

Equity Research: Healthcare - Cannabis

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NEXLEAF SOLUTIONS LTD. CSE:OILS

(Currency is CAD\$, unless noted otherwise)
 (Fiscal year-end is as of Sept. 30)

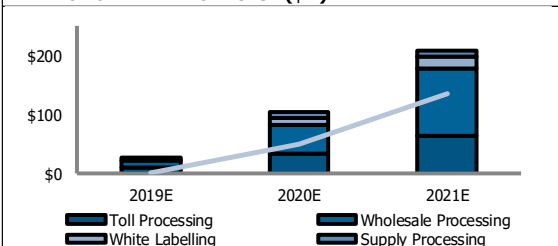
Last Price	\$0.36
Target Price	\$1.75
Potential Return	386%
Net Asset Value Per Share	\$2.37
52 Week Low / High	\$0.30 / \$0.83
Average Daily Volume (30-Day)	326K

CAPITALIZATION		Basic	Diluted
Shares Outstanding (M)		107.8	147.3
Market Capitalization (\$M)			\$38.8
Enterprise Value (\$M)			\$33.3
Last Reported Cash (\$M)			\$5.5
Last Reported Debt Balance (\$M)			\$0.0

OILS OPERATIONS	F2020E	F2021E	F2022E
Biomass Processing Volume (kg)	6,720	24,900	52,600
Crude Produced (kg)	560	1,890	3,420
Distillate Produced (kg)	240	1,000	2,520
Total Revenue (\$M)	\$35.8	\$119.4	\$232.1
EBITDA (\$M)	\$1.5	\$49.4	\$134.9
FCF (\$M)	-\$6.0	\$28.6	\$86.4
Total CAPEX (\$M)	\$6.0	\$4.0	\$3.0
CFPS	\$0.00	\$0.23	\$0.57
EPS	-\$0.02	\$0.20	\$0.56
Cash At Year End (\$M)	\$2.7	\$51.5	\$137.9
Debt At Year End (\$M)	\$0.0	\$0.0	\$0.0

RELATIVE VALUATION	EV/EBITDA		EV/SALES	
	2020E	2021E	2020E	2021E
Nextleaf Solutions	21.7x	0.7x	0.9x	0.3x
Extraction Companies	14.5x	5.2x	4.0x	2.0x
CAN-Based Major Cultivators	12.8x	17.2x	6.0x	3.3x
US-Based Operations	8.9x	5.0x	2.4x	1.6x

REVENUE & EBITDA FORECAST (\$M)



MAJOR SHAREHOLDERS

Management and Insiders (17%)
 Disclosure: 1, 3 (See back page for further details)

Nextleaf 6-Month Share Price Performance



Source: stockcharts.com

ONE MONTH PROGRESS SUMMARY

Over the course of a month, Nextleaf Solutions has made progress against its strategic initiatives with: 1) the establishment of an exclusive beverage partner agreement with BevCanna Enterprises; 2) the acquisition of water-soluble cannabis technology; and 3) the issuance of several patents. Across the same timeframe, the Company added to the foundation of its operation with the consolidation of Nextleaf Labs Ltd., and strengthened its team with the addition of Tom Ulanowski, President of Nextleaf Labs, and Board of Directors with the addition of Dr. Sherry Boodram. As Legalization 2.0 commences, the Company is setting itself up to become a force in the industry, as it ramps production and closes on commercial contracts.

STRATEGIC INITIATIVES

Acquisition of water-soluble technology puts Nextleaf in a solid position for Legalization 2.0. On September 23, 2019, Nextleaf announced the acquisition of intellectual property (IP) pertaining to water-soluble cannabinoid formulations. The IP is based around the nano and micro-emulsification process, which utilizes food-grade emulsifiers already approved by Health Canada. The power of the nano-emulsification technology is that it produces: 1) water-soluble cannabinoids; 2) shelf stable products for at least 6 months; and 3) increased onset & offset times. This solves a substantial issue with cannabis-based beverages, as most do not mimic more desirable onset timings, such as smoking cannabis or drinking alcohol (shortens the onset time to between approx. 5-20 minutes). We note that consistency is essential for mass market acceptance of THC and CBD-infused drinks, as the market matures and consumers demand further standardization. For the acquisition, Nextleaf paid \$100K in cash and \$100K in Nextleaf stock issued at \$0.51 a share. The deal includes an additional \$65K in cash and \$300K in stock if certain key milestones are hit. This follows the Sept. 16, 2019, announcement discussing an exclusive supply agreement with BevCanna Enterprises Inc. (BevCanna) (CSE:BEV), which is detailed below.

