

# PharmaCan Capital Corp. (dba. Cronos Group Inc.) (MJN-V)

## The Sleeping Giant Awakens

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**We are initiating coverage of Cronos with a Buy rating and a target price of \$3.50.** In summary, our recommendation is based on the following:

- **Canada's medical marijuana industry is already sizeable in itself.** The number of registered patients has climbed from 8K to 98K in just over two years, and growth is still accelerating (up 222% y/y). We peg the industry at \$224MM today, and data suggests it could reach \$~1.5B over the coming years.
- That said, once legalized, **the recreational marijuana market is likely to be many times larger**, with forecasts and data from other legal jurisdictions suggesting it could be a \$5B to \$10B industry in Canada. While nothing is ever 100% in politics, our assessment of the situation concludes that the Liberal government has both the will and the ability to follow through on this clear election promise – and the ball is already rolling.
- **Cronos Group is a geographically diversified and vertically integrated cannabis company that operates two wholly-owned LPs** and has a few investments in other LPs and applicants.
- Previously operating as PharmaCan, the company's prior approach was to take minority investments in a portfolio of LPs and applicants. While the company was able to get in early and at attractive valuations, its business ran into problems. In May 2016, Michael Gorenstein was named the company's CEO. He changed the company's business model to be an operator of wholly-owned LPs, attracted other top-tier talent and capital and enacted meaningful operational improvements. In our view, this resulted in the business being stabilized and set on track for growth. **We believe 2017 will be a year of significant expansion across Cronos' multi-provincial footprint and we may see the company take its existing presence in Germany to the next level.**
- The market has clearly taken notice of these moves, with the company's shares up ~1000% since May 2016 – more than double the average return of its peers. That said, in our view, **Cronos is still significantly 'under-known' in the investor community – and we see significant upside ahead as the company executes on its growth strategy.**

### Initiating Coverage

<b>BUY</b>	<b>\$3.50</b>
Previous Close	\$2.08
12-month Target Price	\$3.50
Potential Return	68%
52 Week Price Range	\$0.14 - \$2.23

	Estimates		
YE: Dec 31	FY17E	FY18E	FY19E
Revenue (\$MM)	\$14.6	\$55.3	\$234.1
EBITDA (\$MM)	\$0.6	\$13.8	\$75.7
FD EPS	-\$0.01	\$0.03	\$0.25

	Valuation		
	FY17E	FY18E	FY19E
EV/Sales	17.5x	4.6x	1.1x
EV/EBITDA	453.7x	18.5x	3.4x
P/E	n/m	61.0x	8.3x

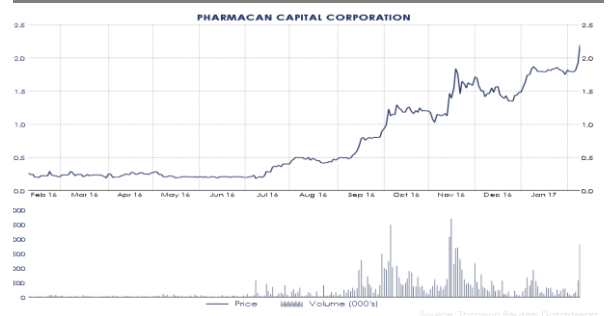
Stock Data (MM)	
Shares Outstanding	
Basic	122.4
FD	169.2
Market Cap	
Basic	\$254.6
FD	\$351.9
Net Debt	\$0.6
Enterprise Value	\$255.2

### About the Company

Cronos Group is a geographically diversified and vertically integrated cannabis company that operates two wholly-owned LPs and holds a portfolio of minority investments in other LPs and ACMPR applicants. The company's wholly-owned flagship LPs are Peace Naturals Project Inc. (Ontario), and In The Zone Produce Ltd. (British Columbia). The company also holds minority equity positions in LPs Whistler Medical Marijuana, Hydropothecary, and ABCann Medicinals.

All figures in C\$ unless otherwise indicated.

### Stock Performance



## Table of Contents

Investment Thesis .....	3
Industry Overview – A Massive Industry Finally About To Go Legit .....	7
Company Overview.....	17
New Management Team Has Already Added Significant Value .....	26
Revenue Model and Forecast.....	29
Competitive Landscape .....	32
Valuation: What's It Worth? .....	33
Potential Catalysts.....	36
Key Risks .....	37
Initiating Coverage with a Buy Rating and a \$3.50 Target Price.....	39
Appendix A: Consolidated Financials .....	40

## Investment Thesis

The Canadian medical marijuana market is already sizeable. **The number of patients has increased from just under 8K in June 2014 to over 98K in September 2016 – and growth is still showing signs of accelerating** with y/y growth of 222% last quarter. Our calculations peg the size of the industry at \$224MM today, however forecasts and extrapolations from another jurisdiction (Oregon) call for the industry to reach **\$~1.5B over the coming years.**

The Liberal Government has pledged to “legalize, regulate, and restrict access to marijuana” and this is an election promise we believe it has the intention and ability to keep. While nothing in politics is ever 100%, in our view, this is as close as it gets. In analyzing the political situation, we conclude that:

- **The ball is already rolling.** In late 2016, a task force presented its report to the government making recommendations regarding a framework for legalizing marijuana. The government has pledged to introduce legislation by spring 2017. We believe this legislation will take effect around spring 2018, although some have speculated that recreational marijuana sales may start in January 2018.
- **There is a clear determination by the majority government to see it through to legalization.** Younger Canadians increased turnout in last year’s election more than any other group and overwhelmingly supported the Liberal Party – helping take it from third place to a majority government. Canadian youth support the legalization of marijuana more than any other age group and have developed a particular fondness to Prime Minister Justin Trudeau. Accordingly, we believe this key group would likely look at a potential flip flop on this matter as a major betrayal.
- **There is very weak opposition.** 59% of Canadians support the government’s intention to legalize and regulate marijuana while only 33% disapprove. The two opposition parties currently have interim leaders and won’t be electing permanent leaders until mid-2017. **The NDP has criticized the government for not legalizing marijuana fast enough and even the Conservative Party seems to be coming around.** Delegates at the Conservative Party’s May 2016 convention voted to ticket rather than criminalize small amounts of marijuana. Among candidates for leader, Kevin O’Leary, Maxime Bernier, Michael Chong and Rick Peterson have indicated they prefer decriminalization or legalization of marijuana.

Most indications are that **a legal recreational marijuana market would dwarf the size of the medicinal market.** The discussion paper for the Task Force on Marijuana Legalization and Regulation claims that the industry currently generates \$7B in income for organized crime and polls indicate that meaningfully more Canadians would use marijuana if it was legalized

(this has been the case in U.S. states which have legalized marijuana). Examining the forecasts by the Parliamentary Budget Officer's report on the industry suggests a potential retail market size of \$5B. Extrapolating the current state of the Colorado and Washington markets (where the industry is legal on a state, but not federal level – and growing 40-70% annually) pegs the size of the Canadian market at \$10B to \$11B.

**Cronos Group is a geographically diversified and vertically integrated cannabis company that operates two wholly-owned LPs** and holds a portfolio of minority investments in other LPs and Access to Cannabis for Medical Purposes Regulations (ACMPR) applicants. The company's flagship LPs, Peace Naturals Project Inc. (Peace) and In The Zone Produce Ltd. (ITZ), are collectively situated on over 125 acres of agricultural land and are currently licensed to produce 2,600 kg of cannabis on an annual basis.

Previously operating as PharmaCan, the company's approach was to take minority investments in a portfolio of LPs and applicants. Back in 2014, by being among the first movers with capital on hand to invest in an emerging industry, the company was well positioned to get in at very attractive valuations. However, the firm ran into problems as the companies they invested in often didn't go public to provide any exit opportunities, ran into cash flow problems, and/or suffered from poor management. Not having control inhibited PharmaCan's ability to drive the necessary changes.

The company's shares had declined 60% in the 12 month period leading up to May 2016, when the company appointed Michael Gorenstein, a former Partner at Alphabet Ventures (an investment manager based in New York City) and M&A attorney, as its new CEO. Since that time, Mr. Gorenstein has:

- Repositioned the company from holding a portfolio of minority investments to being an operator of two wholly-owned LPs, with one core investment. Part of this includes rebranding the company as Cronos Group (shareholder meeting to officially approve the name change will be held on February 24, 2017).
- Attracted other top tier senior management talent, as well as \$15MM of capital (at a premium to market).
- Acquired the 74% of Peace that Cronos did not already own and made significant operational changes at the property.
- More than doubled the acreage at ITZ and secured sales authorization.
- Created two new unique outlets/angles for the company:
  - Entering into a JV with First Nations (called Indigenous Roots, or IR), which will allow the company to scale up without incurring capex to build new facilities – and provide direct access the First Nations demographic.

- Becoming one of only two Canadian LPs to successfully export to Germany – a massive market (80+MM people) which just authorized a medical marijuana program. We believe Cronos is well positioned to acquire one of the first licenses in Germany when they become available. In our view, this could be the key to reaching across Europe.

These moves have not gone unnoticed by the Street. Since Mr. Gorenstein was appointed CEO less than a year ago, the company's share price is up ~1000% – more than double the return of its peers. That said, we continue to see tremendous upside. In our view, the company has been stabilized and put on track towards growth. However, as the company executes on expansion and revenue begins to significantly accelerate and flow to earnings, we believe the company's shares will continue to climb.

We expect 2017 to be a year of massive expansion for Cronos.

- Peace Naturals has 90-acre footprint in Simcoe, ON. In addition to the initial smaller facility (B1), two 15K sq. ft. indoor facilities (B2 and B3) are built and coming online soon. B2 should have its first harvest in the near-term and B3 is approximately six months behind B2. We are modelling the construction of a new 200K sq. ft. indoor building (B4) with the company breaking ground around September this year.
- ITZ has 31 acres in the Okanagan Valley, BC. Currently the site houses only a pilot 2K sq. ft. facility. Now that ITZ has received its sales authorization (last month), we expect the company to develop on this footprint. Specifically, we are modelling the construction of a 100K sq. ft. greenhouse – again with ground being broken around September.
- We are forecasting Cronos' IR JV to build a 30K sq. ft. facility on ITZ's land. Given the nature of the JV agreement, Cronos will incur no capex to build the facility, yet be entitled to 50% of its operating income.

While we expect further expansion across Peace, ITZ, and IR, as well as further penetration into Germany, our model only includes the existing buildings and specific expansions outlined above. Spurred by these expansions, we are modelling the company to produce and sell 1,690 kg of marijuana this year, 5,585 kg in 2018, and 23,410 kg in 2020, ending the year at an annual rate of 30,160 kg. We are forecasting the company to generate \$14.6MM of revenue this year, with meaningful jumps to \$55.3MM in 2018, \$234.1MM in 2019 and \$301.6MM in 2020. We are modelling the company to turn EBITDA positive in Q3/FY17. Our full year EBITDA forecasts are \$13.8MM in 2018, \$75.7MM in 2019, and \$98.4MM in 2020. We note that **our model incorporates significant discounts to figures management believes it can achieve** regarding production and cost per gram, as well as higher capex expectations.

Cronos fully owns two of the 38 licenses granted by Health Canada, has minority interests in another three LPs, as well as options to acquire stakes in two applicants. In our view, Cronos' roster of multiple brands distinctly targeted at different demographics should allow it to carve out a greater market position than others with one catch-all brand identity.

