

# ICC Labs Inc.<sup>1,7</sup>

## Speculative Buy

ICC-TSXV

August 31, 2018

Last: **C\$1.69**  
 ▼ Target: **C\$2.75**

### ICC Labs reports Q2/18 results

ICC reported Q2/18 results which came in mostly in line with our expectations. The company is still at the beginning of its development and as such its current revenues are not material relative to long-term expectations. Revenues were \$151k from recreational cannabis sales in Uruguay, down 8% QoQ and below our expectation of \$193k. SG&A was down 27% QoQ to \$734k, leading to adj. EBITDA of negative \$1.2m, better than our estimate of negative \$1.4m.

**Extraction lab slightly delayed.** Construction at the main CBD extraction facility in Uruguay is now expected to be complete by October 2018 (previously July 2018). ICC decided to double the size of the facility to 32,000 sq.ft. to make room for gel encapsulation equipment. Clients are asking for gel caps and ICC decided to accelerate the installation of the equipment, previously scheduled for 2019.

**Temporary lab awaiting authorization.** ICC completed the construction of its temporary lab in Uruguay on 06/18. The Ministry of Health has completed the final inspection and ICC expects to receive authorization to begin extracting CBD shortly.

**Hemp yields above expectations.** During the quarter, the company harvested its first crop of outdoor hemp from its 430 acres at its Canelones and Flores sites. The harvest yielded 138 tonnes of dried hemp flower, or 322kg per acre, slightly ahead of our forecasted 300kg per acre, but below the 176 tonnes the company previously expected to harvest. We estimate this harvest of hemp could generate 3-5 tonnes of CBD extract, with a potential value of \$60-100m at wholesale prices.

**Reducing our forecasts.** We are reducing our FY18 forecasts to reflect the licensing delay in ICC's temporary lab. ICC will need to conduct stabilization testing which could last three months suggesting that first sales of CBD extracts could occur in early 2019. Management indicated that samples don't need to undergo the stabilization testing and will be sent to clients early this fall. This could trigger the conversion of LOIs into definitive agreements, a potential catalyst for ICC.

### Recommendation and valuation

**Reducing our target by \$0.25 to \$2.75 and maintaining our SPECULATIVE BUY.**

ICC has incurred delays in establishing its extraction capacity in Uruguay which may test investors' patience. However, we see two near-term catalysts in Colombia, (1) the receipt of licenses to cultivate psychoactive cannabis in the recently constructed 134,000 sq.ft. greenhouse and (2) the planting of ICC's first hemp crop on 250 acres of land, which could produce 100,000 kg of flower. Our target is based on a DCF using: 1) a discount rate of 15%, 2) two-stage average revenue growth of 13%, EBITDA margin of 40%, and (3) terminal growth of 0%.

What's Changed	Old	New
Rating	SPEC BUY	n.c
Target (C\$)	\$ 3.00	\$2.75
Revenue 2017A (mm)	\$0.2	n.c.
Revenue 2018E (mm)	\$4.9	\$0.9
Revenue 2019E (mm)	\$84.7	\$58.9
EBITDA 2017A (mm)	(\$3.0)	n.c.
EBITDA 2018E (mm)	(\$3.6)	(\$7.0)
EBITDA 2019E (mm)	\$20.8	\$16.0

#### Share Data

Share o/s (mm, basic/f.d.)	138 / 161.7
52-week high/low	2 / 0.72
Market cap (basic, mm)(CAD\$)	\$233.3
Market cap (f.d., mm)	\$210.3
Net cash (mm)	\$7.6
Net cash (f.d., mm)	\$35.8
EV (f.d., mm)	\$174.4
Projected return	62.7%

#### Financial Data

FYE Dec 31	2017A	2018E	2019E
Revenue (mm)	\$0.2	\$0.9	\$58.9
EBITDA (mm)	(\$3.0)	(\$7.0)	\$16.0
EV/EBITDA	nmf	nmf	10.9x
EPS (f.d.)	(\$0.04)	(\$0.12)	\$0.22
P/E	nmf	nmf	5.8x
CFPS	(\$0.16)	\$0.04	(\$0.05)
P/CF	nmf	nmf	nmf
Net cash (mm)	(\$14.8)	(\$15.2)	(\$1.1)
BVPS	0.21	0.50	0.62
P/BV	6.2x	2.6x	2.1x

All figures in US\$ unless otherwise noted

 [Current Chart](#)

 [Previous Research](#)

**Martin Landry, CPA, CA** (514) 288-4016

[mlandry@gmpsecurities.com](mailto:mlandry@gmpsecurities.com)

**Robert Fagan, CFA** (514) 288-2256

[rfagan@gmpsecurities.com](mailto:rfagan@gmpsecurities.com)