Exclusive supply agreement inked with BevCanna. On Sept. 16, 2019, Nextleaf discussed its exclusive supply agreement with BevCanna, a cannabinoid-infused beverage developer and manufacturer. BevCanna has built out a 40,000 sq. ft. bottling facility in Osoyoos, BC, with an annual production capacity of 72M bottles. Importantly, BevCanna also has a 315 acre aquifer of Canadian alkaline spring water on site. Details of the agreement are as follows: 1) BevCanna has been granted exclusive licensing rights to Nextleaf's IP that is related to water-soluble cannabinoids. The IP is to be used in product development, manufacturing and sales, and will include use in BevCanna's house brands (including the recently-announced Anarchist Mountain Beverages and Gruv), and white-label products; 2) The initial term of the agreement is 3 years after the legalization of infused products (Legalization 2.0 in Canada), with a subsequent 5-year renewal period; 3) Performance milestones include commercialization within 12 months of the legalization of infused products and edibles in Canada. The supply agreement is the first secured by Nextleaf.

STRATEGIC INITIATIVES CONTINUED

Nextleaf is well positioned to benefit from all products made by BevCanna utilizing Nextleaf's IP. Nextleaf's technology, which provides long-term stability (no settling or separation), no cannabis taste, texture or residue, and fast onset with high bioavailability, is the ideal compliment for BevCanna's beverages. Overall, we believe this partnership should be very beneficial to both parties.

Potential to tap into the \$2.0B to \$3.0B non-alcoholic, cannabis-infused beverage market in Canada. According to Molson Coors' CEO Mark Hunter, the non-alcoholic, cannabis-infused beverage market in Canada could make up 30% of the total Canadian cannabis market, which he estimates could total \$7B to \$10B over time. In our view, the major challenge in making a cannabis beverage is the unpredictable and lingering onset and offset. Currently, cannabis beverages have a long onset (45 min to 90 min) and a long offset (6 hours to 8 hours). We believe that the company that can create cannabis beverages that mimic the effect and duration of alcoholic beverages could command significant market share.

We view the exclusive agreement favourably, as it increases the number of potential revenue streams that Nextleaf could realize in 2020E and beyond. We believe product development can ramp in preparation for commercialization, and we anticipate the agreement could be material within a one-to-two-year timeframe. Of note, Nextleaf's facility, Nextleaf Labs, has its Standard Processing License, and BevCanna has its Research License. As a result, this agreement relies on BevCanna receiving its Standard Processing License from Health Canada, and a ramp up of its plant. While we are not modeling any upside from licensing fees, we believe this agreement could be material within a one-to-two-year timeframe once BevCanna receives its processing license from Health Canada and after the plant ramps up.

Nextleaf continues to bolster its patent portfolio with the issuance of three additional patents. On September 18, 2019, the Company announced that it had been issued three additional patents, one from the U.S. patent office and one from the Canadian Intellectual Property Office and another from Intellectual Property Australia. The new patents bring Nextleaf's IP portfolio to a total of eight (8) issued patents related to the extraction, refinement and purification of cannabinoids. The latest U.S. patent relates to post-extraction processing, which includes filtration, novel decarboxylation methodologies, and the targeted removal of pigments – all of which create greater efficiencies and higher throughput rates.

OPERATIONAL UPDATES

Nextleaf Solutions enters into agreement to consolidate Nextleaf Labs to streamline its operations and processes. Upon closing, Nextleaf Solutions is consolidating its commercialization partner Nextleaf Labs Ltd. through a share-purchase agreement that will include the issuance of 1M common shares at \$0.385 per share to Labs' President, Tom Ulanowski. The transaction will: 1) Consolidate Nextleaf Lab's Standard Processing Licence into Nextleaf Solutions; 2) Result in the expansion of the executive team with the addition of Mr. Ulanowski; and 3) Expand Nextleaf Solutions' in-house capabilities into delivering toll processing and white-labeling services. We believe the consolidation of the facility, assets, process, and team, solidifies the Nextleaf Solution's ability to monetization its IP portfolio.

Nextleaf Solutions adds expertise across operations, compliance and strategy with the consolidation of Nextleaf Labs, and announcement of Dr. Boodram to its Board of Directors. Nextleaf Solutions bolsters its team and Board with the addition of Tom Ulanowski to its executive team, upon closing of the consolidation of Nextleaf Labs (as mentioned above), and on October 16, the announcement that Dr. Sherry Boodram, former Senior Regulatory Compliance Officer with Health Canada, has joined its Board of Directors, effective immediately. Regarding Mr. Ulanowski, he will remain President of Nextleaf Labs, and will continue leading the effort to commission the Phase One custom extraction and purification system, and finalize commercialization contracts. Prior to joining Nextleaf Labs, Mr. Ulanowski was Quality Assurance Person (QAP) and Qualified Person in Charge (QPIC) at British Columbia's first Licensed Producer, where he: 1) Brought to market the first legal concentrated cannabis product sold in Canada; 2) QA'd hundreds of batches of cannabis; 3) Obtained multiple production and sales licenses; 4) Increased output 10-fold through facility expansions; and 5) helped develop new processes and products.