### Exhibit 1. Cronos At A Glance

Investment	% Ownership	Status	Location
<b>Core Investments</b>			
Peace Naturals	100%	First LP - First oil license - Already selling Largest site of any LP in Ontario (90 acres) To be Cronos' 'medical' brand in Canada Has distribution capabilities in Germany, the EU, and Switzerland	Simcoe County, ON
In The Zone	100%	Licensed producer - Recently received sales authorization 31 acre site To house a number of Cronos' 'recreational' brands in Canada	Okanagan Valley, BC
Whistler Medical	21.5%	Licensed producer - Already selling Licensed organic by the Fraser Valley Organic Producers Association	Whistler, BC
<b>Strategic Investments</b>			
ABcann	6%	Licensed producer - Already selling	Napanee, ON
Hydropharmacy	1.9%	Licensed producer - Already selling Currently only LP in Quebec	Gatineau, QC
Evergreen Medicinal Supply	Up to 30%	ACMPR applicant - Built out facilities Awaiting pre-license inspection	Victoria, B.C.
CannMart	Up to 8.5%	ACMPR applicant - Built out facilities Awaiting pre-license inspection	Toronto, ON

Source: Company reports, Beacon Securities.

**We are initiating coverage of Cronos with a Buy rating and a \$3.50 target price.** We use a sum of the parts valuation, however, the vast majority (\$~3.00) of the value we are projecting is derived via a DCF for the businesses the company controls (Peace, ITZ, and IR). Highlights from our DCF include: achieving 4.2% market share by FY21; revenue realized per gram rising to \$10 shortly after legalization, and remaining there longer-term; adjusted cost of goods sold falling to \$2.50 longer-term; a discount rate of 10%; and a zero terminal growth rate post FY21.

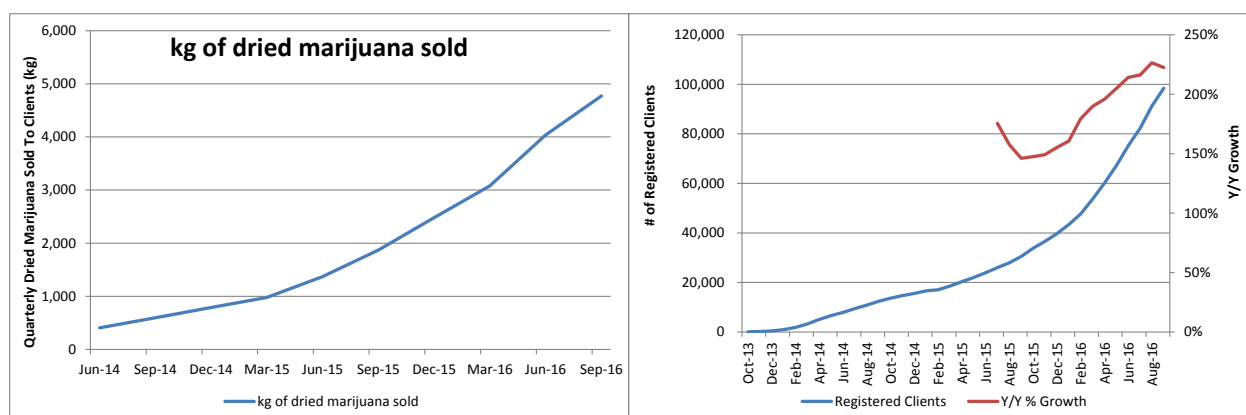
Cronos owns the first non-incumbent license granted by Health Canada and has the largest footprint in Ontario. Cronos is the only LP with licenses in multiple provinces and has already begun exploiting international opportunities. The public company has been stabilized, recruited impressive talent, and has a very supportive shareholder base behind it. **The sleeping giant has awoken and we look forward to the growth it can produce ahead.**

## Industry Overview – A Massive Industry Finally About To Go Legit

### Current State of Industry – Medical Market

- Marijuana possession, production and trafficking are currently prohibited in Canada under the Controlled Drugs and Substances Act – except where authorized by exemptions or regulations, such as those for medical marijuana. Possession of up to 30 g carries a possible fine of up to \$1,000 and up to six months in jail. Police reported nearly 60K marijuana offences in 2014, of which 22K resulted in charges.
- Medical marijuana has been available in Canada since 2001, although regulations have changed over time. Currently, patients with the support of their health care practitioner can register with one of the 38 LPs licensed by Health Canada. Orders are shipped by mail/courier. Health Canada does not play a role in setting/regulating the price LPs charge for medical marijuana. Storefront “dispensaries” are currently illegal. Under the ACMPR authorized patients may also produce a limited amount of marijuana for their own medical purposes or designate someone else to produce it for them.
- As illustrated in Exhibit 2 the medical marijuana industry has been experiencing exponential growth in recent years. During the quarter ended September 30, 2016, LPs sold 4,773 kg of marijuana to clients – up 155% y/y and 18% sequentially. As at September 30, 2016, there were 98,460 clients registered, up 222% y/y and 31% sequentially – growing significantly faster than the LPs’ production (168% y/y, 14% sequentially).

**Exhibit 2. Growth In Canadian Medical Marijuana Industry: Sales (left); and Registered Clients (right)**



Source: Health Canada.

- The average shipment of medical marijuana is for 0.89 g/day. Therefore, assuming all 98,460 patients were receiving this much marijuana, they would demand 31,985 kg annually today. Assuming an average retail price of \$7/g, **medical marijuana is a \$224MM industry at the moment – and rapidly growing.**
- Even with the recent jump in industry production, the industry is currently producing at an annual run rate of 22,936 kg – leaving an **annual shortfall of 9,049 kg (28% of consumption)**. The magnitude of the shortfall actually increased during the quarter ended September 30, 2016 (prior quarter had a shortfall of 6,282 kg / 24% of demand, respectively).

### Conclusion

- Medical marijuana in Canada is a sizeable industry in its own right – and still in exponential growth mode.

### Path to Legalization & Political Considerations

- The Liberal Party of Canada won a majority in the general election held on October 19, 2015. The Liberal election platform stated that “we will legalize, regulate, and restrict access to marijuana.” Barring a need for an early election, the next general election is not scheduled until October 21, 2019.
- **This is an election promise the government seems willing and able to keep.** In the December 2015 Speech From The Throne, the government of Canada reiterated its intention to “legalize, regulate, and restrict access to marijuana.”
- The government appointed a Task Force On Marijuana Legalization and Regulation. After spending months studying the issue and reaching out to key stakeholders and all Canadians, the task force released a comprehensive set of recommendations for a legal medical marijuana framework which we believe favour the incumbent LPs. Highlights from the task force’s recommendations include: federal regulation over the recreational market; maintaining the “direct-to-consumer mail-order system”, while also leaving distribution largely to the provinces; not co-locating alcohol with tobacco or alcohol; staffing retail outlets with trained knowledgeable employees; moving swiftly to increase or create capacity; applying restrictions to advertising and promotion similar to tobacco; allowing forms other than just smoking (i.e., edibles etc.); setting a federal minimum age of 18 to purchase the product (allowing it to be raised to 19 to be consistent with alcohol in certain provinces); keeping taxes low enough to compete effectively with the illicit market; maintaining the ACMPR with some modifications; and promoting research on the use of cannabis for medical purposes. For more details on the task force report please refer to our industry research report dated December 14, 2016.
- The federal government has committed to introduce “legislation on the legalization and strict regulation of marijuana in spring 2017”. We note that Prime Minister Trudeau has appointed 20 non-affiliated



Senators in the last few months – which we feel may ease the passage of upcoming legislation. While no specific timeline has been provided, we believe one year is likely enough to make the required preparations with legislation coming to force in spring 2018.

- On the political front, we believe that **youth have emerged as a stronger political force, have a special bond with Prime Minister Justin Trudeau, helping him win the election, and most strongly support the decriminalization of marijuana.** Consider the following:
  - The largest increase in voter turnout in the 2015 election versus the 2011 election was among Canadians aged 18-24 (67% vs. 55%), then followed by those aged 25-34 (70% vs. 59%).
  - Young Canadians (aged 18 to 25) voted overwhelmingly for the Liberal Party – 45%, versus 25% for the NDP and 20% for the Conservatives. In contrast, the total popular vote was split as follows: Liberals 39%; Conservatives 32%; and the NDP 20%.
  - 60% of Canadians aged 18-25 view Prime Minister Trudeau positively, and 66% believe he is a political leader they can relate to.
  - Mr. Trudeau is Canada's second-youngest Prime Minister ever (aged 44), and the first from Generation X. Interestingly, in addition to being Prime Minister, he retained the position of Minister of Intergovernmental Affairs and renamed it to Minister of Intergovernmental Affairs and Youth.
  - A poll released in November 2015 by Forum Research found that Canadians aged 18-34 are the most likely to support the legalization of marijuana – at 67% versus 55% across those surveyed in all other age groups. The same poll found that 70% of those who prefer the Liberal Party were in favour of legalization – higher than any others except those who preferred the Green Party (78%).
- “Immediately decriminalizing possession of personal amounts of marijuana” was part of the NDP’s election platform, and **the NDP has since harshly criticized the government for not legalizing marijuana fast enough.** The NDP will be electing its new leader in September/October 2017.
- **Even the Conservative Party has significantly moderated its position over the past year.**
  - Its platform for the October 2015 election slammed the other parties for wanting to legalize marijuana.
  - In January 2016, Interim Leader Rona Ambrose pressed the government to present and implement its plan to legalize marijuana to keep it out of the hands of minors. While she stated that her personal view hadn't changed (still opposed to wholesale legalization), **“When this new government was elected, there was a clear message sent that marijuana is legal, marijuana will be legal ...** The problem there is it sent a message to all of those who want to profit from this industry. We see the proliferation of pot dispensaries all across the country, and the concern there is that there is some evidence

- that some of them are selling to young people.” (emphasis ours)
- At its convention in May 2016, **the Conservative Party voted to ticket rather than criminalize small amounts of marijuana** by a vote of 158-116.
  - The party will elect its new leader in May 2017. Registered candidates include (emphasis ours):
    - **Kevin O’Leary, in regards to marijuana legalization, has stated, “I think it has to be federally legal.”**, viewing it as a massive opportunity to generate cash for the country. This is a strong view of his that we have heard him express many times. Most recent polling (Forum Research) of Conservative Party members had Mr. O’Leary leading with 31% support.
    - **Maxime Bernier indicated that he is “more for” legalizing marijuana than against it.** “It depends how the government will do it. At the end I will decide whether I will vote for it or against it. But I am more toward — for — that.” Most recent polling (Forum Research) of Conservative Party members had Mr. Bernier in third place at 10% support.
    - **Michael Chong is in favour of decriminalizing** the possession of small amounts marijuana for personal purposes. **“It’s clear that the current Criminal Code prohibition on marijuana are not working.** They are not working in terms of reducing marijuana usage in Canada. They are not working in terms of prevent organized crime from benefiting from the sale of marijuana.” He indicated that we should look at a model which uses “a combination of tools to reduce the incidence of marijuana smoking while at the same time acknowledging that people should have a degree of liberty to make their own choices.” Mr. Chong’s support among party members had reached as high as 10% in a prior poll.
    - **Rick Peterson declared that he supports “legislation that would allow the controlled and regulated distribution and sale of marijuana through approved channels”.** (emphasis ours)

### Conclusion

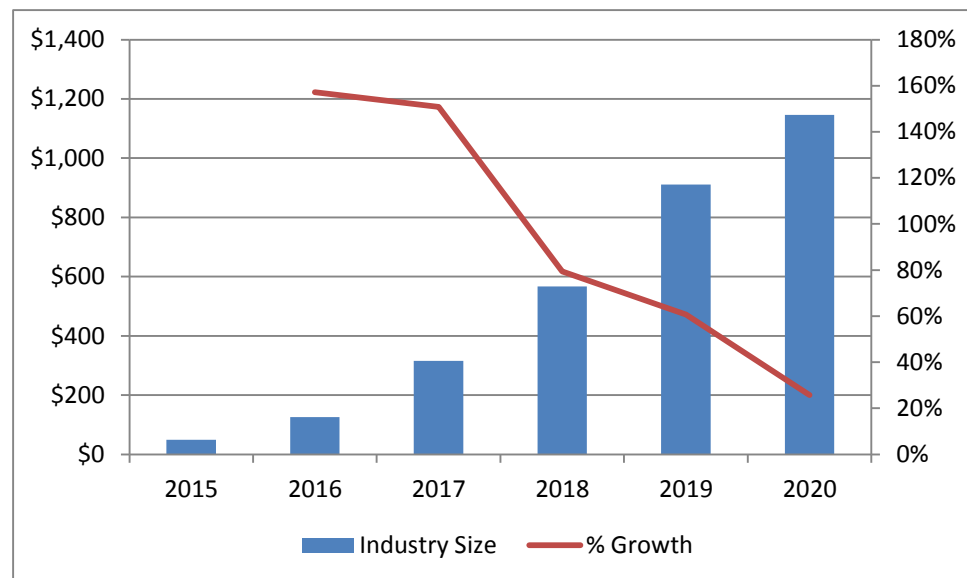
- Whether you like it or not, it is pretty clear to us that marijuana legalization is happening in the nearer-term – although it is not totally clear how it will look.

