Equity Research

A rapidly changing landscape

Initiating coverage on three marijuana licensed producers

Prepared by GMP Securities L.P.

See important disclosures on the last page of this report

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Executive summary

The global landscape with regards to the regulation of both recreational and medical marijuana has rapidly evolved in recent years. This shift has largely been driven by changing attitudes regarding the benefit/risk profile of marijuana as its acceptance as a medical treatment has grown while the perception that it is a harmful drug has diminished. The majority of the change has focused on medical marijuana with countries such as Germany, Australia, Italy and Spain adopting new regulations to make it easier for patients to access medical marijuana.

Canadian companies have the potential to become global leaders. Canada is at the forefront of the changing tide, being the first G20 country to potentially legalize recreational marijuana. This major societal change is not without challenges for the Canadian government, however, we believe legalization presents a unique opportunity for Canadian marijuana companies to be leaders in an emerging global market. The knowledge built up by the Canadian licensed producers on various strains, cultivation methods, propagation techniques and phenotyping is extremely valuable and could speed up their entry into other countries. Canada's federally regulated production and quality environment also bodes well for licensed producers to export to other countries seeking legal sources of marijuana.

Canada is becoming a marijuana hub for investors. The buzz created around the legalization of recreational marijuana in Canada has not gone unnoticed by investors globally which have sent shares of Canadian companies involved in the sector to all-time highs as the combined market capitalization of Canadian licensed producers is estimated at almost $5b. Hence, with easy access to capital, knowledgeable investors and a flourishing industry, Canada is becoming a global marijuana hub for companies and investors. Several international companies have listed their shares in Canada over the last year for these particular reasons.

Focus on expansion possibilities and first mover advantage to identify best investments. Given that Health Canada's licences are tied to one address, licensed producers with large properties in excess of 10 acres will be best positioned to expand without having to re-apply for a new licence. In addition, first mover advantage is key in this new industry as licensed producers which have already grown several crops will have much better yields, more standardized products and fewer crop failures than new entrants. Finally, strong management teams that can execute on strategic plans to drive growth and create value will be an asset.

Upcoming legislation expected to be a catalyst. We expect the Liberal government to table the bill to legalize recreational marijuana this spring. It is still unclear as to how much detail will be included in the proposed bill and whether regulations will be ironed out post-legislation approval, however, the introduction of the bill is expected to be an industry catalyst.

Recreational marijuana sales expected to begin in January 2019. Given that Canada will be a pioneer amongst the G20 countries, one can assume that the government will take time to establish a proper framework. Hence, we believe that recreational sales may only begin in 2019 as it might take 18-24 months to establish the regulatory framework.

Pieces missing from the puzzle. The regulatory framework for recreational marijuana is still uncertain and some elements may have a material impact on our valuations, hence, in reading this report investors must keep in mind our limited visibility on some material pieces of the recreational marijuana puzzle.

Initiating coverage on three medical marijuana companies. In this report we have identified three licensed producers, amongst the more than 20 in operations currently, which we think will emerge and mature into successful and profitable companies. We are initiating coverage on three companies: ACB-TSXV (BUY, TP $3.00), MJN-TSXV (BUY, TP $4.25) and EMC-TSXV (BUY, TP $3.25). First mover advantage has so far proven to be a critical competitive advantage and we believe that these companies, being early applicants, will benefit from an already established presence. We believe these companies are well positioned to be successful licensed producers and to create value for shareholders, mainly due to their capacity expansion plans and unique approach to product development and international partnerships.

Figure 1. Initiating coverage of three licensed producers

Company	Ticker	Current Price	Rating	Target Price	Projected Return	MCAP ($MM)	EV ($MM)	Target EV ($MM)
Aurora Cannabis Inc.[1,7]	ACB-TSXV	$2.40	BUY	$3.00	25%	$815	$829	$1,065
Cronos Group Inc.[1,7]	MJN-TSXV	$2.82	BUY	$4.25	51%	$349	$487	$744
Emblem Corp.[1,7]	EMC-TSXV	$2.68	BUY	$3.25	21%	$191	$287	$357

Source: GMP Securities, FactSet, Company reports

- **Aurora is embarking on an ambitious expansion plan.** We are initiating coverage of ACB-TSXV with a BUY rating and a $3.00 target price. Since launching its dried bud 14 months ago, Aurora has onboarded patients at a rate that exceeds most other licensed producers reaching 12,000 patients in the first year. This pace was driven by the acquisition of a medical clinic, differentiated product offerings including the highest THC strain, and a mobile application for convenient online ordering. More recently, Aurora has begun building an 800,000 sq. ft. facility (Aurora Sky) at the Edmonton airport, which could produce over 100,000kg annually at full capacity and is expected to have low production costs due to the scale, automation and location. We anticipate Aurora will be cash flow positive in FY19 once the Aurora Sky facility is fully operational.

- **Cronos's management has successfully crafted a new strategy.** We are initiating coverage of MJN-TSXV with a BUY rating and a $4.25 target price. Cronos' new management has created significant value for shareholders by revamping the company's strategy, accelerating expansion plans and deploying capital on attractive acquisitions. Cronos is one of two licensed producers to operate multiple licensed facilities, a plus in our view given it reduces operational risks. Over the past six months, Cronos has expanded internationally with a license agreement with Pedanios in Germany and partnered with First Nations to create Indigenous Roots, a First Nations owned and operated medical cannabis company. The company is also expecting to break ground at both of its production sites in 2017 to expand capacity to ~55,000kg. We anticipate Cronos' operations will generate positive cash flows in early FY18.

- **Emblem is a newcomer to the capital markets with a focus on pharmaceutical-like product development.** We are initiating coverage of EMC-TSXV with a BUY rating and a $3.25 target price. Emblem is a newcomer having just started trading on the TSXV in December 2016. The company currently operates a small production facility with an annual capacity of 2,100kg, however, plans are underway to expand the capacity by 10-fold on the current land. Emblem is also focused on developing pharmaceutical-like products that are convenient to take, which could have the potential to broaden the pool of potential patients and prescribing physicians. Although the company is early days in its development and commercialization strategy, we anticipate Emblem will be cash flow positive in early FY18.

Snapshot of publicly traded peers

Figure 2. Snapshot comparison of publicly traded licensed producers

	Organigram[1,7]	Cronos*	Aurora*	Emblem*	Canopy[1,7]	Aphria[7]	Average
VALUATION METRICS							
Recommendation	BUY	BUY	BUY	BUY	BUY	HOLD	
Current price	$2.42	$2.82	$2.40	$2.68	$11.05	$6.62	
Target Price	$4.00	$4.25	$3.00	$3.25	$12.75	$5.00	
Projected return	65.3%	50.7%	25.0%	21.3%	15.4%	-24.5%	**25.5%**
Market Cap, basic ($mm)	$244	$349	$815	$191	$1,743	$815	**$693**
Market Cap, fully diluted ($mm)	$270	$507	$944	$326	$1,862	$884	**$799**
EV ($mm)[a]	$211	$487	$829	$287	$1,722	$738	**$712**
EV/CY17 Sales	11.7x	34.1x	22.0x	34.9x	16.8x	25.7x	**24.2x**
EV/CY17 Production capacity (per kg)	$50,181	$121,792	$150,693	$136,802	$71,746	$98,454	**$104,945**
OPERATING METRICS							
Last reported patient count	~3,895	~3,400	~12,800	~1,500	~50,000	~6,675	**13,128**
Sales (CY16, $mm)	$7.7	$0.6	$8.4	$0.2	$30.3	$15.1	**$10.4**
Sales (CY17, $mm)	$18.1	$14.3	$37.6	$8.2	$102.5	$28.7	**$34.9**
Adj. Gross margin (CY17)[b]	64%	58%	56%	56%	70%	80%	**64%**
Opex (CY17 $/g)[c]	$4.46	$5.09	$4.97	$5.54	$4.55	$4.48	**$4.85**
Estimated production capacity (CY17)	4,200 kg	4,000 kg	5,500 kg	2,100 kg	24,000 kg	7,500 kg	**7,883 kg**
Number of licensed facilities	1	2	1	1	6	1	
Cannabis oil extracts license	Production & Sale	Production & Sale	Production & Sale	Production only	Production & Sale	Production & Sale	
Estimated long-term recreational market share	7.0%	7.0%	10.0%	4.0%	23.0%	5.5%	**9.4%**

a Based on fully diluted shares outstanding

b Adjusted gross margin excludes the fair value adjustment of biological assets and amortization

c Includes Selling, marketing, general, and administrative expenses (excludes depreciation, amortization, and stock based compensation)

* Initiating coverage

Source: Company reports, GMP Securities, FactSet

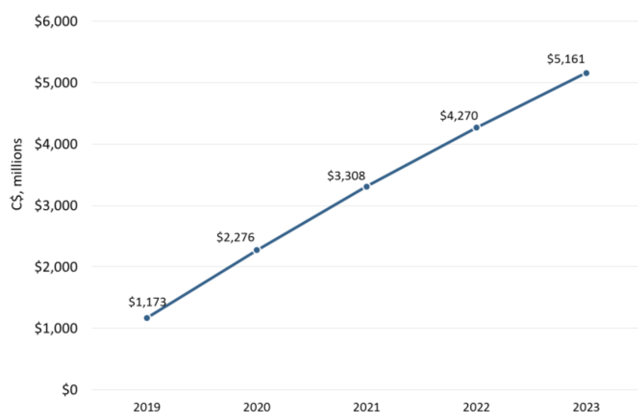
Recreational marijuana – What is the size of the opportunity?

It has been fascinating to see how quickly Canadian attitudes towards marijuana have changed in recent years. Its acceptance as a medical treatment is rapidly growing while the perception that it is a harmful drug has decreased. This change is not unique to Canadians; Americans have voted to legalize recreational marijuana in four states in the last elections, potentially giving ~20% of the American population access to recreational marijuana. Elsewhere in the world, changes are also occurring at lightning speed. Germany, Italy and Spain have all significantly relaxed the access to medical marijuana in recent years and other countries are likely to follow.

Canada is at the forefront of this change, being the first G20 country to potentially legalize recreational marijuana. This major societal change is not without challenges for the Canadian government, but the Liberals are moving forward with legalization with two main objectives: (1) shutting down the illegal market, and (2) reducing youth consumption of cannabis. Thus, we anticipate that by 2019, every Canadian adult could have unrestricted access to recreational marijuana.

Recreational marijuana sales could exceed $5b in 2023. Assessing the size of the market for recreational marijuana is challenging given the limited data available. We have based our estimates on three methods: (1) using estimates of the black market in Canada, (2) using percentage of the population estimates for marijuana consumption, and (3) using sales figures in three US states which have legalized recreational marijuana.

Figure 3. Estimated value of the recreational marijuana market (at retail)



Parameter assumptions	Recreational
Average retail price per gram of dried marijuana	$10.00
Average retail price per equivalent gram of cannabis oils	$15.00
Price erosion	3%
% dried marijuana sold	70%
% cannabis oils sold	30%

Source: Company reports, GMP estimates

Method 1: Canadian black market

Illegal market data suggests a market size of ~500 tons. According to a report published by the Parliamentary Budget Officer (PBO) in November 2016, Canadians will consume 655 metric tons of cannabis in 2018. This estimate is derived using a range of 378 tons to 1,079 tons and accounts for the consumption by individuals aged 15 and older. It is safe to assume that the black market will continue to exist despite recreational marijuana being legal, although it is expected to be much smaller. The task force recommends a minimum age of 18 for consumption of recreational marijuana. Hence, discounting for both age (15-17 years of age accounted for 6.5% of total consumption according to the PBO report) and assuming that the black market shrinks to ~100 tons, would suggest a legal recreational marijuana market of ~500 tons or $5-6b.

Method 2: Percentage of population that will consume marijuana

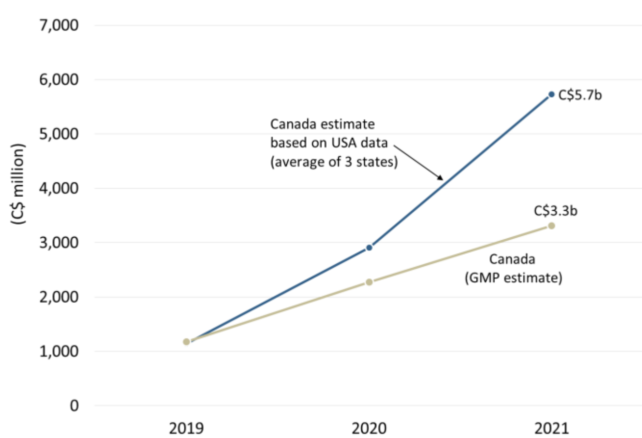
Assuming 9% of population will consume marijuana. According to the PBO report from November 2016, 7% of Canadian aged 15 and over consume marijuana more than once a month and 12% have consumed recreational marijuana once in the last year. This is slightly below observations of the US recreational markets, which suggest that recreational use averages ~11-14% of the adult population. Assuming that ~9% of the adult population aged 20 years and older are recreational users, this would suggest ~2.7m users. We are also assuming that the grams consumed per day is lower than the medical market as use ranges from weekly to annually instead of potentially daily in the medical market. Hence, an average of 0.5 grams per day would suggest that annual consumption could reach 500,000 kg by 2023, which values the market at ~$5-6b.

Method 3: US recreational market

One of the few reference points we have to assess the size of the Canadian recreational market is the experience of the US states which have legalized recreational marijuana. Of the eight states that have voted in favour of legalizing recreations marijuana, three states currently have commercial sales. Colorado and Washington voted to legalize recreational marijuana in 2012 and in 2014 commercial sales began. Oregon followed shortly after voting on legalization in 2014 with sales commencing in 2015.

US data suggests a Canadian recreational market of $5.7b by year three. A scenario assuming that Canada's recreational market mimics the US in terms of growth would suggest a Canadian recreational market valued at $5.7b by year three. This is almost 2x our current estimate of $3.3b in revenues from the recreational market in year three. Hence, we believe there could be some upside to our forecasts depending on the regulated environment for distribution, branding and advertising.

Figure 4. Estimated size of recreational market in Canada using US states as a proxy

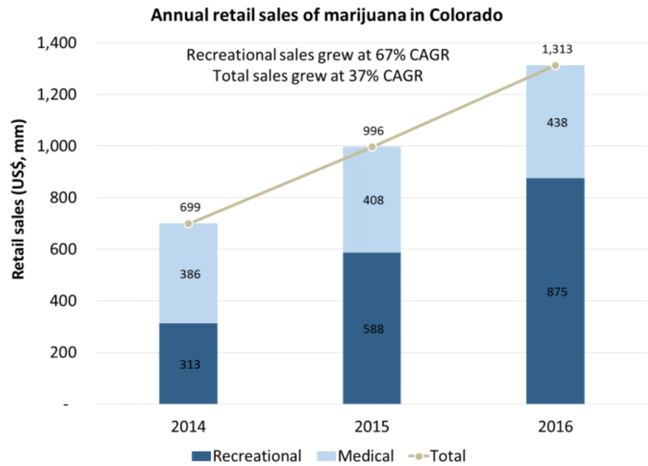


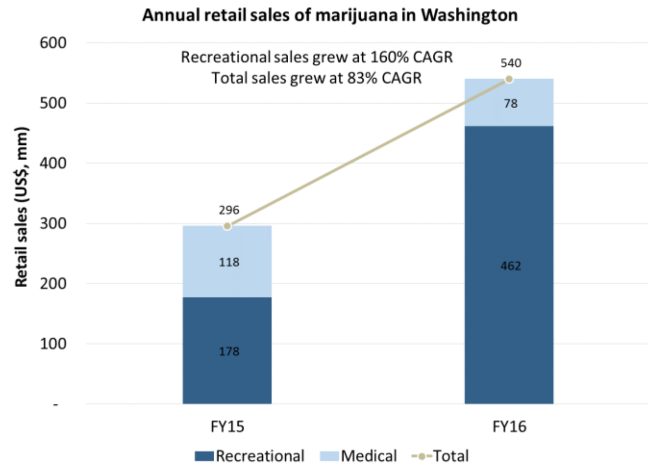
Source: GMP estimates

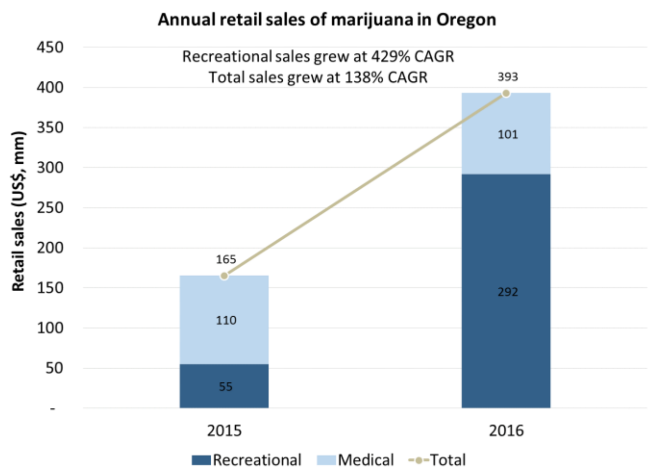
Explosive growth averaging ~225% YoY in the first year. Sales of recreational marijuana in Colorado, Washington and Oregon exploded in the first year with an average growth of ~225%, far outpacing the demand for medical marijuana, which actually declined by an average of ~12% over the same period. While we are expecting sales in the Canadian recreational market to take-off quickly, we are estimating a slower growth rate than seen in the three US states as there is still uncertainty surrounding what the final regulations will look like.

Oils and other formats outperform dried cannabis. Market research reports on Colorado, Washington and Oregon suggest that cannabis oils and other formats including edibles rapidly outpaced dried cannabis. Data suggests that sales of other formats surpassed sales of dried cannabis by year two to capture ~40% of revenues. We are also expecting oils and other formats to be popular in Canada as we believe many individuals are likely to be more comfortable with convenient formats such as oils. We are forecasting that oils and extracts will capture ~30% of recreational revenues from the start and that this will grow to ~40% over the next five years.

Figure 5. Marijuana retail sales in the US







Colorado
- Population: ~5m
- Canada is ~6.5x larger
- **Est Canadian rec market by year 3: $0.9 x 6.5 = $5.7b**

Washington
- Population: ~7m
- Canada is ~5x larger
- **Est Canadian rec market by year 2: $0.4 x 5 = $2.3b**

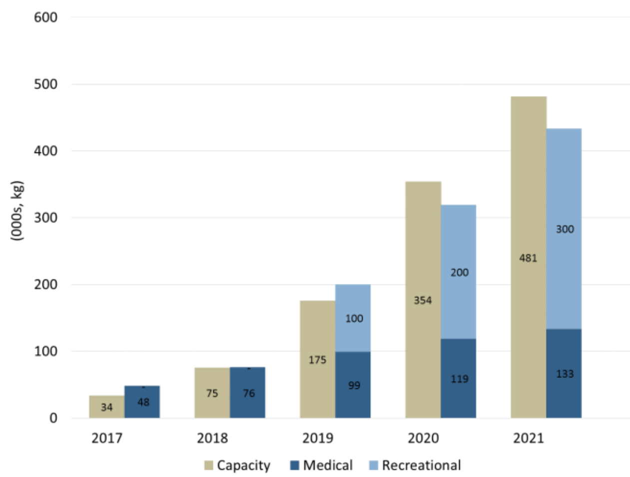
Oregon
- Population: ~4m
- Canada is ~8.9x larger
- **Est Canadian rec market by year 2: $0.3 x 6.5 = $2.6b**

Source: The Cannabist, BDS Analytics, ArcView, Washington Dept. of Revenue, GMP estimates

Supply/demand analysis points to short-term product shortage

Capacity to exceed 480,000 kg annually in five years. In anticipation of the legalization of recreational marijuana and the continued growing demand for medical marijuana, licensed producers have begun embarking on expansion plans in order to increase their capacity. Based on current production levels and announced expansion plans, we estimate that production capacity could exceed 480,000 kg annually by 2021. However, with the recreational market expected to ramp-up quickly once legalized, we are forecasting capacity to lag demand until about 2020 when we anticipate current expansion plans to be operating at full capacity.

Figure 6. Estimated production capacity vs demand



Source: Company reports, GMP estimates

Recreational marijuana – What the framework could look like?

Details surrounding the framework may not be fully available when the legislative bill is tabled as we believe there is a likelihood that final regulations may be put in place subsequent to the bill being passed. While the recreational marijuana framework is still unknown, we outline below our views on what the main structure could look like and the assumptions we have used to derive our valuations in the sector.

We expect recreational marijuana sales in January 2019. In our view, the federal government needs 18-24 months post legislation to implement all the regulations needed to govern the industry. In particular, the government will need to modify the criminal code and amend at least two international UN narcotics treaties to which Canada is a signatory. In addition, details and redistribution of the federal excise taxes will need to be negotiated with the provinces, given that provinces will likely oversee distribution. Hence, assuming that the bill to legalize recreational marijuana is voted into law between June and September 2017, we believe that recreational marijuana will be available in January 2019.

Supply provided by existing licensed producers. Health Canada has invested significant resources to establish a secure and stable production framework by granting licences to companies meeting stringent requirements. For the most part, the current supply system works well and existing licensed producers are all undertaking significant expansion plans to be able to meet the demand that is expected from the recreational market. Hence, given the current established production framework, we believe that the current licensed producers will be the only ones supplying the Canadian recreational market. One unknown remains importation and the extent it could impact the domestic market.

Distribution at retail overseen by provinces. While cannabis production will be overseen by the federal government, the retail distribution will be under provincial jurisdiction. As noted in the task force report, co-location with liquor stores appears unlikely given the general perception that cannabis and alcohol should not be consumed together. In our view, that leaves two options for retail distribution of recreational cannabis: (1) a new government-run point of sale system solely focused on distributing cannabis, or (2) a privately-run retail system of dispensaries or other storefronts solely focused on distributing cannabis. We expect that the retail format will differ from one province to the next, similar to alcohol regulation and distribution. However, our preference would be for a government-run system which, in our view, would reduce the risk of sourcing from the black market.

Mail order system to smooth transition. We believe that it could take time to set up a retail network in each province and therefore a mail order system, similar to the current medical market system, could help facilitate a transition to a recreational market to ensure all Canadians would have access to recreational cannabis. This arrangement could benefit licensed producers as mail orders are likely to drive higher profitability compared to wholesale. A hybrid mail order and retail system could also be a positive for licensed producers by broadening the potential user base to include those that cannot access a retail store while maintaining the higher margin mail order channel.

Limited advertising expected. Under the ACMPR program, Health Canada's policy on advertising created "grey zones" with clear restrictions on print and traditional media and fewer restrictions on social media and sponsorships. For example, licensed producers are allowed to have websites detailing their products in a much more extensive way than tobacco companies. Licensed producers have also entered into sponsorship agreements with high profile artists, which have enabled them to build brand awareness. It is not clear if these regulations will be tightened once the recreational market opens up. However, we believe that tightening the regulations could limit licensed producers' ability to build a differentiated brand and hence impact profit margins.

Figure 7. Recreational and medical market assumptions

	Parameter	Short term	Long term
Recreational market	Wholesale price per gram: dried	$6.00	$5.00
	Wholesale price per gram equivalent: oil	$9.00	$8.00
	Proportion of sales: dried	70%	60%
	Proportion of sales: oil	30%	40%
Medical market	Wholesale price per gram: dried	$7.50-$8.50	$7.00-$7.50
	Wholesale price per gram equivalent: oil	$12.00-$15.00	$12.00-$12.50
	Proportion of sales: dried	50%	30%
	Proportion of sales: oil	50%	70%

Source: GMP Securities

Wholesale recreational prices expected to range between $5.00 and $6.00. We do not expect the government to regulate retail selling prices. However, with the objective of reducing demand for the black market, we expect that the excise taxes applied by the government will be less than for gasoline and alcohol. The task force has suggested that prices must stay below $10.00 per gram in order to stimulate a switch from the black market to the legal market. In our model, we expect that licensed producers will sell to provincial liquor boards at $6.00 per gram until the supply catches up to demand, which could bring prices down. We have assumed long-term wholesale prices of dried marijuana at $5.00 and wholesale prices of cannabis oil at $8.00 per gram.

Wholesale medical marijuana prices expected to range between $7.00 and $8.50. We expect that licensed producers will receive a higher wholesale price for their medical marijuana given: (1) higher potency levels than recreational, (2) potential insurance coverage, and (3) no excise taxes collected. Hence, we expect licensed producers to sell their dried medical marijuana to drug stores at a wholesale price of $7.50 in the first years with a slight erosion to a long-term price of $7.00. We have modeled cannabis oils wholesale prices of $12.00-$15.00 per gram, eroding to $12.00-$12.50 per gram in the long-term. We expect that cannabis oils and derivatives such as gel capsules will account for 70% of products sold in the medical market.

Medical marijuana available at drug stores. Interest from pharmacies such as PharmaChoice and Shopper's Drug Mart in the distribution of medical cannabis has been growing. Recently, CanniMed Therapeutics Inc. (CMED-TSX, not rated) and PharmaChoice inked a letter of intent for PharmaChoice to distribute CanniMed products exclusively through its network of 700 independent pharmacies nationwide. Hence, under a new framework post-legalization, we could see pharmacies sell medical marijuana in their stores. In our view, the current mail order system will continue in parallel to wholesale distribution into pharmacies.

Margin compression. We are expecting margins to improve in the near-term as licensed producers build out capacity and the number of patients registered grows. However, as supply begins to catch up and even surpass demand in the mid to long term, we could see downward pricing pressure which, in turn, could result in margin contraction. We would expect a scenario where large wholesale buyers, such as provincial liquor boards, have bargaining power against licensed producers when supply catches up to demand. This could be exacerbated in a situation where the number of licensed producers continuously grows. We have built in a ~400-500bps EBITDA margin erosion in the long-term as prices contract.

The recreational marijuana puzzle – Risks and unknowns abound

Several unknowns still cloud the outlook. While there has been significant excitement around the legalization of recreational marijuana, investors must remember that several key elements of the upcoming recreational industry are still unknown. These elements may have a material impact on our valuations, hence, in reading this report investors must keep in mind our limited visibility on some material pieces of the recreational marijuana puzzle.

Figure 8. Summary risks and unknowns for recreational marijuana

Major risks/unknowns that could have a material impact on industry valuations	
• Number of licenses awarded by Health Canada	• Importation
• Reaction of illegal market	• Timing of legislation
• Profitability levels	• Transition period framework
• Types of products sold i.e., edibles, topicals	• Reversal of legislation
• Personal cultivation	• Early stage of operations

Source: GMP Securities

Number of licences awarded by Health Canada. Health Canada is not expected to cap the number of licences awarded to produce and sell marijuana. The speed at which the Health Canada will award licences is unknown and will have an important impact on the industry. Investors should expect competition to intensify in the coming years.

Reaction of the illegal market. There has been little discussion on the reaction of illicit producers to the legalization of recreational marijuana. Estimates of the size of the legal recreational marijuana market are made on the premise that there will be a shift away from the illicit market into the legal market. That implies a shift in behaviour of current customers, most of which have formed a relationship with their current provider. One must assume that the illegal market will react and put up a fight.

Profitability levels. We expect that large producers will be able to grow a gram of marijuana for less than $1.50 in coming years. Some greenhouse operators may be able to bring growing costs down to less than $1.00 per gram. With wholesale selling prices of dried recreational cannabis expected to range between $5.00-6.00 at the onset, gross profit margins should be healthy. Our valuations are built on the premise of long-term EBITDA margins of 30-35%, however our visibility on this assumption is limited given the lack of a reference point.

Type of products sold. There are a plethora of derivative cannabis products, such as oil concentrates, infused food and drinks, topical products (creams, balms), etc. In our models and valuations, we have assumed that licensed producers sell only dried cannabis and cannabis oils. We believe the Liberal government may be hesitant to allow multiple cannabis derivatives, however, the ability for licensed producers to sell multiple products could be a driver of shareholder value.

Importation of marijuana products. Up to now there has been little to no importation of marijuana in Canada. Initially, Bedrocan Canada imported products from the Netherlands, however, that is no longer the case now that local production is operational. There do not appear to be any regulations prohibiting importation provided that all parties involved have the necessary approvals and that the product is coming from a country where marijuana is legal. In our view, importing marijuana could be a risk for domestic licensed producers, particularly in the case of low cost product entering the market which could put local producers at a disadvantage.

This idea of importation on a larger scale took a step closer to reality when Emblem Corp. signed a memorandum of understanding with International Cannabis Corp. (ICC-TSXV, not rated) on February 27, 2017. The agreement is not yet finalized, however, under the terms announced ICC would supply Emblem with CBD products at potentially lower costs than local manufacturing. This could give Emblem an advantage of improved margins and potentially a large source of CBD.