OPERATIONAL UPDATES CONTINUED

Dr. Boodram is currently the co-founder and CEO of CannDelta, a Toronto-based regulatory and scientific cannabis consulting company that provides regulatory expertise and strategic insight to help companies gain and maintain regulatory compliance. Prior to CannDelta, Dr. Boodram spent several years in the Canadian federal government, including as a Senior Regulatory Compliance and Enforcement Officer with Health Canada's Medical Cannabis Program, where she was responsible for licence application reviews, and on-site facility inspections under the Marihuana for Medical Purposes Regulations (MMPR) and Access to Cannabis for Medical Purposes Regulations (ACMPR). Dr. Boodram holds a Ph.D. in Chemistry from York University and a B.Sc. from the University of Toronto. We believe her direction and insights will support and enhance Nextleaf's compliance and governance processes; this will be especially crucial as the Company ramps its operations, closes commercial contracts, and begins producing product. Dr. Boodram's compensation package includes options to purchase up to 150,000 common shares, pursuant to the Company's Stock Option Plan, exercisable at \$0.50 per share.

VALUATION

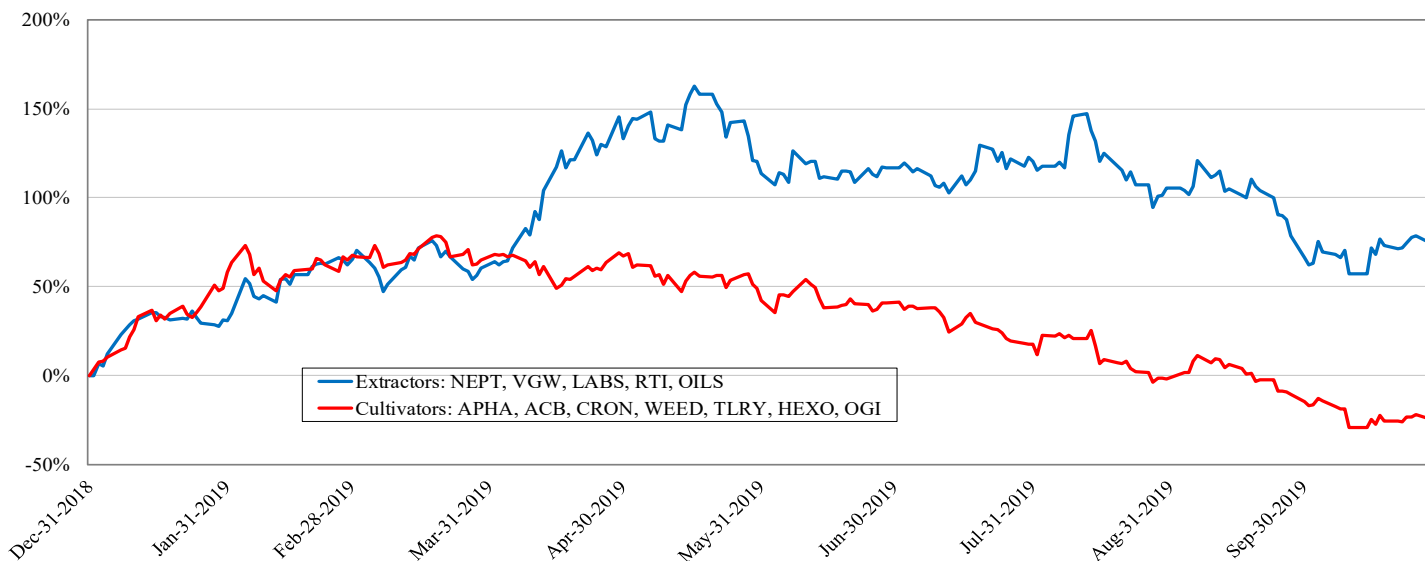
Discount to peers. As of yesterday's close, based on our estimates, OILS trades at 0.3x F2021E sales and 0.7x F2021E EBITDA, a discount to extraction peers, which trade at 5.2x and 2.0x, respectively. We expect announcements of additional supply agreements with Canadian cultivators over time, and believe this confirmation of traction will have a positive impact on Nextleaf's stock. As such, we maintain our one-year price target of \$1.75/share.