**Forecasts/Expectations For The Canadian Market**

**Medical Marijuana**

- In 2013, Health Canada released its forecast for the medical market, calling for the industry to have up to 450,000 patients signed up by 2024 and generate \$1.3B in revenue. Assuming the average patient consumes 0.89 g/day, this would translate to 146,183 kg/year and an average retail price of \$8.89/g.
- While growth rates will likely tail off in the years going forward, **the data we have actually shows signs of acceleration.** We note that the number of patients rose 84% in the last six months (to September 2016), which was slightly faster than growth seen in the prior six months (76%). In terms of bodies, the system added almost as many patients in the past three months (23,294) than it added in all of 2015 (24,123).
- Statista is forecasting the Canadian medical marijuana industry to grow by 151% in 2017 and 79% in 2018, reaching \$1.146B in 2020 (based on prices of \$7.50/g for dried marijuana and \$2.6/mL for oil/extract – Exhibit 3). Their model also incorporates the system to reach 715 K by 2020 (with 501,381 of them using dried marijuana). The market seems to be growing faster than these forecasts. For example, we note that Statista had forecast the size of the market to be \$126MM (including oils/extracts) in 2016, whereas above we calculated the market for dried marijuana alone to currently be worth \$224MM today.

**Exhibit 3. Forecasts For Canadian Medical Marijuana Market**



Source: Statista.

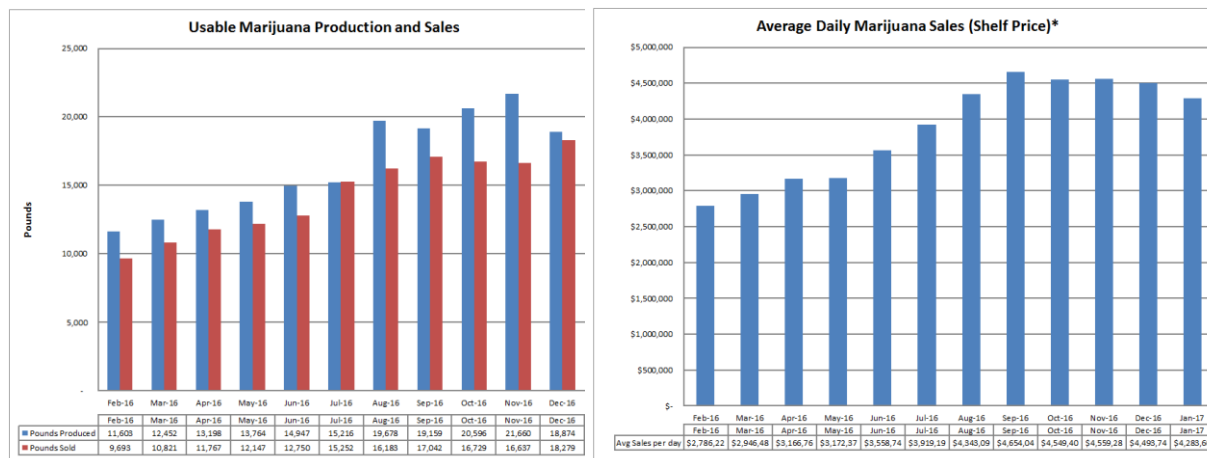
- We believe the state of Oregon, which has had a regulated medicinal market since 1998, offers a good proxy to where Canada's industry can reach. **The Oregon Medical Marijuana Program currently has 68,201 patients, representing 1.7% of the state's population.** Applying that percentage to Canada suggests that this market could reach

612K patients. Using an average consumption of 0.89 g/day and a price of \$7/g, this would **translate to a \$1.4B medicinal marijuana market for Canada.**

### Recreational Marijuana Market

- Statista forecasts that if the Canadian marijuana market is legalized by 2018 (as we expect), the combined medical and recreational market would be worth \$2.8B by 2020 – implying a \$1.7B recreational market size.
- However, looking at the actual results from other states where recreational marijuana has been legal for some time, projections for the potential size of a legal market in Canada are much larger.
  - The state of **Colorado** legalized recreational marijuana as of January 1, 2014. Based on tax data disclosed by the government, the Denver Post calculated that retail sales of marijuana in the state during 2016 were US\$1.3B. **Extrapolating the revenue per capita (\$310) we calculate the potential size of the Canadian market to be \$11.2B.** That said, we note two aspects which could send this figure even higher:
    1. Sales in Colorado are still gathering steam. Retail sales were **up 32% y/y in 2016**, implying a much larger market upon maturity.
    2. While the state has allowed the sale of marijuana, as of September 30, 2015, **218 of the 322 local jurisdictions** (municipalities/counties) **have banned both medical and retail marijuana** and 31 others have allowed one but not the other. In contrast, the legislation in Canada to legalize marijuana is at the federal level (granted there may also be provincial/municipal differences).
  - **Daily retail sales in the state of Washington** (where marijuana is also legal) **are currently running at US\$4.3MM** (\$285 per capita). Extrapolating this figure to **Canada's population would translate to a market size of \$10.3B.** Again, we note the incredible growth in Washington over the past 12 months (January 2017 levels were up 71% y/y).

**Exhibit 4. State of Washington: Marijuana Production and Sales (left); Average Daily Sales of Marijuana (right)**



Source: Washington State Liquor and Cannabis Board.

- The discussion paper for the Task Force on Marijuana Legalization and Regulation claims that “the illegal trade of marijuana reaps **an estimated \$7 billion in income annually** for organized crime” in Canada (emphasis ours). **The size of the industry seems set to increase further from upcoming legalization.** A November 2015 poll by Forum Research found that while 18% of Canadian voters used marijuana in the past 12 months, a further 13% would be likely to use it if it becomes legal, bringing the total addressable market to 31% of Canadians. Again, youth (aged 18-34) were at the forefront of this data (34% have used marijuana in the past year and 18% are somewhat or very likely to use it if legalized).

**Highlights From Parliamentary Budget Officer’s Report**

- “The legalization of recreational cannabis will introduce an entirely new sector into the formal economy”. Legal sales may begin as early as January 2018.
- The PBO projects that 4.6MM individuals over the age of 15 will try marijuana at least once (range of 3.4MM and 6.0MM) in 2018. By 2021, this could rise to 5.2MM (between 3.7MM and 7.0MM), representing a CAGR of 4.2%, using the midpoints.
- In terms of volumes, the **PBO’s midpoint estimate is for Canadians to consume 655 mt of marijuana in 2018** (low estimate of 378 mt, high of 1,017 mt). **By 2021, the midpoint estimate is for 734 mt** (low estimate of 403 mt, high estimate of 1,190 mt). This represents a CAGR of 3.9% at the midpoint. These figures do not include potential demand from non-residents and tourists.
- Marijuana use is highly skewed towards heavier users. Those who use the product at least once a week represent 41% of users, but 98% of total consumption.
- Legalization is likely to put downward pressure on production costs. “At the onset of legalization, prices may be higher [than the mid-point

estimate of \$7.50 currently] due to the potential for supply shortages and regulatory changes. As the legal market matures, there will be downward pressure on wholesale prices as producers' production costs decline. However, long-term prices are less predictable as consumer tastes and product offerings, including value-added products, evolve."

- Per the PBO's projections, **producers of marijuana** will, industry-wide, **see their costs of production fall between 2018 to 2021 from \$2.25/g to \$1.75/g, yet be able to maintain their margin on a per gram basis (at \$2.25/g)**. "The lower expected production costs reflect the potential for growing economies of scale, higher labour productivity, and the application of more productive agricultural approaches and technology." Accordingly, **producers' gross margin is set to increase from 50% to 56%**. **Retailers are expected to maintain their margin at 40% between 2018 and 2021**. Accordingly, the retailer margin decreases on a per gram basis (from \$3.00/g to \$2.67/g) and the final pre-tax sales price would fall from \$7.50/g to \$6.67/g. While we don't know what the industry will look like, **should a firm be vertically integrated** (i.e., do both production and retail – as is currently the case), **the cumulative gross margin would be 70% in 2018** (revenue of \$7/g versus costs of goods sold of \$2.25/g), **and rise to 74% by 2021**.
- "PBO's retail price projections do not take into account supply shortages. However, the potential for such shortages in Canada exists." We point to last quarter's industry production of 5.7 mt representing just 3.5% of the PBO's projected 2018 volume.
- Combining the PBO's price and volume projections, we calculate that **the recreational market would be worth \$5B (pre-tax) in 2018**.

**Exhibit 5. Average Pre-Tax Price Projection**

	2018	2021
Cost of Goods Sold (/g)	<p>\$2.00    \$2.50</p>	<p>\$1.50    \$2.00</p>
Producer Margin (/g)	<p>\$2.00    \$2.50</p>	<p>\$2.00    \$2.50</p>
Retailer Margin (/g)	<p>\$2.67    \$3.33</p>	<p>\$2.33    \$3.00</p>
Total	<p>\$6.67    \$8.33</p>	<p>\$5.83    \$7.50</p>

Source: Parliamentary Budget Officer.

- According to study quoted in the report “between 35 and 55 per cent of users were willing to pay at least \$5.00 USD more for legal cannabis over the illicit market price.” However, “frequent users are less willing to pay higher prices for legal cannabis than infrequent users.”
- Data from Colorado, Washington and Oregon “suggests that reported cannabis use increased substantially – between 10 per cent and 30 per cent – in those three states among those aged 18 and over, during the period leading up to legalization”.

**Exhibit 6. Past-Year Cannabis Use in Select US States Leading up to Legalization**

		Colorado	Washington	Oregon
<b>Past-Year Cannabis Use among Persons 18 Years and Over</b>	<b>2011-2012</b>	16.08%	15.29%	17.54%
	<b>2012-2013</b>	18.94%	17.58%	19.21%
	<b>2013-2014</b>	20.74%	19.06%	19.50%
<b>Change since 2011-12</b>	<b>2012-2013</b>	17.8%	15.0%	9.5%
	<b>2013-2014</b>	29.0%	24.7%	11.2%

Source: Parliamentary Budget Officer.

**Conclusion**

- Based on the above calculations, the Canadian medical marijuana market is growing very quickly and should be able to comfortably be a \$1+B industry in itself. Layering on recreational usage, the total size of the industry likely multiplies several fold – potentially reaching \$11B. For context, this would put retail marijuana sales essentially equal to annual sales at furniture stores (\$10.6B) although less than at beer, wine and liquor stores (\$21.3B).
- While precision on a specific number is difficult, it is clear that marijuana is already a major industry and overnight legalization can unlock profits for investors to earn legitimately.
- Unlike other exponential growth industries which need to gain acceptance and adoption over time, the Canadian marijuana industry is already well established and sizeable today. That said, polling suggests that the existing market will only grow once legalized as new users enter. This has been the case in U.S. states.
- By 2018, the industry may need 28x more production than the industry can produce now. Producers will need to ramp up capacity in the interim. Prices of legal marijuana may be higher initially due to possible supply constraints.
- As producers are looking to ramp up capacity, consolidation has already emerged as a theme in the industry. We point to Cronos' acquisition of Peace Naturals in September 2016.