Companies are in the early stages of their development. Investors must recognize that most public licensed producers have limited operational history, having been formed recently. Some companies' most recent financial statements are dating back no more than five months, limiting investors' ability to properly analyze these companies' operations. While the viability of the companies under coverage is not in question, investors must realize that their current revenue base is very small and there are execution risks associated with most public licensed producers.

Timing on implementation of legislation. The bill to legalize marijuana for recreational purposes is widely expected to be tabled in the spring of 2017 and voted into law before or shortly after the summer recess. We expect the bill will result in substantial debate at the House of Commons given the sensitive nature of the topic. However, given the Liberal majority, we see a high likelihood that the bill gets passed. Once passed, the bill will move to the Senate for final review and vote before receiving Royal Assent. There could be delays at the Senate, but we are expecting the bill to be passed in 2017. We have assumed that the first recreational sales occur in January 2019, so any delays from that date would change our valuations.

Transition period. It remains to be seen how the government will handle the transition period from when the bill is passed to functional marketplace. For instance, it may be realistic to expect that the current mail order system continues to operate until a point of sale system is established, which we believe would be beneficial to patients, licensed producers and investors. However, the government could try to prevent expanded mail-order to a recreational market, only allowing legalization to come into effect when the distribution channels and other controls and regulations are up and running.

Reversal of legislation with a new government. The Liberal government was elected in October 2015 to a four-year term, partly on the basis of a campaign promise to legalize recreational marijuana. All indications suggest that legalization will occur prior to the next federal election in October 2019. Under a scenario where there is a change in the majority political party, there could be a risk the incoming party will seek to reverse the legislation surrounding legalization. However, there appears to have been a softening in the Conservative Party's stance on legalization and a greater focus on the potential regulations. Hence, while a reversal could be possible, we believe that the risk of a complete reversal is minimal. However, we could see modifications to the regulations as time goes by to adapt to the realities that play out in the marketplace.

Personal cultivation expected to have limited impact on industry demand. We believe that personal cultivation could be limited to a niche group of users, primarily those that are pre-legalization users who cannot obtain their preferred strains in the legal market or enthusiasts that prefer homegrown cannabis. However, we expect that the average user is likely to be more comfortable with purchasing product than cultivating, particularly given the challenges in cultivating quality product. This trend is likely to mirror homemade wine or home brewed beer markets, which we believe are very small compared to the retail market.

Drivers of long-term value creation in the cannabis industry

Figure 9. Summary opportunities of value creation in the marijuana space

Drivers of long-term valuation creation	
• Pharmaceutical company	• Reaction of tobacco and alcohol companies
• Consumer branding	• Exports and international expansion
• Gross margin expansion	• EBITDA margin expansion

Source: GMP Securities

In our view, companies that successfully migrate towards a pharmaceutical structure or companies that mature into successful consumer packaged goods companies will create the most value for their shareholders. Pure play growers, with no brand or no patent protected drugs may not get as rich valuations in our view.

Pharmaceutical industry. The pharmaceutical industry generates high profitability levels given the protection that drug patents offer to the manufacturers. In Canada, pharmaceutical companies generate EBITDA margins between 35-45% while in the US, EBITDA margins are often above 50% given fewer pricing regulations. Licenced Producers that successfully develop new cannabis formulations, delivery methods or new cannabinoid-related drugs could aspire to such profitability levels. We believe that by developing and patenting cannabis-based drugs, licensed producers could secure long-term profitability.

Consumer packaged goods industry. Branding will be an integral part of the long-term success of licensed producers as stronger brands should command premium pricing. In our view, a parallel can be drawn between the wine industry and the cannabis industry. While the wine industry has been flourishing for more than 2,000 years and is well developed, it is fragmented and comprised of several local producers. In our view, the Canadian recreational cannabis industry may have 100-200 licensed producers by 2020 and branding will play a key role to secure shelf space and premium prices. Companies which invest in branding, marketing and packaging will become, in our view, the industry leaders and the power of their brands should help protect their profit margins.

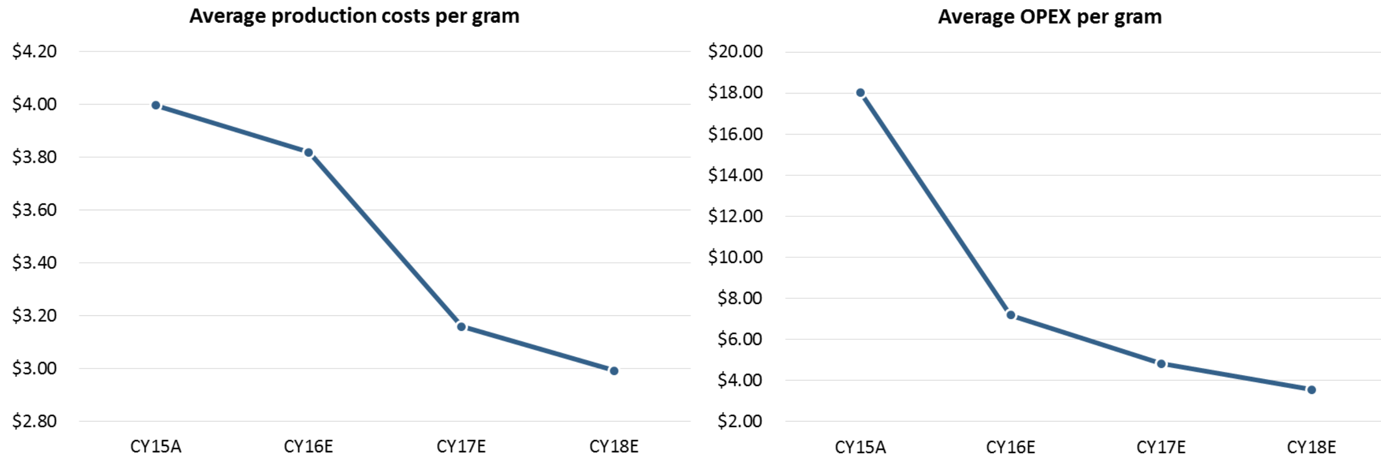
Reaction of alcohol and tobacco companies. One catalyst that could have a material upside to valuations in the sector would be the entrance of large alcohol, tobacco or pharmaceutical companies. Several beer and alcohol companies have identified recreational marijuana as a key risk to the growth in consumption of their products. Hence, it may not be surprising to see some of these companies gain exposure in the sector as a way to boost their growth. Such an event would be a catalyst for the sector.

Exports to international markets. The global landscape for marijuana has changed rapidly in the past three years with over 10 countries adopting new regulations for marijuana, mainly for medical marijuana. Most recently, we have seen Germany pass legislation that is aimed at easing the pathway to accessing medical marijuana. With a population ~2.5x the size of Canada, Germany could represent a growth opportunity. At this point, Germany does not yet have local production. Hence, this could be an opportunity for Canadian licensed producers to both export and possibly build production facilities in Germany given the know-how, regulatory environment and quality brands being developed here. Already, we have seen two licensed producers, Canopy Growth Corp. and Cronos Group Inc. establish partnerships and export to Germany.

Gross margin expansion as production costs per gram decline. Licensed producers are in growth mode and many are in the construction phase of building or renovating new and existing facilities to expand production capacity. We would expect that licensed producers operating at full capacity would be able to derive greater efficiencies and potentially reduce direct costs associated with production as more plants are cultivated and yields are improved.

EBITDA margin expansion as operating expenses per gram decline. In a similar manner, as companies ramp-up commercial operations and patient onboarding resulting in growth in grams sold, we would expect to see a decline in operating expenses per gram. Such a decline in expenses could support EBITDA margin growth, particularly in the launch phase when demand could outstrip supply resulting in higher prices.

Figure 10. Estimated industry average cost per gram



Source: GMP estimates

What to focus on when analyzing the upcoming legislation

Seven key elements to monitor. The Liberal government is expected to table legislation to legalize recreational marijuana in the spring of 2017. Investors should focus on the seven key elements listed below, which will have an impact in shaping this new industry. Our view is that the government may start with tight restrictions at the onset and relax them in the future. We believe that the Liberal government will act prudently given the sensitive nature and limited framework of reference elsewhere in the world.

Advertising. We will closely monitor rules and restrictions on advertising as this could be a real value creator for licensed producers. Should social media and earned media be allowed, we believe that licensed producers will be able to better differentiate their brands making it easier to command premium pricing.

Distribution. We have modeled that licensed producers will sell wholesale to distributors/provincial liquor boards once the retail network is fully established. However, there could be a transition period where licensed producers may continue to sell products directly to recreational users through mail-order, similar to what is being done currently in the medical market. This would enable licensed producers to capture the distribution profits and could boost their profitability over the short-term.

Pricing. Health Canada may want to regulate prices to ensure that legal recreational cannabis is competitive with illegal products. Restricting prices may be difficult to implement and market forces (awarding more licences) may end up being a more effective method to ensure pricing stays competitive.

Edibles. Various forms of cannabis aside from dried flowers are extremely popular in current recreational markets such as Colorado. Cannabis oils are already allowed by Health Canada for medical purposes. Allowing most forms of edibles, as is suggested by the task force's report, could boost the market size and increase the user base above and beyond our assumptions.

Figure 11. Pros and cons of potential regulations for the recreational market

	Task force recommendation	Legislation which would have a positive impact on LPs	Legislation which would have a negative impact on LPs
Advertising	• Plain packaging with strict labeling requirements •Comprehensive restrictions on advertising and promotion similar to the tobacco industry	• Advertising would enable Licensed Producers to build a brand, which could (1) differentiate products, (2) support premium pricing, and (3) build a loyal customer base • Potential upside to our forecast as we have modeled a slight price erosion and limited premium pricing	• Restrictions on advertising/branding could (1) curtail branding initiatives, and (2) create a commodity-like market where Licensed Producers compete more on price than differentiated product • Potential downside to our forecasts due to further price erosion than expected as we are assuming some products differentiation amongst producers
Distribution	• Regulated by provinces and territories in collaboration with municipalities • No co-location with alcohol or tobacco • Dedicated storefronts with trained, knowledgeable staff • Direct to consumer mail-order system	• Using the existing provincial liquor boards' store network would accelerate market penetration given existing retail network • Continuing the medical mail-order system into the recreational industry could: (1) expand the reachable population base, and (2) result in LPs capturing higher profitability levels compared to wholesale pricing	• Establishing a new retail network in each provinces would slow down market growth • No mail-order could: (1) delay sales until a retail network is established, (2) limit the potential reachable population, and (3) reduce profitability of Licensed Producers if selling only at wholesale prices
Pricing	• Establishment of a tax/price which balances health protection and reduction of the illicit market	• No pricing cap would enable premium pricing and potentially higher profit margins for Licensed Producers • Premium pricing would have a positive impact on our forecasts as we assume limited price differentiation between LPs	• A pricing cap, while leveling the playing field, is a negative as it does not allow for price differentiation across products and brands and could favor low cost producers • Downside risk to our forecast as our conservative price assumptions do not include a price cap
Licenses	• Regulate production of cannabis and its derivatives at the federal level through licensing and production controls	• Capping the number of licenses granted by Health Canada would create a significant barrier to entry potentially translating into sustainable profit margins	• An indefinite number of licenses could result in excess supply and diluted profit margins for each market participants
Personal cultivation	• Support personal cultivation with conditions • Limit of 4 plants of 100cm • Oversight and approval by local authorities • Security measures in place to prevent theft and youth access	• Prohibiting personal cultivation would level the playing field for LPs and potentially increase demand for their products	• Allowing personal cultivation could shrink the addressable market as enthusiast and other users elect to cultivate their own marijuana • Some downside risk although we do not see personal cultivation becoming mainstream
Medical market	• Maintain a separate framework for medical patients	• The continuation of the medical market accounts for a important part our forecasts and valuations • Obtaining reimbursement could be a positive as more patients are able to access the market	• Switch to retail only distribution could reduce profitability of Licensed Producers • Price caps could put downward pressure on margins
Edibles	• Support allowing edibles • Edibles include cannabis infused food and drink • Strict packaging and labelling requirements to reduce risk of a child's access • Set a maximum THC amount • Prohibit mixed products (i.e., cannabis infused tobacco)	• Allowing edibles could broaden the potential user base • Market size could grow beyond our $5b estimate • Upside to our forecasts, which do not include edibles	• Not allowing edibles could limit the user base as not everyone wants to try cannabis via smoking or oils • No potential impact on our forecasts as we do not account for edibles

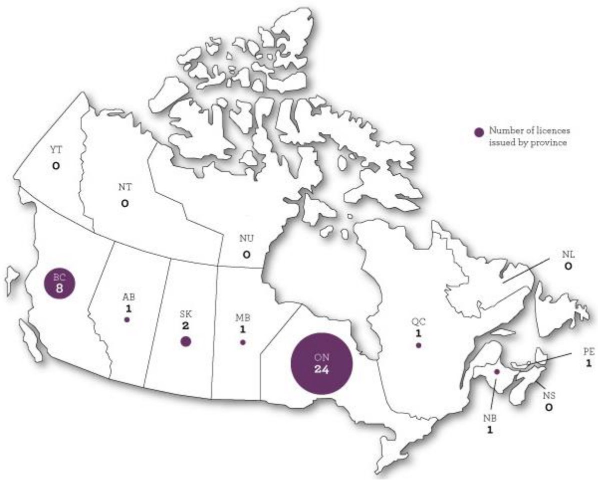
Source: Government of Canada Task Force report December 2016, GMP Securities

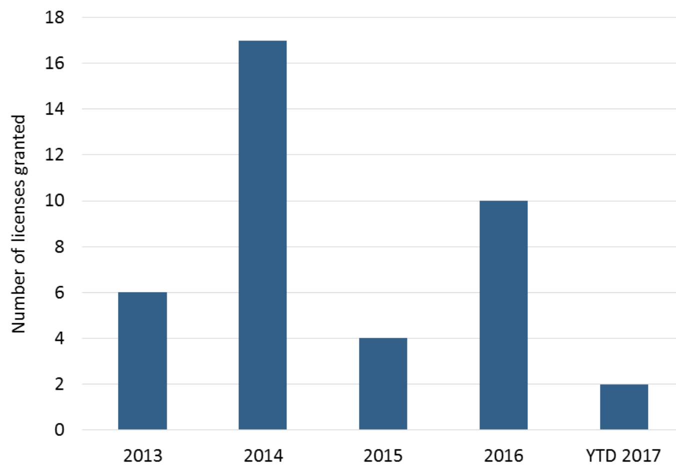
Canadian medical market outlook

Medical marijuana was first recognized in Canada in 1999. Since then, regulations have evolved into the Access to Cannabis for Medical Purposes Regulations (ACMPR), which was introduced in August 2016. The ACMPR governs licensed producers that produce and sell quality controlled medical marijuana to patients that have a physician prescription and register with a licensed producer.

Number of licensed producers continues to grow. As of March 14, 2017 there were 39 licensed producers approved by Health Canada for the cultivation of marijuana. Of these 39 licensed producers, 67% are licensed to sell dried marijuana and 46% are approved to produce and sell cannabis oils. As of August 1, 2016, Health Canada indicated that ~1,560 applications had been received with ~420 under review, ~250 refused, ~800 returned due to incomplete information and ~55 withdrawn. Hence we would expect the number of licensed producers to continue to increase, especially as we approach the opening of the recreational market.

Figure 12. Number of licences granted and location under the ACMPR

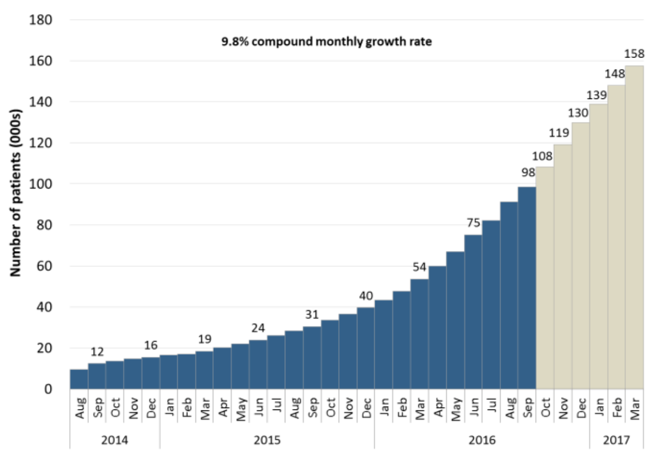




Source: Health Canada

Patient registrations grow at an average of ~10% MoM to 130,000 in December 2016. Since the election of the Liberals in October 2015, the number of patients registering for medical marijuana has grown at ~10% MoM bringing the total number of registered patients to ~130,000 in December 2016. We are forecasting that the growth rate will likely decline to an average of ~5% MoM in 2017 with a further decline in 2018 and 2019 with the arrival of the recreational market. We believe that some individuals may elect to purchase from the recreational market as opposed to obtaining a prescription and registering with a licensed producer.

Figure 13. Registered patients in ACMPR



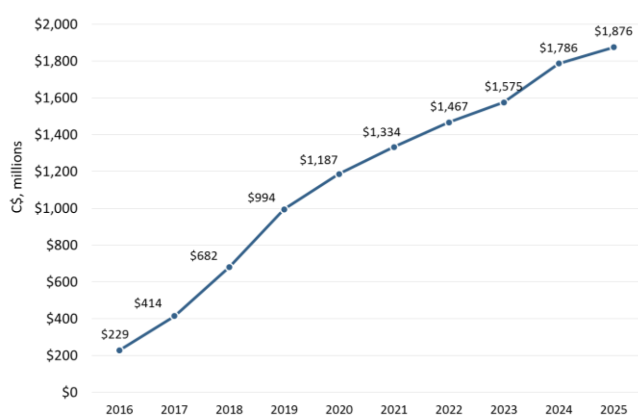
Source: Health Canada, GMP estimates

Medical market to stay robust. We expect that the medical market will continue to thrive despite marijuana being legal for recreational purposes. We support this view with the following: (1) **Higher potency levels**. THC levels are not expected to be capped in the medical market, making the drugs more potent and attractive for a certain class of patients, including war veterans. (2) **Insurance reimbursement.** We expect that private insurance coverage of medical marijuana will increase over time, making medical marijuana more affordable than recreational marijuana, however, public coverage could take a little longer given the lack of a drug identification number and that it doesn't fit in the regular path. (3) **No excise taxes**. We do not expect the government to collect excise taxes on medical marijuana, which should technically result in lower prices relative to recreational marijuana.

Medical market exceeded $225m in 2016. We estimate that the medical marijuana market generated revenues in excess of $225m in 2016, growing at a compound quarter growth rate of ~39% since the Liberals were elected in October 2015. This growth corresponds with the rapid growth in patient registrations that has occurred since the election. We estimate that patient registration will continue to ramp-up in 2017, albeit at a slower pace, and that the medical market could generate revenue in excess of $350m in 2017.

Medical market could surpass $1.2b by 2020. In 2012, Health Canada estimated that the number of registered patients would reach 450,000 by 2024, however, we believe that with the current patient growth we are on track to surpass this estimate. Looking at the US markets as a proxy, we estimate that medical marijuana patients could represent 1-2% of the adult population aged 20 years and older. Hence, we are forecasting that the registered patient base could exceed 450,000 (~1.5% of the adult population) by 2020. Assuming that a medical patient consumes on average 0.7 grams per day, we forecast that the medical market could exceed 115,000 kg annually by 2020, generating revenue in excess of $1.2b.

Figure 14. Estimated size of the Canadian medical marijuana market



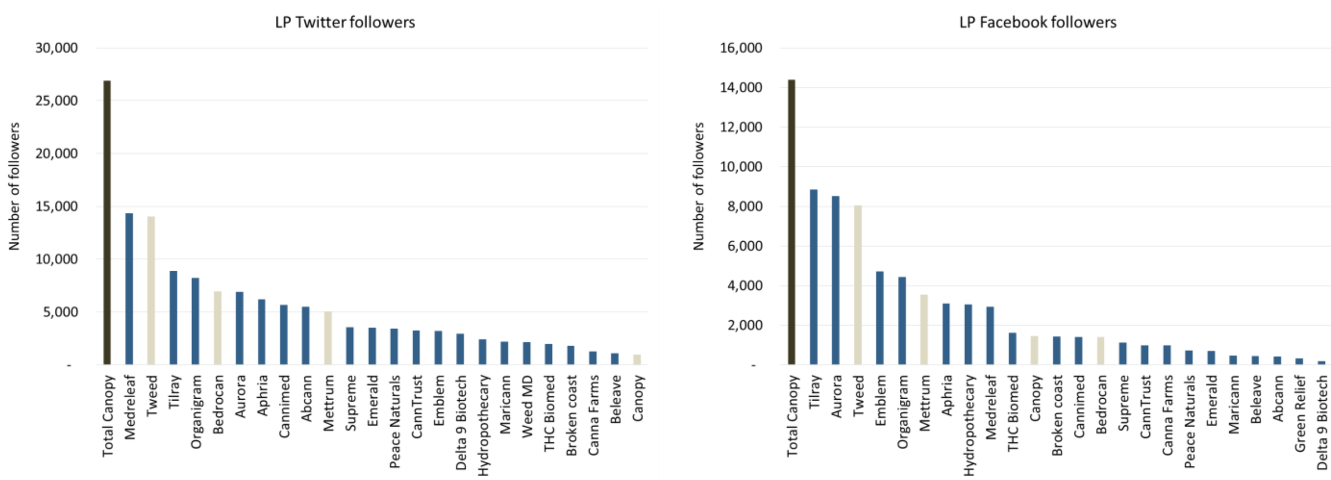
Source: GMP estimates

Building brand equity for a recreational market

Health Canada prohibits advertising for a specific therapeutic indication. Currently, licensed producers must abide by certain advertising restrictions, which are outlined in the ACMPR. In particular, licensed producers are not permitted to advertise their marijuana product as a treatment, preventative or cure for any disease and they cannot advertise in any manner that is false or misleading. In general, licensed producers are limited to providing prospective clients with information, such as the brand name, name of the strain, the price per gram, the cannabinoid content, and the company's contact information. More recently, there have been a number of instances where Health Canada has requested certain information to be removed from the social media sites of licensed producers, particularly relating to therapeutic treatment claims. We believe that restrictions on advertising could get tighter post-legalization, hence building brand awareness now could help drive growth in a recreational market.

Social media helping to build brand equity. At present, the regulations for advertising post-legalization are uncertain, therefore, most licensed producers are working to establish lasting brand equity now while the type of advertising allowed is perhaps more flexible. One key area for advertising has been the online presence, with the majority of licensed producers having turned to social media including Twitter and Facebook to help build brand awareness. A look at the number of followers by licensed producer could suggest that companies such as Tweed have been successful at building a recognizable brand. Currently, Tweed appears to be the most well-known brand both on Facebook and Twitter, but also channel checks suggest it is one of the most requested brands by patients.

Figure 15. Social media followers by licensed producer



Note: Number of followers as of March 5, 2017
Source: Twitter, Facebook

Channel checks: What is happening in the marketplace?

We conducted over half a dozen interviews with various stakeholders from board members to clinic owners, journalists and lawyers in order to determine the current trends and observations that are playing out in the medical marijuana space and how the industry is thinking about the potential recreational market.

Patient demographic is shifting to cannabis naïve patients. Commentary and anecdotal feedback suggests the earlier patients visiting clinics and obtaining prescriptions were experienced cannabis users that had previously been self-medicating. However, over the last few months there appears to be a shift in the patient demographic as more and more cannabis-naïve patients are searching for a solution to their symptoms or condition. This is in part driven by the increased news flow in the sector.

Greater awareness of different licensed producers. Although licensed producers are not allowed to advertise, some have done a good job of building up brand awareness using tools such as social media. As such, there is greater awareness of different licensed producers amongst patients. Anecdotal feedback from clinics suggests that Tweed's brand is the most requested and the most familiar to patients. Other brands that are often requested are local or regional to a particular clinic.

Lack of oils is a disadvantage. Cannabis oils are gaining in popularity among patients and doctors as they are convenient to take and do not carry the stigma associated with smoking. Hence, some clinics are less likely to work with a licensed producers if they do not have oils in the product portfolio. Having cannabis oils, and eventually other formats, could be important in accessing a broader pool of patients.

Lack of patient loyalty to a particular brand. According to industry sources, it is uncommon to see a patient that is well-versed in cannabis and what they need. The majority of patients are searching for a solution and making decisions based on advice and recommendations made by physicians or counselors in the various clinics, particularly in the beginning as patients try various products to find the one that delivers the benefit they need. As prescriptions are filled every couple of months and a patient is required to register with a licensed producer each time, there is a potential for lack of stickiness and movement between licensed producers.

Product shortages are common driving patients to switch licensed producers. Product shortages are a fairly common issue at the moment as demand is building faster than capacity is coming online. Our conversations suggested that product shortages were a bigger concern for patients than the recalls issued by Organigram, Mettrum and Aurora. One key reason for the current lack of loyalty is a product shortage that tends to drive patients to seek out other licensed producers.

Need for more education. According to some clinic employees, many patients appear to be focused on the THC content, but CBD levels are thought to be more important for the medical market. Hence, there is a need for continuing education for both physicians and patients on the potential benefits of marijuana and the strains available.

Licensed producer customer service is improving. Like all industries and companies there are growing pains in the beginning, particularly as licensed producers have ramped up production and launched commercial operations. However, clinics have noticed an improvement over the past few months in interactions with licensed producers with some licensed producers providing advanced notice on product shortages and others have field reps that act as a liaison at the local level. In addition, customer service at the patient level also appears to be improving as clinics are hearing less from patients.

GMP

Equity Research

Aurora Cannabis Inc.[1,7]

BUY

ACB-TSXV

March 15, 2017

Last: **C$2.40**
Target: **C$3.00**

Initiating coverage: Full throttle forward!

Since it debuted selling cannabis 14 months ago, Aurora has been unique in many ways. Aurora invested in a purpose-built facility out of the gate, something rare as most licensed producers started in existing industrial buildings. The company onboarded patients at a frenetic rate of 12,000 in its first year, achieving a market share of 8-9%. Aurora developed the industry's first mobile application to order online. It developed the highest THC strain currently on the market in Canada. It was one of the first licensed producers to acquire a medical clinic which accelerated Aurora's patient acquisition. And recently the company announced an ambitious expansion plan to build the largest facility in Canada which is expected to produce over 100,000kg of cannabis annually. The above mostly explains why Aurora has the second largest market capitalization of all public licensed producers.

With the most recent financing closing in February 2017, Aurora now has a cash balance of ~$115m to carry out near term capacity expansion plans. We expect the company to generate positive EBITDA in early 2018 with further improvement in margins as the new Aurora Sky facility comes online and scale drives improved efficiencies.

Our positive stance on Aurora is based on the following:

- **Low cost advantage**. Aurora's large production facility, currently in construction, is expected to provide the company with low production costs due to its large scale and high level of automation. In addition, its location, at the Edmonton airport, should reduce the company's shipping costs and shipping times, an important advantage for the mail order system. Hence, we would expect Aurora to have low production costs once its Aurora Sky facility is fully operational.
- **Large expansion**. Aurora's ambitious expansion plans could generate production of over 100,000kg annually at full capacity. To put things in perspective, such a high capacity output would be able to supply roughly 20% of our estimate of the size of the recreational market.

We are initiating coverage with a target price of $3.00. We derive our target price using a two-stage, 10-year DCF model. We estimate that Aurora will capture a 12% share of the recreational market vs. an ~8% share of the medical market today. Our DCF assumptions include: (1) a discount rate of 10%, (2) two-stage average revenue growth of 30%, an average EBITDA margin of ~30%, and (3) a terminal growth rate of 3%.