MARKET COMMENTARY

Ouch! Canopy Growth Corp is hovering around two-year lows. The cannabis market has been weak across the board due to a combination of factors, primarily due to lackluster quarterly financials in general from the larger Canadian cultivators, such as Canopy and Aurora. Investors have lost patience and are now looking for profits. This seems to be why extractors are outperforming. **As a result, fundamentals are beginning to play out in the Canadian market with a vast discrepancy between the majors, intermediates, and juniors.** The Top 5 cultivators by market cap are now trading on average at a more reasonable 2021 EV/sales multiple of 5.0x (was 7.9x in May 2019), but, in our opinion, there could be more room weakness for the traditional vertical-integrated players, especially if expectations continue to be missed.

To illustrate, we generated an equal weighted index chart comparing the Top 7 classic CDN cultivators, in comparison to the 5 extraction-weighted stocks. **Year-to-date, extractors are outperforming cultivators by 99%.** One of the best wins this year was MediPharm Labs, which was \$1.31 on October 29, 2019 (now \$4.64). Of note, the performance of each stock carries equal importance in the value of the indexes (no adjustments).

YTD Index Performance: Extractors (Blue) vs. Cultivators (Red)



Source: Capital IQ, Ubika

Nextleaf's Comps Table

Company Name	Last Price (\$CAD)	Mrkt Cap (\$CAD)	EV (\$CAD)	Cash (\$CAD)	Debt (\$CAD)	EV/Revenues			EV/EBITDA		
						2019E	2020E	2021E	2019E	2020E	2021E
Nextleaf Solutions Ltd	\$0.36	\$38.8	\$33.3	\$5.5	\$0.0	n/a	0.9x	0.3x	n/m	21.7x	0.7x
<u>Pure Play Cannabis Extraction Companies</u>											
MediPharm Labs Corp.	\$4.80	\$620.8	\$542.1	\$72.7	\$6.0	3.7x	2.2x	1.3x	14.7x	6.8x	4.0x
Neptune Wellness Solutions Inc.	\$5.11	\$486.4	\$475.2	\$5.3	\$5.8	19.4x	7.3x	2.6x	n/m	31.0x	7.5x
Valens GroWorks Corp.	\$4.02	\$489.1	\$432.1	\$57.0	\$0.0	8.1x	2.7x	2.0x	24.4x	5.8x	4.2x
Radiant Technologies Inc.	\$0.70	\$189.8	\$158.9	\$23.5	\$7.3	n/a	n/a	n/a	n/m	n/m	n/m
Mean Cannabis Extraction						10.4x	4.0x	2.0x	19.5x	14.5x	5.2x
<u>Canadian Majors</u>											
Canopy Growth Corporation	\$33.85	\$11,688.3	\$7,675.2	\$1,816.6	\$2,196.4	33.9x	12.4x	6.5x	n/m	n/m	n/m
Aurora Cannabis Inc.	\$6.75	\$6,861.8	\$6,044.3	\$172.7	\$644.8	24.4x	10.5x	5.8x	n/m	n/m	26.2x
Cronos Group Inc.	\$13.71	\$4,571.7	\$2,988.9	\$1,579.2	\$3.5	n/a	14.0x	7.4x	n/m	n/m	33.3x
Tilray, Inc.	\$38.88	\$3,790.7	\$2,980.7	\$241.4	\$568.6	12.3x	6.6x	3.9x	n/m	n/m	44.8x
Aphria Inc.	\$8.18	\$2,053.3	\$1,013.9	\$550.8	\$488.6	4.3x	1.5x	1.1x	n/m	12.0x	5.9x
HEXO Corp.	\$5.95	\$1,500.8	\$1,293.9	\$173.1	\$33.7	21.8x	3.7x	2.5x	n/m	24.7x	9.9x
OrganiGram Holdings Inc.	\$5.53	\$851.2	\$754.5	\$47.2	\$49.5	7.6x	3.6x	2.6x	19.9x	9.6x	6.8x
The Green Organic Dutchman Holdings Ltd.	\$2.62	\$741.1	\$670.0	\$68.7	\$2.4	27.0x	3.2x	1.4x	n/m	11.8x	7.4x