**Canadian LPs Likely To Have An International Edge**

- Canada is set to become the first G7 nation to legalize marijuana. We believe that its status as a pioneer recreationally, combined with the several years of robust regulation from Health Canada for medical marijuana, has made the Canadian model the gold standard internationally. We point to two countries, Germany and Brazil, which have recently legalized medical marijuana, and have elected to import it from Canada (as opposed to allowing local production).
- We expect that recreational marijuana will remain federally illegal in the U.S. for several years. In our view, this will allow Canada to grow major firms in the sector, allowing them to become global champions.



## Company Overview

- Cronos Group is a geographically diversified and vertically integrated cannabis company that operates two wholly-owned LPs and holds a portfolio of minority investments in other LPs and ACMPR applicants. The company's flagship LPs, Peace Naturals Project Inc. (Ontario), and In The Zone Produce Ltd. (British Columbia) are collectively situated on over 125 acres of agricultural land and are currently licensed to produce 2,600 kg of cannabis on an annual basis. The company also holds minority equity positions in LPs Whistler Medical Marijuana, Hydropharmacy, and ABcann Medicinals.

### Exhibit 7. Cronos' Portfolio

Investment	% Ownership	Status	Location
<b>Core Investments</b>			
Peace Naturals	100%	First LP - First oil license - Already selling Largest site of any LP in Ontario (90 acres) To be Cronos' 'medical' brand in Canada Has distribution capabilities in Germany, the EU, and Switzerland	Simcoe County, ON
In The Zone	100%	Licensed producer - Recently received sales authorization 31 acre site To house a number of Cronos' 'recreational' brands in Canada	Okanagan Valley, BC
Whistler Medical	21.5%	Licensed producer - Already selling Licensed organic by the Fraser Valley Organic Producers Association	Whistler, BC
<b>Strategic Investments</b>			
ABcann	6%	Licensed producer - Already selling	Napanee, ON
Hydropharmacy	1.9%	Licensed producer - Already selling Currently only LP in Quebec	Gatineau, QC
Evergreen Medicinal Supply	Up to 30%	ACMPR applicant - Built out facilities Awaiting pre-license inspection	Victoria, B.C.
CannMart	Up to 8.5%	ACMPR applicant - Built out facilities Awaiting pre-license inspection	Toronto, ON

Source: Company reports, Beacon Securities.

### Peace Naturals Project – Focus To Remain On Medical Marijuana

- Formerly one of Cronos' minority investments, at a 26% interest, the company acquired the remaining shares of Peace it did not already own on September 6, 2016. Cronos began consolidating Peace's results on that date.
- Peace produces and sells dried marijuana and cannabis oil under its Peace Naturals brand targeted towards medical consumers. Its product offering of 18 different cannabis strains and 2 cannabis oils provide patients with a sliding scale of indica and sativa combinations and a variety of THC and CBD concentrations that patients can select from based on their specific preferences and needs. Management's intention is for Peace to remain medically focused, even post legalization.
- Peace primarily sells to its patients through its online store and via phone. Distribution is conducted through a secure courier. Pricing is currently determined by growth time, strain yield, and competitive

forces. On average, Peace's strains skew towards being premium priced at an average strain price of \$9.50/gram (9% premium to competitors – Exhibit 8 below).

**Exhibit 8. Pricing by LP**

DRIED CANNABIS												JANUARY 11 2017											
<b>AB Cann</b>			<b>Aphria</b>			<b>Aurora</b>			<b>Bedrocan</b>			<b>Broken Coast</b>			<b>Canna Farms</b>			<b>CanniMed</b>					
Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg					
THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1
\$4.62	-	\$5.60	\$9.49	\$7.72	\$8.59	\$3.64	\$4.21	\$4.96	\$3.67	\$7.50	\$4.22	\$4.66	-	-	\$4.61	-	\$4.36	\$4.06	\$5.33	\$4.30			
Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price				
8	\$9.13		10	\$10.48		4	\$8.00		5	\$6.75		6	\$7.04		11	\$7.86		7	\$6.79				
<b>Cantrust</b>			<b>Emblem</b>			<b>Emerald</b>			<b>Hydrothecary</b>			<b>MariCann</b>			<b>MedReleaf</b>			<b>Mettrum</b>					
Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg					
THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1
\$5.43	\$6.11	\$5.00	\$4.71	-	-	\$6.01	-	\$7.60	\$7.40	\$10.34	\$10.20	\$5.08	-	\$5.80	\$5.29	\$8.62	\$5.81	\$9.50	-	-			
Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price				
7	\$9.50		8	\$8.75		10	\$8.60		14	\$11.11		11	\$10.09		8	\$11.56		1	\$7.60				
<b>Organigram</b>			<b>Peace Naturals</b>			<b>RedeCan</b>			<b>Tilray</b>			<b>Tweed</b>			<b>Whistler</b>			<b>Δ-9 BioTech</b>					
Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg			Average Price Per 100mg					
THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1	THC	CBD	1:1
\$8.84	-	-	\$6.24	-	-	\$3.45	-	\$3.35	\$5.45	-	\$5.88	-	\$9.71	\$4.69	\$6.94	-	-	\$5.40	-	\$5.57			
Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price		Number of Selections	Average Per Gram Price				
8	\$8.63		5	\$9.50		7	\$6.07		7	\$9.86		4	\$7.69		12	\$11.42		8	\$7.28				

Source: Lift.co

- With a footprint of 90 acres in Simcoe, Peace has the largest acreage of any LP in Ontario. The property currently has three buildings – B1, the initial licensed facility, as well as two 15K sq. ft. indoor buildings (B2 and B3). B2 is in full production and we understand B3 should be licensed in the near-term. Peace has 38.7K sq. ft. of production space across the three facilities. Peace is currently licensed to produce and sell up to 2,500 kg of cannabis annually, however we expect this limit to be adjusted upwards over time. For reference, management believes that once fully operational, the three buildings currently at Peace can produce 4,200 kg annually initially, and that it can subsequently increase this figure via efficiencies to 5,000 kg a year. Management intends to expand further on this sprawling property.

**Exhibit 9. Birds' Eye View Of Peace Existing Facilities And Expansion Potential**



Source: Beacon Securities.

- Peace was also granted the first oils license from Health Canada, which we believe generates significantly superior economics versus dry flower (approximately double the selling price with only a ~10% increase in costs).

**Exhibit 10. Pictures of Peace – December 2016**



Source: Beacon Securities.

**Peace Is On The Shelf In Germany – First Step Towards Cultivation There?**

- While most LPs and applicants include exporting to Germany in their grand strategy, we note that Peace is one of only two LPs to date which have met the stringent requirements and successfully exported product.
- On October 10, 2016, Peace announced its first shipment of medical marijuana to Germany through the German-based European pharmaceutical wholesale distributor, Pedanios GmbH (Pedanios).



**Exhibit 12. ITZ's Current Footprint**

 Recently acquired incremental 17 acres

Source: Company reports.

- ITZ currently has an initial ~2,000 sq. ft. facility on the property. The company is licensed to produce 100 kg of marijuana annually; however, management believes it can increase this figure to 300 kg annually in the near-term (from just its initial facility).
- ITZ just received sales authorization on January 11, 2017. Now licensed, we suspect it may scale up by selling to Peace initially. However, once marijuana is legalized it will be focused on the recreational market. We believe ITZ will house at least two brands – one being more main-stream, targeted at the general consumer, and the other being positioned as a super-premium product targeted towards cannabis connoisseurs and those more deeply immersed in marijuana culture. We also understand that ITZ plans to leverage the west coast/BC-bud culture in its branding and would look to break in to the U.S. market when it is allowed to do so.
- Eric Klein was recently brought on to lead Cronos' marketing and communications. Given his experience having worked in brand management and marketing for a number of multinational CPG companies (Oreo, Chobani, Aquafina) we believe the company will be able to successfully build multiple brands which resonate with consumers – within the rules permitted by the government.

**Exhibit 13. Pictures Of In The Zone – January 2017**

Source: Beacon Securities.

**Indigenous Roots – An ITZ and First Nations JV**

- On December 5, 2016 Cronos announced a strategic joint venture with Canadian First Nations that will operate and be marketed under the Indigenous Roots (IR) label.
- Under the terms of the JV agreement, a First Nations finance company lead by Phil Fontaine (prior National Chief of the Assembly of First Nations) will construct and finance the construction of a facility on ITZ's property. Cronos will provide the license to produce, IP, and engineering expertise and the operating profit will be split 50/50.
- We believe the JV will construct a 30,000 sq. ft. indoor facility on ITZ's property and then look to license and build additional facilities on First Nations reserves – where Cronos would still be entitled to half the operating profit.
- We see this arrangement as an excellent way for Cronos to scale up production without spending meaningful up front capex. We also believe employing a significant number of First Nations employees may give the company significant "socially conscious" brand status amongst the wider population.
- The JV intends to remain First Nations owned and operated and will seek to become a component of the First Nations reserve economy. We believe this strategy can unlock access to a ~1.5MM person demographic that may be more difficult to reach via traditional retail distribution channels.
- IR will be focusing on the medical side as a distinct brand. We believe the government may look to reimburse medical marijuana for First Nations which could help accelerate adoption and/or give IR a degree of market power.

**Exhibit 14. Overview Of Indigenous Roots JV**



Source: Company reports.

**Whistler Medical Marijuana – The Highly Esteemed Organic Producer (21.5% Ownership)**

- Whistler is a privately held LP focused on research, development, production and distribution of dried marijuana, cannabis oils, and marijuana plants out of Whistler, BC.
- Whistler positions itself as the most healthy marijuana and cannabis option. They are the only Canadian LP whose entire product line is 100% certified organic and is a certified member of the Fraser Valley Organic Producers Association (FVOPA), ensuring compliance with International Organic Growing Standards.
- As per the company website, the way Whistler produces cannabis “means that irradiation and cold pasteurization are not required to ensure that your medication passes laboratory testing”.
- Whistler offers 12 strains of marijuana and 18 types of cannabis oil, a product mix more heavily skewed towards healthier ingestion methods, as oil consumption avoids the combustion of derivative by-products found in marijuana that hold no medical or recreational value. The products are marketed as a more premium brand with an average price per gram of \$11.42 (the second-highest price point of the 21 LPs listed in Exhibit 8). The product mix also skews towards higher potencies as measured by THC.
- The operation is currently licensed to produce and sell up to 700 kg of marijuana annually. Whistler operates a ~12,000 sq. ft. facility with an opportunity to add an additional 120,000 sq. ft.
- We understand that Whistler operates a fundamentally different business model than most of its peers. The company designates a large portion of its production to selling its genetics to patients eligible to grow their own cannabis, via its clone plants, which allows it to leverage its highly regarded IP. We understand Whistler is currently selling its clones at \$~158/clone.

- Cronos does not exert control over Whistler's operations; although we believe management views it as a core investment. Whistler paid a \$2.154MM dividend in 2016 and we understand it will continue to pay dividends going forward.

**ABcann  
(6% ownership)**

- ABcann is a medical marijuana business out of Napanee, ON. It is a licensed producer of up to 625 kg annually with current production facilities of 42,000 sq. ft.

**Hydrothecary  
(1.9% ownership)**

- Hydrothecary is currently the only Quebec-based LP. The company is involved in the production and sale of cannabis and dried marijuana capsules. It is also currently developing a cannabis oil.
- Hydrothecary's medical marijuana portfolio consists of two product lines – Time of Day (its signature premium brand consisting of 4 strains), and H<sup>2</sup> (a more recent offering of main-stream strains at the low-mid pricing tiers of prevailing market prices). At an average price of \$11.11/g (Exhibit 8) Hydrothecary targets the high end of the market.
- Hydrothecary's dried marijuana capsules, marketed under CanaCap, provide patients with an edible alternative to consuming controlled doses of marijuana. The company also sells capsules and a capsule making kit through its online store.
- The cannabis oil, to be marketed under Elixir No 1, will allow the company to compete in the extracts business and increase the breadth of its customer base.