Rating	BUY
Target	$3.00
Revenue 2016A (mm)	$1.4
Revenue 2017E (mm)	$22.4
Revenue 2018E (mm)	$56.3
adj. EBITDA 2016A	($6.1)
adj. EBITDA 2017E	($5.5)
adj. EBITDA 2018E	$11.1

Share Data

Share o/s (mm, basic/f.d.)	339.4 / 393.4
52-week high/low	3.95 / 0.41
Market cap (mm) f.d.	$944.2
EV (mm)	$828.8
Net debt (net cash) (mm)*	($115.3)
Dividend	n.a.
Dividend yield	n.a.
Projected return	25.0%

Financial Data

FYE Jun 30	2016A	2017E	2018E
Revenue (mm)	$1.4	$22.4	$56.3
P/revenue	nmf	42.2x	16.8x
adj. EBITDA (mm)	($6.1)	($5.5)	$11.1
EV/EBITDA	nmf	nmf	nmf
adj. EPS (f.d.)	($0.07)	($0.05)	$0.00
P/E	nmf	nmf	nmf
CFPS	($0.05)	($0.02)	$0.00
Net debt (net cash) (mm)	$10.2	($83.0)	($31.6)
BVPS	$0.05	$0.46	$0.38
P/BV	51.9x	5.2x	6.3x

** Net debt is proforma the most recent financing*
All figures in C$ unless otherwise noted

Current Chart   Previous Research

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Figure 16. Snapshot comparison of publicly traded licensed producers

	Organigram	Cronos*	Aurora*	Emblem*	Canopy	Aphria	Average
VALUATION METRICS							
Recommendation	BUY	BUY	BUY	BUY	BUY	HOLD	
Current price	$2.42	$2.82	$2.40	$2.68	$11.05	$6.62	
Target Price	$4.00	$4.25	$3.00	$3.25	$12.75	$5.00	
Projected return	65.3%	50.7%	25.0%	21.3%	15.4%	-24.5%	**25.5%**
Market Cap, basic ($mm)	$244	$349	$815	$191	$1,743	$815	**$693**
Market Cap, fully diluted ($mm)	$270	$507	$944	$326	$1,862	$884	**$799**
EV ($mm)[a]	$211	$487	$829	$287	$1,722	$738	**$712**
EV/CY17 Sales	11.7x	34.1x	22.0x	34.9x	16.8x	25.7x	**24.2x**
EV/CY17 Production capacity (per kg)	$50,181	$121,792	$150,693	$136,802	$71,746	$98,454	**$104,945**
OPERATING METRICS							
Last reported patient count	~3,895	~3,400	~12,800	~1,500	~50,000	~6,675	**13,128**
Sales (CY16, $mm)	$7.7	$0.6	$8.4	$0.2	$30.3	$15.1	**$10.4**
Sales (CY17, $mm)	$18.1	$14.3	$37.6	$8.2	$102.5	$28.7	**$34.9**
Adj. Gross margin (CY17)[b]	64%	58%	56%	56%	70%	80%	**64%**
Opex (CY17 $/g)[c]	$4.46	$5.09	$4.97	$5.54	$4.55	$4.48	**$4.85**
Estimated production capacity (CY17)	4,200 kg	4,000 kg	5,500 kg	2,100 kg	24,000 kg	7,500 kg	**7,883 kg**
Number of licensed facilities	1	2	1	1	6	1	
Cannabis oil extracts license	Production & Sale	Production & Sale	Production & Sale	Production only	Production & Sale	Production & Sale	
Estimated long-term recreational market share	7.0%	7.0%	10.0%	4.0%	23.0%	5.5%	**9.4%**

a Based on fully diluted shares outstanding

b Adjusted gross margin excludes the fair value adjustment of biological assets and amortization

c Includes Selling, marketing, general, and administrative expenses (excludes depreciation, amortization, and stock based compensation)

* Initiating coverage

Source: Company reports, GMP Securities, FactSet

Key catalysts to create shareholder value

Sale of oils → Expected in March/April. Aurora received its licence to sell cannabis oils on January 20, 2017, but has not yet released any cannabis oils to patients. The company is stockpiling products to ensure adequate availability upon release. We would expect Aurora to announce shortly cannabis oils available for sale, which we see as a near-term catalyst that should boost the company's sales.

Graduating to the TSX. Aurora is in the top three licensed producers by market capitalization. Hence, we are expecting the company to graduate to the TSX in the coming months.

Details surrounding Aurora's recreational branding strategy. Aurora has been relatively quiet with its strategy to penetrate the recreational market. The company has a Chief Brand Officer, Neil Belot, who is currently crafting Aurora's recreational strategy. We would expect the company to have various price points and positioning to cater to most market segments.

Health Canada approval of first phase of Aurora Sky → Expected in early 2018. Given the massive size of the facility under construction, Aurora will get Health Canada to inspect the facility in phases to expedite the approval process. We expect the construction of the first phase of the project to be completed by December 2017 and Health Canada approval in early calendar 2018. This will be a catalyst for Aurora as it will be the first "stamp of approval" on the company's massive expansion facility, which is key to our valuation and investment thesis.

First harvest at Aurora Sky → Expected in spring 2018. We expect the first harvest to occur roughly 3-4 months after Health Canada's approval, hence, sometime in the spring of 2018. This harvest should have a material impact on the company's profitability as the facility's production costs are anticipated to be significantly lower than its Cremona facility and the higher revenue should improve fixed cost absorption. Hence, we expect this news would be an important milestone for the company which should be rewarded by investors.

Company overview

AURORA

Aurora Cannabis Inc. (Aurora) is a licensed producer of medical marijuana operating a 55,000 sq.ft. indoor facility in Cremona, Alberta. The company was founded in 2013 by Terry Booth and Steve Dobler and is headquartered in Vancouver, British Columbia. Aurora went public on the Canadian Stock Exchange on December 9, 2014 by way of a reverse takeover of Prescient Mining Corp., and on October 4, 2016 Aurora's shares graduated onto the TSX Venture Exchange.

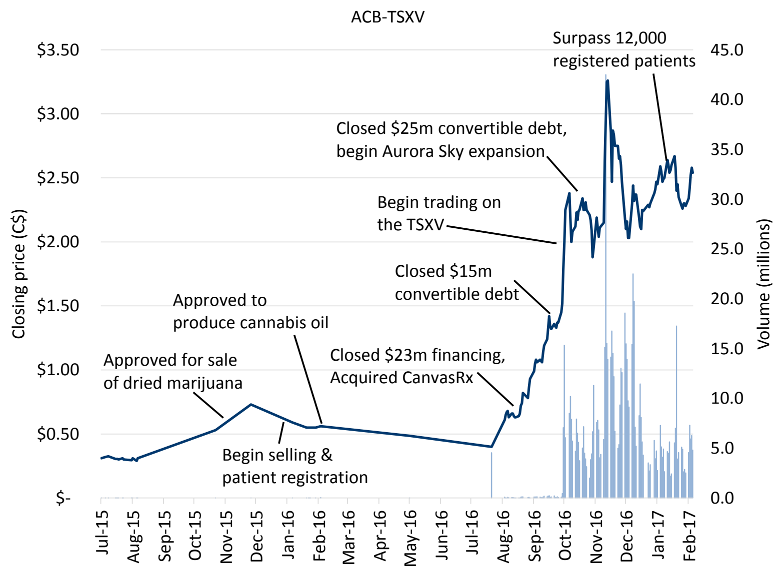
Aurora filed its licence application with Health Canada in 2013. Aurora Cannabis Enterprises Inc. (ACE), a subsidiary of Aurora, received its cultivation licence on February 17, 2015 and its licence to sell medical marijuana on November 27, 2015. ACE also received approval from Health Canada to produce and sell cannabis oils in February 2016 and January 2017, respectively.

In November 2013, Aurora began the construction, from scratch, of a 55,000 sq.ft. purpose-built marijuana facility, something different than most licensed producers which have started with existing industrial buildings. This $11.5m high tech facility is built ergonomically and specifically for cannabis production with sophisticated water and nutrient delivery systems and is expected to produce 5,500kg of marijuana. The company's founders, Terry Booth and Steve Dobler have expertise in the construction and permitting industry which facilitated their decision to build from scratch.

More recently, Aurora announced its intention to undertake an ambitious expansion plan to build a state-of-the-art purpose-built 800,000 sq.ft. production facility capable of potentially producing over 100,000kg of high quality marijuana annually. The facility is being custom built to optimize greenhouse growing conditions and minimize any cross contamination that could impact finished product quality. In addition, the location at the Edmonton airport provides direct access to ample supply of energy at low costs which should enable Aurora to significantly reduce its production costs.

Over 40% return since trading on TSXV. 2016 was a break-out year for cannabis stocks as the legalization of marijuana took a giant leap forward towards reality with the Liberal government and the task force report. Aurora's stock has generated a return of over 40% since October 2016 when it transitioned from the CSE to the TSXV with a run-up in the months preceding the release of the task force report in December 2016.

Figure 17. Evolution of Aurora's share price



Source: Bloomberg, FactSet, Company reports

Rapid patient onboarding led to some growing pains. Aurora has signed up more than 12,000 patients in its first year of operations, achieving a market share of 8-9%. This rapid growth has outpaced the company's growth in production capacity and led Aurora to source additional products from other licensed producers. Aurora sourced products that contained prohibited chemicals by Health Canada and had to proceed with a product recall. This contamination was detected by Aurora upon inspecting the product received from Organigram, which highlights the company's commitment to product quality testing, a silver lining. However, these growing pains have led Aurora to slow down patient onboarding significantly, adding less than 1,000 patients in the first two months of calendar 2017.

Products and pricing strategy

Developed high THC and CBD levels. Aurora, through propagation techniques, has developed proprietary products which contain industry-leading THC and CBD levels. The company's Warwick #2 strain contains 32% THC levels, the highest levels seen so far in the industry. In addition, Aurora developed a strain which contains 24% CBD level called Temple, which according to lift.co ranks as the fourth highest CBD strain available in Canada. These achievements are a testament of the company's dedication to research and propagation.

Limited inventory available. Due to its rapid patient acquisition, Aurora currently has a limited product offering; however, with over 10 strains in various production stages, we would expect the company's production to catch up with eight to 12 products becoming available in the coming months.

Flat $8.00 per gram pricing. Unlike competitors that charge varying prices depending on the strain and THC:CBD combination, Aurora employs a flat pricing scheme of $8.00 per gram and a $5.00 per gram option for low income individuals.

Figure 18. Aurora's dried marijuana product

Source: Company reports

Figure 19. Aurora's current strain guide

Name	Strain	Plant type	THC%	CBD %	Status
3 Sisters #2	Diary queen	Sativa	15	<0.5	Available
Chester	Hurkle	Indica	7	12	Available
Sentinel	Cannatonic	Hybrid	< 1	15	Available
Chester	Hurkle				Available soon
Elias	Strawberry cough				Available soon
Odin	Sour diesel				Available soon
Thor	Ghost train haze				Available soon
Tower	Cannatonic				Available soon
Warwick #1	91 K-OG melon				Available soon
Warwick #2	91 K-OG chemdawg				Available soon
Ambition	Blue dream				Growing
Odin	Sour diesel				Growing
Snow done	LA confidential				Growing
Stokes	Querkle				Growing
Temple	Cannatonic				Growing

Note: According to Aurora's website as of March 6, 2017
Source: Company reports

Cannabis oil sales coming soon. Aurora received its production licence for oils in February 2016 and its licence to sell in January 2017. We are expecting Aurora to begin generating revenues from cannabis oil products in Q3/FY17. Management expects to launch three products: (1) highest THC in Canada, (2) balanced, and (3) high CBD. We do not have details regarding pricing and bottle size and therefore are conservatively modeling average industry prices of $12.00 per gram.

Growth strategy – Customer centric approach

Convenient ordering with the first mobile app. One of Aurora's growth strategies focuses on building a leading e-commerce platform in recognition of trends that are shifting more towards social media and online purchasing. On September 12, 2016, Aurora announced the launch of a mobile application that enables patients to purchase federally regulated medical marijuana, a first for a licensed producer in Canada. The mobile app has the potential to make ordering easy, fast and convenient as well as provide Aurora with an avenue to communicate with and engage customers effectively. Since launching, the availability of the app has reduced the volume of calls to the customer service centre by ~50%.

Rapid access with same day delivery. Aurora was one of the first licensed producers to offer same day delivery targeting two cities, Calgary and Edmonton, with ~90% of patients in Calgary and >80% of patients in Edmonton opting for same day delivery, according to management. In 2016, the company made ~16,000 same day deliveries. In addition, the location of Aurora Sky, right next to the cargo terminals at the Edmonton airport, is expected to facilitate more rapid same day or next day delivery to elsewhere nationwide.

Over 12,000 registered patients in first year. Aurora registered over 12,000 patients in the first year since launching in January 2016. Aurora's pace of patient onboarding is one of the fastest rates we have seen in the industry. Within three months, Aurora had 1,000 registered patients and two months later had added another 2,000 patients for a total of 3,000 patients in the first five months. The company added another 4,700 patient over the summer bringing the total to 7,700 by September 2016. However, the rate of patient onboarding appears to have slowed down slightly in Q3/FY17 as Aurora deals with product shortages, which we are expecting to be short-term. As of the end of February 2017, Aurora had over 12,800 registered patients.

Commitment to quality through a partnership with Anandia. Aurora is committed to providing patients with products that are free of a range of possible contaminants including myclobutanil, which has been the cause of recent product recalls. All products produced in Aurora's facility or acquired wholesale are subject to Aurora's quality assurance and testing protocols before being released for sale. Aurora has partnered with Anandia Labs Inc., a leading cannabis genetics and testing laboratory, to provide a Certificate of Analysis with each product outlining the results of Anandia's independent third party testing for potency and contaminants. With the media attention on pesticide use and product recalls, we believe that the steps Aurora is taking should help reassure patients on product quality.

canvas RX

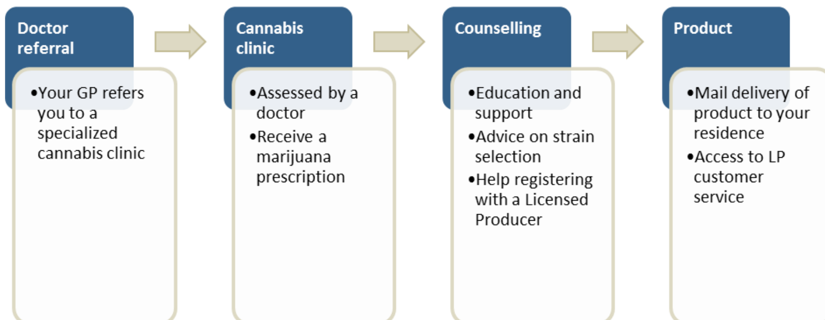
Vertical integration into clinics via CanvasRx acquisition. In August 2016, Aurora acquired 100% of CanvasRx Inc., a medical cannabis patient outreach and counselling service for a maximum consideration of $37.5m to be satisfied in cash or shares, at the election of Aurora. The purchase price included ~$1.6m upfront cash payment with the remaining purchase price to be paid based on milestones related to patient acquisition and revenue targets over the next three years. Two milestone payments have already been triggered and a payment of $9m has been made to CanvasRx.

At the onset, this purchase price appears rich as medical clinics in the industry have not generated high profitability levels so far. CanvasRx provides a solid footprint into cannabis clinics and contributed to Aurora's successful onboarding of patients this fall. In addition, the valuable aggregate data regarding customer behaviour and preferences generated could help drive Aurora's growth strategy and future direction, particularly regarding strain selection.

Referred over 4,000 patients to Aurora since August 2016. CanvasRx currently operates in ~19 locations across Ontario and Alberta with plans underway to add additional facilities across Canada. Currently, CanvasRx has referred over 20,000 patients including ~4,000-5,000 patients registering with Aurora since August 2016, representing approximately one-third of patients registered with Aurora in 2016.

Patient experience from doctor to product. CanvasRx provides counseling services to patients that already have a prescription for medical marijuana. This is an important differentiation point as CanvasRx operates independently of the clinic and is not involved with patients prior to a cannabis prescription. Initially, patients are referred to a clinic where they are assessed by a doctor and, if appropriate, receive a prescription for medical marijuana. The majority of these patients will then meet with a CanvasRX counsellor who will help the patient choose the appropriate strain and licensed producer. CanvasRx is agnostic in its product and licensed producer referrals and will charge a $25 per month per referral fee. When a prescription expires, a patient must go through the process of obtaining a prescription and re-registering with a licensed producer and the majority will see a counsellor again.

Figure 20. Patient flow from doctor to product



Source: Company reports, GMP Securities

Current capacity and expansion plans

Cremona facility to reach full capacity in Q3/FY17. Aurora currently leases ~160 acres of land located in Cremona, Alberta. The existing 55,200 sq.ft. facility houses 13 grow rooms, 10 of which are flowering rooms, with an annual production capacity of ~5,500kg. At an average price of $8 per gram, the facility could generate revenue of ~$45m. Management anticipates reaching full capacity in Q3/FY17, however, continuous improvement on yields per plant could increase the capacity to a total of 7,000kg annually. At this time, the company has additional plans to expand the facility at Cremona and anticipates submitting a development proposal to the municipality in the near future.

Aurora Sky. Aurora has embarked on an ambitious plan to build a state-of-the art automated facility located next to the Edmonton airport. The purpose-built facility will be in the style of a Dutch hybrid greenhouse. The goal of the facility is to produce high quality marijuana at the lowest possible cost. To achieve this, the Aurora Sky facility will be a closed system complete with automated grow rooms to reduce human intervention to a minimum and also potentially reduce any cross-contamination. In addition, the location, right next to the cargo terminal at an international airport, is ideal to reduce shipping costs and shipping times and could support Aurora’s strategy of rapid, same day or next day delivery.

Figure 21. Aurora Sky's expansion potential footprint

Source: Company reports, GMP estimates

Production capacity of over 100,000kg. The new purpose-built facility is expected to encompass ~800,000 sq.ft. and could add over 100,000kg to production capacity. At the current average selling price of $8 per gram, this facility could generate in excess of ~$800m in revenues. Construction of the facility has already begun and the first phase is expected to be complete by the end of December 2017. However, we would expect production to roll out pending Health Canada approval and as such do not anticipate harvest from the facility until the spring of 2018.

Figure 22. Aurora production capacity breakdown

Facility	Estimated capacity added (kg/yr)	Estimated completion date of construction	Estimated date of first harvest	Cumulative capacity (kg/yr)
Cremona	5,400 kg			5,500 kg
Aurora Sky (Phase I)	~30,000 kg	Dec-17	May-18	~35,500 kg
Aurora Sky (Phase II)	~70,000 kg	Jun-18	Dec-18	~105,500 kg
Total capacity after expansion				**>105,500 kg**

Source: Company reports, GMP estimates

Acquired Peloton, a Quebec-based ACMPR applicant. On March 6, 2017 Aurora announced that it had acquired Peloton Pharmaceuticals Inc. (Peloton) out of bankruptcy protection for $7m in cash and shares. Peloton is a Quebec-based, late-stage ACMPR applicant that received a "ready to build" letter from Health Canada in 2014. Construction on the company's 40,000 sq. ft. cannabis production facility is ~80% complete and management estimates that the facility will be ready for Health Canada pre-licence inspection by the summer of 2017. In our view, the acquisition of Peloton could provide Aurora with an entry into the Quebec market, which has some local nuances compared to the rest of Canada that could favour local production and knowledge. In addition, production at Peloton could help bridge the supply gap until the Aurora Sky is operational beginning in late calendar 2018.

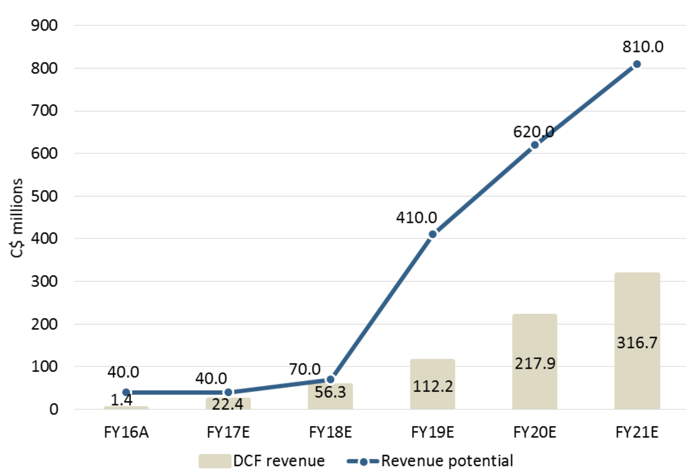
On-site analytical lab to shorten time to market. Currently, Aurora sends its products to external third party laboratories for Health Canada mandated testing prior to releasing a production batch for sale and shipment to registered patients. Aurora is establishing an on-site analytical testing laboratory that will comply with Health Canada standards and testing protocols. Once the laboratory is approved by Health Canada, product testing will be conducted on-site instead of by an external party. This could potentially accelerate the time it takes to release a production batch for sale, thus shortening the time it takes for a batch to move from production to sale and increasing the sales capacity of Aurora.

Developing more efficient extraction techniques. In December 2016, Aurora signed a memorandum of understanding with Radient Technologies Inc. (“Radient”) (RTI-TSXV, not rated) to evaluate Radient’s proprietary extraction technology for cannabis. Radient operates a 20,000 sq.ft., GMP compliant, Natural Health Products Directorate of Health Canada-licensed facility in Edmonton, Alberta. The company’s extraction technology is currently used to extract natural ingredients in a wide range of industries including food and beverage, nutrition and pharmaceutical. Aurora has partnered with Radient to evaluate the quality and efficiency of the technology for cannabis extract production. As part of the collaboration, Aurora has invested $2m in Radient by way of a convertible debenture. The debenture has a term of two years and bears an interest rate of 10% annually and is convertible into units at $0.14 per unit. We believe the potential to more efficiently extract high quality extracts from cannabis could give Aurora a competitive edge in a premium priced market.

Financing history

Our long-term DCF expectations appear conservative in light of Aurora’s potential capacity. We expect that Aurora Sky will start production in Q4/FY18 (May 2018), which accounts for potential delays in construction and approval. We estimate that it will take three years for the facility to reach its full production pace of 100,000kg by FY21. Despite this conservative rollout of capacity, Aurora’s potential revenue generation is much higher than our long-term DCF expectations. Hence, should Aurora accelerate its revenue growth faster than expected, it will have ample production capacity to support its growth.

Figure 23. Capacity expansion vs revenue expectations



Source: Company reports, GMP estimates

Cash on hand to fund capacity expansion. Aurora has raised over $150m in equity and debt over the past two years to support its growth strategy. With the closing of the most recent equity financing for ~$70m in net proceeds, we estimate that Aurora has a current cash balance of ~$115m, which according to our analysis could be sufficient to support construction of the Aurora Sky facility which we assess should cost roughly $80m.

Figure 24. Aurora appears fully funded to support expansion plans

FYE Jun 30 (C$000s, unless otherwise noted)	FY15	FY16E	FY17E	FY18E	FY19E	FY20E
Estimated production capacity (kg)		1,750	4,000	8,000	50,000	105,500
Capex	**7,834**	**1,885**	**28,842**	**52,301**	**2,587**	**2,965**
Cash balance - Beginning	917	316	259	103,454	52,051	69,159
Cash from operations	(3,324)	(6,771)	(5,660)	898	19,695	35,338
Free cash flow	(11,158)	(8,656)	(34,502)	(51,403)	17,108	32,373
Equity & debt financing	7,283	9,116	144,465	-	-	-
Other source (uses) of cash	3,274	(517)	(6,768)	-	-	
Cash balance - End	**316**	**259**	**103,454**	**52,051**	**69,159**	**101,532**

Source: Company reports, GMP Securities

Expecting positive cash flows by FY18. We expect that Aurora will generate positive operating cash flows before working capital starting in FY18. For FY18, we expect Aurora to generate $9m of operating cash flows and a working capital investment of $8m to partly offset operating cash flows.

Share lock-up until June 29, 2017. Despite raising almost $150m, only the shares from the latest equity raised which closed on February 28, 2017 are in lock-up. The 33.3m units, comprised of one share and one-half common share purchase warrant at $3.00 are under a four-month lock-up that expires June 29, 2017.

Figure 25. Aurora's financing history

Announcement Date	Units	Shares	Offer price	Gross Proceeds
27-Jun-14		9.5M	$0.10	$1.0M
11-Jul-14		6.5M	$0.10	$0.7M
22-Aug-14		8.0M	$0.25	$2.0M
15-Oct-14		1.2M	$0.85	$1.0M
31-Dec-15	3.3M		$0.53	$1.7M
19-Jan-16	5.8M		$0.53	$3.1M
10-May-16 (Convertible debenture)[a]		3.8M	$0.40	$1.5M
20-May-16 (Convertible debenture)[a]		1.4M	$0.40	$0.6M
17-Aug-16[b]	57.5M		$0.40	$23.0M
28-Sep-16[c,d]		13.0M	$1.15	$15.0M
01-Nov-16 (Convertible debenture)[e]		12.5M	$2.00	$25.0M
28-Feb-17[f]	33.3M		$2.25	$75.0M
				$149.5M

[a]Conversion price was amended from $0.53. Debentures converted in September 2016.
[b]Units are comprised of one share and one-half common share purchase warrant @$0.55
[c]Converted $10m of convertible debenture in October 2016
[d]Converted $5m balance of debenture in November 2016
[e]Debentures interest rate at 8% per annum and convertible into common share at $2.00 per share
[f]Units are comprised of one share and one-half common share purchase warrant @ $3.00

Source: Company reports

Q2FY17 results

Figure 26. Aurora's Q2FY17 earnings results

Year-end Jun-30 (C$)	Q2/FY17A	Q1/FY17A	Chg. QoQ
Average selling price ($/gram)	$5.95	$6.31	-6%
# of Grams sold	538,045	435,720	23%
Revenues	**3,884,462**	**3,071,422**	**26%**
Adj. COGS	2,404,624	1,722,876	40%
Adj. gross profit	**1,479,838**	**1,348,546**	10%
Gross profit margin	*38.1%*	*43.9%*	-581bps
Sales & marketing expense	2,410,701	1,570,491	53%
% of sales	*62.1%*	*51.1%*	1093bps
Research & development expense	99,087	39,912	148%
General & administrative expense	1,553,558	1,212,060	28%
% of sales	*40.0%*	*39.5%*	53bps
Adj. EBITDA	**(2,583,508)**	**(1,473,917)**	**75.3%**
Depreciation & amortization	163,178	158,662	3%
Stock-based compensation	2,510,075	379,818	561%
Net financing costs (income)	1,702,059	3,011,745	-43%
Taxes (recovery)	(1,400,494)	(673,617)	nmf
Adj. net income	**(5,558,326)**	**(4,350,525)**	**27.8%**
Adj. EPS (f.d.)	**($0.02)**	**($0.02)**	**($0.11)**
Shares outstanding, diluted	263,865,017	183,610,213	44%

Source: Company reports, GMP Securities

Aurora reported on February 27, 2017 its Q2/FY17 results for the quarter ending December 31, 2016. While revenues showed a nice progression, up 26% QoQ, expenses also increased materially which led the company to report a bigger loss than Q1/FY17.

Revenues reached almost $4m. Aurora reported revenues of $4m, the fourth highest level of all publicly traded licensed producers, after Canopy, Mettrum and Aphria, while having received its licence to sell more than one year later than the above licensed producers. Aurora's price per gram sold decreased to $5.95 per gram, which is lower than other licensed producers. This may be due in part to the lower proportion of veteran patients than other licensed producers. Also Aurora offers a compassionate pricing program in which it sells its products for $5.00 per gram.

Gross margin declines on wholesale purchases. Aurora's gross margin declined more than 500bps QoQ in part due to a higher proportion of product sourced from other licensed producers. Anecdotal discussions with industry participants indicates that the wholesale market is tight suggesting higher sourcing costs. Aurora's margin compression is evidence of growing pains as the company onboarded more patients than its current production can support.

OPEX per gram increases to $7.55. Aurora's total operation expenses reached $4m, or more than 100% of sales mostly due to strong increases in sales and marketing expenses. This may be due to the company's aggressive growth strategy which resulted in higher patient acquisition costs. Industry sources suggest that referral fees paid to clinics range from 10-15% of sales, which can explain in part the large increase QoQ.

Forecasts and valuation

We derive a target price of $3.00. Our target price of $3.00 represents an expected return of ~25% from the current share price. Given the high growth potential of the industry with the potential legalization of a recreational market and the near-term capital expenditures required to support the company's expansion plans, we are valuing Aurora using a DCF analysis. Our DCF assumptions include: (1) a discount rate of 10%, (2) two-stage average revenue growth of 30%, an average EBITDA margin of ~30%, and (3) a terminal growth rate of 3%.