**Ryan Macdonell** (514) 288-4022

[rmacdonell@gmpsecurities.com](mailto:rmacdonell@gmpsecurities.com)

**Andrew Partheniou, B.Eng, MBA** (514) 288-2256

[apartheniou@gmpsecurities.com](mailto:apartheniou@gmpsecurities.com)

## Financial statements

Figure 1. ICC's income statement

FYE Dec 31 (US\$)	2015	2016	2017A	Q1/FY18A	Q2/FY18A	Q3/FY18E	Q4/FY18E	2018E	2019E
CBD extract revenues	-	-	-	-	-	-	-	-	56,010,926
Domestic recreational revenues	-	-	218,040	164,126	151,518	248,390	310,488	874,522	2,897,885
<b>Total revenues</b>	-	-	<b>218,040</b>	<b>164,126</b>	<b>151,518</b>	<b>248,390</b>	<b>310,488</b>	<b>874,522</b>	<b>58,908,811</b>
Growth YoY %						69%	337%	301%	6636%
COGS (excluding IFRS adj.)	-	232,534	1,403,509	703,457	639,570	900,000	937,500	3,180,527	25,515,482
<b>Adj. gross margin</b>	-	<b>(232,534)</b>	<b>(1,185,469)</b>	<b>(539,331)</b>	<b>(488,052)</b>	<b>(651,610)</b>	<b>(627,012)</b>	<b>(2,306,005)</b>	<b>33,393,330</b>
Gross margin %			-543.7%	-328.6%	-322.1%	-262.3%	-201.9%	-263.7%	56.7%
Operating expenses	36,748	1,313,508	1,779,148	1,000,322	734,492	1,248,636	1,748,091	4,731,541	17,385,813
% of sales	<i>nmf</i>	<i>nmf</i>	816.0%	609.5%	484.8%	502.7%	563.0%	541.0%	29.5%
<b>Adj. EBITDA</b>	<b>(36,748)</b>	<b>(1,546,042)</b>	<b>(2,964,617)</b>	<b>(1,539,653)</b>	<b>(1,222,544)</b>	<b>(1,900,246)</b>	<b>(2,375,103)</b>	<b>(7,037,546)</b>	<b>16,007,516</b>
Margin %			-1359.7%	-938.1%	-806.9%	-765.0%	-765.0%	-804.7%	27.2%
Stock-based compensation	-	1,942,528	448,968	6,414,386	98,651	400,000	400,000	7,313,037	1,600,000
Depreciation & amortization	-	634,917	1,292,753	445,488	418,450	511,195	646,265	2,021,398	2,919,482
<b>EBIT</b>	<b>(36,748)</b>	<b>(4,123,487)</b>	<b>(4,506,338)</b>	<b>(8,399,527)</b>	<b>(1,739,645)</b>	<b>(2,811,441)</b>	<b>(3,421,368)</b>	<b>(16,371,981)</b>	<b>11,488,034</b>
Financial expenses (income)	2,984	241,826	41,550	397,136	202,166	56,250	112,500	768,052	450,000
<b>EBT</b>	<b>(39,732)</b>	<b>(4,365,313)</b>	<b>(4,547,888)</b>	<b>(8,796,663)</b>	<b>(1,941,811)</b>	<b>(2,867,691)</b>	<b>(3,533,868)</b>	<b>(17,140,033)</b>	<b>11,038,034</b>
Income taxes	-	-	-	-	-	-	-	-	3,980,599
Tax rate (%)	-	-	-	-	-	-	-	-	36.1%
<b>Adj. net income</b>	<b>(39,732)</b>	<b>(4,365,313)</b>	<b>(4,547,888)</b>	<b>(8,796,663)</b>	<b>(1,941,811)</b>	<b>(2,867,691)</b>	<b>(3,533,868)</b>	<b>(17,140,033)</b>	<b>7,057,435</b>
<b>EPS (f.d.)</b>	<b>(\$0.99)</b>	<b>(\$0.07)</b>	<b>(\$0.04)</b>	<b>(\$0.06)</b>	<b>(\$0.01)</b>	<b>(\$0.02)</b>	<b>(\$0.03)</b>	<b>(\$0.12)</b>	<b>\$0.22</b>
Total one-time items (after-tax)	-	(26,130,145)	296,116	14,720,439	1,043,300	32,037,942	8,845,714	56,647,395	12,868,083
Reported net income	(39,732)	(30,495,458)	(4,451,772)	5,923,776	(898,511)	29,170,250	5,311,846	39,507,362	19,925,518
Reported EPS (f.d.)	(\$0.99)	(\$0.53)	(\$0.04)	\$0.04	(\$0.01)	\$0.18	\$0.03	\$0.25	\$0.10
Shares outstanding (f.d.)	40,000	66,184,162	130,935,510	145,641,872	161,746,951	161,746,951	161,746,951	157,720,681	161,746,951

Source: Company reports, GMP Securities

## Disclosures

GMP FirstEnergy is a trade name and division of GMP Securities L.P. (“GMP”), and a trade name of FirstEnergy Capital LLP (together with GMP referred to as “GMP/FirstEnergy”).