## Exhibit 15. Illustration Of Hydrothecary's Offerings



Source: Company website.

- Hydrothecary is currently licensed to produce 350 kg annually and runs a 42,000 sq. ft. facility on a 80 acre plot.
- While Cronos' interest in this business is small, we do see partnership value in having a relationship with the only currently licensed producer in the province of Quebec.

### Evergreen Medicinals

#### (6.25% ownership + option for up to another 23.75%)

- Evergreen Medicinals is an ACMPR applicant awaiting its pre-license inspection. The company has built out ~5,500 sq. ft. of production facilities on 2.5 acres of land in Victoria, BC. Cronos owns a 6.25% stake and has the option to purchase up to an additional 23.75%, which would put its total interest at 30%.

### CannMart

- CannMart is also an ACMPR applicant awaiting its pre-license inspection. It has built out ~4,000 sq. ft. of facilities located near Toronto, ON. Cronos currently has no equity in the business but holds an option to purchase up to 8.5%.

### Other Investments

- As consideration for the sale of Cronos' 12% stake in Vert Medical (another late stage applicant) to Canopy Growth Corp. in late 2016, the company received 7,374 shares of Canopy with an additional 29,498 shares to be granted upon Vert achieving of certain milestones.

## New Management Team Has Already Added Significant Value

- **We believe Cronos' new management team has successfully stabilized the company and put it back onto a growth trajectory.**
- Cronos' prior approach was to make minority investments in a portfolio of LPs and applicants. Back in 2014, PharmaCan was among the first movers which had capital on hand to invest in an emerging industry. This allowed it to get in at very attractive valuations. However, the firm ran into issues as the companies it invested in often didn't go public to provide any exit opportunities, ran into cash flow problems and/or suffered from poor management – and not having control inhibited PharmaCan's ability to drive the necessary changes.
- On May 16, 2016, Michael Gorenstein was appointed CEO of the company (he was the Vice-Chairman at the time). Since assuming the role, the company has done the following:
  - **Repositioned the company** from holding a portfolio of almost exclusively minority investments **to being an operator of two wholly-owned LPs**. Steps taken on this front include: **acquiring the 74% of Peace it did not already own**; divesting of Vert Medical; and rebranding the company as Cronos Group.
  - **Attracted what we view to be very impressive talent** to the company, including: William Hilson (CFO), David Hsu (COO), Eric Klein (Marketing and Communications) and Jason Adler (Director).
  - **Attracted \$15MM of equity** via a non-brokered private placement at a premium to market.
  - Made many **operational changes at Peace** (increased power and growing capacity, optimized production methodologies and facility layout, overhauled retail pricing strategy). We look forward to **seeing the start of these benefits with the release of the company's Q4/FY16 results**. Perhaps most notably, we highlight Peace's patient count. Prior to being acquired by Cronos, Peace had 3,400 patients and this figure had been stagnant for some time. On November 29, 2016, Cronos announced that it had recently established a new patient enrollment program with and was adding ~10 patients/day. We suspect this figure may accelerate further going forward. "Hosting community-based support groups and direct physician outreach initiatives" was cited as being a key component of the company's approach.
  - Successfully **exported medical marijuana from Peace to Germany** – on the second Canadian LP to do so.
  - Significantly **raised the value of ITZ** by: more than doubling the acreage of the site (acquired 17 acres of adjacent land for \$600K); entering into the IR JV; and re-obtaining sales authorization.

- The good news is that the above moves have not gone completely unnoticed. **While the company's shares were down 60% in the year before Mr. Gorenstein was appointed CEO, Cronos is the best performing publicly traded LP in the period since – up ~1000%, representing twice the gains of its peers.**
- That said, we still see significant room for the shares to run in the year ahead as management demonstrates tangible growth at Peace, expansion at ITZ and IR, and exploits international opportunities.

#### Exhibit 16. Share Price Performance Since Mike Gorenstein Appointed CEO

	Share Price on May 16, 2016 (Mike Gorenstein Appointed CEO)	Current Share Price	Return
	16-May-16	10-Feb-17	
Canopy Growth Corp.	\$2.61	\$12.40	475%
Aphria	\$1.48	\$5.50	372%
Organiram	\$1.20	\$2.70	225%
Aurora Cannabis	\$0.47	\$2.54	546%
Supreme Pharmaceuticals	\$0.36	\$1.78	501%
Average			424%
Cronos Group	\$0.21	\$2.08	990%

Source: Thomson Reuters, Beacon Securities.

#### Senior Management Bios

- **Michael Gorenstein – CEO & Chairman:** Michael Gorenstein has been CEO of the company since May 2016 and Chairman since November 2015. Prior to this role he was a Partner at Alphabet Ventures, an investment manager focused on emerging growth companies that are underserved by traditional capital providers. He was previously a the VP and General Counsel of Saiers Capital LLC and a corporate attorney at Sullivan & Cromwell LLP.
- **William Hilson, CPA – CFO:** William Hilson has held the role of CFO since September 2016. He has extensive experience in the pharmaceutical industry having worked as regional CFO for over 15 years at Merck KGaA and Serono S.A, two multinational pharmaceutical businesses. We view his pharmaceutical experience as highly valuable given that the scope of his roles spanned multiple relevant aspects of the industry including finance, M&A activity, strategy, clinical trial management, and capital raising.
- **David Hsu – COO:** David Hsu has held the role of COO since October 2016. Mr. Hsu spent 10 years at Deloitte's Corporate Restructuring Group, where he operated and managed distressed companies with revenue in excess of \$500MM. He is a certified Lean Six Sigma Black Belt.
- **Eric Klein – Marketing and Communications:** Eric has a long history in CPG brand management, marketing and distribution. He was a Senior Brand Manager at PepsiCo in charge of branding for Aquafina.

His prior experience includes brands such as Chobani, Oreo and Chips Ahoy!

**Board of Director Bios**

- **Michael Gorenstein – CEO & Chairman:** See above.
- **Jason Adler – Director:** Jason Adler has been a Director since July 12, 2016. He is the CEO and Management Member of Alphabet Ventures where he has work history with Michael Gorenstein.
- **Michael Krestell – Director:** Michael Krestell has been a Director since December 10, 2014. He is the president of M Partners, an independent investment bank that has been involved in transactions in the marijuana industry.
- **Alan Friedman – Director:** Alan Friedman has been a Director since August 21, 2012. He is an attorney and CEO of Rivonia Capital, a Canadian investment firm specializing in public market transactions.

**Exhibit 17. Insider Ownership**

Name	Title / Role	Common Shares	Common Shares % of Total	Options	Warrants
Michael Gorenstein	CEO, President, Chairman	1,284,450	1.1%	1,687,500	8,635,776
William Hilson	CFO	759,643	0.6%	487,500	0
Jason Adler	Director	6,954,092	5.8%	9,842,523	1,283,333
Alan Friedman	Director	213,689	0.2%	120,475	0
Michael Krestell	Director	10,525	0.0%	263,675	992,263
		<b>9,222,399</b>	<b>7.7%</b>	<b>12,401,673</b>	<b>10,911,372</b>

Sources: SEDI, Company Filings, Beacon Securities

## Revenue Model and Forecast

### Exhibit 18. Highlights of Our Model

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Dec-20	Dec-21	
	Q4/F16	Q1/F17	Q2/F17	Q3/F17	Q4/F17	FY2017	Q1/F18	Q2/F18	Q3/F18	Q4/F18	FY2018	Q1/F19	Q2/F19	Q3/F19	Q4/F19	FY2019	Q1/F20	Q2/F20	Q3/F20	Q4/F20	FY2020	FY2021	
<b>Revenue Drivers</b>																							
Production Sold (kg)																							
From Peace	20	140	295	515	670	1,620	770	770	1,145	1,770	4,455	2,770	3,770	4,770	5,770	17,080	5,770	5,770	5,770	5,770	23,080	23,080	
From IITZ	0	10	20	20	20	70	20	20	320	620	980	920	1,520	1,520	1,520	5,480	1,520	1,520	1,520	1,520	6,080	6,080	
From IIR - Cronos' Share	0	0	0	0	0	0	0	0	50	100	150	150	200	250	250	500	250	250	250	250	1,000	1,000	
kg and kg equivalents sold	20	150	315	535	690	1,690	790	790	1,515	2,490	5,585	3,840	5,490	6,540	7,540	23,410	7,540	7,540	7,540	7,540	30,160	30,160	
Realized Price (\$/g)	\$7.75	\$8.00	\$8.25	\$8.50	\$9.00	\$8.61	\$9.50	\$9.75	\$10.00	\$10.00	\$9.89	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00	
<b>Revenue (000's)</b>	<b>\$155</b>	<b>\$1,200</b>	<b>\$2,599</b>	<b>\$4,548</b>	<b>\$6,210</b>	<b>\$14,556</b>	<b>\$7,505</b>	<b>\$7,703</b>	<b>\$15,150</b>	<b>\$24,900</b>	<b>\$55,258</b>	<b>\$38,400</b>	<b>\$54,900</b>	<b>\$65,400</b>	<b>\$75,400</b>	<b>\$234,100</b>	<b>\$75,400</b>	<b>\$75,400</b>	<b>\$75,400</b>	<b>\$75,400</b>	<b>\$301,600</b>	<b>\$301,600</b>	
<b>Variable Costs</b>																							
Adjusted COGS (\$/g)	\$3.50	\$3.50	\$3.25	\$3.00	\$2.75	\$2.99	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	
Adjusted COGS (000's)	\$70	\$525	\$1,024	\$1,605	\$1,898	\$5,051	\$1,975	\$1,975	\$3,788	\$6,225	\$13,963	\$9,600	\$13,725	\$16,350	\$18,850	\$58,525	\$18,850	\$18,850	\$18,850	\$18,850	\$75,400	\$75,400	
Adjusted Gross Margin	\$85	\$675	\$1,575	\$2,943	\$4,313	\$9,505	\$5,530	\$5,728	\$11,363	\$18,675	\$41,295	\$28,800	\$41,175	\$49,050	\$56,550	\$175,575	\$56,550	\$56,550	\$56,550	\$56,550	\$226,200	\$226,200	
<b>Overhead Expenses (000's)</b>																							
Salary & Benefits	\$400	\$600	\$700	\$800	\$900	\$3,000	\$1,200	\$1,200	\$1,500	\$1,500	\$5,400	\$1,380	\$1,380	\$1,725	\$1,725	\$6,210	\$1,587	\$1,587	\$1,984	\$1,984	\$7,142	\$8,213	
Stock Based Compensation	\$150	\$175	\$175	\$175	\$175	\$700	\$200	\$200	\$200	\$200	\$800	\$225	\$225	\$225	\$225	\$900	\$250	\$250	\$250	\$250	\$1,000	\$1,000	
General & Administrative	\$300	\$600	\$1,040	\$1,819	\$2,484	\$5,943	\$3,002	\$3,081	\$6,060	\$9,960	\$22,103	\$15,360	\$21,960	\$26,160	\$30,160	\$93,640	\$30,160	\$30,160	\$30,160	\$30,160	\$120,640	\$105,560	
Interest Expense	\$128	\$128	\$128	\$128	\$128	\$512	\$128	\$128	\$128	\$128	\$512	\$128	\$128	\$128	\$128	\$512	\$128	\$128	\$128	\$128	\$512	\$512	
Depreciation	\$97	\$126	\$135	\$235	\$383	\$880	\$570	\$755	\$757	\$759	\$2,840	\$760	\$762	\$764	\$766	\$3,052	\$767	\$769	\$771	\$773	\$3,080	\$3,108	
<b>Overhead Expenses</b>	<b>\$1,075</b>	<b>\$1,629</b>	<b>\$2,177</b>	<b>\$3,157</b>	<b>\$4,070</b>	<b>\$11,034</b>	<b>\$5,100</b>	<b>\$5,364</b>	<b>\$8,645</b>	<b>\$12,547</b>	<b>\$31,655</b>	<b>\$17,853</b>	<b>\$24,455</b>	<b>\$29,002</b>	<b>\$33,004</b>	<b>\$104,314</b>	<b>\$32,892</b>	<b>\$32,894</b>	<b>\$33,293</b>	<b>\$33,294</b>	<b>\$132,374</b>	<b>\$118,392</b>	
Net Income (000's)	-\$990	-\$954	-\$602	-\$215	\$182	-\$1,590	\$323	\$273	\$2,038	\$4,596	\$7,230	\$8,210	\$12,540	\$15,036	\$17,660	\$53,446	\$17,743	\$17,742	\$17,443	\$17,442	\$70,370	\$80,856	
<b>EPS - Fully Diluted</b>	<b>-\$0.01</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>-\$0.01</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.02</b>	<b>\$0.03</b>	<b>\$0.04</b>	<b>\$0.06</b>	<b>\$0.07</b>	<b>\$0.08</b>	<b>\$0.25</b>	<b>\$0.08</b>	<b>\$0.08</b>	<b>\$0.08</b>	<b>\$0.08</b>	<b>\$0.33</b>	<b>\$0.38</b>	
<b>Adjusted EBITDA (000's)</b>	<b>-\$615</b>	<b>-\$525</b>	<b>-\$165</b>	<b>\$324</b>	<b>\$929</b>	<b>\$562</b>	<b>\$1,328</b>	<b>\$1,447</b>	<b>\$3,803</b>	<b>\$7,215</b>	<b>\$13,792</b>	<b>\$12,060</b>	<b>\$17,835</b>	<b>\$21,165</b>	<b>\$24,665</b>	<b>\$75,725</b>	<b>\$24,803</b>	<b>\$24,803</b>	<b>\$24,406</b>	<b>\$24,406</b>	<b>\$98,419</b>	<b>\$112,427</b>	
<b>Key Operational Data</b>																							
kg sold - Y/Y % Change	-	-	-	-	3350%	-	427%	151%	183%	261%	230%	386%	595%	332%	203%	319%	96%	37%	15%	0%	29%	0%	
Revenue - Y/Y % Change	-	-	-	-	3906%	100%	525%	196%	233%	301%	280%	412%	613%	332%	203%	324%	96%	37%	15%	0%	29%	0%	
Adjusted Gross Margin %	54.8%	56.3%	60.6%	64.7%	69.4%	65.3%	73.7%	74.4%	75.0%	75.0%	74.7%	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%	
EBITDA Margin %	-	-	-	7.1%	15.0%	3.9%	17.7%	18.8%	25.1%	29.0%	25.0%	31.4%	32.5%	32.4%	32.7%	32.3%	32.9%	32.9%	32.4%	32.4%	32.6%	37.3%	
As a Percentage of Revenue																							
Salary & Benefits	258.1%	50.0%	26.9%	17.6%	14.5%	20.6%	16.0%	15.6%	9.9%	6.0%	9.8%	3.6%	2.5%	2.6%	2.3%	2.7%	2.1%	2.1%	2.6%	2.6%	2.4%	2.7%	
General & Administrative	193.5%	50.0%	40.0%	40.0%	40.0%	40.8%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	35.0%	