Figure 27. Aurora's DCF analysis

Aurora Cannabis Inc, FYE Jun 30	Forecasts		Stage 1					Stage 2					Total
C$ thousands	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	
Recreational market													
Estimated addressable market size ('000 kg)			50,000	150,000	250,000	350,000	450,000	512,500	538,125	565,031	593,283	622,947	
Aurora's estimated market share			10.0%	12.0%	12.0%	12.0%	12.0%	11.5%	11.0%	10.5%	10.0%	10.0%	
Implied number of kilos sold			5,000	18,000	30,000	42,000	54,000	58,938	59,194	59,328	59,328	62,295	
Average price per gram ($/gram)			$6.90	$6.90	$6.90	$6.90	$6.90	$6.20	$6.20	$6.20	$6.20	$6.20	
Revenues (recreational market)			34,500	124,200	207,000	289,800	372,600	365,413	367,001	367,835	367,835	386,227	
Medical market													
Avg customers for period	9,200	23,100	29,100	35,100	41,100	47,100	53,100	59,100	65,100	71,100	77,100	83,100	
Number of kilos sold (dried equivalent)	2,765	6,102	7,966	9,609	11,251	12,894	14,536	16,179	17,821	19,464	21,106	22,749	
Average price per gram equivalent	$7.73	$9.23	$9.75	$9.75	$9.75	$9.75	$9.75	$10.65	$10.65	$10.65	$10.65	$10.65	
Total revenues medical market	22,383	56,322	77,670	93,684	109,698	125,713	141,727	172,302	189,795	207,288	224,780	242,273	
Total revenues	**22,383**	**56,322**	**112,170**	**217,884**	**316,698**	**415,513**	**514,327**	**537,715**	**556,796**	**575,123**	**592,616**	**628,500**	
EBITDA margins - recreational			26.0%	27.0%	28.0%	29.0%	30.0%	25.0%	25.0%	25.0%	25.0%	25.0%	
EBITDA margins - medical			33.0%	34.0%	35.0%	36.0%	37.0%	32.0%	32.0%	32.0%	32.0%	32.0%	
EBITDA	**(5,539)**	**11,133**	**34,601**	**65,387**	**96,354**	**129,299**	**164,219**	**146,490**	**152,485**	**158,291**	**163,889**	**174,084**	
margin	-24.7%	19.8%	30.8%	30.0%	30.4%	31.1%	31.9%	27.2%	27.4%	27.5%	27.7%	27.7%	
Depreciation & amortization	948	3,353	5,968	6,097	6,245	6,402	6,583	6,867	6,973	7,072	7,163	7,419	
Net finance costs & other	5,298	1,168	1,285	1,413	1,555	1,710	1,881	2,069	2,276	2,504	2,754	3,029	
EBT	(11,785)	6,613	27,348	57,876	88,555	121,187	155,755	137,553	143,236	148,716	153,972	163,636	
Cash taxes (30%)	(2,074)	1,144	8,205	17,363	26,566	36,356	46,726	41,266	42,971	44,615	46,192	49,091	
NOPAT	(4,413)	6,637	20,429	41,927	63,543	86,541	110,909	98,357	102,541	106,605	110,534	117,574	
+ Depreciation & amortization	948	3,353	5,968	6,097	6,245	6,402	6,583	6,867	6,973	7,072	7,163	7,419	
- Net increase in working capital	935	(7,923)	(6,702)	(12,686)	(11,858)	(11,858)	(11,858)	(2,807)	(2,290)	(2,199)	(2,099)	(4,306)	
- CAPEX	(28,842)	(52,301)	(2,587)	(2,965)	(3,128)	(3,627)	(5,685)	(2,110)	(1,974)	(1,825)	(5,121)	(2,741)	
Free cash flow to the firm	**(31,372)**	**(50,235)**	**17,108**	**32,373**	**54,802**	**77,458**	**99,950**	**100,308**	**105,250**	**109,652**	**110,477**	**117,946**	
PV factor	1.0000	0.9545	0.8697	0.7925	0.7221	0.6579	0.5995	0.5462	0.4977	0.4535	0.4132	0.3765	
PV of Free Cash Flows	**(31,372)**	**(47,952)**	**14,879**	**25,655**	**39,572**	**50,962**	**59,918**	**54,790**	**52,383**	**49,725**	**45,649**	**44,405**	358,614

Valuation	
PV of Free cash flow to the firm	358,614
Terminal value	699,640
Enterprise value	1,058,255
Current net debt (net cash)	(115,347)
Equity value (C$, 000s)	1,173,602
Shares O/S (f.d.)	393,400
Equity value /share	**$ 2.98**

Recreational - Stage 1 key assumptions	
Aurora's average market share	12%
Price of dried marijuana ($/gram)	$6.00
Price of cannabis oil ($/gram)	$9.00
% of sales - dried marijuana	70%
% of sales - oils/extracts	30%
EBITDA margin	28.0%

Recreational - Stage 2 key assumptions	
Aurora's average market share	11%
Price of dried marijuana ($/gram)	$5.00
Price of cannabis oil ($/gram)	$8.00
% of sales - dried marijuana	60%
% of sales - oils/extracts	40%
EBITDA margin	25.0%

Medical - Stage 1 key assumptions	
Annual customer acquisition	6,000
Average consumption per day (grams)	0.75
Price of dried marijuana ($/gram)	$7.50
Price of cannabis oil ($/gram)	$12.00
% of sales - dried marijuana	50%
% of sales - oils/extracts	50%
EBITDA margin	35.0%

Medical - Stage 2 key assumptions	
Annual customer acquisition	6,000
Average consumption per day (grams)	0.75
Price of dried marijuana ($/gram)	$7.50
Price of cannabis oil ($/gram)	$12.00
% of sales - dried marijuana	30%
% of sales - oils/extracts	70%
EBITDA margin	32.0%

Terminal Value	
Terminal FCFF	121,720
Terminal growth rate	3%
WACC	10%
WACC - g	7%
TCF/(WACC-g)	1,858,328
Present value	699,640

Source: GMP Securities

Forecasting FY17 revenues of $22.4m. We estimate Aurora will generate $22.4m in revenues from the sale of ~2,500kg of dried marijuana at an average price of ~$7.26 and ~275 kg of equivalent grams in cannabis oils at an average price of $12.00 per gram. Aurora received its licence to sell cannabis oils in January 2017 and we are expecting that sales commenced shortly afterward. We are estimating that ~15% of the patient base will order a 50ml bottle twice per month at a cost of $100 per bottle. We are forecasting a gross margin of ~50%, which is lower than the industry average mainly due to Aurora purchasing a significant share of inventory wholesale. We are also expecting operating expenses to be ~5.96 per gram given the company is in growth mode.

Forecasting FY18 EBITDA of $11.1m. We are forecasting that Aurora will generate positive EBITDA of $11.1m in FY18 on the back of revenue growth of 152% YoY to $56.3m. The revenue growth is primarily driven by: (1) strong patient onboarding as capacity ramps-up with the completion of the Aurora Sky facility, and (2) cannabis oils, which we forecast to grow by ~581% YoY reaching 40% of total revenues. We are anticipating that gross margin will increase ~1300 bps YoY to 62% as Aurora reduces its wholesale purchases and sales of Aurora Sky inventory come online. We are also expecting operating expenses to decline to an average of $3.88 per gram as a result of increased scale and operating leverage with the Aurora Sky facility.

The assumptions used in our DCF model are as follows:

1. **Rapid patient onboarding when Aurora Sky becomes operational**. We are expecting Aurora's patient onboarding to accelerate in FY18 as the Aurora Sky capacity comes online. Hence, we are forecasting Aurora to onboard 9,400 patients in FY17 and 18,000 in FY18. We are assuming that once the recreational market opens in FY19 that patient onboarding could slow down, however, we are expecting Aurora to continue onboarding at a rate greater than the industry average given the capacity. We note that our assumptions regarding medical marijuana patients could change if prescriptions obtain reimbursement status.

2. **Assuming an average selling price that aligns with the industry average**. We are forecasting an average selling price per equivalent gram of $7.50 and $12.00 for dried medical marijuana and cannabis oils, respectively. For the recreational market we have assumed a wholesale price of $6.00 per dried cannabis and $9.00 per gram equivalent for oils. We expect price erosion in our second stage as more producers enter the market. Our near-term average selling price assumptions could prove conservative should Aurora be allowed to sell directly to consumers.

3. **Capture 10% share of the recreational market in FY19.** We are expecting the recreational market to open beginning of January 2019 and are forecasting that Aurora could capture a 10% market share, representing $35m in FY19 sales. We are expecting Aurora's market share to increase to 12% in the first stage of our DCF, primarily due to Aurora's potential annual capacity of greater than 100,000kg, which we expect to be fully operational in FY19. We expect market share erosion in the second stage of our DCF as more producers enter the market.

4. **Average EBITDA margin of ~30%.** We have assumed an average operating margin of 31% in stage one of our DCF and 28% in stage two, which is roughly in line with other peers. We expect that Aurora will use its lower production costs to pass on some savings to customers in the form of lower prices, which is why we don't expect above average EBITDA margins. This assumption could prove conservative depending on the company's pricing strategy.

5. **Capex.** We are assuming capital expenditures of ~$28m in FY17 and $52m in FY18 in order to complete the construction of the Aurora Sky facility, which is expected to be complete in FY18 and operating fully operational in FY19.

Sensitivity analysis

Parameters driving Aurora's target price. Our analysis is predicated on certain assumptions, however, there are a number of unknowns regarding both the recreational and the medical market that could affect our analysis. Hence, we looked at the potential impact of changes in various parameters on our target price. According to our analysis, changes in discount rate, EBITDA margin and selling price have the largest impact on Aurora's target price by 15-20%, 7% and 13%, respectively.

Figure 28. Sensitivity of Aurora's target price to various parameters

Parameter	Impact on target price
Discount rate: +/- 1%	+/-15-20%
Patient count: +/- 1,000	+/- ~5%
EBITDA margin: +/- 2%	+/- ~7%
Selling price: +/- $1.00	+/- ~13%
% of dried marijuana: +/- 10%	+/- ~4%

Source: GMP estimates

Figure 29. Comparable table of publicly listed licensed producers

March 14, 2017	Ticker	Price	Basic Shares O/S (m)	Market Cap	EV	Current EV / sales			EV/EBITDA	
				($m)	($m, f.d.)	CY17	CY18	CY19	CY18	CY19
Select publicly listed licensed marijuana producers										
APHRIA INC	APH-CA	6.62	123	815	738	25.7x	9.8x	6.3x	27.3x	17.3x
AURORA CANNABIS INC	ACB-CA	2.40	339	815	829	22.0x	9.8x	5.0x	36.2x	16.6x
BELEAVE INC	BE-CA	2.49	26	64	85	22.6x	n.a.	n.a.	n.a.	n.a.
CANNIMED THERAPEUTICS INC	CMED-CA	11.44	21	236	198	7.9x	3.8x	2.1x	8.8x	4.0x
CANOPY GROWTH CORPORATION	WEED-CA	11.05	158	1,743	1,722	16.8x	9.0x	5.7x	62.2x	30.1x
CRONOS GROUP (aka Pharmacan)	MJN-CA	2.82	124	349	487	34.1x	11.7x	4.4x	41.8x	15.0x
EMBLEM CORP	EMC-CA	2.68	71	191	287	34.9x	11.9x	4.8x	56.9x	16.3x
EMERALD HEALTH THERAPEUTICS	EMH-CA	1.26	78	98	89	nmf	16.6x	n.a.	nmf	n.a.
INVICTUS MD STRATEGIES CORP	IMH-CA	1.45	33	47	48	n.a.	n.a.	n.a.	n.a.	n.a.
ORGANIGRAM HOLDINGS INC	OGI-CA	2.42	101	244	211	11.7x	5.3x	3.2x	14.5x	8.8x
SUPREME PHARMACEUTICALS INC	SL-CA	1.53	174	267	388	30.2x	6.8x	n.a.	27.3x	n.a.
THC BIOMED INTERNATIONAL LTD	THC-CA	0.76	103	78	79	n.a.	n.a.	n.a.	n.a.	n.a.
Average				*412*	*430*	*22.9x*	*9.4x*	*4.5x*	*34.4x*	*15.4x*
Aurora premium (discount) to peers						*-4%*	*5%*	*11%*	*5%*	*7%*

Source: Company reports, FactSet, GMP Securities

Aurora trades at a slight premium to peers. Shares of Aurora currently trade at an average premium of ˜6% to peers on a forward EV/EBITDA basis. We believe that a slight premium could be justified given: (1) the potential scale of the company with Aurora Sky, (2) the potential increase in capacity, and (3) its approach to quality product. However, we also believe the uncertainty surrounding the regulations for the recreational market could result in the gap narrowing over the next 12 months.

Recommendation

Initiating coverage with a BUY rating and C$3.00 target price. Our positive stance on Aurora is based on:

1. **Low cost advantage.** Aurora's production facilities are currently located in Alberta, which potentially provides for low energy costs, low taxes and low labour costs. In addition, the Aurora Sky facility is expected to provide the company with low production costs due to its large scale and high level of automation.
2. **Significant growth potential.** Aurora is currently operating a 55,200 sq.ft. facility with the potential to produce over 7,000kg annually. However, the company has begun construction of an 800,000 sq.ft. capacity facility that could generate production of over 100,000kg annually at full capacity, potentially representing ~$800m in annual revenues at today's average selling price of $8.00 per gram.

Company-specific risks

Execution risk for facility expansion. Aurora has undertaken an ambitious expansion plan, which management expects to have completed before the end of 2017. The size and automation of the project could pose a risk, however, this is offset in part by the modular design and experienced team from the Netherlands that will be assisting with the assembly.

Maintaining high quality standard. With recent industry recalls, it will be important for Aurora to deliver a consistent, high quality product. The purpose-built facilities to minimize cross-contamination and optimize growing conditions should support the company's strategy to be a high quality producer.

Recreational market contributes ~$1.60 to our valuation. Under the scenario where the legalization of marijuana for recreational use does not materialize, we estimate the value of Aurora would be ~$1.40 per share. Our valuation of the medical-only market is based on removing the recreational market assumptions including any related capex for capacity expansion.

Declining prices with legalization could squeeze profitability. We are anticipating that marijuana prices will decline in the mid to long-term, hence, Aurora's potential for low cost production will be a key contributor to profitability.

Management and Board of Directors

Terry Booth, CEO and Founder. Mr. Booth founded Aurora in 2014 by investing $2.5m of his own capital in start-up funding to secure 100+ acres of land that now houses Aurora's marijuana cultivation facility. Mr. Booth is also part owner and President of Superior Safety Codes Inc., which he founded in 2004 and Trans True Vehicle Safety Inc., which he founded in 2008. Previously, he was previously the founder and CEO of Alberta Permit Pro, an accredited agency under the Safety Codes Act to provide inspection and permit work related to electrical, plumbing, gas, etc., which he sold in 2004 for $6m.

Steve Dobler, P.Eng, President and Founder. Mr. Dobler has personally invested $2m of start-up capital in Aurora. He brings over 25 years of experience in private and public company operations. He is part owner and Vice-President of Superior Safety Codes Inc. Previously, Mr.

Dobler was the Executive Vice-President at Alberta Permit Pro. Mr. Dobler obtained his Professional Engineering designation from the University of Alberta.

Neil Belot, Chief Brand Officer. Mr. Belot joined Aurora as CBO and member of the executive management team in September 2015. Previously, he was the inaugural executive director of the Canadian Medical Cannabis Industry Association, the industry association for licensed producers now known as Cannabis Canada. Mr. Belot has over six years of experience in federally regulated medical cannabis and eight years of experience in public service including managing one of Canada's largest commodity bulk purchasing portfolios and energy services programs in the housing sector. He obtained his MBA from Dalhousie University in 2009.

Cam Battley, Executive Vice President. Mr. Battley joined Aurora in March 2016 as Senior Vice President, Communications and Medical Affairs before being appointed Executive Vice President in November 2016. He brings over 15 years of experience in the pharmaceutical and biotech sectors. Mr. Battley was the founder and President of Health Strategy Group Inc., a health sector management consultancy and Wind Gage Communications Inc., a communications technology services company. He also currently serves on the Board of Directors of Cannabis Canada. Prior to Aurora, Mr. Battley was Vice President, Communications and Corporate Development at Bedrocan Canada.

Amy Stephenson, Interim CFO. Prior to being appointed Interim CFO and member of the management team in August 2016, Ms. Stephenson worked with Aurora as a consultant starting in June 2016. Ms. Stephenson is also CFO of Branson Corporate Services Inc., Nutritional High International Inc. and Interim CFO at The Tinley Beverage Company Inc. She has over 20 years of senior management and capital markets experience including stints as CFO of Bedrocan Cannabis Corp. and Goldeye Explorations Ltd. Ms. Stephenson is a CFA Charterholder, a Chartered Professional Accountant and a member of the Financial Executive International.

Michael Singer, Chairman. Mr. Singer joined the Board of Directors in May 2016 and currently serves as Chariman. He has over 15 years of finance and pharmaceutical industry experience and currently is the CFO for Clementia Pharmaceuticals Inc. Prior to Clementia, Mr. Singer was CFO of Bedrocan Canada Inc. and Thallion Pharmaceuticals. Mr. Singer is a Certified Professional Accountant – Certified General Accountant with the Ordre des CPA du Quebec.

Jason Dyck, PhD, Director and Head of Research Council. Dr. Dyck is a Professor in the Department of Pediatrics and the Canada Research Chair in Molecular Medicine at the University of Alberta. His research interests range from obesity to hypertension to chemotherapy-induced cardiotoxicity. In addition, he has experience in drug development and commercialization having co-founded a University of Alberta spin-off company. Dr. Dyck obtained his PhD in Medical Sciences from the University of Alberta.

Chuck Rifici, Director. Mr. Rifici is the co-founder and former CEO of Tweed Marijuana Inc. Mr. Rifici currently services on the Board of Directors for CannaRoyalty Corp and Supreme Pharmaceuticals Inc. and is the Chairman of National Access CANNABIS. He is also CEO of Nesta Holding Co. Ltd, a private equity firm building partnerships and brands in the cannabis space. Mr. Rifici is a chartered professional accountant and former CFO of various technology companies.

Adam Szweras, Director. Mr. Szweras brings over 20 years of experience in corporate and securities law to the Board. He is currently a partner in the Securities Law Group of Fogler, Rubinoff LLP and serves as a board member for several publicly listed companies including

Nutritional High International Inc. and The Tinley Beverage Company Inc. Mr. Szwera obtained his LLB from the Osgoode Hall Law School at York University.

Joseph Del Moral, Director. Mr. Del Moral joined the Board in October 2016. He is the co-founder and CEO of Canadian Cannabis Clinics, a group of fee-free medical marijuana specialized clinics in Ontario and the former CEO of CanvasRx, a medical marijuana resource and consulting service that was acquired by Aurora in August 2016 for $1.6m upfront plus performance based milestone payments.

Barry Fishman, Director. Mr. Fishman joined the Board in October 2016. He is currently the CEO of Merus Labs International Inc. Prior to Merus, Mr. Fishman served as CEO of Teva Canada and Taro Canada. He is also the past Chair of the Canadian Generic Manufacturers Association and past member of the Board of Directors of Canopy Growth Corp. and Bedrocan Cannabis Corp.

Figure 30. Aurora - Insider ownership

Major shareholders	# of shares	% ownership
Steve Dobler, President & Founder	17,090,348	5.04%
Terry Booth, CEO & Founder	13,384,282	3.94%
Joseph Del Moral, Director	5,182,086	1.53%
Dale Lesack	3,840,000	1.13%
Christopher Mayerson	2,683,000	0.79%
Jason Dyck, Director	2,970,644	0.88%
Total outstanding shares (basic)		339,400,000

Note: Shares outstanding and ownership as of March 6, 2017
Source: SEDI, FactSet

Aurora Cannabis Inc. - Financial statements

Figure 31. Income statement

FYE Jun 30 (C$)	FY2015A	FY2016A	Q1/FY17A	Q2/FY17A	Q3/FY17E	Q4/FY17E	FY2017E	FY2018E
Total sales of equivalent dried marijuana (grams)		257,080	435,720	538,045	863,363	928,200	2,765,328	6,101,550
Avg. selling price per equivalent dried gram		$5.60	$6.31	$5.95	$8.62	$8.62	$8.10	$9.23
Revenues		**$1,439,271**	**$3,071,422**	**$3,884,462**	**$7,438,200**	**$7,996,800**	**$22,390,884**	**$56,322,000**
Growth YoY %		*nmf*	*nmf*	*nmf*	*3292.9%*	*555.5%*	*1455.7%*	*151.5%*
COGS (excluding adj. for biological assets)		2,241,152	1,722,876	2,404,624	3,719,100	3,598,560	11,445,160	21,503,790
Adj. gross margin		**(801,881)**	**1,348,546**	**1,479,838**	**3,719,100**	**4,398,240**	**10,945,724**	**34,818,210**
Gross margin %		*nmf*	*43.9%*	*38.1%*	*50.0%*	*55.0%*	*48.9%*	*61.8%*
Operating expenses	3,189,793	5,287,024	2,822,463	4,063,346	4,607,841	4,991,482	16,485,132	23,684,955
% of sales		367.3%	91.9%	104.6%	61.9%	62.4%	73.6%	42.1%
Operating expense per gram sold		$20.57	$6.48	$7.55	$5.34	$5.38	$5.96	$3.88
Adj. EBITDA	**(3,189,793)**	**(6,088,905)**	**(1,473,917)**	**(2,583,508)**	**(888,741)**	**(593,242)**	**(5,539,408)**	**11,133,255**
Margin %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*19.8%*
Stock-based compensation	872,587	912,698	379,818	2,510,075	1,510,075	1,010,075	5,410,043	4,090,300
Depreciation & amortization	304,796	593,216	158,662	163,178	263,178	363,178	948,196	3,352,712
EBIT	**(4,367,176)**	**(7,594,819)**	**(2,012,397)**	**(5,256,761)**	**(2,661,994)**	**(1,966,495)**	**(11,897,647)**	**3,690,243**
Interest expense (income)	297,969	1,370,723	3,011,745	1,702,059	292,492	291,492	5,297,788	1,167,968
EBT	**(4,665,145)**	**(8,965,542)**	**(5,024,142)**	**(6,958,820)**	**(2,954,486)**	**(2,257,987)**	**(17,195,435)**	**2,522,276**
Income taxes	(207,708)	(148,837)	(673,617)	(1,400,494)	-	-	(2,074,111)	1,143,974
Net income	**(4,457,437)**	**(8,816,705)**	**(4,350,525)**	**(5,558,326)**	**(2,954,486)**	**(2,257,987)**	**(15,121,324)**	**1,378,302**
Margin %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*2.4%*
Growth YoY %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*
EPS (f.d)	**($0.06)**	**($0.07)**	**($0.02)**	**($0.02)**	**($0.01)**	**($0.01)**	**($0.05)**	**$0.00**
Total one-time items (after-tax)	5,060,932	(3,093,199)	1,262,281	(2,880,522)	-	-	(1,618,241)	-
Reported net income	(9,518,369)	(5,723,506)	(5,612,806)	(2,677,804)				
Reported EPS (f.d.)	($0.12)	($0.04)	($0.03)	($0.01)				
Shares outstanding (f.d.)	76,936,375	128,988,266	183,610,213	263,865,017	393,400,000	393,400,000	308,568,808	393,400,000

Source: Company reports, GMP Securities

Figure 32. Balance sheet

FYE Jun 30 (C$)	FY2015A	Q1/FY16A	Q2/FY16A	Q3/FY16A	Q4/FY16A	FY2016A	FY2017E	FY2018E
ASSETS								
Cash & cash equivalents	315,853	693,882	543,638	342,718	169,579	169,579	103,453,651	52,050,783
Restricted cash	-	-	-	-	89,494	89,494	-	-
Accounts receivable	628,247	-	-	85,529	86,170	86,170	2,459,662	6,187,032
Inventory	-	314,358	998,753	3,750,749	2,317,216	2,317,216	6,236,770	14,502,570
Biological assets	25,409	-	2,219,696	4,419,770	1,845,108	1,845,108	3,118,385	3,625,643
Other current assets	91,086	156,461	220,681	606,899	736,308	736,308	1,277,743	1,277,743
Total current assets	**1,060,595**	**1,164,701**	**3,982,768**	**9,205,665**	**5,243,875**	**5,243,875**	**116,546,211**	**77,643,770**
Property Plant & Equipment	10,785,521	11,027,598	11,063,228	11,375,411	11,370,484	11,370,484	39,076,139	88,024,679
Notes receivable	1,680,506	1,704,475	1,714,839	1,738,870	1,782,186	1,782,186	1,898,512	1,898,512
Goodwill	-	-	-	-	-	-	16,104,931	16,104,931
Total assets	**13,526,622**	**13,896,774**	**16,760,835**	**22,319,946**	**18,396,545**	**18,396,545**	**173,625,793**	**183,671,892**
LIABILITIES								
Accounts payable & accrued liabilities	1,323,224	1,518,869	1,590,586	953,067	1,686,794	1,686,794	8,485,919	12,556,158
Deferred revenue	-	-	-	-	27,629	27,629	726,565	726,565
Short-term debt	4,787,388	4,980,753	6,118,888	5,887,343	6,047,408	6,047,408	1,657,630	1,657,630
Convertible notes	1,291,192	1,327,650	271,698	-	-	-	-	-
Finance lease	-	-	-	-	-	-	17,469	17,469
Derivative liabilities	-	-	-	-	233,444	233,444	-	-
Total current liabilities	**7,401,804**	**7,827,272**	**7,981,172**	**6,840,410**	**7,995,275**	**7,995,275**	**10,887,583**	**14,957,822**
Long-term debt (term loan)	2,018,000	3,000,000	3,000,000	4,000,000	3,158,569	3,158,569	-	-
Convertible notes	274,008	-	-	-	1,280,531	1,280,531	18,841,831	18,841,831
Finance lease	-	-	-	-	-	-	99,622	99,622
Total liabilities	**9,693,812**	**10,827,272**	**10,981,172**	**10,840,410**	**12,434,375**	**12,434,375**	**29,829,036**	**33,899,275**
SHAREHOLDERS EQUITY								
Share capital	11,432,977	12,123,269	14,053,787	17,031,276	17,147,878	17,147,878	160,581,928	160,581,928
Share-based reserve	3,741,737	3,657,304	3,830,065	3,968,571	5,730,300	5,730,300	11,804,423	15,894,723
Retained Earnings (deficit)	(11,341,904)	(12,711,072)	(12,104,189)	(9,520,311)	(16,916,008)	(16,916,008)	(28,994,829)	(27,616,527)
Total shareholders equity	**3,832,810**	**3,069,501**	**5,779,663**	**11,479,536**	**5,962,170**	**5,962,170**	**143,391,522**	**148,860,124**
Total liabilities and shareholders equity	**13,526,622**	**13,896,773**	**16,760,835**	**22,319,946**	**18,396,545**	**18,396,545**	**173,220,558**	**182,759,399**

Source: Company reports, GMP Securities

Figure 33. Cash flow statement

FYE Jun 30 (C$)	FY2015A	FY2016A	Q1/FY17A	Q2/FY17A	Q3/FY17E	Q4/FY17E	FY2017E	FY2018E
OPERATING ACTIVITIES								
Net earnings	**(9,518,369)**	**(5,723,506)**	**(5,612,806)**	**(2,677,804)**	**(2,954,486)**	**(2,257,987)**	**(13,503,083)**	**1,378,302**
Unrealized gain on change in fair value of biological assets	-	(3,004,117)	1,262,281	(2,430,522)	-	-	(1,168,241)	-
Depreciation	304,796	593,216	158,662	312,137	263,178	363,178	1,097,155	3,352,712
Non cash fees and compensation	12,600	12,500	-	-	-	-	-	-
Deferred tax recovery	(207,708)	(70,102)	(665,977)	(1,389,130)	-	-	(2,055,107)	-
Accrued interest	175,043	68,486	9,042	(5,541)	-	-	3,501	-
Accretion expense	113,724	622,434	911,446	588,350	-	-	1,499,796	-
Financing fees	-	191,556	1,578,114	542,876	-	-	2,120,990	-
Stock based comp	872,587	912,698	379,818	2,510,075	1,510,075	1,010,075	5,410,043	4,090,300
Gain on derivatives	-	(89,082)	-	-	-	-	-	-
Loss on investment	2,347	-	-	-	-	-	-	-
Listing costs	4,947,046	-	-	-	-	-	-	-
Cash flow from operating before working capital	**(3,297,934)**	**(6,485,917)**	**(1,979,420)**	**(2,549,559)**	**(1,181,233)**	**(884,734)**	**(6,594,946)**	**8,821,314**
Change in non-cash working capital balances	(26,244)	(285,562)	1,104,439	(2,584,041)	(1,157,364)	3,571,788	934,822	(7,922,930)
Cash flows related to operating activities	**(3,324,178)**	**(6,771,479)**	**(874,981)**	**(5,133,600)**	**(2,338,596)**	**2,687,054**	**(5,660,123)**	**898,384**
INVESTING ACTIVITIES								
Purchase of PP&E	(7,833,612)	(1,884,833)	(629,357)	(4,212,658)	(4,000,000)	(20,000,000)	(28,842,015)	(52,301,252)
Acquisition of CanvasRx	-	-	(3,400,000)	-	-	-	(3,400,000)	-
Bank indebtedness assumed on RTO of Prescient	(1,686)	-	(18,421)	-	-	-	(18,421)	-
Cash flows related to investing activities	**(7,835,298)**	**(1,884,833)**	**(4,047,778)**	**(4,212,658)**	**(4,000,000)**	**(20,000,000)**	**(32,260,436)**	**(52,301,252)**
FINANCING ACTIVITIES								
Issuance of common shares	266,733	5,035,884	25,820,830	16,933,885	71,258,906	-	114,013,621	-
Share issue costs	-	(200,697)	(1,804,009)	-	-	-	(1,804,009)	-
Proceeds (repayment) of convertible notes	2,750,000	800,000	15,000,000	25,000,000	-	-	40,000,000	-
Proceeds (repayment) from short-term loans	2,248,335	2,298,470	(5,548,645)	-	-	-	(5,548,645)	-
Proceeds (repayment) from long-term debt	2,018,000	982,000	(4,000,000)	-	-	-	(4,000,000)	-
Financing fee	(54,000)	(316,125)	(610,000)	(1,000,000)	-	-	(1,610,000)	-
Receivable from shareholders	(1,680,506)	-	-	-	-	-	-	-
Finance lease	-	-	-	64,170	-	-	64,170	-
Pre-RTO loans from Prescient	5,010,000	-	-	-	-	-	-	-
Cash flows related to financing activities	**10,558,562**	**8,599,532**	**28,858,176**	**40,998,055**	**71,258,906**	**-**	**141,115,137**	**-**
Net increase (decrease) in cash	(600,914)	(56,780)	23,935,417	31,651,797	64,920,310	(17,312,946)	103,194,578	(51,402,868)
Cash beginning of period	**916,767**	**315,853**	**259,073**	**24,194,490**	**55,846,287**	**120,766,597**	**259,073**	**103,453,651**
Cash end of period	**315,853**	**259,073**	**24,194,490**	**55,846,287**	**120,766,597**	**103,453,651**	**103,453,651**	**52,050,783**

Source: Company reports, GMP Securities

Cronos Group Inc.[1,7]

BUY

MJN-TSXV

March 15, 2017

Last: **C$2.82**
Target: **C$4.25**

Initiating coverage: Turning the corner

Cronos has undergone a transformation in the last two years from a passive holding company invested in multiple licensed producers to an operator with two ACMPR licensed properties. Cronos is one of only two licensed producers to operate multiple licences, a plus in our view given it reduces operational risks. Peace Naturals Project Inc. is a wholly-owned subsidiary which operates two indoor facilities totaling ~25,000 sq.ft. located on 90 acres in Stayner, Ontario. In the Zone Produce Ltd., also wholly-owned, is located on ~30 acres in the Okanagan valley and operates a ~2,500 sq.ft. indoor facility.