The information contained in this report is drawn from sources believed to be reliable but the accuracy or completeness of the information is not guaranteed, nor in providing it does GMP/FirstEnergy assume any responsibility or liability whatsoever. Information on which this report is based is available upon request. This report is not to be construed as a solicitation of an offer to buy or sell any securities. GMP/FirstEnergy and/or affiliated companies or persons may as principal or agent, buy and sell securities mentioned herein, including options, futures or other derivative instruments thereon.

The superscript(s) following the issuer name(s) mentioned in this report refers to the company-specific disclosures below. If there is no such superscript, then none of the disclosures are applicable and/or required.

### Company-Specific Disclosures:

- 1 GMP/FirstEnergy has, within the previous 12 months, provided paid investment banking services or acted as underwriter to the issuer.
- 2 RESERVED
- 3 GMP/FirstEnergy owns 1% or more of this issuer’s securities.
- 4 GMP Securities, LLC (“GMP LLC”), an affiliate of GMP/FirstEnergy, discloses the following in relation to this issuer as required by the Financial Industry Regulatory Authority (“FINRA”) Rule 2241: as applicable.
- 5 The analyst is related to an officer, director or advisory board member of this issuer, but that related individual has no influence in the preparation of this report.
- 6 The analyst has viewed the operations of this issuer and the issuer paid all or a portion of the travel expenses associated with the analyst’s site visit to its operations.
- 7 The analyst has viewed the operations of this issuer.
- 8 The analyst and/or a member of their household has a position in this issuer’s securities.
- 9 A member of the Board of Directors of this issuer is also a member of the Board of Directors of GMP Capital Inc., but that individual had no influence in the preparation of this report.
- 10 The analyst owns this issuer’s securities in a managed account but has no involvement in the investment decisions for that managed account.

Each research analyst and associate research analyst who authored this document and whose name appears herein certifies that:

(1) the recommendations and opinions expressed in the research report accurately reflect their personal views about any and all of the securities or issuers discussed herein that are within their coverage universe; and (2) no part of their compensation was, is or will be, directly or indirectly, related to the provision of specific recommendations or views expressed herein.

GMP/FirstEnergy Analysts are not registered and/or qualified as research analysts with FINRA and may not be associated persons of GMP LLC and therefore may not be subject to FINRA Rule 2241 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account as defined by FINRA but are subject to the applicable regulatory rules as mentioned below.

All relevant disclosures required by regulatory rules (including The Investment Industry Regulatory Organization of Canada, and Financial Conduct Authority), GMP/FirstEnergy’s recommendation statistics and research dissemination policies can be obtained at [www.gmpsecurities.com](http://www.gmpsecurities.com) or by calling GMP’s Compliance Department at 416-367-8600.

GMP/FirstEnergy Analysts are compensated competitively based on several criteria. The Analyst compensation pool is comprised of several revenue sources, including secondary trading commissions, new issue commissions, investment banking fees, and directed payments from institutional clients.

The GMP/FirstEnergy research recommendation structure consists of the following ratings:

**Buy:** A Buy rating reflects 1) bullish conviction on the part of the analyst; and 2) typically a 15% or greater return to target.

**Speculative Buy:** A Speculative Buy rating reflects 1) bullish conviction on the part of the analyst accompanied by a substantially higher than normal risk, including the possibility of a binary outcome; and 2) typically a 30% or greater return to target.

**Hold:** A Hold rating reflects 1) a lack of bullish or bearish conviction on the part of the analyst; and 2) typically a return of 0 to 20%.

**Reduce:** A Reduce rating reflects 1) bearish conviction on the part of the analyst; and 2) typically a 5% or lower return to target.

**Tender:** Clients are advised to tender their shares to a takeover bid or similar offer.

### Country Specific Disclaimers:

**Canada:** GMP is a member of IIROC and a participant of the TSX, TSX Venture and the Montreal Exchange. 145 King Street West, Suite 300 Toronto, Ontario M5H 1J8 Tel: (416) 367-8600.

**UK and Europe:** This material is distributed by FirstEnergy Capital LLP to persons who are eligible counterparties or professional clients. FirstEnergy Capital LLP is authorised and regulated by the Financial Conduct Authority. 85 London Wall, London, EC2M 7AD Tel: +44 (0)20 7448 0200

**Other countries:** circulation of this report may be restricted by laws and regulations in other countries and persons in receipt of this document must satisfy any relevant legal requirements in that country.

© GMP. All rights reserved. Reproduction in whole or in part without permission is prohibited.