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Elixinol Global (EXL)

US Growth Continues

Speculative

Refer to key risks on page 4 and Biotechnology Risk Warning on page 8. Speculative securities may not be suitable for retail clients.

Recommendation

Buy (unchanged)

Price

\$1.68

Valuation

\$2.40 (previously \$2.31)

Risk

Speculative

GICS Sector

Healthcare Equipment and Services

Expected Return

Capital growth	42.9%
Dividend yield	0%
Total expected return	42.9%

Company Data & Ratios

Enterprise value	\$161.2m
Market cap	\$209.2m
Issued capital	124.5m
Free float	37%
Avg. daily val. (52wk)	\$290,000
12 month price range	\$1.235 - \$2.15

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	2.15	1.50	
Absolute (%)	-23.0	10.3	
Rel market (%)	-16.7	17.5	

Absolute Price



SOURCE: IRESS

Strong Revenue Growth Continues

Elixinol continued its encouraging growth in the September quarter recording quarter on quarter revenue growth of 27%. Revenues of \$10.4m were approximately 11% ahead of our forecast. The revenue result is inclusive of a small currency tailwind from the lower A\$. The strong revenue growth was primarily driven by Elixinol US where demand for hemp derived cannabidiol dietary supplements and skincare products continues to grow. The result validates the recent capital raise and has resulted in meaningful upgrades to forecast earnings.

Capital Deployment Under Way

The recent \$40m raise has facilitated several initiatives to underpin future growth. EXL has now completed the acquisition of land adjacent to the new production facility. The land is earmarked for future expansion of the plant. The December quarter will see the company spend a further \$6m on fitout and purchase of capital items for the new facility which is also due for commissioning this quarter.

The major upgrade to the Elixinol website has now been commissioned and is due for completion within weeks. The platform will be multilingual and suitable for the US market and European markets.

FY18 revenues are upgraded by \$4.7m to \$37.8m while EBITDA increases from \$1.8m to \$3.0m. Revenues for FY19 and FY20 are upgraded by 16% and 15% respectively. The resulting upgrades to EPS are modest in quantum, but large in percentage terms as they are off a low base. Nevertheless, EXL is now forecast to be highly profitable in the forecast period. We expect the current sales momentum will continue into the December quarter.

Following the recent capital raise and the upgrades to earnings following this quarterly update, the target price is increased by 4% to \$2.40. We retain our Buy recommendation.

Earnings Forecast

December Year End	FY18e	FY19e	FY20e	FY21e
Revenues	37.8	52.2	72.6	87.8
EBITDA \$m	3.0	8.9	14.2	18.0
NPAT (underlying) \$m	1.4	5.7	9.7	11.8
NPAT (reported) \$m	1.4	5.7	9.7	11.8
EPS underlying (cps)	1.1	4.6	7.8	9.5
EPS growth %	large	302%	70%	22%
PER (x)	na	37	21.7	17.7
FCF yield (%)	-11%	1%	-3%	3%
EV/EBITDA (x)	54	18	11.4	9.0
Dividend (cps)	-	-	-	-
Franking	0%	0%	0%	0%
Yield %	0.0%	0.0%	0.0%	0.0%
ROE %	1.0%	3.9%	6.2%	7.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES. * FY17 RESULTS ARE PRO FORMA

US Market Expansion Continues

Figure 1 - Quarterly Revenue Expansion



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

September quarter revenues of \$10.4m were approximately \$1m ahead of our forecast. Quarter on quarter growth was ~27% inclusive of a small currency tailwind. The result validates the company's recent capital raising as well as underpinning our expectation of ongoing revenue growth.

Elixinol did not provide further analysis of the split between ecommerce, wholesale, private label and bulk sales, however, we understand that all categories experienced growth. There was no read through on margins from the quarterly statement, however, we do not expect any material variance from the gross margin recorded in 2H18.

Direct competitors CWEB and CVSI in the US market are yet to release their September quarterly updates. While both companies are likely to show a higher level of absolute sales for the quarter, the key comparison will be in the relative growth rates. We note that both these competitors have a large retail presence in the US where Elixinol does not. We expect Elixinol is investigating the potential to expand into this channel at some point.