A new management team joined in mid-2016 and has revamped the company's strategy. They expanded internationally with a license agreement with Pedanios in Germany and partnered with First Nations to create Indigenous Roots, a First Nations owned and operated medical cannabis company. In addition, they accelerated expansion with construction at both production sites in 2017 to expand capacity to a cumulative ~55,000kg.

Cronos' financial statements are dated, the last reported quarter ended September 30, 2016, which limits our visibility as to the company's recent progression to lower operational costs and on-board patients. However, the recent price increases and premium pricing of their products would suggest a positive outlook. Our positive stance on Cronos is based on the following:

- **Strong management team.** In our view, Cronos' new management team has created significant value for shareholders in a short timeframe. They have revamped the company's strategy and deployed capital effectively.
- **Indigenous Roots partnership**. Indigenous Roots' goal is to work with First Nations to build cannabis facilities and to provide medical cannabis to First Nations patients, which represents a potential $300m market.
- **Optionality in Germany.** Cronos is exploring its options to apply for a marijuana cultivation licence in Germany. Our forecasts do not include any international revenues, which could provide upside to our valuation.

We are initiating coverage with a target price of $4.25. We derive our target price using a two-stage, 10-year DCF model. We estimate that Cronos will capture a ~7% share of the recreational market. Our DCF assumptions include (1) a discount rate of 11%, (2) two-stage average revenue growth of 30%, an average EBITDA margin of ~31%, and (3) a terminal growth rate of 3%.

Rating	BUY
Target	$4.25
Revenue 2016E (mm)	$0.6
Revenue 2017E (mm)	$14.3
Revenue 2018E (mm)	$41.7
EBITDA 2016E	($2.6)
EBITDA 2017E	$1.0
EBITDA 2018E	$11.6

Share Data

Share o/s (mm, basic/f.d.)	123.9 / 179.9
52-week high/low	3.46 / 0.14
Market cap (mm) f.d.	$507.3
EV (mm)	$487.2
Net debt (net cash) (mm)	($20.2)
Dividend	n.a.
Dividend yield	n.a.
Projected return	50.7%

Financial Data

FYE Dec 31	2016E	2017E	2018E
Revenue (mm)	$0.6	$14.3	$41.7
P/revenue	nmf	35.5x	12.2x
EBITDA (mm)	($2.6)	$1.0	$11.6
EV/EBITDA	nmf	nmf	41.8x
EPS (f.d.)	($0.05)	($0.01)	$0.04
P/E	nmf	nmf	67.0x
CFPS	($0.11)	($0.03)	$0.03
Net debt (net cash) (mm)	$4.2	($1.7)	($2.7)
BVPS	$0.44	$0.36	$0.40
P/BV	6.5x	7.9x	7.0x

All figures in C$ unless otherwise noted

Current Chart   Previous Research

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Figure 34. Snapshot comparison of publicly traded licensed producers

	Organigram	Cronos*	Aurora*	Emblem*	Canopy	Aphria	Average
VALUATION METRICS							
Recommendation	BUY	BUY	BUY	BUY	BUY	HOLD	
Current price	$2.42	$2.82	$2.40	$2.68	$11.05	$6.62	
Target Price	$4.00	$4.25	$3.00	$3.25	$12.75	$5.00	
Projected return	65.3%	50.7%	25.0%	21.3%	15.4%	-24.5%	**25.5%**
Market Cap, basic ($mm)	$244	$349	$815	$191	$1,743	$815	**$693**
Market Cap, fully diluted ($mm)	$270	$507	$944	$326	$1,862	$884	**$799**
EV ($mm)[a]	$211	$487	$829	$287	$1,722	$738	**$712**
EV/CY17 Sales	11.7x	34.1x	22.0x	34.9x	16.8x	25.7x	**24.2x**
EV/CY17 Production capacity (per kg)	$50,181	$121,792	$150,693	$136,802	$71,746	$98,454	**$104,945**
OPERATING METRICS							
Last reported patient count	~3,895	~3,400	~12,800	~1,500	~50,000	~6,675	**13,128**
Sales (CY16, $mm)	$7.7	$0.6	$8.4	$0.2	$30.3	$15.1	**$10.4**
Sales (CY17, $mm)	$18.1	$14.3	$37.6	$8.2	$102.5	$28.7	**$34.9**
Adj. Gross margin (CY17)[b]	64%	58%	56%	56%	70%	80%	**64%**
Opex (CY17 $/g)[c]	$4.46	$5.09	$4.97	$5.54	$4.55	$4.48	**$4.85**
Estimated production capacity (CY17)	4,200 kg	4,000 kg	5,500 kg	2,100 kg	24,000 kg	7,500 kg	**7,883 kg**
Number of licensed facilities	1	2	1	1	6	1	
Cannabis oil extracts license	Production & Sale	Production & Sale	Production & Sale	Production only	Production & Sale	Production & Sale	
Estimated long-term recreational market share	7.0%	7.0%	10.0%	4.0%	23.0%	5.5%	**9.4%**

a Based on fully diluted shares outstanding

b Adjusted gross margin excludes the fair value adjustment of biological assets and amortization

c Includes Selling, marketing, general, and administrative expenses (excludes depreciation, amortization, and stock based compensation)

* Initiating coverage

Source: Company reports, GMP Securities, FactSet

Key catalysts to create shareholder value

Health Canada approval of building #3 → Expected in coming weeks. Cronos has completed the construction of its 15,000 sq.ft. building #3 earlier this year. We believe that Health Canada has already inspected the building and Cronos is awaiting approval to proceed with cultivation, which should be awarded in coming weeks.

Breaking ground on building #4 → Expected in summer 2017. The company's largest expansion plans will come from the construction of a ~200,000 sq.ft. indoor facility on the company's 90 acre property in Stayner, Ontario. The start of construction will be an important milestone for the company, and a significant driver of our valuation.

News from Germany → Expected summer/fall 2017. Cronos is exploring options to apply for a licence to cultivate medical marijuana locally in Germany. We expect the German health authorities to grant cultivation licences this summer or fall, and the receipt of a licence by Cronos would be an important catalyst for the company. We do not have any revenues in our forecasts from international opportunities, so this represent potential upside to our valuation.

Details surrounding ITZ's recreational branding strategy. Cronos' ITZ recently received its licence to sell dried marijuana. Cronos will use ITZ's brand for the recreational market, hence we are expecting to see further details on products, pricing and positioning over the coming months as Cronos prepares for the opening of the recreational market. In addition, we are expecting ITZ to expand into cannabis oil production in preparation for the recreational market.

Company overview

Cronos Group was incorporated in August 2012 and went public on December 10, 2014 by way of a reverse takeover of Searchtech Ventures. Following the transaction, the company changed its name to PharmaCan Capital Corp. before changing it a second time to Cronos Group Inc. in October 2016. Cronos Group's head office is located in Toronto, Ontario, however, the company operates production facilities in the Okanagan Valley, British Columbia and Simcoe County, Ontario.

Initially, Cronos Group's strategy focused on passive investing in other companies that either had an ACMPR licence from Health Canada to produce marijuana or were actively seeking one. However, this changed in November 2014 when Cronos Group acquired 100% of In the Zone Produce Ltd. (ITZ), essentially shifting the company's strategy from solely investing to becoming a licensed producer. Today, Cronos Group is a licensed producer operating two production sites in Ontario and British Columbia as well as remaining an investor in five other companies.

New management appointed in May 2016. On May 16, 2016, following the closing of a $6m non-brokered private placement, Michael Gorenstein was appointed CEO of the company replacing Paul Rosen, who was the founder of PharmaCan Capital Corp. On July 15, 2016, the new management team acquired the remaining controlling interest in Peace Natural for $11.8m, valuing Peace Natural at an enterprise value of $22m. This transaction was done at a low valuation compared to the valuation of other licensed producers at that time and contributed to the generation of significant value for Cronos' shareholders.

Figure 35. Cronos - Corporate structure

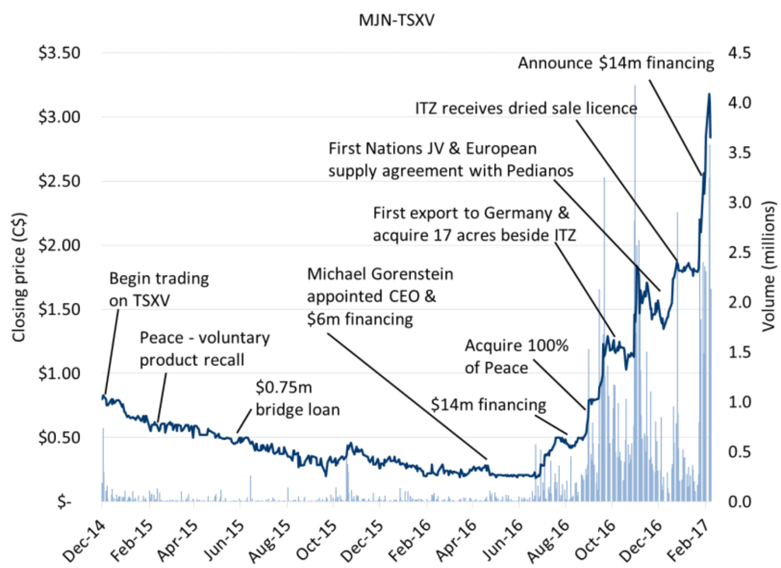
Asset	License status	Ownership	Location	Highlights
The Peace Naturals Project	Produce & sell dried Produce & sell oil	100%	Clearview, On	• Licensed capacity of 2,500kg annually • 40,000 sq ft facility on 90 acres of land
In the Zone	Produce & sell dried	100%	Okanagan Valley, BC	• Licensed capacity of 100kg annually • 2,000 sq ft facility on 31 acres of land
Whistler Medical Marijuana Corp	Produce & sell dried Produce & sell oil	21.5%	Whistler, BC	• Licensed capacity of 600kg annually • 12,000 sq ft facility • Expansion plans for >120,000 sq ft
Abcann	Produce & sell dried	6%	Napanee, ON	• Licensed capacity of 625kg annually • 14,500 sq ft facility on 1 acre of land
Hydropothecary	Produce & sell dried Produce oil	1.9%	Gatineau, QC	• Licensed capacity of 350kg annually • 42,000 sq ft facility on 80 acres of land
Evergreen	Pre-license	up to 30%	Victoria, BC	• 5,500 sq ft facility on 2.5 acres of land
CannMart	Pre-license	up to 8.5%	Toronto, ON	• 4,000 sq ft facility

Source: Company reports

21.5% ownership of WMMC. On March 9, 2017, Cronos announced a further investment of ~$1.1m (at a pre-money valuation of $75m) in Whistler Medical Marijuana Corp. (WMMC) in order to maintain its 21.5% ownership stake. WMMC is the only actively selling licensed producer whose entire product range of 13+ dried strains and 19+ cannabis oil products is 100% certified organic. The company recently received approval from Health Canada to build a new 65,000 sq.ft. purpose-built facility, which is expected to be completed in Q2/FY18 with further expansion plans for an 80,000 sq.ft. facility and an option on an additional 160 acres of land. We believe that access to WMMC's niche organic product range as well as the expanded capacity could be a positive for Cronos' growth strategy for the recreational market.

Impressive share performance since arrival of new management team. Cronos has been the best performing stock amongst publicly traded licensed producers in the last year. This is tied, in our view, to the arrival of the new management team who have orchestrated a significant turnaround and shift in strategy. Amongst other things, the new management team acquired Peace Naturals at a very low valuation, established a partnership with First Nations, established a partnership with a distributor to pharmacies in Germany, accelerated expansion plans and rebranded the company as Cronos Group.

Figure 36. Cronos's historical price action



Source: Bloomberg, FactSet, Company reports

Peace Naturals: Targeting the medical market

Peace Naturals Project Inc. was incorporated in November 2012 and is a licensed producer under ACMPR. Peace Naturals was the first licensed producer approved by Health Canada having received its licence for the production and sale of dried marijuana in October 2013. This was followed by a supplemental licence for the production and sale of cannabis oil in December 2015. Cronos first invested in Peace Naturals in June 2013, acquiring ~27.3% of the shares outstanding. Subsequently, Cronos acquired the remaining outstanding shares in September 2016 for $11.8m, valuing Peace Naturals at an attractive enterprise value of $22m.

Large seeds and genetics bank. Following the introduction of the Marijuana for Medical Purposes Regulations (MMPR) in July 2013, there was a transition period where genetics could be transferred to a licensed producer before April 2014. Peace Naturals was one of 14 licensed producers that could accept genetic material from other growers during this period. Hence, Peace Naturals compiled a substantial seed and genetic bank with over 2,000 seeds and over 100 unique genetics. Currently, licensed producers can only source genetics or seeds from other licensed producers or from a country with a legal program allowing exports such as Holland or Israel. Therefore, Cronos' database could potentially be beneficial in a recreational market as licensed producers look to offer differentiated strains and potentially partner with Cronos for access to its database.

Products and pricing strategy

Peace Naturals products positioned with a premium pricing. Cronos focuses on producing high quality products and wants to position the Peace Naturals brand as a premium brand within the medical marijuana market. Cronos currently offers six products in bud format for sale and has over 10 strains in various production stages. The strains currently offered are mainly Indica dominant with mid to high THC content. Prices range from $8.50 to $12.00 per gram, which is much higher than other licensed producers where the average sales price is closer to $8.00 per gram. Compassionate pricing is offered through a program called The Robin Hood Fund (RHF), which subsidizes the cost of medical marijuana for those who qualify for financial support.

Oils extracts priced the highest in Canada. Although Peace Naturals was granted the first Health Canada licence to sell cannabis oils in December 2015, oils remain a small percentage of product sales at this point. However, we expect Cronos to derive high profitability levels with its oil extracts given the premium price point. Peace Naturals' oil extracts are priced at $119 for a 30ml bottle, which is the equivalent of $24 per gram of dried marijuana equivalent. This appears to be twice as high as the industry average. We expect Cronos to make a push on oil extracts as capacity ramps up. The popularity of oil extracts is expected to increase significantly given the ease of delivery method and the improved accuracy of dosage vs smoking dried marijuana.

Figure 37. Cronos' current strains available and in production

Company	Strain	Plant type	THC%	CBD %	Dried/oil	Price/gram	Status
Peace Naturals	Daybreak	Hybrid	13.3	<0.05	Dried	$8.50	Available
Peace Naturals	Onyx	Indica dominant	14	<0.05	Dried	$8.50	Available
Peace Naturals	Opal	Indica dominant	17.5	<0.05	Dried	$10.00	Available
Peace Naturals	Rio	Indica dominant	15.8	<0.05	Dried	$10.00	Available
Peace Naturals	Tiamo	Indica dominant	19	<0.05	Dried	$12.00	Available
Peace Naturals	The Grail	Indica dominant	14.1	<0.05	Dried	$10.00	Available
Peace Naturals	Omega		22mg/ml	<0.07mg/ml	Oil	$119/30ml	In production
Peace Naturals	Raphael	Indica dominant	19.2	<0.05	Dried	$10.00	In production
Peace Naturals	Cerene		15.4	10.8	Oil	$119/30ml	In production
Peace Naturals	Chrome+	Indica dominant	14	<0.05	Dried	$8.50	In production
Peace Naturals	Happy feet	Sativa dominant	15.6	<0.05	Dried	$10.00	In production
Peace Naturals	Infiniti	Hybrid	19.8	<0.05	Dried	$12.00	In production
Peace Naturals	Jocelyn	Sativa dominant	16.2	<0.05	Dried	$10.00	In production
Peace Naturals	Marcela	Hybrid	13.4	<0.05	Dried	$8.50	In production
Peace Naturals	Nina	Hybrid	7.78	5.58	Dried	$8.50	In production

Note: Strain information as of March 3, 2017
Source: Company reports

Figure 38. Cronos' packaging and brand look

Source: Company reports

Focus on whole health through client care. Peace Naturals is focused on building a "Whole Health" brand, which incorporates diet, lifestyle, support and treatment. The company believes that medical cannabis is only one option in an individual's journey to achieve health and wellness. Hence, the company has a client care team dedicated to supporting its registered patients as well as educating and working with wellness professionals in the community.

Non-gamma irradiated product. Gamma irradiation is a common and approved method of sterilization to ensure that medical marijuana is toxin, fungus and bacteria free. It is standard practice for licensed producers in Canada. However, a recent study[a] concluded that while gamma irradiation remained the safest and most effective technique, there was some suggestion that it could affect some terpenes in marijuana. Terpenes are responsible for the flavour and aroma of marijuana, but have also been shown to act synergistically with CBD to potentially magnify the therapeutic effect. Hence, non-irradiated products could potentially be of higher quality, for which some patients may also be willing to pay a premium price. Cronos employs a third party lab to conduct quality testing on its final products. If the quality testing detects the presence of mould or bacteria, the product is destroyed instead of undergoing gamma irradiation to make the product acceptable for sale.

Current capacity and expansion plans

Existing facility could support capacity of 4,200kg. Peace Naturals currently operates ~25,000 sq.ft. of production space in Stayner, Ontario across two indoor facilities. The company is currently licensed to sell 2,500kg of medical cannabis annually. However, according to management, the existing facility plus the upcoming building #3 could support a capacity of ~4,200kg annually, which at an average price of $8.00 per gram could generate ~$34m in revenue. We are expecting capacity utilization to ramp-up over the coming quarters as construction on the third building is completed and production begins to ramp-up, which we are estimating to happen by Q3/FY17.

About 80 acres zoned for development. Peace Natural owns ~95 acres of land in Stayner, Ontario of which ~80 acres is available for further expansion. The company is planning to construct two new facilities on this land. The first facility will be a 23,000 sq. ft. pilot greenhouse for the extraction of cannabis oil. The second facility (building #4) is expected to be a 200,000 sq. ft. enclosed building. Construction of building #4 is expected to start in the summer with production ramping up to full capacity by mid FY18. This facility could potentially add ~26,000kg of

[a] Hazekamp A. "Evaluating the effects of gamma-irradiation for decontamination of medicinal cannabis". Frontiers in Pharmacology 7:108, 2016.

production capacity annually, which at an average price of $8.00 per gram could generate ~$210m in revenue.

Figure 39. Peace Natural's expansion potential footprint

Facility	Estimated capacity added (kg/yr)	Estimated completion date of construction	Estimated date of first harvest	Cumulative capacity (kg/yr)
Indoor building 1 (~8,700 sq ft)				~240 kg
Indoor building 2 (~15,000 sq ft)	~1,980 kg			~2,200 kg
Indoor building 3 (~15,000 sq ft)	~1,980 kg		Q3/FY17	~4,200 kg
Indoor building 4 (~200,000 sq ft)	~26,400 kg	Q4/FY17	Q3/FY18	~30,600 kg
Greenhouse Pilot (~23,000 sq ft)	~1,380 kg	Q4/FY17	Q2/FY18	~31,900 kg
Total capacity after expansion				**~31,900 kg**

Source: Company reports, GMP Securities

In The Zone: Targeting the recreational market

In The Zone

ITZ was incorporated in March 2013 and was granted a licence by Health Canada to produce medical marijuana in February 2014. The company only recently received its licence to sell dried marijuana to patients in January 2017. Cronos acquired ITZ in November 2014 for a purchase price of ~$1.8m.

Products and pricing strategy

Dried cannabis. ITZ only recently received its licence to sell dried marijuana. Hence, up to now, the company has only shipped small quantities of marijuana to Peace Naturals. At present, the company is not registering any patients and we are forecasting sale of dried cannabis from ITZ to roll out in the second half of 2018 prior to when the recreational market is expected to open in January 2019.

Cannabis oil. At this time, ITZ lacks the production capabilities to extract cannabis oil. However, the company has plans to expand oil production at ITZ to coincide with the legalization of recreational marijuana. We consider the ability to produce extracts a key factor for penetrating the recreational market, particularly as trends in the US indicate that alternative forms to dried bud are quickly gaining market share.

Current capacity and expansion plans

Pilot facility supporting capacity of 100kg annually with room to expand. ITZ owns ~31 acres in the Okanagan Valley, BC. The original 14 acres has been zoned for ~200,000 sq. ft. of production space. However, in September 2016, Cronos acquired an additional 17 acres, which the company plans to merge with the adjacent 14 acres. Hence, ITZ will not require a new licence from Health Canada to produce marijuana on the 31 acres. The property currently houses a small, highly automated pilot facility with an annual production capacity of ~100kg. The site also has a well providing a free source of water at >200 gallons per minute.

Indigenous Roots build-out could add ~4,000kg. ITZ has plans to construct two facilities bringing the total capacity of ITZ to ~12,100kg annually. The first facility will be a 30,000 sq. ft. indoor facility built by Indigenous Roots (see below for more details on Indigenous Roots) as a pilot facility for future builds on reservation land. Indigenous Roots is expected to fund the capital expenditure estimated at $15-20m for the construction. The facility is scheduled to be operational in early FY18. This facility could potentially generate ~4,000kg in annually capacity.

Greenhouse could support a capacity of ~8,000kg. The climate and environment in British Columbia support an enclosed greenhouse production facility. The second facility will be a 100,000 sq. ft. greenhouse with a production capacity of ~8,000kg annually. This additional capacity could generate ~$65m in revenues without requiring a new licence from Health Canada. The company expects to break ground on the greenhouse in the late summer of FY17 with production ramping up in late FY18.

Figure 40. ITZ's expansion potential footprint

Facility	Estimated capacity added (kg/yr)	Estimated completion date of construction	Estimated date of first harvest	Cumulative capacity (kg/yr)
Indoor pilot (~2,400 sq ft)				100 kg
Indigenous Roots JV (~30,000 sq ft)	~4,000 kg	Q3/FY17	Q2/FY18	~4,100 kg
Greenhouse 1 (~100,000 sq ft)	~8,000 kg	Q4/FY17	Q4/FY18	~12,100 kg
Total capacity after expansion				**~12,100 kg**

Note: Yellow represents the original 14 acres and blue represents the recently purchased adjacent 17 acres.
Source: Company reports, GMP Securities

Indigenous Roots partnership

Joint venture with First Nations. On December 6, 2016, Cronos announced the company has partnered with Phil Fontaine, former National Chief of the Assembly of First Nations, to launch Indigenous Roots, a First Nations owned and operated medical cannabis company. The partnership is a 50/50 joint venture with operating profits being divided in half between Cronos and First Nations. This profit sharing extends to any facility that is built on land owned by Cronos or on First Nations reservation land. Under the partnership Cronos will provide land for an initial pilot facility, a licence with Health Canada, IP and engineering expertise, while First Nations will construct and finance a pilot facility located on ITZ land.

The purpose of the pilot facility is to give Indigenous Roots access to an ACMPR licence enabling them to learn how to build and successfully manage and operate a cannabis production facility. It is expected that the company will establish additional facilities on First Nations reservations providing jobs and training as well as reaching a generally hard to reach target audience with medical marijuana products.

Potential untapped market could reach in excess of $300m. Studies indicate that the percentage of Aboriginals that smoke marijuana is almost double that of the non-Aboriginal populations. Hence, if we assume that ~20% of approximately one million First Nations and Inuit members are likely to smoke regularly, we arrive at a market that could potentially reach in excess of $300m in annual revenue at maturity. Under a scenario where reimbursement was achieved, Indigenous Roots could be well positioned to capitalize on the new underserved market opportunity.

Potential for reimbursement. Health Canada provides supplementary health benefits including prescription and over-the-counter medications to eligible First Nations and Inuit under the Non-Insured Health Benefits (NIHB) plan. The list of drugs made available under the NIHB is generally updated quarterly and a prescription from a licensed practitioner is required in order to process a benefit. While the path to reimbursement under NIHB may not be straightforward, precedent exists for reimbursement under federally administered health plans such as Veterans Affairs Canada.

International strategy: Partnered with Pedanios GmbH

Exclusive partner of Pedanios GmbH for Europe. On December 28, 2016, Cronos announced the signing of an exclusive supply agreement with Pedanios GmbH (Pedanios). Under the terms of the agreement, Cronos will supply marijuana products including flower, extracts and other formulated products to Pedanios for commercialization and distribution in the European Union and Switzerland. As the agreement is exclusive, Pedanios cannot purchase cannabis products from another North American supplier. With Canada being one of only three countries that can currently export cannabis, this partnership secures a channel for Cronos to expand internationally.

Pedanios supplies over 200 pharmacies. Pedanios is a licensed pharmaceutical wholesaler and narcotics dealer supplying over 200 pharmacies located in Germany. The company is one of only two companies licensed to distribute and import cannabis into Germany.

First shipment was in October 2016. In October 2016, Peace Naturals successfully shipped two lots of non-gamma irradiated dried flower to Pedanios for distribution in Germany. This shipment took place under an earlier supply agreement with Pedanios and Peace Natural.

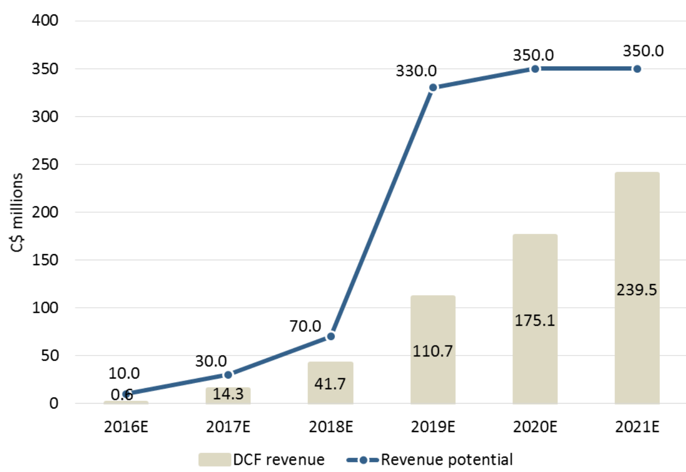
According to management, it takes less than one month to obtain the necessary import and export approvals and documents. In addition, Cronos is shipping bulk product at potentially higher margins given that there are no costs associated with customer service for internationally shipped product.

Potential to build production capabilities in Germany. With the recent regulation changes in Germany, Cronos is now exploring the option of applying for a licence to establish production capabilities in Germany. We are expecting that licences could be granted in the coming quarters and that Cronos could break ground on a new facility as early as the end of FY17, under a scenario where they receive a licence to cultivate.

Longer term capacity and funding assumptions

Cronos' near-term expansion plans are sufficient to support our revenue forecasts. Our current forecasts suggest that Cronos' capacity expansion will be sufficient to support our revenue expectations out to 2021. We have assumed that Cronos captures a 7% market share of the recreational market at the opening in January 2019 and the company continues to onboard medical patients at a rate of 5,000 per year.