Source: Company reports, Beacon Securities estimates.

### Expansion At Peace To Be The Single-Largest Driver Of Revenue

### Exhibit 19. Expected Production At Peace

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Dec-20	Dec-21	
	Q4/F16	Q1/F17	Q2/F17	Q3/F17	Q4/F17	FY2017	Q1/F18	Q2/F18	Q3/F18	Q4/F18	FY2018	Q1/F19	Q2/F19	Q3/F19	Q4/F19	FY2019	Q1/F20	Q2/F20	Q3/F20	Q4/F20	FY2020	FY2021	
<b>Peace Production (kg)</b>																							
B1	20	20	20	20	20	80	20	20	20	20	80	20	20	20	20	80	20	20	20	20	80	80	
B2	-	120	275	375	375	1,145	375	375	375	375	1,500	375	375	375	375	1,500	375	375	375	375	1,500	1,500	
B3	-	-	-	120	275	395	375	375	375	375	1,500	375	375	375	375	1,500	375	375	375	375	1,500	1,500	
B4	-	-	-	-	-	-	-	-	375	1,000	1,375	2,000	3,000	4,000	5,000	14,000	5,000	5,000	5,000	5,000	20,000	20,000	
Total	20	140	295	515	670	1,620	770	770	1,145	1,770	4,455	2,770	3,770	4,770	5,770	17,080	5,770	5,770	5,770	5,770	23,080	23,080	

Source: Company reports, Beacon Securities estimates.

- Peace currently has three buildings on its 90 acre footprint:
  - B1: The historic building ('the barn') was the first licensed facility by Health Canada, on October 31, 2013 – making Peace the first non-incumbent license granted under the MMPR (Prairie Plant Systems was the only government authorized source previously). Given its small size, we estimate that Peace will be able to produce 20 kg of marijuana from B1 every quarter going forward. The company subsequently erected two buildings (B2 and B3) which are 15K sq. ft. each.
  - B2: Plants have already been growing in B2 for some time and we expect them to be harvested in the near-term. We are

modelling B2 production to start contributing to sales in Q1/FY17, and hit its full 1,500 kg run rate in Q3/FY17.

- B3: We believe B3 is identical to B2, except that it is approximately six months behind in terms of licensing and production. We are modelling production from B3 to start contributing to Q3/FY17 results and for it to hit its annual run rate of 1,500 kg in Q1/FY18.
- B4: Our model incorporates the construction of B4 – a ~200K sq. ft. indoor facility with an all-in cost to Cronos of \$65MM. We expect the company will start generating revenue from the production of this facility in Q3/FY18 and that it will ramp up to an annual run rate of 20,000 kg by Q4/FY19.
- Accordingly, by Q4/FY19 we expect Peace to be producing just over 23,000 kg of marijuana annually. Our model does not factor in any subsequent development of the expansive Peace property.

### ITZ Expansion Expected Concurrently

#### Exhibit 20. Expected Production At ITZ

ITZ Production (kg)	Dec-16 Q4/F16	Mar-17 Q1/F17	Jun-17 Q2/F17	Sep-17 Q3/F17	Dec-17 Q4/F17	Dec-17 FY2017	Mar-18 Q1/F18	Jun-18 Q2/F18	Sep-18 Q3/F18	Dec-18 Q4/F18	Dec-18 FY2018	Mar-19 Q1/F19	Jun-19 Q2/F19	Sep-19 Q3/F19	Dec-19 Q4/F19	Dec-19 FY2019	Mar-20 Q1/F20	Jun-20 Q2/F20	Sep-20 Q3/F20	Dec-20 Q4/F20	Dec-20 FY2020	Dec-21 FY2021
B1	-	10	20	20	20	70	20	20	20	20	80	20	20	20	20	80	20	20	20	20	80	80
B2	-	-	-	-	-	-	-	-	300	600	900	900	1,500	1,500	1,500	5,400	1,500	1,500	1,500	1,500	6,000	6,000
Total	-	10	20	20	20	70	20	20	320	620	980	920	1,520	1,520	1,520	5,480	1,520	1,520	1,520	1,520	6,080	6,080

Source: Company reports, Beacon Securities estimates.

- ITZ's initial building (B1) can similarly be considered a pilot facility. With ITZ having just received sales authorization last month, we expect it to produce 10 kg of marijuana in Q1/FY17, and 20 kg a quarter thereafter.
- We expect that Cronos will undergo construction at ITZ essentially concurrently with Peace's B4 (i.e., breaking ground before the end of 2017). We are modelling this to be a 100K sq. ft. greenhouse with an all-in cost of \$12.5MM. We expect revenue from production at B2 to commence in Q3/FY18 and hit its full stride of 6,000 kg annually by Q2/FY19. We are not modelling any expansions at ITZ beyond B2, and IR below.

#### IR Production To Be Capex-Free

- We are forecasting IR to erect its first facility on ITZ's land and be a 30K sq. ft. indoor grow. Recall that under the terms of the JV, the First Nations partners are responsible for construction costs. Accordingly, we have incorporated no capex cost for Cronos. We estimate production from IR to start translating into revenue in Q3/FY18 and hit its 2,000 kg annual run rate by Q3/FY19.

- As Cronos and its partners will be evenly splitting operating income derived by the IR JV, we have elected to allocate half of IR's production to Cronos and have its impact flow through its income statement.
- Following a successful first facility on ITZ, we believe Cronos and its JV partners will look to build multiple facilities on First Nations reserves (with Cronos still receiving half of the operating profit). However, we have not factored any such expansion in our model.

### **Consolidated Production And Expenses**

- We are forecasting consolidated production of 1,690 kg in 2017, rising to 5,585 kg in 2018, 23,410 kg in 2019, and a steady state of 30,160 kg in 2020 and beyond. Accordingly, at 30,160 kg, Cronos' production in Canada only would represent 4.2% of the PBO's midpoint estimate for the Canadian market in 2021. While this is consistent with Cronos' current ~3.5% market share of registered medical patients, given its total acreage, multiple licenses, ability to carry multiple brands, JV relationship with First Nations, and export opportunities, we would not be surprised to see Cronos increase its market share over time.
- We anticipate upward pressure on Cronos' average realized price per gram given: management has just begun to overhaul its pricing strategy at Peace; expectations for higher priced oils to grow share; the ability to offer more premium brands at ITZ; the potential for more inelastic demand from IR's customers should the government decide to cover medical marijuana for First Nations members; and the potential for higher margins in export sales and/or eventually in production in other countries such as Germany. We are modelling the company to receive \$7.75/g in Q4/FY16, with this figure rising to a steady state level of \$10.00 in Q3/FY18.
- Driven by expectations of both higher volumes and higher prices, we are forecasting consolidated revenue of \$14.6MM in 2017, \$55.3MM in 2018, \$234.1MM in 2019 and \$301.6MM in 2020, with revenue holding flat in 2021.
- We foresee downward pressure on Cronos' cost per gram, given economies of scale as the company grows, operational efficiencies learned over the coming quarters and the introduction of lower cost greenhouse growing at ITZ. We are modelling COGS of \$3.50/g in Q4/FY16 and trickling down to a steady state level of \$2.50/g in Q1/FY18.
- Our model incorporates general and administrative expenses (including research and distribution and patient acquisition-related outreach) to represent 40% of revenue from Q2/FY17 through the end of 2020. Given our expectation for no revenue growth beyond 2020, we are modelling this figure to drop to 35% in 2021.
- Ultimately, we are forecasting Cronos to turn EBITDA positive in Q3/FY17 and generate EBITDA of \$13.8MM in 2018, jumping to \$75.7MM in 2019 (concurrent with the large increase in production/revenue), and reach \$98.4MM in 2020 and \$112.4MM in 2021.

## Competitive Landscape

- As of August 1, 2016, Health Canada has received 1,561 applications to become an LP. 801 (51%) of these were incomplete and have been returned. A further 54 (3%) of them have been withdrawn.
- While 419 applications were still in progress, the track record of applicants successfully making it to the end is weak. Even ignoring the hundreds of applications which were returned or withdrawn, **looking at just those that have received an 'up or down' decision, we note that 253 (88%) have been refused while only 12% have been approved. Cronos wholly owns two of these 38 licenses, minority interests in another three of them and options to acquire stakes in two applicants.**
- Cronos is the only company with LPs in multiple provinces. As discussed in our business overview, it is also one of only a few incumbents with a distinct variety of brands (Peace, the medical brand; at least two brands under ITZ, one "super-premium" and one "main-stream" recreational brand; Indigenous Roots, a socially conscious/First Nations incorporated brand – in addition to its stake in Whistler (a 100% organic brand)). With this breadth of branding and marketing efforts in Canada, as well as international opportunities, we believe that Cronos is very well positioned to grow to be one of a handful of giants in this sector.
- We expect companies across the industry will need to significantly increase capacity over the coming few years to meet demand post legalization (PBO is estimating 655 mt by 2018 and 734 mt by 2021 versus industry production of 5.7 mt last quarter). In our view, Cronos' large quantity of land under ownership (over 125 acres) and its plan to aggressively build out its production facilities put the business in a good position to scale up quickly to cater to this expected jump in demand.