Village Farms International, Inc.	\$13.94	\$680.5	\$608.4	\$15.3	\$56.7	2.6x	2.0x	1.4x	12.2x	5.7x	3.5x
CannTrust Holdings Inc.	\$1.71	\$243.3	\$224.5	\$3.2	\$15.6	3.0x	1.8x	0.6x	n/m	n/m	n/m
Mean Canadian Majors						15.2x	6.0x	3.3x	16.1x	12.8x	17.2x
<u>US Based Operations</u>											
Curaleaf Holdings, Inc.	\$10.37	\$4,947.8	\$4,605.5	\$140.4	\$201.9	13.7x	3.4x	2.3x	n/m	11.5x	6.7x
Green Thumb Industries Inc.	\$13.38	\$2,958.7	\$2,620.0	\$177.6	\$161.1	9.3x	4.1x	2.7x	79.1x	14.7x	8.8x
Charlotte's Web Holdings, Inc.	\$22.10	\$2,188.1	\$2,109.5	\$67.3	\$11.3	12.6x	5.3x	3.5x	50.5x	16.5x	10.1x
Cresco Labs Inc.	\$9.10	\$615.8	\$471.6	\$80.0	\$64.2	2.1x	0.6x	0.4x	14.6x	1.7x	0.8x
MedMen Enterprises Inc.	\$2.25	\$1,189.8	\$894.5	\$29.3	\$266.0	4.6x	1.9x	1.0x	n/m	6.6x	3.4x
Trulieve Cannabis Corp.	\$11.45	\$1,294.2	\$1,065.1	\$70.7	\$158.5	3.3x	2.1x	1.7x	6.8x	5.3x	4.1x
Acreage Holdings, Inc.	\$11.88	\$1,026.8	\$878.2	\$110.5	\$38.1	3.7x	1.5x	0.8x	n/m	10.8x	3.8x
iAnthus Capital Holdings, Inc.	\$2.77	\$487.9	\$306.7	\$39.9	\$141.3	2.2x	0.8x	0.6x	n/m	3.6x	2.0x
Origin House	\$7.01	\$515.8	\$479.7	\$14.8	\$21.4	3.4x	1.7x	n/a	34.3x	9.6x	n/m
Mean US Based Operations						6.1x	2.4x	1.6x	37.1x	8.9x	5.0x
<u>Beverage Companies</u>											
BevCanna Enterprises Inc.	\$0.53	\$22.5	\$17.7	\$4.9	\$0.0	n/a	n/a	n/a	n/m	n/m	n/m
The Tinley Beverage Company Inc.	\$0.56	\$54.9	\$45.5	\$6.8	\$2.6	n/a	n/a	n/a	n/m	n/m	n/m
Sproutly Canada Inc.	\$0.40	\$73.5	\$57.9	\$3.9	\$11.8	n/a	n/a	n/a	n/m	n/m	n/m
New Age Beverages Corporation	\$3.70	\$298.6	\$110.9	\$109.3	\$78.3	0.3x	0.3x	0.3x	n/m	6.4x	n/m
The Alkaline Water Company Inc.	\$2.23	\$98.8	\$80.6	\$13.1	\$5.0	1.9x	1.1x	0.7x	n/m	n/m	n/m
Mean US Based Operations						1.1x	0.7x	0.5x	n/m	6.4x	n/m
<u>Outdoor Cultivators</u>											
48North Cannabis Corp.	\$0.78	\$134.9	\$116.9	\$18.0	\$0.0	20.2x	1.3x	0.9x	n/m	55.7x	6.6x
Speakeasy Cannabis Club Ltd.	\$0.45	\$39.1	\$27.8	\$11.2	\$0.1	n/a	n/a	n/a	n/m	n/m	n/m
WeedMD Inc.	\$1.38	\$156.8	\$109.2	\$11.3	\$36.2	2.7x	0.8x	0.7x	n/m	2.3x	3.0x
Aleafia Health Inc.	\$0.91	\$252.8	\$141.9	\$58.0	\$52.9	8.8x	0.9x	0.5x	n/m	4.1x	1.6x
Mean US Based Operations						10.5x	1.0x	0.7x	n/m	20.7x	3.7x
<u>Outdoor Cultivators</u>											
Dixie Brands Inc.	\$0.72	\$93.4	\$90.5	\$3.0	\$0.0	n/a	n/a	n/a	n/m	n/m	n/m
Plus Products Inc.	\$4.72	\$173.2	\$105.9	\$44.6	\$22.7	4.3x	1.1x	0.7x	n/m	10.6x	2.4x
Harvest One Cannabis Inc.	\$0.48	\$101.9	\$72.1	\$29.5	\$0.3	5.9x	1.2x	0.5x	n/m	5.4x	1.9x
Mean US Based Operations						5.1x	1.1x	0.6x	n/m	8.0x	2.1x

Source: Capital IQ, Ubika

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

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N/R: Not Rated.

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- | | |
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