing at scale is a lot more complex than originally anticipated, and that they are far behind on extraction, refinement, and purification technology. For example, LABS has signed multiple, multi-year extraction contracts, including agreements with prominent companies such as Canopy Growth, Supreme, Emerald Therapeutics, and Up Cannabis. Similarly, VGW has signed multiple extraction agreements with companies such as The Green Organic Dutchman, Organigram, Tilray, and Canopy Growth. In our view, Nextleaf remains a prime candidate for multi-year extraction agreements with major and intermediate licensed cultivators who lack sufficient extraction and purification capacity, as well as junior and micro cultivators who may not have the equipment, capital, expertise, or license to facilitate their own extraction and purification.
- **Distillate vape pens are the future.** We believe concentrate sales in Canada will increase to more than 25% of total market share of cannabis products within three years. We are basing this assumption on data from two mature legal cannabis markets in the U.S.: Colorado and Washington state, which legalized recreational marijuana in November 2012 and January 2014, respectively. In Colorado, non-flower products went to 38% of total sales in 2017 from 26% of total sales in 2015. Additionally, data from the Washington Liquor and Cannabis Boards shows that ~18,000 kg of extracts were produced in 2017, a 353% increase from 5,100 kg in 2015. In Canada, we already have a decent sample size as well: based on data provided by [Health Canada](#), ([new data](#)) medical cannabis oil sales grew 33% to 4,983 kg in January 2019, from 3,734 kg in April 2018. In comparison, medical dried cannabis sales were down 24% to 1,779 kg in January 2019, from 2,354 kg in April 2018. In our opinion, once value-added cannabis products are legalized for the Canadian medical and recreational markets (estimated to be legal by October 17, 2019, the federal government's target date for legalizing these types of products), the growth of derivative cannabis product sales should follow a similar trajectory in the recreational market, as seen in the medical market, and increase significantly over the next three-year period.

COMPANY HIGHLIGHTS CONTINUED

Primely positioned to benefit from the future macroeconomic conditions of the cannabis markets. We believe demand for dried flower in Canada has been overestimated by the market, especially when derivative cannabis products enter the legal framework later this year. Thus, this excess biomass will have to be processed/extracted somewhere, otherwise, it could become bottlenecked in minimal distribution channels, and/or worthless as inventory, leading to potential write-downs for licensed cultivators. We fundamentally believe that the average amount of medical cannabis authorized per client of 2.1 grams/day (as published on [Health Canada](#)) is unsustainable in the long term. For example, the State of Colorado notes that customers consume an average of 1.60 grams/day if they use cannabis 26-31 days/month. Alternatively, customers that frequent 11-15 days/month consume an average of 0.67 grams/day. We highlight that even if packaged and cared for properly, the shelf life of dried cannabis flower is limited to 6-12 months. In comparison, cannabis distillate is estimated to have a shelf life of more than three years or longer, depending on storage conditions. As of January 2019, [Health Canada](#) reported 114,628 kg of dried cannabis was inventoried by Canadian licensed cannabis companies, an increase of 131% from 49,710 kg in April 2018. In the same month, only 7,856 kg of dried cannabis (medical and recreational) was sold to clients (19,099 kg was available for sale). On this subject, our general questions are: what proportion of this inventory is sellable as flower, who is going to buy it, and how will it get distributed? We note that although this inventory might appear as an oversupply, we do not believe this to be true. To us, it's likely that a majority of this reported dried cannabis inventory is low-quality, extraction-grade biomass. For instance, 7/12 cannabis oil products (THC & CBD) on MedReleaf's website are currently sold out. Extraction companies, such as Nextleaf, have the potential to purchase all this excess, low-quality biomass as low-cost material used for extraction and purification.

Issued patent for extraction and purification of cannabinoids represents significant value. On March 28, 2019, the Company announced that it had received a U.S. patent for its proprietary extraction, refinement, and distillation process for cannabis. Additionally, the Company has also been granted a standard patent from the Australian patent agency, IP Australia. According to management, Nextleaf is the first publicly-traded company to be issued a patent for the extraction and purification of cannabinoids. For reference, the THC/CBD extract is tasteless, odorless, with a standardized potency, and is expected to be used in a wide range of cannabis products, including vape pens, edibles, oils, beverages, and topicals.