## Valuation: What's It Worth?

### Exhibit 21. Market Comparables

Marijuana Comparables												
Company	Ticker	Year End	Last Price	Market Cap. (MM)	Net Cash (MM)	EV (MM)	EV/Sales			EV/EBITDA		
							2017E	2018E	2019E	2017E	2018E	2019E
PharmaCan Capital Corp	MJN.V	DEC	\$2.08	\$255	-\$1	\$255	17.5x	4.6x	1.1x	453.7x	18.5x	3.4x
Other Public Companies												
Canopy Growth Corp	WEED.TO	MAR	\$12.40	\$1,956	\$107	\$1,849	41.3x	15.5x	7.4x	-	-	537.2x
Supreme Pharmaceuticals Inc	SL.CD	JUN	\$1.78	\$291	\$13	\$278	185.3x	10.1x	2.5x	-	106.3x	8.3x
Aphria Inc	APH.V	MAY	\$5.50	\$672	\$141	\$531	25.8x	11.8x	4.5x	118.6x	37.4x	11.3x
OrganiGram Holdings Inc	OIG.V	AUG	\$2.70	\$272	\$62	\$211	16.5x	6.1x	3.1x	90.5x	18.2x	8.7x
Aurora Cannabis Inc.	ACB.V	JUN	\$2.54	\$729	\$88	\$640	19.8x	3.3x	1.7x	48.9x	8.0x	3.7x
<b>Group Average</b>				<b>\$784</b>	<b>\$82</b>	<b>\$702</b>	<b>57.7x</b>	<b>9.4x</b>	<b>3.8x</b>	<b>86.0x</b>	<b>42.5x</b>	<b>113.8x</b>

Marijuana Comparables													
Company	Sales (MM)			Sales Growth		EBITDA (MM)			EBITDA Growth		EBITDA Margin %		
	2017E	2018E	2019E	2018E	2019E	2017E	2018E	2019E	2018E	2019E	2017E	2018E	2019E
PharmaCan Capital Corp	\$14.6	\$55.3	\$234.1	280%	324%	\$0.6	\$13.8	\$75.7	2352%	449.1%	3.9%	25.0%	32.3%
Other Public Companies													
Canopy Growth Corp	\$44.8	\$119.1	\$248.7	166%	109%	-\$7.6	-\$10.2	\$3.4	-	-	-	-	1.4%
Supreme Pharmaceuticals Inc	\$1.5	\$27.5	\$112.5	1736%	309%	-\$3.9	\$2.6	\$33.4	-	1180.3%	-	9.5%	29.7%
Aphria Inc	\$20.6	\$44.8	\$118.5	118%	164%	\$4.5	\$14.2	\$47.1	217%	232.1%	21.8%	31.7%	39.8%
OrganiGram Holdings Inc	\$12.7	\$34.7	\$68.7	172%	98%	\$2.3	\$11.6	\$24.1	397%	108.5%	18.3%	33.3%	35.1%
Aurora Cannabis Inc.	\$32.3	\$192.3	\$379.3	495%	97%	\$13.1	\$80.2	\$173.2	512%	116.0%	40.6%	41.7%	45.7%
<b>Group Average</b>				<b>538%</b>	<b>155%</b>				<b>375%</b>	<b>409%</b>	<b>27%</b>	<b>29%</b>	<b>30%</b>

Note: MJN, WEED, and SL estimates are Beacon Securities'. Estimates for other companies are consensus.

Source: Company reports, Thomson Reuters, Beacon Securities estimates.

- Cronos' shares currently trade at:
  - An EV/FY17E Sales multiple of 17.5x (peers are at 25.9x – excluding Supreme).
  - An EV/FY18E Sales multiple of 4.6x (peers are at 9.4x). Cronos also trades at an EV/FY18E EBITDA multiple of 18.5x (peers are at 21.2x – excluding Supreme). This should approximate the first year post legalization.
- We believe that as Cronos achieves more of a higher profile in the investor community the above valuation discounts will narrow, and potentially turn into premiums. We note that Cronos is expected to have significantly faster revenue growth than its peers.

**Exhibit 22. Justification of Target Price**

Value Of Core Assets - Peace, ITZ, IR					
	Dec-18	Dec-19	Dec-20	Dec-21	
	FY2018	FY2019	FY2020	FY2021	Terminal Value
(000's - expect share prices and share count)					
Revenue	\$55,258	\$234,100	\$301,600	\$301,600	
Adjusted Gross Margin	\$41,295	\$175,575	\$226,200	\$226,200	
EBITDA	\$13,792	\$75,725	\$98,419	\$112,427	
Net Income	\$7,230	\$53,446	\$70,370	\$80,856	
Free Cash Flow	-\$19,249	\$48,348	\$70,450	\$80,963	\$809,634
PV of Free Cash Flow	-\$19,099	\$41,093	\$54,887	\$57,343	\$527,256
Discount Rate	10%				
Total PV of FCF	\$661,480				
Investments		Value	Rationale		
Core investments - Peace, ITZ and IR	\$661,480	DCF above			
Whistler	\$30,771	Dividend growth model			
ABcann	\$6,000	Assumed valuation when public			
Hydrothecary	\$3,000	Assumed valuation when public			
Evergreen	\$600	Amount invested to date			
Canopy	\$107	7,374 shares @ our target price of \$14.50			
Cannmart	\$0				
<b>Investment value</b>	<b>\$701,959</b>				
Cash					
Net cash as at valuation date (Q4/FY17)	\$20,248				
Value of in the money options/warrants	\$11,530	Maturing subsequent to valuation date			
<b>Total cash value</b>	<b>\$31,778</b>				
Shares					
Shares outstanding at valuation date	164,078				
# of shares from in the money options/warrants	48,110	To be issued subsequent to valuation date			
<b>Total shares</b>	<b>212,188</b>				

NAV / Target Price Calculation	
Total investment value	\$701,959
Total cash value	\$31,778
Total asset value	\$733,737
Number of shares outstanding	212,188
<b>Net asset value per share (rounded)</b>	<b>\$3.50</b>
Current share price	\$2.08
<b>Implied return</b>	<b>68%</b>

Source: Thomson Reuters, Company reports, Beacon Securities.

- **We use a sum of the parts approach in determining our target price for Cronos.** The vast majority of the value of the company is represented by its core assets – Peace, ITZ and IR. We value these assets using a DCF. Highlights from our DCF include: achieving **4.2% market share by FY21**; **revenue realized per gram rising to \$10.00** shortly after legalization, and remaining there longer-term; **adjusted cost of goods sold falling to \$2.50 in FY18 and beyond**; a discount rate of 10%; and a zero terminal growth rate post FY21. This approach results in a total value for these assets of \$661MM.
- For Whistler we use the dividend growth model. Whistler paid Cronos a dividend of \$2.154MM in Q2/FY16. We understand Whistler will continue paying dividends. Using a base of \$2.154MM received annually, a long-term growth rate of 3% and a discount rate of 10%, results in Cronos' 21.5% share in Whistler being valued at \$31MM. As a check, we note that this would value all of Whistler at \$143MM.
- We understand ABCann and Hydrothecary are each planning on going public in the near-term. Based on valuation levels we feel the companies may achieve once public, we have allocated \$6MM of value for Cronos' 6% stake in ABCann and \$3MM of value of Cronos' 1.9% stake in Hydrothecary.
- We value Evergreen at the amount Cronos has invested in it to date (~\$600K).
- Via its previous investment in Vert Medical, Cronos currently owns 7,374 shares of Canopy Growth Corp. (this figure could increase by a

further 29,498 shares conditional on Vert achieving certain milestones). We use our target price for Canopy (\$14.50 per share) in our 12 month forward net asset value derivation for Cronos (\$107K).

- We have applied no value to CannMart.
- To these investments we add our estimated net cash as at our valuation date (December 31, 2017 - \$20.2MM) and the amount to be received subsequently by all in the money warrants and options (\$11.5MM). We therefore arrive at a net asset value of \$733.7MM.
- We divide this asset value by our forecast shares outstanding as at December 31, 2017, as well as those to be issued over time from in the money warrants and options (212.2 MM) arriving at our NAV per share (rounded) of \$3.50.

## Potential Catalysts

### Industry-Wide Catalysts

- **Legislation Legalizing Recreational Marijuana To Be Introduced.** The federal government has committed to introduce “legislation on the legalization and strict regulation of marijuana in spring 2017”. While unconfirmed, there is a view among many circles that this could occur on April 20, 2017. We expect the vast majority of the Task Force’s recommendations will be part of this legislation. While we do not have a specific start date for recreational sales (we anticipate could be ~spring 2018) as certain items such as distribution will need to be ironed out by the provinces, in our view, the introduction of legislation by a majority government will cement the fact that ‘legalization is happening’, which will be positively received by investors.

### Company Specific Catalysts

- **Improvement Of / Growth In Peace Naturals.** Since acquiring control, the company has made many operational changes (increased power and growing capacity, optimized production methodologies and facility layout, overhauled retail pricing strategy, established new patient enrollment programs). We look forward to **seeing the start of these benefits with the release of the company’s Q4/FY16 results.**
- **Operational Upside Versus Our Model.** In an effort to be conservative, **we have taken significant haircuts to levels management believes it can achieve**, particularly regarding annual production and cost of goods sold – and assumed higher growth capex. Accordingly, we feel there is strong potential for positive surprises as actual results start to come in.
- **Further Details / Plans Re Indigenous Roots JV.** The partnership will start with Cronos’ JV partners constructing and financing the operation. We look forward to receiving more information regarding the plans for this JV in the near-term.
- **Further Details Regarding International Opportunities/Shipments.**
- **Hydrothecary and ABCann to Go Public.** We understand that Hydrothecary and ABCann are planning to go public in the near-term. We believe this could help crystallize the value of Cronos’ investments in these companies.
- **Achieving a TSX Senior Exchange Listing.**
- **Evergreen and/or CannMart Being Granted Licenses.**

## Key Risks

### Industry Wide Risks

- **Legalization – Political Flip-Flop.** While as described above, political considerations seem to suggest that marijuana legalization in Canada is virtually certain, nothing is 100% in politics. Pressure/reaction from other governments may be a factor in how Canada's government proceeds.
- **Onerous Regulations.** The upcoming regulatory regime may crimp the supply side (requirements for production, taxes raising costs, advertising restrictions inhibiting companies' ability to differentiate/promote their product, regulations in different provinces/municipalities may make it inefficient to scale), or the demand side (make it too difficult/expensive to buy legally sending users back to the black market, warnings on packaging scaring customers from consumption, allowing very restrictive variety on different formats etc.). Justin Trudeau recently stated that "The promise we made around legalizing marijuana was done for two reasons ... that I was very, very clear about: one, to better protect our kids from the easy access they have right now to marijuana; and, two, to remove the criminal elements that were profiting from marijuana ... I don't know how much clearer we can be that **we're not legalizing marijuana to please recreational users** ... I mean, that will be a byproduct. We recognize that that is something that's going to happen when it happens, but it's not happened yet." (emphasis ours)
- **Eventual Oversupply.** While we believe newcomers face an uphill battle (lengthy licensing process, low probability of success, financing requirements, established competitors) Health Canada may issue 'too many licenses' in the longer term which could commoditize the product with supply eventually outstripping demand (putting pressure on prices). That said, Cronos and some others have already begun supplying other countries with medical marijuana. In our view, Canada's regulatory regime will likely represent a gold standard for those looking to move toward legal medicinal/recreational marijuana – which would advantage companies such as Cronos.
- **Banking.** Scotiabank and Royal Bank have indicated that they will not provide accounts to businesses associated with the marijuana industry. While other financial institutions such as Alterna Savings and Credit Union are eager to obtain share in this industry, there remains a risk that companies in this industry experience difficulties interfacing with the financial system.