Figure 41. Capacity expansion vs revenue expectations



Source: Company reports, GMP estimates

Additional financing may be needed. Cronos has raised almost $40m since the company's inception and we estimate that Cronos has a cash balance of ~$20m including the most recent equity offering. However, according to our analysis, Cronos may need to raise additional equity to support the construction of the new facilities at Peace Naturals and ITZ, which we estimate will require a capital investment of ~$25m in FY17. We are assuming that Cronos will raise $21m at $3.00 per share in Q2/FY17. This would dilute shareholders by ~7m shares, bringing the total outstanding shares on a fully diluted basis to ~187m. While we are assuming the company issues equity, we note they could also issue debt, or monetize some of their minority investments.

Figure 42. Cronos may need additional financing to support expansion plans

FYE Dec 31 (C$000s, unless otherwise noted)	2016E	2017E	2018E	2019E	2020E
Estimated production capacity (kg)	840	2,700	7,000	37,000	41,000
Capex	**1,033**	**25,691**	**5,154**	**2,456**	**2,475**
Cash balance - Beginning	1,127	2,420	5,656	6,700	19,358
Cash from operations	(7,229)	(4,902)	6,198	15,114	29,354
Free cash flow	(8,262)	(30,593)	1,044	12,658	26,879
Equity financing*	20,800	36,419	-	-	-
Other source (uses) of cash	(11,247)	(2,590)	-		
Cash balance - End	**2,420**	**5,656**	**6,700**	**19,358**	**46,237**

**Assumes an additional equity financing of $21m at $3.00 per share in Q2/17*

Source: Company reports, GMP Securities

Share lock-ups to expire in 2017. The first lock-up relates to ~4.5m RTO shares, 70% of which are free trading. The remaining 30% are expected to come out of lock-up in two tranches: (1) 15% on June 14, 2017 and (2) the remaining 15% on December 14, 2017. The second lock-up relates to shares acquired by management as part of the February 14, 2017 bought deal. The lock-up on these shares is expected to expire 90 days from March 9, 2017.

Figure 43. Cronos's financing history

Announcement Date	Units	Shares	Offer price	Gross Proceeds
9-Oct-12		2.7M	$0.05	$0.1M
10-Apr-14		1.2M	$0.05	$0.1M
10-Apr-14		1.0M	$0.10	$0.1M
9-May-16[a]	32.4M		$0.19	$6.0M
31-Aug-16		42.9M	$0.35	$15.0M
14-Feb-17		7.7M	$2.25	$17.3M
				$38.6M

[a]Units are comprised of one share and one-half share purchase warrant @ $0.245

Source: Company reports

Forecast and valuation

We derive a target price of $4.25. Our target price of $4.25 represents an expected return of ~51% from the current share price. As we have with other licensed producers under coverage, we are valuing Cronos using a discounted cash flow as we believe this is the most accurate valuation methodology for a company in a high growth potential market. Our DCF assumptions include: (1) a discount rate of 11%, (2) two-stage average revenue growth of 30%, an average EBITDA margin of ~31%, and (3) a terminal growth rate of 3%.

Figure 44. Cronos' DCF analysis

Cronos Group Inc, FYE Dec 31st	Forecasts		Stage 1					Stage 2					Total
C$ thousands	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	
Recreational market													
Estimated addressable market size ('000 kg)			100,000	200,000	300,000	400,000	500,000	525,000	551,250	578,813	607,753	638,141	
Cronos' estimated market share			7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	
Implied number of kilos sold			7,000	14,000	21,000	28,000	35,000	36,750	38,588	40,517	42,543	44,670	
Average price per gram ($/gram)			$6.90	$6.90	$6.90	$6.90	$6.90	$6.20	$6.20	$6.20	$6.20	$6.20	
Revenues (recreational market)			48,300	96,600	144,900	193,200	241,500	227,850	239,243	251,205	263,765	276,953	
Medical market													
Avg customers for period	6,400	14,400	19,400	24,400	29,400	34,400	39,400	44,400	49,400	54,400	59,400	64,400	
Number of kilos sold (dried equivalent)	1,415	3,949	5,311	6,680	8,048	9,417	10,786	12,155	13,523	14,892	16,261	17,630	
Average price per gram equivalent	$10.10	$10.55	$11.75	$11.75	$11.75	$11.75	$11.75	$11.00	$11.00	$11.00	$11.00	$11.00	
Total revenues medical market	14,292	41,668	62,401	78,484	94,567	110,650	126,733	133,700	148,756	163,812	178,868	193,925	
Total revenues	**14,292**	**41,668**	**110,701**	**175,084**	**239,467**	**303,850**	**368,233**	**361,550**	**387,998**	**415,017**	**442,633**	**470,878**	
EBITDA margins - recreational			26%	27%	28%	29%	30%	30%	30%	30%	30%	30%	
EBITDA margins - medical	7%	28%	32%	33%	34%	35%	36%	36%	36%	36%	36%	36%	
EBITDA	**1,015**	**11,647**	**32,526**	**51,982**	**72,725**	**94,755**	**118,074**	**116,487**	**125,325**	**134,334**	**143,522**	**152,899**	
margin	7.1%	28.0%	29.4%	29.7%	30.4%	31.2%	32.1%	32.2%	32.3%	32.4%	32.4%	32.5%	
Depreciation & amortization	801	1,491	1,749	1,872	1,995	2,123	2,515	2,761	2,988	3,172	3,360	3,554	
Net finance costs & other	371	280	350	438	547	684	854	1,068	1,335	1,669	2,086	2,608	
EBT	(157)	9,876	30,428	49,673	70,183	91,949	114,704	112,658	121,001	129,493	138,076	146,737	
Cash taxes (30%)	-	489	9,128	14,902	21,055	27,585	34,411	33,797	36,300	38,848	41,423	44,021	
NOPAT	214	9,667	21,649	35,208	49,675	65,048	81,148	79,929	86,036	92,314	98,739	105,323	
+ Depreciation & amortization	801	1,491	1,749	1,872	1,995	2,123	2,515	2,761	2,988	3,172	3,360	3,554	
- Net increase in working capital	(644)	(10,878)	(8,284)	(7,726)	(7,726)	(7,726)	(7,726)	802	(3,174)	(3,242)	(3,314)	(3,389)	
- CAPEX	(25,691)	(5,154)	(2,456)	(2,475)	(2,547)	(7,844)	(4,922)	(4,550)	(3,665)	(3,772)	(3,884)	(3,154)	
Free cash flow to the firm	**(25,320)**	**(4,874)**	**12,658**	**26,879**	**41,397**	**51,600**	**71,014**	**78,942**	**82,186**	**88,472**	**94,901**	**102,334**	
PV factor	1.0000	0.9016	0.8128	0.7328	0.6606	0.5956	0.5370	0.4841	0.4364	0.3935	0.3547	0.3198	0.3198
PV of Free Cash Flows	**(25,320)**	**(4,394)**	**10,288**	**19,696**	**27,348**	**30,733**	**38,132**	**38,215**	**35,869**	**34,811**	**33,665**	**32,728**	271,770

Valulation	
PV of Free cash flow to the firm	271,770
Terminal value	437,498
Minority ownership in private LPs	60,000
Enterprise value	769,268
Current net debt (net cash)	(20,158)
Equity value (C$, 000s)	789,427
Shares O/S (f.d.)	186,902
Equity value /share	**$ 4.22**

Recreational - Stage 1 key assumptions	
Cronos' average market share	7%
Price of dried marijuana ($/gram)	$6.00
Price of cannabis oil ($/gram)	$9.00
% of sales - dried marijuana	70%
% of sales - oils/extracts	30%
EBITDA margin	28%

Recreational - Stage 2 key assumptions	
Cronos' average market share	7%
Price of dried marijuana ($/gram)	$5.00
Price of cannabis oil ($/gram)	$8.00
% of sales - dried marijuana	60%
% of sales - oils/extracts	40%
EBITDA margin	30%

Medical - Stage 1 key assumptions	
Annual customer acquisition	5,000
Average consumption per day (grams)	0.75
Price of dried marijuana ($/gram)	$8.50
Price of cannabis oil ($/gram)	$15.00
% of sales - dried marijuana	50%
% of sales - oils/extracts	50%
EBITDA margin	34%

Medical - Stage 2 key assumptions	
Annual customer acquisition	5,000
Average consumption per day (grams)	0.75
Price of dried marijuana ($/gram)	$7.50
Price of cannabis oil ($/gram)	$12.50
% of sales - dried marijuana	30%
% of sales - oils/extracts	70%
EBITDA margin	36.0%

Terminal Value	
Terminal FCFF	105,609
Terminal growth rate	3%
WACC	11%
WACC - g	8%
TCF/(WACC-g)	1,367,994
Present value	437,498

Source: GMP Securities

Forecasting 2017 revenues of $14.3m. We forecast that Cronos will generate $14.3m in revenues from the sale of ~1,200kg of dried marijuana at an average price of ~$8.50 per gram. We are assuming a slightly higher average selling price than peers as Cronos' current products sell at premium prices ranging $8.50-$12.00 per gram. We are also projecting the sale of ~175kg of equivalent grams in cannabis oils at an average price of $22.00 per gram, which is higher than the industry average as Cronos is focused on the high end market. We are forecasting a gross margin of ~58%, which is slightly a below our expectations for the industry average. We are also estimating operating expenses to be ~5.09 per gram, which we expect to decline over the near-term as capacity utilization ramps-up. We have forecasted an adj. EPS of ($0.01).

Forecasting 2018 EBITDA of $11.6m. We are forecasting that Cronos will generate EBITDA of $11.6m as revenues grow 192% YoY to $41.7m. We expect revenue growth to be largely driven by: (1) continued patient onboarding, and (2) sales of cannabis oils, which we are projecting to grow ~360% YoY reaching ~41% of total revenues. We forecast that the price of cannabis oils will decline over time as more licensed producers enter the market with oils and other formats of cannabis. We are also expecting operating expenses to decline to ~$3.38 per gram once the additional capacity comes online.

The assumptions used in our DCF model are as follows:

1. **Increased capacity drives patient growth**. Cronos does not operate clinics, instead focusing on offering consistent high quality products. Hence, we are expecting patient onboarding to ramp-up with capacity and are estimating that Cronos will add 5,000 new patients in FY17 and 11,000 in FY18. However, we are assuming that once the recreational market opens in FY19 that patient onboarding could slow down to ~5,000 patients per year. We note that our assumptions regarding medical marijuana patients could change if prescriptions obtain reimbursement status.

2. **Average selling price is a premium to the industry average**. We are forecasting an average selling price per equivalent gram of ~$8.50 and ~$22.00 for dried medical marijuana and cannabis oils, respectively in FY17. However, we are expecting the price of oils to decline to $16.00 in FY18 as more competitors enter the market with oils and other formats putting pressure on pricing. For the recreational market we have assumed a wholesale price of $6.00 per gram for dried marijuana and $9.00 per for cannabis oils. Our average selling price assumptions could increase should Cronos be allowed to sell directly to consumers.

3. **Capture 7% share of the recreational market in FY19.** We anticipate the recreational market to open beginning of January 2019 and are forecasting Cronos could capture ~7% in the first year, representing sales of $48m. We are expecting an addressable market to be ~$500m in FY19 (~$1b in retail) assuming no mail order sales. We forecast that Cronos' market share will keep its ~7% at maturity as the company has ambitious expansion plans.

4. **Capex.** We are assuming that Cronos breaks ground in FY17 on its various capacity expansion plans and that the new facilities are operational in the second half of FY18, bringing the company's total production capacity to ~55,000kg. We estimate capital expenditures of ~$25m to support Cronos' expansion plans.

5. **Minority ownership in private licensed producers.** As part of its strategy, Cronos has invested in five private licensed producers, three (WMMC, Abcann and Hydropothecary) of which have licences to produce and sell marijuana. The largest investment is a 21.5% ownership stake in WMMC, which is licensed to produce and sell both dried marijuana and cannabis oils. As these are private licensed producers, we have limited visibility on the operations and valuation. Hence, we have estimated a valuation of ~$200m each for the three licensed producers with sales licences given the current and future expansion opportunities and the potential to access additional land. According to our estimates, the minority ownership contributes ~$0.30 per share.

Sensitivity analysis

Parameters impacting Cronos' target price. We made certain assumptions regarding the medical and recreational market in our analysis, however, we acknowledge that there are a number of unknowns regarding the marketplace that could affect our numbers. Hence, we looked at the potential impact of changes in various parameters on our target price. According to our analysis, changes in discount rate and selling price have the largest impact on Cronos' target price by 13-18% and 12%, respectively.

Figure 45. Sensitivity of Cronos' target price to various parameters

Parameter	Impact on target price
Discount rate: +/- 1%	+/-13-18%
Patient count: +/- 1,000	+/- ~6%
EBITDA margin: +/- 2%	+/- ~6%
Selling price: +/- $1.00	+/- ~12%
% of dried marijuana: +/- 10%	+/- ~5%

Source: GMP estimates

Figure 46. Comparable table of publicly listed licensed producers

March 14, 2017	Ticker	Price	Basic Shares O/S (m)	Market Cap ($m)	EV ($m, f.d.)	Current EV / sales CY17	CY18	CY19	EV/EBITDA CY18	CY19
Select publicly listed licensed marijuana producers										
APHRIA INC	APH-CA	6.62	123	815	738	25.7x	9.8x	6.3x	27.3x	17.3x
AURORA CANNABIS INC	ACB-CA	2.40	339	815	829	22.0x	9.8x	5.0x	36.2x	16.6x
BELEAVE INC	BE-CA	2.49	26	64	85	22.6x	n.a.	n.a.	n.a.	n.a.
CANNIMED THERAPEUTICS INC	CMED-CA	11.44	21	236	198	7.9x	3.8x	2.1x	8.8x	4.0x
CANOPY GROWTH CORPORATION	WEED-CA	11.05	158	1,743	1,722	16.8x	9.0x	5.7x	62.2x	30.1x
CRONOS GROUP (aka Pharmacan)	MJN-CA	2.82	124	349	487	34.1x	11.7x	4.4x	41.8x	15.0x
EMBLEM CORP	EMC-CA	2.68	71	191	287	34.9x	11.9x	4.8x	56.9x	16.3x
EMERALD HEALTH THERAPEUTICS	EMH-CA	1.26	78	98	89	nmf	16.6x	n.a.	nmf	n.a.
INVICTUS MD STRATEGIES CORP	IMH-CA	1.45	33	47	48	n.a.	n.a.	n.a.	n.a.	n.a.
ORGANIGRAM HOLDINGS INC	OGI-CA	2.42	101	244	211	11.7x	5.3x	3.2x	14.5x	8.8x
SUPREME PHARMACEUTICALS INC	SL-CA	1.53	174	267	388	30.2x	6.8x	n.a.	27.3x	n.a.
THC BIOMED INTERNATIONAL LTD	THC-CA	0.76	103	78	79	n.a.	n.a.	n.a.	n.a.	n.a.
Average				*412*	*430*	*22.9x*	*9.4x*	*4.5x*	*34.4x*	*15.4x*
Cronos premium (discount) to peers						*49%*	*24%*	*-2%*	*22%*	*-3%*

Source: Company reports, FactSet, GMP Securities

Cronos trades at a premium to peers. Shares of Cronos currently trade at an average premium of ~9% to peers on a forward EV/EBITDA basis. This is a slight premium, which we believe could be justified given: (1) the approach to quality product, (2) the international partnerships, and (3) the partnership with Indigenous Roots. However, we also believe that given the size of the current operations and the uncertainty with regulations of the recreational market, the gap is likely to narrow over the next 12 months.

Recommendation

Initiating coverage with a BUY rating and C$4.25 target price. Our positive stance on Cronos is based on:

1. **Strong management team**. Cronos' new management team put in place last summer has accomplished a lot in a short period of time. They have completely revamped the company's strategy, established key partnerships and deployed capital very effectively by, for instance, acquiring Peace Natural at a very low valuation.
2. **Indigenous Roots partnership**. Indigenous Roots' goal is to work with First Nations to build cannabis facilities and to provide medical cannabis to First Nations patients, which represents a potential $300m market.
3. **Optionality in Germany.** Cronos is exploring its options to apply for a marijuana cultivation licence in Germany. Our forecasts do not include any international revenues, which could provide upside to our valuation.

Company-specific investment risks

Scale-up of production. A key risk for all licensed producers will be the ability to scale-up production and increase the size of its product portfolio as there currently appears to be a lack of customer loyalty and shortages could be the main driver of switching between licensed producers.

Maintaining high quality standard. With the latest recall news, many companies appear to be augmenting their quality control measures to ensure a consistent product across production batches. Consistency in product could be particularly important in the medical market. Hence, we believe that Cronos will need to stay at the front of competitors.

Lack of cannabis oil production capabilities at ITZ. ITZ currently is not licensed to produce cannabis oil. This could be a big risk as we are forecasting that the market share of cannabis oils will continue to grow rapidly. Hence, not being able to supply cannabis oil could impact a company's growth.

Recreational market contributes ~$2.25 to our valuation. Under the scenario where the legalization of marijuana for recreational use does not materialize, we estimate the value of Cronos would be ~$2.00 per share. Our valuation of the medical-only market is based on removing the recreational market assumptions including any related capex for capacity expansion. Hence, this would imply that the recreational market contributes $2.25 to our current target price of $4.25.

Declining prices with legalization could squeeze profitability. We are anticipating that marijuana prices will decline in the mid to long-term in a recreational market as supply-demand levels out. With the higher cost of indoor production as compared to greenhouse, we could see margins and profitability being squeezed. Hence, low cost production could be key to growth.

Management and Board of Directors

Michael Gorenstein, President, CEO & Chairman. Mr. Gorenstein was appointed President and CEO of Cronos in May 2016. Prior to Cronos, he was a partner at Alphabet Ventures LLC in New York City. Mr. Gorenstein has also held various positions at Saiers Capital LLC and Sullivan & Cromwell. He obtained his J.D. from the University of Pennsylvania Law School.

David Hsu, Chief Operating Officer. Mr. Hsu joined Cronos in 2016. He brings extensive financial and operational restructuring, growth creation and lean manufacturing experience to the team. Prior to Cronos, Mr. Hsu spent over 10 years with Deloitte/CRG Partners operating and managing distressed companies. He obtained his B.Sc. in Business Management from Babson College and is a certified Lean Six Sigma Black Belt.

William Hilson, Chief Financial Officer. Mr. Hilson brings over 15 years of experience in financial operations, strategy, M&A and licensing deals in the pharmaceutical industry. Prior to Cronos, he was the regional CFO for Merck KGaA and Serono S.A. Mr. Hilson holds an Honours B.Sc. in Genetics and a M.Sc. in Clinical Biochemistry from The University of Western Ontario and a Certified Public Accountant designation.

Jason Adler, Director. Mr. Adler joined the Board in July 2016. He is currently the CEO and Managing Member of Alphabet Ventures LLC. Prior to Alphabet Ventures, Mr. Adler was the co-founder and CEO of Alphabet Management LLC and founder of Geronimo LLC. He obtained his B.A. from the University of Rhode Island.

Michael Krestell, Director. Mr. Krestell joined the Board in 2016. He has been the President of M Partners Inc. since 2013 and previously the Managing Director of Equity Research. Mr. Krestell obtained an MBA from the Schulich School of Business and is a CFA Charterholder.

Alan Friedman, Director. Mr. Friedman joined the Board in August 2012. He is the CEO of Rivonia Capital. Mr. Friedman is an attorney and has extensive experience in acquisitions, financings and go-public transactions for Canadian companies. He is the co-founder and Director of Adira Energy Ltd. and Eco (Atlantic) Oil and Gas Ltd. and also co-founded Auryx Gold Corp.

Figure 47. Cronos - Insider ownership

Major shareholders	# of shares	% ownership
Jason Adler, Director	6,594,092	5.32%
Moshe Azogui	6,295,723	5.08%
Andrew Garnock	5,197,756	4.20%
Michael Gorenstein, President, CEO & Chairman	1,284,450	1.04%
Total outstanding shares (basic)		123,902,484

Note: Shares outstanding and ownership as of March 5, 2017
Source: SEDI, FactSet

Cronos Group Inc. - Financial statements

Figure 48. Income statement

FYE Dec 31 (C$)	2015A	Q1/16A	Q2/16A	Q3/16A	Q4/16E	2016E	2017E	2018E
Total sales of equivalent dried marijuana (grams)				19,003	34,923	53,926	1,415,040	3,949,219
Avg. selling price per equivalent dried gram				$6.51	$13.36	$9.93	$10.16	$10.55
Revenues				**$123,647**	**$466,532**	**$590,179**	**$14,291,715**	**$41,668,359**
Growth YoY %				*nmf*	*nmf*	*nmf*	*2321.6%*	*191.6%*
COGS (excluding adj. for biological assets)	181,190	34,406	64,053	258,902	326,572	683,933	6,070,909	16,667,344
Adj. gross margin	**(181,190)**	**(34,406)**	**(64,053)**	**(135,255)**	**139,960**	**(93,754)**	**8,220,806**	**25,001,016**
Gross margin %				*nmf*	*30.0%*	*nmf*	*57.5%*	*60.0%*
Operating expenses	2,036,664	372,414	459,898	663,112	984,581	2,480,005	7,206,166	13,353,692
% of sales				*536.3%*	*211.0%*	*420.2%*	*50.4%*	*32.0%*
Operating expense per gram sold				$34.90	$28.19	$45.99	$5.09	$3.38
Adj. EBITDA	**(2,217,854)**	**(406,820)**	**(523,951)**	**(798,367)**	**(844,621)**	**(2,573,759)**	**1,014,641**	**11,647,324**
Margin %					*nmf*	*nmf*	*7.1%*	*28.0%*
Stock-based compensation				287,366	287,366	574,732	1,349,464	1,519,464
Depreciation & amortization	113,321	63,250	63,849	87,755	87,755	302,609	801,020	1,491,020
EBIT	**(2,331,175)**	**(470,070)**	**(587,800)**	**(1,173,488)**	**(1,219,742)**	**(3,451,100)**	**(1,135,843)**	**8,636,840**
Interest expense (income)	283,581	47,246	37,001	22,342	115,331	221,920	370,663	280,000
EBT	**(2,614,756)**	**(517,316)**	**(624,801)**	**(1,195,830)**	**(1,335,073)**	**(3,673,020)**	**(1,506,506)**	**8,356,840**
Income taxes	-	-	-	-	-	-	-	489,302
Net income	**(2,443,756)**	**(475,316)**	**(568,801)**	**(1,132,830)**	**(1,335,073)**	**(3,512,020)**	**(1,506,506)**	**7,867,538**
Margin %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*18.9%*
Growth YoY %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*
EPS (f.d)	**($0.06)**	**($0.01)**	**($0.01)**	**($0.02)**	**($0.01)**	**($0.05)**	**($0.01)**	**$0.04**
Total one-time items (after-tax)	(2,829,922)	14,814	1,273,698	(905,223)	-	383,289	-	-
Reported net income	386,166	(490,130)	(1,842,499)	(227,607)				
Reported EPS (f.d.)	$0.01	($0.01)	($0.04)	($0.00)				
Shares outstanding (f.d.)	43,694,412	42,618,971	43,168,381	64,067,295	121,459,895	67,828,636	185,152,484	186,902,484

Source: Company reports, GMP Securities

Figure 49. Balance sheet

FYE Dec 31 (C$)	2015A	Q1/16A	Q2/16A	Q3/16A	Q4/16E	2016E	2017E	2018E
ASSETS								
Cash & cash equivalents	1,127,340	318,062	3,474,531	5,779,354	2,419,575	2,419,575	5,655,518	6,699,938
Accounts receivable	-	-	-	29,171	255,149	255,149	2,901,224	5,124,212
Prepaid expenses and other receivables	97,745	75,036	70,001	198,016	198,016	198,016	198,016	198,016
Inventory	-	-	-	1,272,331	2,947,778	2,947,778	7,864,816	20,004,762
Biological assets	-	-	45,968	1,147,274	1,768,667	1,768,667	3,565,383	5,001,190
Other current assets	-	-	-	734,271	734,271	734,271	734,271	734,271
Total current assets	**1,225,085**	**393,098**	**3,590,500**	**9,160,417**	**8,323,456**	**8,323,456**	**20,919,228**	**37,762,390**
Equity accounted investment	2,404,615	2,389,801	2,399,465	2,534,103	2,534,103	2,534,103	2,534,103	2,534,103
Other investments	6,391,034	6,391,034	5,065,050	1,968,005	1,968,005	1,968,005	1,968,005	1,968,005
Property Plant & Equipment	2,699,886	2,696,253	2,642,400	12,948,696	13,711,941	13,711,941	38,601,921	42,264,901
License	1,611,226	1,611,226	1,611,226	11,207,050	11,207,050	11,207,050	11,207,050	11,207,050
Goodwill	392,000	392,000	392,000	1,792,000	1,792,000	1,792,000	1,792,000	1,792,000
Total assets	**14,723,846**	**13,873,412**	**15,700,641**	**39,610,271**	**39,536,555**	**39,536,555**	**77,022,307**	**97,528,449**
LIABILITIES								
Trades payables and other liabilities	1,061,991	743,687	200,316	1,016,926	1,990,918	1,990,918	5,804,641	16,923,781
Deposit payable	200,000	200,000	-	-	-	-	-	-
Convertible loans payable	115,000	115,000	115,000	-	-	-	-	-
Promissorty note payable	950,000	950,000	-	-	-	-	-	-
Mortgage payable	-	-	-	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000
Holdback payable	-	-	-	2,590,367	2,590,367	2,590,367	-	-
Total current liabilities	**2,326,991**	**2,008,687**	**315,316**	**7,607,293**	**8,581,285**	**8,581,285**	**9,804,641**	**20,923,781**
Mortgage payable	500,000	500,000	-	-	-	-	-	-
Deferred income tax liability	195,000	153,000	97,000	1,434,000	1,434,000	1,434,000	1,434,000	1,434,000
Total liabilities	**3,021,991**	**2,661,687**	**412,316**	**9,041,293**	**10,015,285**	**10,015,285**	**11,238,641**	**22,357,781**
SHAREHOLDERS EQUITY								
Share capital	14,799,821	14,799,821	17,880,963	32,896,945	32,896,945	32,896,945	69,316,383	69,316,383
Warrants	1,328,882	1,328,882	4,160,911	4,146,384	4,146,384	4,146,384	4,146,384	4,146,384
Contributed surplus	598,650	598,650	604,578	855,042	1,142,408	1,142,408	2,491,872	4,011,336
Subscription shares	-	-	-	38,426	38,426	38,426	38,426	38,426
Accumulated deficit	(5,025,498)	(5,515,628)	(7,358,127)	(7,585,734)	(8,920,807)	(8,920,807)	(10,427,314)	(2,559,776)
Accumulated other comprehensive income	-	-	-	217,915	217,915	217,915	217,915	217,915
Total shareholders equity	**11,701,855**	**11,211,725**	**15,288,325**	**30,568,978**	**29,521,271**	**29,521,271**	**65,783,666**	**75,170,668**
Total liabilities and shareholders equity	**14,723,846**	**13,873,412**	**15,700,641**	**39,610,271**	**39,536,555**	**39,536,555**	**77,022,307**	**97,528,449**

Source: Company reports, GMP Securities

Figure 50. Cash flow statement

FYE Dec 31 (C$)	2015A	2016E	Q1/17E	Q2/17E	Q3/17E	Q4/17E	2017E	2018E
OPERATING ACTIVITIES								
Net earnings	**386,166**	**(3,895,309)**	**(717,162)**	**(493,462)**	**(316,368)**	**20,486**	**(1,506,506)**	**7,867,538**
Share of income from equity accounted investment	477,107	(131,642)	-	-	-	-	-	-
Accrued interest on promissory note	25,001	-	-	-	-	-	-	-
Depreciation	113,321	302,609	97,755	197,755	247,755	257,755	801,020	1,491,020
Deferred income tax recovery	(171,000)	(161,000)	-	-	-	-	-	-
Gain on reversal of impairment losses on loans receivable	698,292	(725,150)	-	-	-	-	-	-
Unrealized gain on investment	(4,590,321)	-	-	-	-	-	-	-
Loss on revaluation of other investments	750,000	1,672,954	-	-	-	-	-	-
Increase in fair value of biological assets	20,000	(392,405)	-	-	-	-	-	-
Stock based compensation	-	580,660	307,366	312,366	362,366	367,366	1,349,464	1,519,464
Deferred financing fees	325,170	-	-	-	-	-	-	-
Cash flow from operating before working capital	**(1,966,264)**	**(2,749,283)**	**(312,041)**	**16,659**	**293,753**	**645,607**	**643,978**	**10,878,022**
Change in non-cash working capital balances	588,780	(4,480,121)	(1,532,078)	(523,229)	(1,289,810)	(2,200,989)	(5,546,105)	(4,679,601)
Cash flows related to operating activities	**(1,377,484)**	**(7,229,404)**	**(1,844,119)**	**(506,570)**	**(996,057)**	**(1,555,382)**	**(4,902,127)**	**6,198,421**
INVESTING ACTIVITIES								
Cash acquired from Peace	-	109,443	-	-	-	-	-	-
Advances of loans receivable to Peace prior to acquisition	(40,000)	(771,898)	-	-	-	-	-	-
Receipts of loans receivable	90,000	-	-	-	-	-	-	-
Purchase of property, plant, equipment	(1,509,460)	(1,032,729)	(1,125,000)	(5,432,000)	(12,987,000)	(6,147,000)	(25,691,000)	(5,154,000)
Acquisition of Peace Natural Projects	-	(6,247,543)	-	-	-	-	-	-
Dividends received from equity accounted investment	-	2,154	-	-	-	-	-	-
Cash flows related to investing activities	**(1,459,460)**	**(7,940,573)**	**(1,125,000)**	**(5,432,000)**	**(12,987,000)**	**(6,147,000)**	**(25,691,000)**	**(5,154,000)**
FINANCING ACTIVITIES								
Proceeds from mortgage payable	500,000	-	-	-	-	-	-	-
Repayment of mortgage payable	-	(500,000)	-	-	-	-	-	-
Proceeds from exercise of warrants	40,017	28,400	-	-	-	-	-	-
Proceeds from exercise of options	-	96,070	-	-	-	-	-	-
Share repurchase	(300,000)	-	-	-	-	-	-	-
Repayment of deposit payable	-	(200,000)	-	-	-	-	-	-
Proceeds from promissorty note payable	750,000	-	-	-	-	-	-	-
Repayment of promissory note payable	-	(950,000)	-	-	-	-	-	-
Repayment of loans	-	(2,688,938)	-	-	(2,590,367)	-	(2,590,367)	-
Debt issuance cost	(25,170)	-	-	-	-	-	-	-
Proceeds from share subscriptions	-	38,426	-	-	-	-	-	-
Proceeds from share issuance	2,231,027	20,799,967	16,469,438	19,950,000	-	-	36,419,438	-
Share issuance cost	(27,120)	(161,713)	-	-	-	-	-	-
Cash flows related to financing activities	**3,168,754**	**16,462,212**	**16,469,438**	**19,950,000**	**(2,590,367)**	**-**	**33,829,071**	**-**
Net increase (decrease) in cash	331,810	1,292,235	13,500,318	14,011,430	(16,573,424)	(7,702,382)	3,235,943	1,044,421
Cash beginning of period	**795,530**	**1,127,340**	**2,419,575**	**15,919,893**	**29,931,323**	**13,357,899**	**2,419,575**	**5,655,518**
Cash end of period	**1,127,340**	**2,419,575**	**15,919,893**	**29,931,323**	**13,357,899**	**5,655,518**	**5,655,518**	**6,699,938**

Source: Company reports, GMP Securities

Equity Research

Emblem Corp.[1,7]

BUY

EMC-TSXV

March 15, 2017

Last: **C$2.68**
Target: **C$3.25**

Initiating coverage: Pharma-like approach

Emblem is a licensed producer established in southwestern Ontario with a small production capacity of 2,100 kg. However, management has aggressive growth plans to expand capacity by 10-fold at its current facility, which would use the company's entire property. Additional expansion plans would require acquiring supplementary land, either adjacent to the current property or elsewhere. Longer-term, management would like to grow capacity to 100,000kg, which could support revenues of up to $600-700m.