The Company plans to act as a strategic partner to any licensed standard and micro cultivators, providing primarily tolling and wholesale processing services, as well as white-label production of products like vape pens. Nextleaf currently has an issued U.S. patent on the entire end-to-end process (from biomass preparation to molecular distillation), and to our knowledge, is currently the only publicly-traded cannabis company to have a cannabis-specific extraction and purification patent granted by the US Patent Agency. OILS also expects to be issued another U.S. patent on its cold filtration methodology by Q2/19, and two more are pending (process and system & extraction using a proprietary chilling system).

COMPARABLE COMPANIES
Figure 5: Nextleaf Comparable Companies

Company Name	Last Price (\$CAD)	Mrkt Cap (\$CAD)	EV (\$CAD)	Cash (\$CAD)	Debt (\$CAD)	EV/Revenues		EV/EBITDA	
						2019E	2020E	2019E	2020E
<u>Cannabis Extraction Companies</u>									
MediPharm Labs Corp.	\$3.70	\$352	\$343	\$6.4	\$2.0	3.5x	1.9x	16.3x	6.2x
Radiant Technologies Inc.	\$1.00	\$271	\$227	\$37.6	\$6.7	n/a	n/a	n/m	n/m
Valens Groworks Corp.	\$2.91	\$271	\$269	\$1.7	\$0.0	6.3x	2.4x	13.3x	4.5x
Halo Labs Inc.	\$0.75	\$125	\$105	\$15.7	\$3.7	n/a	n/a	n/m	n/m
Nutritional High International Inc.	\$0.29	\$88	\$72	\$6.6	\$9.2	n/a	n/a	n/m	n/m
World Class Extractions Inc.	\$0.15	\$65	\$65	\$0.4	\$0.0	n/a	n/a	n/m	n/m
Beleave Inc.	\$0.09	\$41	\$32	\$1.8	\$7.7	13.5x	0.7x	n/m	n/m
Mean Cannabis Extraction						7.8x	1.7x	14.8x	5.4x
<u>Canadian Majors</u>									
Canopy Growth Corporation	\$56.76	\$19,873	\$14,966	\$4,115.9	\$791.5	61.8x	18.7x	n/m	80.2x
Aurora Cannabis Inc.	\$12.20	\$12,239	\$11,844	\$46.8	\$347.6	38.1x	13.7x	n/m	57.3x
Tilray, Inc.	\$84.05	\$8,476	\$7,226	\$664.9	\$585.6	26.4x	12.3x	n/m	190.5x
Cronos Group Inc.	\$24.90	\$8,175	\$8,121	\$32.6	\$21.0	115.8x	33.3x	n/m	99.5x
Aphria Inc.	\$13.27	\$3,119	\$2,912	\$152.1	\$55.2	11.3x	3.8x	n/m	16.4x
HEXO Corp.	\$9.01	\$1,858	\$1,693	\$165.0	\$0.0	27.1x	4.6x	n/m	16.5x
The Green Organic Dutchman Holdings Ltd.	\$4.83	\$1,308	\$1,094	\$213.5	\$1.1	18.3x	2.2x	n/m	11.3x
Mean Canadian Majors						42.7x	12.7x		67.4x
<u>US Based Operations</u>									
Curaleaf Holdings, Inc.	\$12.30	\$5,583	\$5,426	\$0.0	\$157.2	11.2x	6.0x	32.4x	12.7x
Green Thumb Industries Inc.	\$20.65	\$4,100	\$3,897	\$193.6	\$9.8	12.8x	6.2x	61.8x	20.9x
Charlotte's Web Holdings, Inc.	\$28.11	\$2,437	\$2,336	\$100.2	\$0.6	11.5x	5.4x	35.9x	15.6x
Acreage Holdings, Inc.	\$27.20	\$2,276	\$2,105	\$95.7	\$75.4	6.4x	3.0x	28.4x	10.0x
MedMen Enterprises Inc.	\$4.03	\$1,980	\$1,733	\$106.6	\$140.7	7.2x	2.8x	n/m	26.8x
Trulieve Cannabis Corp.	\$19.10	\$1,972	\$1,891	\$54.5	\$26.5	6.4x	4.8x	14.9x	11.0x
Cresco Labs Inc.	\$15.65	\$559	\$438	\$121.4	\$0.0	1.5x	0.7x	5.6x	1.8x
Mean US Based Operations						8.1x	4.1x	29.8x	14.1x
Nextleaf						4.2x	0.3x	n/m	1.2x