The other key items included in the announcement were as follows:

The JV entity NCHPP harvested its first crop of hemp during the quarter¹. NCHPP is one of the growers for Elixinol with the company also able to access crop from contracted farmers in Colorado as well as in Europe. The security of raw material supply has been a major focus of the company's expansion and the recent capital raise. We are relatively confident the company will have sufficient access to crop to meet demand growth in FY19.

Capital expenditure during the quarter was \$1.5m. This included \$0.4m for land adjacent to the new production facility. The land has been earmarked for further expansion of the production facility, though the timeline for this build is dependent upon demand growth.

The new production facility remains on schedule for completion in the December quarter with the purchase of \$5.9m of capital equipment and fit out planned.

EXL has also commissioned a major upgrade of its ecommerce platform in the US which is expected to be up and running within weeks. This entirely new platform will include major upgrades to functionality and will be multilingual and suitable for markets outside of the US.

¹ Northern Colorado High Plains Producers

Figure 2 - Earnings Revisions

	2018			2019			2020		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Revenues	37.8	33.1	14%	52.2	45.2	16%	72.6	63.0	15%
EBITDA	3.0	1.8	66%	8.9	6.1	46%	14.2	9.0	58%
NPAT - underlying	1.4	0.5	183%	5.7	3.6	58%	9.7	5.7	69%
EPS	1.1	0.5	127%	4.6	3.5	30%	7.8	5.6	38%

SOURCE: BELL POTTER SECURITIES ESTIMATES

The stronger than expected revenue growth in 3Q18 has warranted revenue upgrades in the forecast period. We now anticipate 4Q18 revenues of \$12.5m representing quarter on quarter growth of 20%. We now expect EXL will generate EBITDA of \$3.0m in FY18 being an increase of \$1.2m over our previous estimate.

Based on the forecast run rate for 4Q18, revenues for FY19 will be at least \$50.0m. Our forecast for FY19 remains relatively modest by this measure notwithstanding that it represent 15.5% growth.

The forecast assumes the company will at least maintain the current rates of gross margin at ~65% and an EBITDA margin increasing to approximately 20% by 2020.

Other adjustments to the forecast model include the dilution from the recent capital raise. The recent \$40m placement and rights issue diluted the shares on issue by approximately 21% to ~124m shares on issue.

Following the upgrade to earnings and dilution to the shares on issue, our target price actually increases by 4% to \$2.40 and we retain our Buy rating.

Key Risks

Both Elixinol US and HFA are businesses generating revenues and earnings. We expect the industries in which they operate to experience significant growth. Elixinol Australia is a start-up and carries significantly higher risk in relation to the development of medicines.

Agricultural Risk - The businesses of Elixinol AUS, Elixinol US and HFA are reliant on agricultural products. As such, the businesses are subject to the risks inherent in the agriculture industry. These risks include insects, plant diseases, storm, fire, frost, flood, water availability, water salinity, pests, bird damage and force majeure events. Both broadacre and greenhouse cultivation systems are subject to their own unique inherent risks. Any adverse outcomes in respect of these matters will or may adversely affect the Elixinol Group's activities and operations, financial performance and prospects.

Loss of key relationships - The medicinal cannabis, CBD nutraceutical and hemp food industry are undergoing rapid growth and change, which has resulted in increasing consolidation and formation of strategic relationships. It is expected that this consolidation and strategic partnering will continue. Acquisitions or other consolidating transactions could harm the Elixinol Group in a number of ways. The Elixinol Group may lose strategic relationships if third parties with whom the Elixinol Group has arrangements with are acquired by or enter into relationships with a competitor (which could cause the company to lose access to necessary resources).

Supplier arrangements - The Company has arrangements with a number of key suppliers. In particular, currently, the key grower for Elixinol US is Colorado Cultivars, whilst HFA has a key supply relationship with Tiverton Agriculture. To the extent that Elixinol US, HFA and Elixinol AUS (once it commences operations) cannot secure and retain key suppliers or negotiate binding long form agreements, their respective abilities to maintain consistent production levels may be compromised, which in turn may have a material adverse impact on the financial performance and position of the Elixinol Group.

Funding the company may require additional shareholder funding depending on the progress against the business plan as well as numerous other factors. These include failure to achieve planned revenues, higher than expected costs, capital expenditure requirements or other opportunities for growth including acquisition.