### Company Specific Risks

- **Crop Failure.** The risk of a crop failure (low quality and/or yields) exists for any producer.
- **Growth And Execution.** Much of the upside we see in Cronos' future financials is contingent upon the company scaling up production at Peace, ITZ and IR. Should the company be unable to secure financing for expansion, or generate the yields/pricing/costs we are expecting (or if it is pushed out in terms of timing), our target price may be revised downward.
- **Reliance on Key Inputs.** The company is heavily reliant on other parties for timely delivery of key inputs at stable prices. These inputs include utilities providing water, heat, and electricity. Any significant interruption in, or price hike of, these inputs in Cronos' areas of operations could have an adverse impact to our target price.
- **Licensing.** Having been the first licensee under the MMPR framework and with over 100 inspections to date, we believe Cronos has a good relationship with Health Canada. While we believe this may provide a competitive advantage on the regulatory front (other LPs/applicants may simply not know what to look for causing delays/problems), there is no guarantee that the company will be able to maintain a positive relationship with Health Canada, renew licenses for its facilities annually, or achieve successful licensing for new properties in the future.

## Initiating Coverage with a Buy Rating and a \$3.50 Target Price

**We are initiating coverage of Cronos with a Buy rating and a \$3.50 target price, representing a projected total return of 68%.** While the medical market is large and growing in its own right, it is pretty clear to us that legalization is coming which will expand the market several-fold overnight. We believe Cronos' new management team has stabilized and revitalized the company and set it on strong footing to be able to pursue expansion across the country and capitalize on unique opportunities such as First Nations and Germany. While the company's shares are at all-time highs, in our view, it remains an under-known and under-appreciated story in the market which provides a great opportunity for investors.

## Appendix A: Consolidated Financials

('000s - except per share and per gram amounts)

	Q4/F16	FY2017	FY2018	FY2019	FY2020	FY2021
<b>Revenue</b>						
Production Sold (kg)	20	1,690	5,585	23,410	30,160	30,160
Price / g	\$7.75	\$8.61	\$9.89	\$10.00	\$10.00	\$10.00
<b>kg * Price (\$000's)</b>	<b>\$155</b>	<b>\$14,556</b>	<b>\$55,258</b>	<b>\$234,100</b>	<b>\$301,600</b>	<b>\$301,600</b>
<b>Total Revenue</b>	<b>\$155</b>	<b>\$14,556</b>	<b>\$55,258</b>	<b>\$234,100</b>	<b>\$301,600</b>	<b>\$301,600</b>
<b>Adjusted Cost of Sales</b>	\$70	\$5,051	\$13,963	\$58,525	\$75,400	\$75,400
<b>Gross margin</b>	<b>\$85</b>	<b>\$9,505</b>	<b>\$41,295</b>	<b>\$175,575</b>	<b>\$226,200</b>	<b>\$226,200</b>
<b>Overhead Expenses</b>						
Salary & Benefits	\$400	\$3,000	\$5,400	\$6,210	\$7,142	\$8,213
Stock Based Compensation	\$150	\$700	\$800	\$900	\$1,000	\$1,000
General & Administrative	\$300	\$5,943	\$22,103	\$93,640	\$120,640	\$105,560
Depreciation	\$97	\$880	\$2,840	\$3,052	\$3,080	\$3,108
<b>Total Overhead Expenses</b>	<b>\$947</b>	<b>\$10,522</b>	<b>\$31,143</b>	<b>\$103,802</b>	<b>\$131,862</b>	<b>\$117,880</b>
<b>Income From Operations</b>	<b>-\$862</b>	<b>-\$1,017</b>	<b>\$10,152</b>	<b>\$71,773</b>	<b>\$94,338</b>	<b>\$108,320</b>
<b>Other Income (Expenses)</b>						
Interest expense	\$128	\$512	\$512	\$512	\$512	\$512
<b>Net Income (Loss) Before Taxes</b>	<b>-\$990</b>	<b>-\$1,529</b>	<b>\$9,640</b>	<b>\$71,261</b>	<b>\$93,826</b>	<b>\$107,808</b>
Deferred Income Tax Recovery (Expense)	-	-\$61	-\$2,410	-\$17,815	-\$23,457	-\$26,952
<b>Net Income</b>	<b>-\$990</b>	<b>-\$1,590</b>	<b>\$7,230</b>	<b>\$53,446</b>	<b>\$70,370</b>	<b>\$80,856</b>
<b>EPS - Basic</b>	<b>-\$0.01</b>	<b>-\$0.01</b>	<b>\$0.04</b>	<b>\$0.31</b>	<b>\$0.41</b>	<b>\$0.41</b>
<b>EPS - Diluted</b>	<b>-\$0.01</b>	<b>-\$0.01</b>	<b>\$0.03</b>	<b>\$0.25</b>	<b>\$0.33</b>	<b>\$0.38</b>
<b>EBITDA</b>	<b>-\$615</b>	<b>\$563</b>	<b>\$13,792</b>	<b>\$75,725</b>	<b>\$98,419</b>	<b>\$112,427</b>

Source: Company reports, Beacon Securities estimates.



**Cronos (PharmaCan Capital Corp.)  
Consolidated Statement of Cash Flows**

(*'000s - except per share amounts*)

	<b>Q4/F16</b>	<b>FY2017</b>	<b>FY2018</b>	<b>FY2019</b>	<b>FY2020</b>	<b>FY2021</b>
<b>Cash Flows From Operating Activities</b>						
Net Loss	-\$990	-\$1,590	\$7,230	\$53,446	\$70,370	\$80,856
Items Not Affecting Cash						
Depreciation and amortization	\$97	\$880	\$2,840	\$3,052	\$3,080	\$3,108
Stock Based Compensation	\$150	\$700	\$800	\$900	\$1,000	\$1,000
Cash Flows From Operating Activities - Before Changes in Non-Cash W/C	-\$743	-\$10	\$10,870	\$57,398	\$74,450	\$84,963
Changes in Non-Cash W/C	-\$3	-\$606	-\$1,869	-\$5,050	-	-
<b>Cash Flows From Operating Activities</b>	<b>-\$746</b>	<b>-\$616</b>	<b>\$9,001</b>	<b>\$52,348</b>	<b>\$74,450</b>	<b>\$84,963</b>
<b>Cash Flows From Investing Activities</b>						
Purchase of PP&E	-\$4,000	-\$4,250	-\$4,000	-\$4,000	-\$4,000	-\$4,000
Expansion	-	-\$55,750	-\$24,250	-	-	-
<b>Cash Flows From Investing Activities</b>	<b>-\$4,000</b>	<b>-\$60,000</b>	<b>-\$28,250</b>	<b>-\$4,000</b>	<b>-\$4,000</b>	<b>-\$4,000</b>
<b>Cash Flows From Financing Activities</b>						
Proceeds from Exercise of Warrants	\$172	\$276	\$525	-	\$2,447	\$7,946
Proceeds from Exercise of Options	\$7	\$966	-	-	-	\$613
Proceeds from Share Subscriptions	-	\$85,000	-	-	-	-
<b>Cash Flows From Financing Activities</b>	<b>\$179</b>	<b>\$86,242</b>	<b>\$525</b>	<b>\$0</b>	<b>\$2,447</b>	<b>\$8,558</b>
Net Cash and Cash Equivalents Inflow (Outflow)	-\$4,567	\$25,626	-\$18,724	\$48,348	\$72,897	\$89,522
Cash and Cash Equivalents, Opening Balance	\$5,779	\$1,212	\$26,838	\$8,114	\$56,462	\$129,359
<b>Cash and Cash Equivalents, Ending Balance</b>	<b>\$1,212</b>	<b>\$26,838</b>	<b>\$8,114</b>	<b>\$56,462</b>	<b>\$129,359</b>	<b>\$218,880</b>

Source: Company reports, Beacon Securities estimates.

**Cronos (PharmaCan Capital Corp.)  
Consolidated Balance Sheet**

('000s - except per share amounts)

	Q4/F16	FY2017	FY2018	FY2019	FY2020	FY2021
<b>Assets</b>						
Current Assets						
Cash	\$1,212	\$26,838	\$8,114	\$56,462	\$129,359	\$218,880
Accounts receivable	\$29	\$29	\$29	\$29	\$29	\$29
Prepaid & Other Receivables	\$198	\$198	\$198	\$198	\$198	\$198
Biological assets	\$1,147	\$1,147	\$1,147	\$1,147	\$1,147	\$1,147
Inventory	\$1,272	\$1,272	\$1,272	\$1,272	\$1,272	\$1,272
Loans Receivables	\$734	\$734	\$734	\$734	\$734	\$734
Other Assets	\$3	\$609	\$2,478	\$7,528	\$7,528	\$7,528
<b>Current Assets</b>	<b>\$4,596</b>	<b>\$30,828</b>	<b>\$13,973</b>	<b>\$67,371</b>	<b>\$140,267</b>	<b>\$229,789</b>
Non-Current Assets						
Equity Accounted Investment (Whistler)	\$2,534	\$2,534	\$2,534	\$2,534	\$2,534	\$2,534
Other Investments	\$1,968	\$1,968	\$1,968	\$1,968	\$1,968	\$1,968
Property, Plant & Equipment	\$16,852	\$75,972	\$101,382	\$102,330	\$103,250	\$104,142
License	\$11,207	\$11,207	\$11,207	\$11,207	\$11,207	\$11,207
Goodwill	\$1,792	\$1,792	\$1,792	\$1,792	\$1,792	\$1,792
Non-Current Assets	\$34,353	\$93,473	\$118,883	\$119,831	\$120,751	\$121,643
<b>Total Assets</b>	<b>\$38,949</b>	<b>\$124,301</b>	<b>\$132,856</b>	<b>\$187,202</b>	<b>\$261,018</b>	<b>\$351,432</b>
<b>Liabilities</b>						
Current Liabilities						
Trade Payables & Other Liabilities	\$1,017	\$1,017	\$1,017	\$1,017	\$1,017	\$1,017
Mortgage Payable	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000
Holdback Payable	\$2,590	\$2,590	\$2,590	\$2,590	\$2,590	\$2,590
<b>Current Liabilities</b>	<b>\$7,607</b>	<b>\$7,607</b>	<b>\$7,607</b>	<b>\$7,607</b>	<b>\$7,607</b>	<b>\$7,607</b>
Non-Current Liabilities						
Deferred Income Tax Liability	\$1,434	\$1,434	\$1,434	\$1,434	\$1,434	\$1,434
Non-Current Liabilities	\$1,434	\$1,434	\$1,434	\$1,434	\$1,434	\$1,434
<b>Total Liabilities</b>	<b>\$9,041</b>	<b>\$9,041</b>	<b>\$9,041</b>	<b>\$9,041</b>	<b>\$9,041</b>	<b>\$9,041</b>
Shareholders' Equity	\$29,908	\$115,260	\$123,815	\$178,160	\$251,977	\$342,391
<b>Total Liabilities and Equity</b>	<b>\$38,949</b>	<b>\$124,301</b>	<b>\$132,856</b>	<b>\$187,202</b>	<b>\$261,018</b>	<b>\$351,432</b>

Source: Company reports, Beacon Securities estimates.

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As at January 31, 2017	#Stocks	Distribution
Buy	70	81.4%
Speculative Buy	8	9.3%
Hold	3	3.5%
Sell	0	0.0%
Under Review	5	5.8%
Tender	0	0.0%
<b>Total</b>	<b>86</b>	<b>100.0%</b>

Buy	Total 12-month return expected to be > 15%
Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
Hold	Total 12-month return is expected to be between 0% and 15%
Sell	Total 12-month return is expected to be negative
Tender	Clients are advised to tender their shares to a takeover bid or similar offer

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