Source: Ubika, Capital IQ

COMPS CONTINUED & VALUATION

Figure 6: Extraction Companies Production Statistics

Ticker	Company Name	Consolidated sq. ft.*	Annual Biomass Capacity (Grams)*	Extraction Type				Other Chemical Solvent
				Ethanol	Butane	Propane	CO2	
OTCPK:AGEE.F	Halo Labs Inc.	42,700	69,437,000	No	Yes	Yes	Yes	Yes
CNSX:EAT	Nutritional High International I	86,600	20,611,000	Yes	No	No	No	Yes
TSXV:LABS	Medipharm Labs Corp	70,000	150,000,000	No	No	No	Yes	No
TSXV:RTI	Radiant Technologies Inc	23,000	56,000,000	No	No	No	No	Yes
CNSX:OILS	Nextleaf Solutions	6,540	100,000,000	Yes	No	No	No	No
CNSX:VGW	Valens Groworks Corp	400,000	240,000,000	Yes	No	No	Yes	No

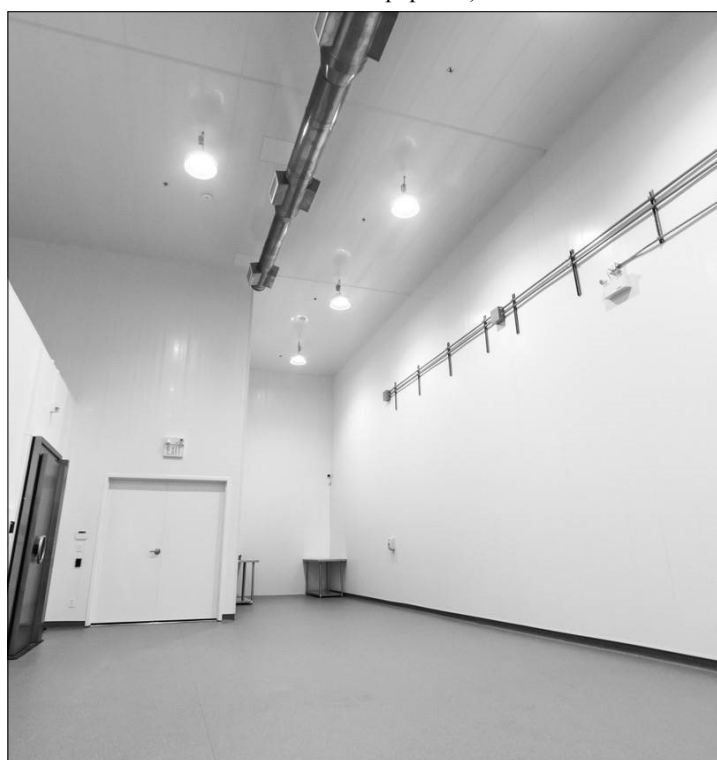
***Consolidated sq. ft & annual biomass capacities are by company estimates only. Some of these companies do not provide how much of the space is currently operating/funded**

Source: Ubika, Company Reports

- Undervalued compared with peers.** Based on our preliminary revenue estimates of \$80.4M for 2020E, Nextleaf trades at a 0.3x sales, compared with other cannabis extractors, and Canadian majors and U.S.-based operations, which trade at a consensus average of 1.7x, 12.7x, and 4.1x, respectively. We note that in our initial analysis, we only assumed one shift (Nextleaf can do more than two) and modelled ~17% utilization of Nextleaf's Phase 1 capacity (100,000 kg/year) in 2019E. As a result, we believe there is plenty of room to exceed our estimates. If we increase utilization to 50%, we believe Nextleaf could reach revenue of \$113.5M in 2021E.

Figure 7: Nextleaf's Extraction Facility

(Soon to house large, custom ethanol-based extraction and refinement equipment)



Source: Nextleaf Solutions

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Buy: Recommendation: stock is expected to appreciate from its current price beyond 20% in the next 12 months.

Neutral: Recommendation: stock is expected to trade in a narrow range from its current price level in the next 12 months.

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U/R: Under Review.

N/R: Not Rated.

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- | | |
|---|--------|
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