Although the company received its licence to sell in July 2016, Emblem did not launch its patient registration platform until November giving it time to build up sufficient inventory as well as a solid customer service enterprise.

One differentiating factor is Emblem's focus on developing pharmaceutical-like products, which could broaden the pool of potential patients and physicians that are willing to prescribe by making it easier and more convenient for patients to take their medication.

The company's financial statements are dated, with the last reported quarter ending on September 30, 2016. This limits our visibility as to the company's recent progression to lower operational costs and on-board patients. Our positive stance on Emblem is supported by the following:

- **High profile grower**. Emblem hired an experienced grower to oversee its cannabis cultivation. We believe that his experience may lead Emblem to generate better yields and higher quality products than competitors.
- **Pharmaceutical approach**. Emblem's management team has significant pharmaceutical expertise and is expected to develop new formulations and delivery methods to appeal to a broader patient and physician base.
- **Targeting high-end market.** Emblem is targeting the high-end recreational market which could potentially lead to higher profit margins.

We are initiating coverage with a target price of $3.25. We derive our target price using a two-stage, 10-year DCF model with a discount rate of 12%. We estimate that Emblem will capture a ~3% share of the recreational market. Our DCF assumptions include: (1) a discount rate of 12%, (2) two-stage average revenue growth of 32%, an average EBITDA margin of ~30%, and (3) a terminal growth rate of 3%.

Rating	BUY
Target	$3.25
Revenue 2016E (mm)	$0.2
Revenue 2017E (mm)	$8.2
Revenue 2018E (mm)	$24.1
EBITDA 2016E	($3.7)
EBITDA 2017E	($0.9)
EBITDA 2018E	$5.0

Share Data

Share o/s (mm, basic/f.d.)	71.2 / 121.6
52-week high/low	4.6 / 0.38
Market cap (mm) f.d.	$325.8
EV (mm)	$287.3
Net debt (net cash) (mm)	($38.5)
Dividend	n.a.
Dividend yield	n.a.
Projected return	21.3%

Financial Data

FYE Dec 31	2016E	2017E	2018E
Revenue (mm)	$0.2	$8.2	$24.1
P/revenue	nmf	39.6x	13.5x
EBITDA (mm)	($3.7)	($0.9)	$5.0
EV/EBITDA	nmf	nmf	nmf
EPS (f.d.)	($0.06)	($0.03)	$0.02
P/E	nmf	nmf	nmf
CFPS	($0.11)	($0.03)	$0.02
Net debt (net cash) (mm)	($19.3)	($19.3)	($12.5)
BVPS	$0.76	$0.35	$0.37
P/BV	3.5x	7.8x	7.3x

All figures in C$ unless otherwise noted

Current Chart   Previous Research

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Figure 51. Snapshot comparison of publicly traded licensed producers

	Organigram	Cronos*	Aurora*	Emblem*	Canopy	Aphria	**Average**
VALUATION METRICS							
Recommendation	BUY	BUY	BUY	BUY	BUY	HOLD	
Current price	$2.42	$2.82	$2.40	$2.68	$11.05	$6.62	
Target Price	$4.00	$4.25	$3.00	$3.25	$12.75	$5.00	
Projected return	65.3%	50.7%	25.0%	21.3%	15.4%	-24.5%	**25.5%**
Market Cap, basic ($mm)	$244	$349	$815	$191	$1,743	$815	**$693**
Market Cap, fully diluted ($mm)	$270	$507	$944	$326	$1,862	$884	**$799**
EV ($mm)[a]	$211	$487	$829	$287	$1,722	$738	**$712**
EV/CY17 Sales	11.7x	34.1x	22.0x	34.9x	16.8x	25.7x	**24.2x**
EV/CY17 Production capacity (per kg)	$50,181	$121,792	$150,693	$136,802	$71,746	$98,454	**$104,945**
OPERATING METRICS							
Last reported patient count	~3,895	~3,400	~12,800	~1,500	~50,000	~6,675	**13,128**
Sales (CY16, $mm)	$7.7	$0.6	$8.4	$0.2	$30.3	$15.1	**$10.4**
Sales (CY17, $mm)	$18.1	$14.3	$37.6	$8.2	$102.5	$28.7	**$34.9**
Adj. Gross margin (CY17)[b]	64%	58%	56%	56%	70%	80%	**64%**
Opex (CY17 $/g)[c]	$4.46	$5.09	$4.97	$5.54	$4.55	$4.48	**$4.85**
Estimated production capacity (CY17)	4,200 kg	4,000 kg	5,500 kg	2,100 kg	24,000 kg	7,500 kg	**7,883 kg**
Number of licensed facilities	1	2	1	1	6	1	
Cannabis oil extracts license	Production & Sale	Production & Sale	Production & Sale	Production only	Production & Sale	Production & Sale	
Estimated long-term recreational market share	7.0%	7.0%	10.0%	4.0%	23.0%	5.5%	**9.4%**

a Based on fully diluted shares outstanding

b Adjusted gross margin excludes the fair value adjustment of biological assets and amortization

c Includes Selling, marketing, general, and administrative expenses (excludes depreciation, amortization, and stock based compensation)

* Initiating coverage

Source: Company reports, GMP Securities, FactSet

Key catalysts to create shareholder value

Licence to sell oils → Expected by end of June. Emblem is expected to file shortly for Health Canada approval to sell cannabis oils, which we are anticipating could be as early as the end of Q2/FY17 and should boost the company's sales.

Pharmaceutical-like dosage forms → Expected 2018. Emblem is developing medical dosage forms such as gel capsules. We believe these formats could support sales growth given their convenience and familiar format for physicians and patients.

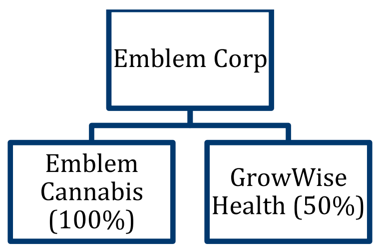
Production at new facility build-out → Expected in early 2019. Emblem is expected to construct a new facility build-out of ~100,000 sq. ft. on the company's existing three acres of land. We are anticipating that production of the 21,000kg capacity will ramp-up by early 2019.

Acquisition of land for further expansion. We are expecting further news over the coming months as Emblem explores various options including the acquisition of nearby land in order to achieve ~100,000kg in capacity for the recreational market.

Company overview

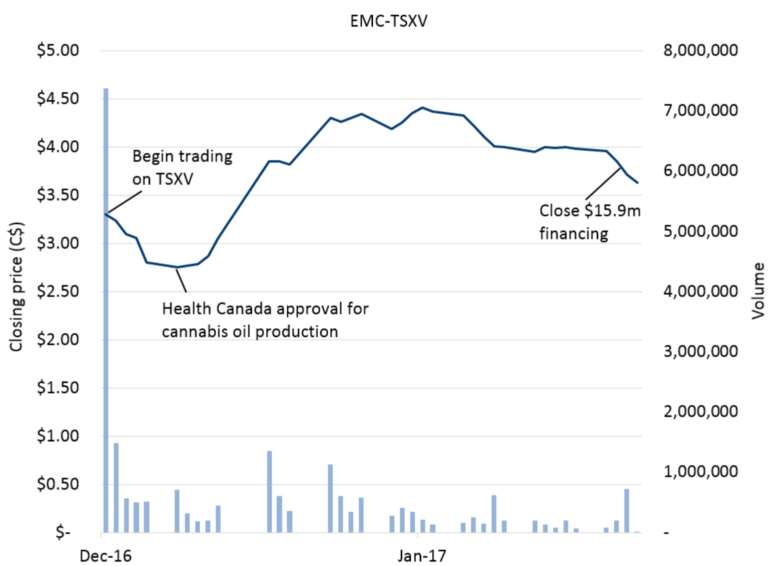
Emblem Cannabis Corp. (ECC) was incorporated in August 2013 along with Emblem Corp in October 2014 (originally called KindCann Holdings Ltd.) for the purpose of submitting an application to Health Canada for a licence under the ACMPR framework. ECC received its first licence to produce and sell medical marijuana in August 2015 and July 2016, respectively. In addition, the company received approval from Health Canada to produce cannabis oils in December 2016. The company went public on December 12, 2016 by way of a reverse takeover transaction with Saber Capital Corp.

Figure 52. Emblem - Corporate legal structure



Source: Company reports

Figure 53. Emblem's historical price action



Source: Bloomberg, FactSet, Company reports

Emblem is led by a team of former healthcare and pharmaceutical executives who are taking a more pharmaceutical-like approach to product development. The company's strategy encompasses three key aspects:

1. **Pharmaceutical-like formulations.** Emblem is focused on the development of advanced medical dosage forms that mimic drugs in delivery format and are more convenient and easier to take for patients.

2. **High quality marijuana production.** From optimal strain selection to consistent cultivation to extraction, Emblem's goal appears to be to cultivate high quality consistent batches across a strain.

3. **Patient education.** Emblem has a 50% ownership stake in GrowWise Health, which provides patient and healthcare practitioners with education and support services.

Pharmaceutical-like dosage forms

Evidence-based strain selection. According to management, Emblem used an evidence-based approach to select the strains that the company would cultivate. Recognizing that different strains offer different benefits, the team tried to select strains that had the greatest amount of scientific evidence to support their effectiveness for a particular indication (e.g. pain, epilepsy). Currently, Emblem has identified 20 key strains to move forward with developing and growing.

Medical dosage forms to launch in 2018. A key focus for Emblem is the development of medical dosage forms that are more convenient and easier for patients to take. Medical dosage forms could include gel capsules, oral sprays, controlled release tablets, etc. These formats are familiar to both physicians and patients as they mimic pharmaceutical products. We believe that such dosage forms could support further market development by removing any historical stigma associated with "smoking pot".

Approval pathway similar to oils. Emblem anticipates beginning studies such as pharmacokinetics and bioavailability, with various medical dosage forms over the coming quarter. At this time, we are expecting the different dosage forms to follow a similar approval pathway as cannabis oil as Emblem is not focused on obtaining a label for a specific indication. Hence, the timeline to approval for a new dosage form could take three to four months.

Experienced management team. The work on medical dosage forms is being led by John Stewart. Mr. Stewart has extensive experience in research and development including drug development, delivery and formulation having worked for over 20 years at Purdue Pharma with a focus on opioids. We would expect that his experience could be instrumental in guiding Emblem's product development and pharmaceutical-like quality standards.

High profile grower. Emblem recently hired Nathan Nienhuis to head the company's production. Mr. Nienhuis brings strong expertise and experience in growing medical cannabis and in working with government agencies to the company. He is recognized in the industry as one of the leading global authorities on the cultivation of medical marijuana having obtained the first federal licence granted in the US for the cultivation of marijuana. Mr. Nienhuis has also worked with the various government agencies to develop protocols regarding marijuana cultivation and to design, build and operate medical marijuana facilities. Prior to Emblem, Mr. Nienhuis was Vice President of Horticulture at Canadian Cannabis Corp. He obtained a degree in Mechanical Engineering from California State University.

Products and pricing strategy

Champagne quality product. Emblem is focused on building high quality brands that could be attractive to the discerning connoisseur. This high-end market may be smaller than the overall market, however, the company expects to be able to sell its products at a premium price. The company is not interested in producing commodity-like “table wine” cannabis which may be harder to differentiate from competing producers.

Dried cannabis. Emblem has about 60 strains of cannabis, 37 of which were imported from Holland and the balance acquired from other Canadian licensed producers. However, the company is only producing ~12 strains of dried cannabis of which currently 10 strains are offered for sale. The strains are classified according to four different categories reflecting a particular desired effect. The majority of Emblem’s strains are mid to high THC with only the Heal category offering strains containing CBD. Prices range from $7.00 to $12.00 per gram, with an average price of $8.50 per gram. We would expect this average price to increase as Emblem introduces more refined strains with higher THC or CBD once capacity on these strains comes online in October 2017.

Figure 54. Emblem product categories

Source: Company reports

Figure 55. Emblem’s current product selection

Category	Name	Strain	Plant type	THC%	CBD %
Balance	Forest Life	Sour OG	Hybrid	23.8	0
Balance	Good Neighbour	Girl scout cookies	Hybrid	15.1	0
Balance	Journey On	Exodus cheese	Hybrid	17.3	0
Balance	Moon dance	Lemon Larry	Hybrid	19.7	0
Elevate	Liv by Lift	Exclusive	Sativa dominant	24.2	0
Elevate	Paradise Island	Dela haze	Sativa dominant	19.7	0
Elevate	Sweet Escape	Strawberry cough	Sativa dominant	17.2	0
Heal	Aqua Flora	Shark shock CBD	Indica dominant	6.4	10.6
Heal	Zen's Garden	Black widow CBD	Indica dominant	7.6	13.3
Reflect	Yellow Submarine	Larry OG kush	Indica dominant	17.7	0

Source: Company reports as of March 3, 2017

Cannabis oil production licence obtained in December 2016. In December 2016, Health Canada amended Emblem’s ACMPR licence to permit the production of cannabis oils. To date, Emblem has invested over $1m in its extraction and purification platform and has been fine-tuning its extraction, purification and production process. In addition, the company plans to construct a 5,000 sq. ft. dedicated extraction and formulation development laboratory. We would expect the company to file shortly for Health Canada approval to sell cannabis oils, which could be as early as the end of Q2/FY17.

Liv by Lift brand. In November 2016, Emblem partnered with Lift Cannabis Co Ltd ("Lift") to offer Liv by Lift, a limited edition sativa dominant strain of cannabis. Liv has a 24.2% THC content and is known to deliver an uplifting effect. The product sells at a premium price of $12/gram. Lift is a Canadian cannabis company focused on empowering and educating patients on medical marijuana and its benefits. Lift operates an online site providing access to products, a nation-wide network of clinics and a leading news publication service.

Figure 56. Emblem's Liv by Lift brand

Source: Company reports

We estimate ~1,500 patients in three months. Emblem began onboarding patients in November 2016 and within three months reached an estimated ~1,500 patients. The company is closely tracking patients and inventory in order to do its best to avoid a back-order situation. Hence, the rate of onboarding could slow down over the summer months as production is not expected to reach full capacity until Q4/FY17.

GrowWise Health: Patient acquisition strategy

GrowWise™ Health

50% ownership. Emblem owns 50% of GrowWise Health with the remaining 50% owned by White Cedar Pharmacy Corp. ("White Cedar"), which is owned by Harvey Shapiro and Gordon Fox. The company has an option to purchase all remaining shares of GrowWise owned by White Cedar after December 31, 2017 at a price equal to one-half of the book value of GrowWise's assets. GrowWise generates revenue through referral fees paid by licensed producers after a patient is registered with that licensed producer. Currently, GrowWise does not generate any profits.

Patient acquisition through medical education. The objective of GrowWise is to provide both patients and healthcare providers with an integrated healthcare service from assessment to follow-up helping both patients and physicians make informed choices about medical marijuana. Once a patient has a prescription, they are referred to GrowWise where healthcare professionals counsel patients on strain selection and can assist with registering and ordering with a licensed producer, hence Emblem expects GrowWise to be a source of patient referrals. In addition to providing education on strain selection, GrowWise can also refer patients to doctors for assessments to determine if medical cannabis is right for the patient.

Operates 11 locations in Canada. GrowWise has 11 locations in Canada, 10 in Ontario and one in British Columbia, and management anticipates opening additional locations in the coming months. Locations can be standalone operations or situated within a medical clinic. GrowWise has partnered with licensed producers in order to be able to offer patients a wide selection of cannabis strains and products to meet the various needs of the patient demography. GrowWise is still in the early days of growth, however, we believe it can be a valuable source of patient referrals and patient preference data for Emblem in the long-term.

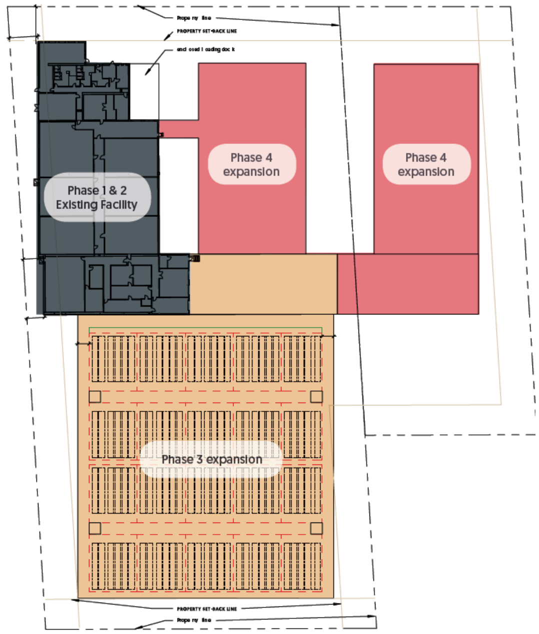
Current capacity and expansion plans

Existing facility could support capacity of 2,100kg. Emblem currently owns ~4 acres of land located in Paris, Ontario, which includes a 23,500 sq.ft. facility. The company obtained its Health Canada-issued licence to produce and sell 625kg of dried marijuana in August 2015 and July 2016, respectively. The current facility has two operational grow rooms with a total production capacity of 700kg annually, which at an average price of $8.00 per gram could generate ~$6m in revenue. However, we are expecting the capacity to increase to 2,100kg annually in the next quarter as the company has four additional grow rooms built and expects to begin planting in June, pending approval by Health Canada. Total capacity of 2,100kg has the potential to generate ~$17m in revenues.

Three undeveloped acres available for further expansion. Emblem has about three acres of land that could support a new facility build-out of approximately 100,000 sq.ft. including about 75,000 sq.ft. of growing space. This could potentially add ~19,000kg to production capacity. This additional capacity could generate ~$150m in revenues without requiring a new licence from Health Canada. We expect this expansion to target the recreational market, hence while construction is expected to begin by the end of 2017, production will not likely ramp-up until the end of 2018/beginning of 2019 when management expects the recreational market to be legalized.

Looking at further expansion options. Management is currently exploring other options including acquiring additional land nearby in order to achieve a capacity of ~100,000 kg. We are expecting further news regarding new expansion plans over the coming months as the company prepares for the recreational market.

Figure 57. Emblem's expansion potential footprint



Facility	Expansion phase	Estimated capacity added (kg/yr)	Estimated completion date of construction	Estimated date of first harvest	Cumulative capacity (kg/yr)
Existing building	Phase I	700 kg			700 kg
Existing building	Phase II	1,400 kg	Q2/FY17	Q3/FY17	2,100 kg
New build	Phase III	11,400 kg	Q3/FY17	Q3/FY18	13,500 kg
New build	Phase IV	7,600 kg	Q2/FY18	Q1/FY19	21,100 kg
Total capacity on existing land after expansion					**21,100 kg**

Source: Company reports, GMP Securities

Long-term capacity and funding assumptions

Emblem appears funded for near-term expansion. We estimate that Emblem has a cash balance of ~$38m including the most recent equity offering and according to our analysis, Emblem would have enough cash on hand to support Phase III and Phase IV of its expansion plans. In addition, we are forecasting that Emblem could begin to generate positive operating cash flow in 2018 once the current expansion projects are complete. We would expect that Emblem may need additional financing under a scenario where they would want to accelerate the expansion of their production capacity, beyond the announced Phase III and Phase IV.

Figure 58. Capacity expansion vs revenue expectations

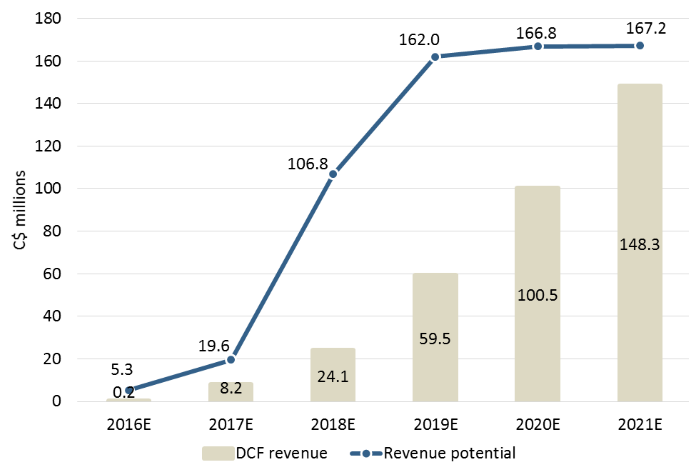
FYE Dec 31 (C$000s, unless otherwise noted)	2015	2016	2017E	2018E	2019E	2020E
Estimated production capacity (kg)		700	2,115	2,115	2,115	2,115
Capex	**7,557**	**2,062**	**11,395**	**8,979**	**2,814**	**3,000**
Cash balance - Beginning	5,491	1,237	24,619	24,631	17,847	23,883
Cash from operations	(2,348)	(4,441)	(3,398)	2,195	8,850	16,779
Free cash flow	(9,905)	(6,502)	(14,794)	(6,784)	6,036	13,779
Equity financing	3,211	30,092	14,806	-	-	-
Other source (uses) of cash	2,440	(207)	-	-	-	-
Cash balance - End	**1,237**	**24,619**	**24,631**	**17,847**	**23,883**	**37,662**

Source: Company reports, GMP Securities

Efficient capital deployment with low operating expenses. Emblem has invested less than $12m to acquire and renovate its production facility. Emblem's capex efficiency appears better than other licensed producers which have spent more money for less output. In addition, while the company is still small, the level of operating expenses appears low vs peers, suggesting a lean operating model. For instance, Emblem's total operating expenses in Q3/FY16 amounted to $800k, a low number vs other peers.

Emblem's near-term expansion plans will bring on ample capacity to support our revenue forecasts. Our current forecasts suggest that Emblem's upcoming capacity expansion (Phase III and IV) will be sufficient to support our revenue expectations until 2021. We have assumed that Emblem captures a 3% market share of the recreational market at the opening in January 2019 and the company continues to onboard medical patients.

Figure 59. Capacity expansion vs revenue expectations



Source: Company reports, GMP Securities

Final share lock-up expires in December 2017. Emblem has raised almost $60m in equity over the past two years to support its growth strategy. Shares from the last financing round are still under lock-up and the holds are expected to expire on June 7, 2017 and December 7, 2017. After these dates, there are no further holds on Emblem's shares.

Figure 60. Emblem's financing history

Announcement Date	Units	Shares	Offer price	Gross Proceeds
12/1/2014 [a]	0.7M		$10.00	$7.0M
12/1/2015 [a]	0.3M		$10.00	$3.5M
12/31/2015 [b]		0.9M	$0.00	$0.0M
6/23/2016 [c]	5.8M		$0.50	$2.9M
9/9/2016 [d]	1.4M		$0.75	$1.0M
9/12/2016 [d]	4.2M		$0.75	$3.1M
9/15/2016 [d]	1.2M		$0.75	$0.9M
9/19/2016 [d]	0.1M		$0.75	$0.0M
12/8/2016 [e]	1.7M		$1.15	$2.0M
12/8/2016 [e]	6.7M		$1.15	$7.7M
12/8/2016 [e]	11.8M		$1.15	$13.6M
12/9/2017 [e]	0.7M		$1.15	$0.8M
1/6/2017 [f]	4.4M		$3.63	$15.9M
				$58.6M

[a] Units are comprised of 20 Class A shares and warrant for 10 shares; convert 2 years after listing on TSX/TSXV
[b] Issued to holder of Emblem preferred share as dividend
[c] 291,280 units at $10 = 20 shares/unit plus warrant to acquire 10 shares
[d] Units are comprised of one share and one-half common share purchase warrant @$1.20
[e] Units are comprised of one share and one-half common share purchase warrant @$1.75
[f] Units are comprised of one share and one-half common share purchase warrant @$4.75

Source: Company reports

Import CBD to augment supply

Looking to import CBD concentrates. Demand for CBD is expected to increase significantly with the continued growth of the medical market. Hence, Emblem has entered into a memorandum of understanding (MOU) with ICC International Cannabis Corp. (ICC-TSXV, not rated) whereby Emblem has agreed to purchase at least 10% of ICC's 2018 CBD production at prices to be determined in a future definitive agreement. The agreement is expected to be implemented in 2018 as there are two main hurdles that could take time to resolve. First, the export/import of CBD requires approval by regulatory authorities in Uruguay and Canada and discussions with Health Canada are already underway. Second, chemical testing is required to ensure that the quality of the product meets Emblem's expectations.

Import low cost CBD. ICC is growing cannabis in Uruguay and has much lower operational costs than Canadian licensed producers. This stems from ICC's low labour costs and low operational costs due to their greenhouse growing. This partnership has the potential to augment Emblem's production capacity over the mid to long term and improve margins given the potential low cost of the product. CBD oils are a key component to Emblem's pharmaceutical product approach, particularly as GrowWise has a high exposure to pain clinics, thus most patients and medical professionals that interact with GrowWise prefer CBD-based oils.

Forecasts and valuation

We derive a target price of $3.25. Our target price of $3.25 represents an expected return of ~21% from the current share price. Similar to all licensed producers under coverage, we are valuing Emblem using a DCF analysis as we believe it is the most accurate valuation methodology to capture the full potential of the recreational market and the continued expansion of the medical market. Our DCF assumptions include: (1) a discount rate of 12%, (2) two-stage average revenue growth of 32%, an average EBITDA margin of ~30%, and (3) a terminal growth rate of 3%.

Our DCF assumptions include a discount rate of 12% which is 200-300bps higher than other licensed producers to reflect Emblem's smaller size relative to our coverage universe. Our visibility on the company's cost structure is limited at this point given the limited financial history. The upcoming quarters should give us more insights into the company's cost structure and operational efficiency. Our current forecasts assume Emblem will generate industry average profitability levels.

Figure 61. Emblem's DCF analysis

Emblem Corp, FYE Dec 31	Forecasts		Stage 1					Stage 2					Total
C$ thousands	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	
Recreational market													
Estimated addressable market size (000, kg)			100,000	200,000	300,000	400,000	500,000	525,000	551,250	578,813	607,753	638,141	
Emblem's estimated market share			3.0%	3.5%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	
Implied number of kilos sold			3,000	7,000	12,000	16,000	20,000	21,000	22,050	23,153	24,310	25,526	
Average price per gram ($/gram)			$6.90	$6.90	$6.90	$6.90	$6.90	$6.20	$6.20	$6.20	$6.20	$6.20	
Total revenues recreational market			20,700	48,300	82,800	110,400	138,000	130,200	136,710	143,546	150,723	158,259	
Medical market													
Avg customers for period	4,090	9,540	14,540	19,540	24,540	29,540	34,540	39,540	44,540	49,540	54,540	59,540	
Number of kilos sold (dried equivalent)	993	2,576	3,980	5,349	6,718	8,087	9,455	10,824	12,193	13,562	14,930	16,299	
Average price per gram equivalent	$8.28	$9.34	$9.75	$9.75	$9.75	$9.75	$9.75	$10.50	$10.50	$10.50	$10.50	$10.50	
Total revenues medical market	8,222	24,057	38,808	52,153	65,499	78,844	92,189	113,653	128,025	142,397	156,768	171,140	
Total revenues	**8,222**	**24,057**	**59,508**	**100,453**	**148,299**	**189,244**	**230,189**	**243,853**	**264,735**	**285,942**	**307,491**	**329,399**	
EBITDA margins - recreational			25.0%	26.0%	27.0%	28.0%	29.0%	25.0%	25.0%	25.0%	25.0%	25.0%	
EBITDA margins - medical			32.0%	33.0%	34.0%	35.0%	36.0%	32.0%	32.0%	32.0%	32.0%	32.0%	
EBITDA	**(900)**	**5,047**	**17,594**	**29,769**	**44,626**	**58,507**	**73,208**	**68,919**	**75,145**	**81,453**	**87,847**	**94,330**	
Consolidated margin	-10.9%	21.0%	29.6%	29.6%	30.1%	30.9%	31.8%	28.3%	28.4%	28.5%	28.6%	28.6%	
Depreciation & amortization	904	1,364	1,813	1,953	2,103	2,269	2,567	2,699	2,833	2,971	3,111	3,255	
Net finance costs & other	741	741	815	896	986	1,084	1,193	1,312	1,443	1,588	1,746	1,921	
EBT	(2,544)	2,942	14,966	26,919	41,537	55,154	69,448	64,908	70,869	76,895	82,989	89,154	
Cash taxes	-	-	4,490	8,076	12,461	16,546	20,834	19,472	21,261	23,068	24,897	26,746	
NOPAT	(1,804)	3,683	11,291	19,740	30,061	39,692	49,806	46,748	51,051	55,414	59,839	64,329	
+ Depreciation & amortization	904	1,364	1,813	1,953	2,103	2,269	2,567	2,699	2,833	2,971	3,111	3,255	
- Net increase in working capital	(1,812)	(2,111)	(4,254)	(4,913)	(5,741)	(4,913)	(4,913)	(1,640)	(2,506)	(2,545)	(2,586)	(2,629)	
- CAPEX	(11,395)	(8,979)	(2,814)	(3,000)	(3,318)	(5,965)	(2,632)	(2,688)	(2,746)	(2,807)	(2,871)	(2,124)	
Free cash flow to the firm	**(14,107)**	**(6,043)**	**6,036**	**13,779**	**23,105**	**31,083**	**44,828**	**45,119**	**48,633**	**53,033**	**57,493**	**62,830**	
PV factor	1.0000	0.8933	0.7979	0.7127	0.6367	0.5687	0.5080	0.4538	0.4053	0.3621	0.3234	0.2889	
PV of Free Cash Flows	**(14,107)**	**(5,398)**	**4,816**	**9,821**	**14,710**	**17,677**	**22,772**	**20,474**	**19,712**	**19,201**	**18,594**	**18,151**	146,423

Valuation	
PV of Free cash flow to the firm	146,423
Terminal value	208,891
Enterprise value	355,314
Current net debt (net cash)	(38,485)
Equity value (C$, 000s)	393,798
Shares O/S (f.d.)	120,870
Equity value /share	**$ 3.26**

Recreational - Stage 1 key assumptions	
Emblem's average market share	4%
Price of dried marijuana ($/gram)	$6.00
Price of cannabis oil ($/gram)	$9.00
% of sales - dried marijuana	70%
% of sales - oils/extracts	30%
EBITDA margin	27%

Recreational - Stage 2 key assumptions	
Emblem's average market share	4%
Price of dried marijuana ($/gram)	$5.00
Price of cannabis oil ($/gram)	$8.00
% of sales - dried marijuana	60%
% of sales - oils/extracts	40%
EBITDA margin	25%

Medical - Stage 1 key assumptions	
Annual customer acquisition	5,000
Average consumption per day (grams)	0.75
Price of dried marijuana ($/gram)	$7.50
Price of cannabis oil ($/gram)	$12.00
% of sales - dried marijuana	50%
% of sales - oils/extracts	50%
EBITDA margin	34%

Medical - Stage 2 key assumptions	
Annual customer acquisition	5,000
Average consumption per day (grams)	0.75
Price of dried marijuana ($/gram)	$7.00
Price of cannabis oil ($/gram)	$12.00
% of sales - dried marijuana	30%
% of sales - oils/extracts	70%
EBITDA margin	32%

Terminal Value	
Terminal FCFF	64,715
Terminal growth rate	3%
WACC	12%
WACC - g	9%
TCF/(WACC-g)	723,077
Present value	208,891

Source: GMP Securities

Forecasting FY17 revenues of $8.2m. Emblem is in the early days of its development having launched its dried products in the fall of 2016 and is expecting to launch its cannabis oil products by the end of Q2/17. Hence, we are estimating that Emblem will generate $8.2m in revenues from the sale of ~875kg of dried marijuana at an average price of $7.79 per gram and ~115kg of equivalent grams of cannabis oil at an average price of $12.00 per gram. We are forecasting a gross margin of ~56%, which is lower than the industry average and mainly due to Emblem being in the early days of its product production and launch. We are also estimating operating expenses to be ~$5.54 per gram, which are expected to decline over the near-term as capacity utilization scales up. We forecast an adj. EPS of ($0.03).

Forecasting FY18 EBITDA of $5m on revenues of $24.1m. We are forecasting revenue growth of ~193% YoY reaching $24.1m in FY18. Our revenue growth is largely driven by: (1) continued patient onboarding, (2) an increase in the average selling price per gram to $8.15 for dried bud as the company increases its focus on premium products, and (3) sales of cannabis oils, which we project reach 40% of total revenues. We anticipate gross margin growth of ~465 bps YoY to ~61% as Emblem's premium brand inventory becomes available for sale. We also expect operating expenses to decline to an average of $3.70 per gram once the facility is operating at capacity.

Our DCF includes the following assumptions:

1. **Near-term capacity expansion.** We are assuming that Emblem will go forward with its Phase III and Phase IV capacity expansion in early 2018 to bring the company's total production capacity to 21,100kg by late 2018. We have modeled ~$18m for the expansion of the company's current facility.
2. **3% share of the recreational market.** We expect that the recreational market will open up on January 1, 2019. We have limited visibility at this point on the proportion of recreational sales done through mail order, therefore, to be conservative we have assumed none. Under a wholesale model for the recreational market, we expect wholesale prices of $6.00 per gram for dried bud and $9.00 per gram for cannabis oils to allow retailers to capture profit margins while making the product competitive with the black market. We expect Emblem to capture 3% of the recreational market, which is higher than the company's current market share of the medical market. We are assuming Emblems market share will grow to 4% over the first couple of years as capacity comes online.
3. **Medical market expected to generate higher margins**. We expect the price received by Emblem for its medical cannabis to be higher than its recreational products. Oils, gel capsules and creams are expected to account for most of the medical market, which should command a higher price. In addition, patients may get insurance reimbursement, deductions on income taxes and sales taxes may not be applied to medical products, all of which leave more margins for retailers and producers. We expect producers to generate on average 700bps higher EBITDA margins selling medical cannabis than recreational cannabis.
4. **Upside potential for selling prices**. We are forecasting an average selling price for dried medical marijuana of $7.50 per gram. For cannabis oils, we are expecting a price per equivalent gram of $12.00, although we do not have any details as to the format and pricing strategy of Emblem as the company is not selling oils yet. Our average selling price assumptions could increase if Emblem is allowed to sell directly to consumers or if the company is able to capture a premium price.

5. **Patient onboarding expected to accelerate near-term.** Emblem is the early days of patient onboarding having started less than six months ago. Hence, with a product available and a market share below 2%, we expect Emblem to continue to add new patients and are forecasting 6,900 in 2017 and 4,000 in 2018. However, we are assuming that once the recreational market opens in early 2019, the rate of onboarding medical patients could reach ~5,000 patients per year.

Sensitivity analysis

Parameters impacting Emblem's target price. We recognize there are a number of unknowns regarding the recreational market that could have an impact on the assumptions made in our analysis. Hence, we looked at the potential impact of changes in various parameters on our target price. According to our analysis, changes in discount rate, patient count, EBITDA margin and selling price have the largest impact on Emblem's target price by 12-16%, 8%, 7% and 12%, respectively.

Figure 62. Sensitivity of Emblem's target price to various parameters

Parameter	Impact on target price
Discount rate: +/- 1%	+/-12-16%
Patient count: +/- 1,000	+/- ~8%
EBITDA margin: +/- 2%	+/- ~7%
Selling price: +/- $1.00	+/- ~12%
% of dried marijuana: +/- 10%	+/- ~5%

Source: GMP estimates

Figure 63. Comparable table of publicly listed licensed producers

March 14, 2017	Ticker	Price	Basic Shares O/S (m)	Market Cap	EV	Current EV / sales			EV/EBITDA	
				($m)	($m, f.d.)	CY17	CY18	CY19	CY18	CY19
Select publicly listed licensed marijuana producers										
APHRIA INC	APH-CA	6.62	123	815	738	25.7x	9.8x	6.3x	27.3x	17.3x
AURORA CANNABIS INC	ACB-CA	2.40	339	815	829	22.0x	9.8x	5.0x	36.2x	16.6x
BELEAVE INC	BE-CA	2.49	26	64	85	22.6x	n.a.	n.a.	n.a.	n.a.
CANNIMED THERAPEUTICS INC	CMED-CA	11.44	21	236	198	7.9x	3.8x	2.1x	8.8x	4.0x
CANOPY GROWTH CORPORATION	WEED-CA	11.05	158	1,743	1,722	16.8x	9.0x	5.7x	62.2x	30.1x
CRONOS GROUP (aka Pharmacan)	MJN-CA	2.82	124	349	487	34.1x	11.7x	4.4x	41.8x	15.0x
EMBLEM CORP	EMC-CA	2.68	71	191	287	34.9x	11.9x	4.8x	56.9x	16.3x
EMERALD HEALTH THERAPEUTICS	EMH-CA	1.26	78	98	89	nmf	16.6x	n.a.	nmf	n.a.
INVICTUS MD STRATEGIES CORP	IMH-CA	1.45	33	47	48	n.a.	n.a.	n.a.	n.a.	n.a.
ORGANIGRAM HOLDINGS INC	OGI-CA	2.42	101	244	211	11.7x	5.3x	3.2x	14.5x	8.8x
SUPREME PHARMACEUTICALS INC	SL-CA	1.53	174	267	388	30.2x	6.8x	n.a.	27.3x	n.a.
THC BIOMED INTERNATIONAL LTD	THC-CA	0.76	103	78	79	n.a.	n.a.	n.a.	n.a.	n.a.
Average				*412*	*430*	*22.9x*	*9.4x*	*4.5x*	*34.4x*	*15.4x*
Emblem premium (discount) to peers						*53%*	*27%*	*7%*	*66%*	*6%*

Source: Company reports, FactSet, GMP Securities

Emblem trades at a premium to peers. Shares of Emblem currently trade at an average premium of ~36% to peers on a forward EV/EBITDA basis. This is a significant premium, however, we believe that a slight premium could be justified given: (1) the focus on high quality product, (2) the potential access to low cost CBD product, and (3) the potential scale-up plans of the company. However, we also believe that given the smaller size of the current operations and the uncertain timing of the recreational market, the premium is too large and that the gap is likely to narrow over the next 12 months.

Recommendation

Initiating coverage with a BUY rating and C$3.25 target price. Our positive stance on Emblem is based on:

1. **High profile grower**. Emblem hired an experience grower, Nathan Nienhuis to oversee the company's cannabis cultivation. Mr. Nienhuis is recognized in the industry as one of the leading global authorities on the cultivation of medical marijuana having obtained the first federal licence granted in the US for the cultivation of marijuana. Mr. Nienhuis has also worked with various government agencies to develop protocols regarding marijuana cultivation and to design, build and operate medical marijuana facilities. We would expect that his experience could help Emblem generate better yields and produce higher quality products than competitors.
2. **Pharmaceutical-like product focus.** Emblem is investing in the development of pharmaceutical-like dosage forms such as capsule, inhalers, etc. Products of this type have the potential to appeal to a wider base of physicians and patients and could potentially expand the medical market reach by offering a convenient, easy to take product with a specific dose of medication.
3. **Targeting the high-end market**. Emblem is focused on developing a high-end brand that could target the discerning cannabis connoisseur. Like the wine or beer market, there is likely going to be a smaller portion of the market that will prefer champagne quality products and are willing to pay a premium price to enjoy them. Higher-end products could potentially lead Emblem to generate higher profit margins.

Company specific investment risks

Execution on growth strategy. In addition to the risks noted elsewhere, a key risk will be the ability of Emblem to scale-up production and increase its product portfolio. We believe management's experience in the pharmaceutical industry could mitigate part of the execution risk.

Maintaining high quality standard. With the latest industry recalls, it will be important for Emblem to deliver a consistent, high quality product. We were impressed with the operating standards on our visit as Emblem required full cover-up suit, masks, gloves and booties for each visitor.

Recreational market contributes ~$1.25 to our valuation. Under the scenario where the legalization of marijuana for recreational use does not materialize, we estimate the value of Emblem would be closer to $2.00 per share. Our valuation of the medical-only market is based on removing the recreational market assumptions including any related capex for capacity expansion. Hence, this would imply that the recreational market contributes ~$1.25 to our current target price of $3.25.

Declining prices with legalization could squeeze profitability. We are anticipating that marijuana prices will decline in the mid to long-term in a recreational market as supply-demand levels out. With the higher cost of indoor production as compared to greenhouse, we could see margins and profitability being squeezed. Hence, low cost production could be key to growth.

Management and Board of Directors

Gordon Fox, CEO. Mr. Fox co-founded Emblem in 2014 and has invested over $1.3m to date. He is a former partner at Goodman & Carr LLP from 1979 to 1995 where he practiced securities law. Mr. Fox is also the co-founder of White Cedar Pharmacy Corp. and founder of Lytton Capital, a limited market dealer.

Harvey Shapiro, Co-founder and President (GrowWise Health). Mr. Shapiro co-founded Emblem in 2014 and has invested over $1.3m to date. He brings over 20 years of senior executive experience in the pharmaceutical and healthcare industry to Emblem. Mr. Sharpiro is the co-founder and former CEO of Dynacare (1988-2002), which was acquired by Laboratory Corp. of America for ~US$480m in 2002. He is also a former partner at Goodman & Carr LLP from 1977 to 1987 where he practiced securities law.

John H. Stewart, President (Emblem Pharmaceuticals). Mr. Stewart co-founded Emblem and has invested over $1m to date in the company. He has over 20 years of senior executive experience in the pharmaceutical industry including drug development, delivery, formulation and commercialization. Mr. Stewart was the President and CEO of Purdue Pharma Canada (1991-2006) and Purdue Pharma US (2007-2013). While at Purdue, the company launched 11 new products including MS Contin, OxyContin and Biphentin.

Maxim Zavet, Co-founder and President (Emblem Cannabis). Mr. Zavet joined Emblem two years ago. He is the founding partner of Levy Zavet PC, where his practice focused on real estate and commercial leasing law. Mr. Zavet has developed in-depth knowledge regarding marijuana regulations and cultivation as well as a global network of contacts.

John Laurie, CFO. Mr. Laurie joined Emblem as CFO in June 2016. He brings over 20 years of experience as Treasurer and CFO of small to large public companies in Canada.

Daniel Saperia, COO. Mr. Saperia joined Emblem in June 2014. He brings over 15 years of finance and operations experience to Emblem including stints at two rapidly growing companies where he developed accounting and operational processes.

Terry Johnson, Director. Mr. Johnson began his career in the pharmaceutical industry at Warner Lambert (now Pfizer) and Johnson & Johnson before transitioning into communications and advertising. He has over 35 years of extensive experience in the advertising industry having founded Allard Johnson Communications and Veritas Communications and served as Chair and partner at Integrated Healthcare Communications. He is presently the Chairman of the Board at Republic, a Toronto public relations firm.

Jeffrey Fineberg, Director. Mr. Fineberg has been Counsel at Dentons Canada LPP since 2011. He has been a practicing lawyer for over 30 years focused on private mergers and acquisitions and financings in the real estate and healthcare sectors. He is also Director of White Cedar Pharmacy Corp, which owns 50% of GrowWise.

Lorne Gertner, Director. Mr. Gertner brings over 15 years of experience having been involved in over $1 billion in transactions in the fashion, retail, cannabis and real estate industry. He is the co-founder and former director of Cannasat Pharmaceuticals, the first medical marijuana company to be listed on the TSX in 2002 and the co-founder and former Chairman of Pharmacan.

Mr. Gertner is currently the co-founder and Chairman of Tokyo Smokes and founding partner and CEO of Hill & Gertner Capital Corp.

Figure 64. Emblem - Insider ownership

Major shareholders	# of shares	% ownership
Harvey Shapiro, President, GrowWise Health	2,646,188	3.72%
Gordon Fox, CEO, Emblem Corp	2,591,185	3.64%
John Stewart, President, Emblem Pharmaceuticals	1,798,901	2.53%
Maxim Zavet, President, Emblem Cannabis	1,630,434	2.29%
Daniel Saperia	915,641	1.29%
Total outstanding shares (basic)		71,217,916

Note: Shares outstanding and ownership as of January 25, 2017
Source: SEDI, FactSet

Emblem Corp. - Financial statements

Figure 65. Income statement

FYE Dec 31 (C$)	2015A	Q1/16A	Q2/16A	Q3/16A	Q4/16E	2016E	2017E	2018E
Total sales of equivalent dried marijuana (grams)					21,600	21,600	992,925	2,575,800
Avg. selling price per equivalent dried gram					$7.50	$7.50	$8.28	$9.34
Revenues		**$9,000**	**$0**	**$29,250**	**$162,000**	**$200,250**	**$8,221,553**	**$24,056,895**
Growth YoY %		*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*4005.6%*	*192.6%*
COGS (excluding adj. for biological assets)	69,519	193,286	176,294	367,556	72,900	810,036	3,623,573	9,482,412
Adj. gross margin	**(69,519)**	**(184,286)**	**(176,294)**	**(338,306)**	**89,100**	**110,138**	**4,597,979**	**14,574,483**
Gross margin %	*nmf*	*nmf*	*nmf*	*nmf*	*55.0%*	*55.0%*	*55.9%*	*60.6%*
Operating expenses	1,957,163	654,554	776,728	820,811	871,923	3,124,016	5,497,854	9,527,938
% of sales	*nmf*	*7272.8%*	*nmf*	*2806.2%*	*538.2%*	*1560.1%*	*66.9%*	*39.6%*
Operating expense per gram sold	*nmf*	*nmf*	*nmf*	*nmf*	*$40.37*	*$144.63*	*$5.54*	*$3.70*
Adj. EBITDA	**(2,026,682)**	**(838,840)**	**(953,022)**	**(1,159,117)**	**(782,823)**	**(3,733,802)**	**(899,875)**	**5,046,545**
Margin %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*21.0%*
Stock-based compensation	99,512	83,329	83,329	119,330	124,330	410,318	862,320	987,320
Depreciation & amortization	282,814	129,661	165,249	173,408	178,408	646,726	903,632	1,363,632
EBIT	**(2,409,008)**	**(1,051,830)**	**(1,201,600)**	**(1,451,855)**	**(1,085,561)**	**(4,790,846)**	**(2,665,827)**	**2,695,593**
Interest expense (income)	239,252	200,356	323,690	275,838	164,913	964,797	740,652	740,652
EBT	**(2,648,260)**	**(1,252,186)**	**(1,525,290)**	**(1,727,693)**	**(1,250,474)**	**(5,755,643)**	**(3,406,478)**	**1,954,941**
Income taxes	-	-	-	-	-	-	-	-
Net income	**(2,648,260)**	**(1,252,186)**	**(1,525,290)**	**(1,727,693)**	**(1,250,474)**	**(5,755,643)**	**(3,406,478)**	**1,954,941**
Margin %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*8.1%*
Growth YoY %	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*	*nmf*
EPS (f.d)	**($0.13)**	**$0.00**	**$0.00**	**($0.04)**	**($0.02)**	**($0.06)**	**($0.03)**	**$0.02**
Total one-time items (after-tax)	780,967	110,508	166,538	3,810,437	-	4,087,483	-	-
Reported net income	(3,429,227)	(1,362,694)	(1,691,828)	(5,538,130)				
Reported EPS (f.d.)	($0.17)	n.a	n.a.	($0.14)				
Shares outstanding (f.d.)	20,369,160	n.a	n.a.	38,867,197	79,686,096	38,867,197	120,870,331	121,555,594

Source: Company reports, GMP Securities

Figure 66. Balance sheet

FYE Dec 31 (C$)	2015A	Q1/16A	Q2/16A	Q3/16A	Q4/16E	2016E	2017E	2018E
ASSETS								
Cash & cash equivalents	1,236,646	554,017	2,129,923	4,643,580	24,619,440	24,619,440	24,631,374	17,847,417
Accounts receivables	-	-	-	-	54,000	54,000	459,532	1,344,625
Prepaid expense	458,591	344,563	335,318	151,654	276,432	276,432	552,507	995,082
Inventory	47,704	144,299	456,001	697,037	1,105,730	1,105,730	2,762,537	4,975,412
Biological assets	9,125	103,690	11,152	131,364	131,364	131,364	131,364	131,364
Other receivables	213,330	91,084	75,827	164,940	213,330	213,330	213,330	213,330
Total current assets	**1,965,396**	**1,237,653**	**3,008,221**	**5,788,575**	**26,400,296**	**26,400,296**	**28,750,645**	**25,507,231**
Property Plant & Equipment	8,461,356	8,523,382	8,628,828	9,054,559	9,876,151	9,876,151	20,367,666	27,982,999
Total assets	**10,426,752**	**9,761,035**	**11,637,049**	**14,843,134**	**36,276,447**	**36,276,447**	**49,118,311**	**53,490,230**
LIABILITIES								
Accounts payable & accrued liabilities	610,241	659,015	966,770	684,582	904,084	904,084	1,484,529	2,914,187
Provisions	724,884	600,000	600,000	600,000	600,000	600,000	600,000	600,000
Note payable	-	-	1,000,000	900,000	900,000	900,000	900,000	900,000
Mortgage payable - current	-	-	-	3,854,345	3,854,345	3,854,345	3,854,345	3,854,345
Dividends payable	-	237,253	424,643	-	-	-	-	-
Financial liabilities	8,560,847	8,560,847	7,660,865	-	-	-	-	-
Total current liabilities	**9,895,972**	**10,057,115**	**10,652,278**	**6,038,927**	**6,258,429**	**6,258,429**	**6,838,874**	**8,268,532**
Mortgage payable	3,807,877	4,260,382	4,335,862	550,000	550,000	550,000	550,000	550,000
Total liabilities	**13,703,849**	**14,317,497**	**14,988,140**	**6,588,927**	**6,808,429**	**6,808,429**	**7,388,874**	**8,818,532**
SHAREHOLDERS EQUITY								
Share capital	1,580,125	1,580,125	4,112,608	20,404,170	42,868,455	42,868,455	58,536,352	59,523,672
Warrants	958,174	958,174	1,239,561	1,972,097	1,972,097	1,972,097	1,972,097	1,972,097
Options	99,512	182,841	266,170	385,502	385,502	385,502	385,502	385,502
Retained Earnings (deficit)	(5,914,908)	(7,277,602)	(8,969,430)	(14,507,562)	(15,758,036)	(15,758,036)	(19,164,514)	(17,209,573)
Total shareholders equity	**(3,277,097)**	**(4,556,462)**	**(3,351,091)**	**8,254,207**	**29,468,018**	**29,468,018**	**41,729,437**	**44,671,698**
Total liabilities and shareholders equity	**10,426,752**	**9,761,035**	**11,637,049**	**14,843,134**	**36,276,447**	**36,276,447**	**49,118,311**	**53,490,230**

Source: Company reports, GMP Securities

Figure 67. Cash flow statement

FYE Dec 31 (C$)	2015A	2016E	Q1/17E	Q2/17E	Q3/17E	Q4/17E	2017E	2018E
OPERATING ACTIVITIES								
Net earnings	**(3,429,227)**	**(9,843,128)**	**(1,006,867)**	**(1,013,990)**	**(780,648)**	**(604,974)**	**(3,406,478)**	**1,954,941**
Depreciation and amortization	282,814	646,726	198,408	218,408	238,408	248,408	903,632	1,363,632
Stock based compensation	99,512	410,318	174,330	224,330	229,330	234,330	862,320	987,320
Change in fair value of financial instruments	-	4,425,303	-	-	-	-	-	-
Change in fair value of biological asset	254,438	(763,496)	-	-	-	-	-	-
Non-cash interest	-	478,405	-	-	-	-	-	-
Advances to associate	-	406,963	-	-	-	-	-	-
Issuance costs on Class A preferred shares liability	254,438	-	-	-	-	-	-	-
Gain on Class A preferred shares liability	(300,000)	100,000	-	-	-	-	-	-
Dividend on Class A preferred shares	819,445	-	-	-	-	-	-	-
Cash flow from operating before working capital	**(2,018,580)**	**(4,138,909)**	**(634,129)**	**(571,252)**	**(312,910)**	**(122,236)**	**(1,640,526)**	**4,305,893**
Change in non-cash working capital balances	(329,320)	(301,704)	(766,477)	(822,535)	(370,540)	201,583	(1,757,969)	(2,110,885)
Cash flows related to operating activities	**(2,347,900)**	**(4,440,613)**	**(1,400,606)**	**(1,393,787)**	**(683,450)**	**79,347**	**(3,398,496)**	**2,195,008**
INVESTING ACTIVITIES								
Purchase of property, plant and equipment	(7,557,271)	(2,061,521)	(500,000)	(895,147)	(6,000,000)	(4,000,000)	(11,395,147)	(8,978,965)
Investment in and advances to associate	(375,116)	(531,847)	-	-	-	-	-	-
Cash flows related to investing activities	**(7,932,387)**	**(2,593,368)**	**(500,000)**	**(895,147)**	**(6,000,000)**	**(4,000,000)**	**(11,395,147)**	**(8,978,965)**
FINANCING ACTIVITIES								
Advances from related company	(162,172)	-	-	-	-	-	-	-
Advances from shareholders	(60,000)	-	-	-	-	-	-	-
Subscriptions receivable	100,000	-	-	-	-	-	-	-
Mortgage payable	3,500,000	425,000	-	-	-	-	-	-
Mortgage issuance cost	(308,100)	-	-	-	-	-	-	-
Note payable	-	(100,000)	-	-	-	-	-	-
Issuance of units, net of issuance costs	3,211,104	30,091,773	14,805,577	-	-	-	14,805,577	-
Cash flows related to financing activities	**6,280,832**	**30,416,773**	**14,805,577**	**-**	**-**	**-**	**14,805,577**	**-**
Net increase (decrease) in cash	(3,999,455)	23,382,792	12,904,971	(2,288,934)	(6,683,450)	(3,920,653)	11,934	(6,783,957)
Cash beginning of period	**5,490,539**	**1,236,646**	**24,619,440**	**37,524,412**	**35,235,478**	**28,552,028**	**24,619,440**	**24,631,374**
Cash end of period	**1,236,646**	**24,619,440**	**37,524,412**	**35,235,478**	**28,552,028**	**24,631,374**	**24,631,374**	**17,847,417**

Source: Company reports, GMP Securities

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