Obtaining licences for importing, cultivating, manufacture and distribution (including export) of medicinal cannabis products. Elixinol Australia's business model is reliant upon the necessary licences and permits issued by the ODC to import products, cultivate cannabis and manufacture medicinal cannabis products. There is no assurance or guarantee that the necessary licences and permits will be granted to Elixinol AUS, or granted on the terms anticipated by Elixinol AUS. Investors should be aware that Elixinol AUS cannot guarantee that any approvals, licences or permits required for its proposed operations will be obtained. A failure to obtain any such approvals, licences or permits will result in Elixinol AUS being unable to establish its business.

Start up Risk - Potential investors should be aware that investing in a start-up enterprise and industry, such as the Company, and in particular, with respect to Elixinol AUS, should be considered highly speculative and involves several significant risks including under capitalisation and obstacles or delays in the implementation of the business model or revenue generation.

Additionally, the future profitability of Elixinol AUS is contingent on patient uptake, the results of further medical research and clinical trials, general economic conditions, the level of competition in the industry and regulatory factors.

Regulatory changes - Each of the operating companies has operations within industries which have recently experienced key regulatory and legislative changes. Whilst this is seen as an opportunity for growth, as with any legislative and regulatory change, there is a natural period of uncertainty whilst regulators, market participants and consumers interpret and respond to the change. These risks are amplified with Elixinol US which is subject to local law enforcement.

Management considers that the businesses of Elixinol US, Elixinol AUS and HFA have complied historically with all applicable industry laws and regulations. Notwithstanding this, given the continuing developments in the relevant laws and regulations, there is a risk that a regulatory body could, in the future, change the retrospective application of these laws which may adversely impact the Elixinol Group.

Clinical Trials – Elixinol intends to run clinical trials both in Australia and the US in the broad field of medicinal cannabis. While the nature of the drugs to be tested is known (broadly), the company has not yet discussed specifics of clinical indications or timing (which is initially dependent upon the granting of certain licences. The clinical trial process is expensive and highly regulated. There is no guarantee of success. Indeed any adverse findings from Elixinol's trials or those conducted by other market participants may have an adverse impact on the company's financial prospects.

This listing of risk areas is not intended to be exhaustive. The prospectus includes several other risk areas, most of which are generic in nature. These include but are not limited to contracts and agreements, counterparty risk, integration risk and US Tax Inversion.

Table 1 - Financial summary

Profit & Loss (A\$m)						Valuation Ratios (A\$m)					
	FY17	FY18e	FY19e	FY20e	FY21e		FY17	FY18e	FY19e	FY20e	FY21e
Year Ending December	Proforma					Reported EPS (cps)	-1.8	1.1	4.6	7.8	9.5
Total Revenues	16.5	37.8	52.2	72.6	87.8	Normalised EPS (cps)	-0.6	1.1	4.6	7.8	9.5
COGS	-6.0	-14.0	-18.5	-25.1	-30.3	EPS grow th (%)	na	large	302%	70%	22%
Gross profit	10.5	23.8	33.7	47.5	57.5	PE(x)	na	na	36.8	21.7	17.7
GP margin	63.7%	63.0%	64.6%	65.5%	65.5%	EV/EBITDA (x)	8060.3	54.0	18.2	11.4	9.0
Operating expenses	(10.5)	(20.8)	(24.8)	(33.4)	(39.6)	EV/EBIT (x)	-658.0	85.5	21.3	12.5	10.3
EBITDA	0.0	3.0	8.9	14.2	18.0	NTA (cps)	23.8	55.0	60.9	70.4	81.3
Depreciation and Amortisation	-0.3	-1.1	-1.3	-1.3	-2.3	P/NTA (x)	7.1	3.1	2.8	2.4	2.1
EBIT	-0.2	1.9	7.6	12.9	15.7	Book Value (cps)	96.3	112.8	117.4	125.1	134.6
EBIT margin	-1.5%	5.0%	14.5%	17.7%	17.9%	Price/Book (x)	1.7	1.5	1.4	1.3	1.2
Pre tax profit	-0.2	1.9	7.6	12.9	15.7	DPS (cps)	0.0	0.0	0.0	0.0	0.0
Tax expense	-0.3	-0.5	-1.9	-3.2	-3.9	Payout ratio %	0%	0%	0%	0%	0%
NPAT- normalised	-0.6	1.4	5.7	9.7	11.8	Dividend Yield %	0%	0%	0%	0%	0%
Amortisation - acquired intangibles	(1.3)	-	-	-	-	Net debt/Equity	0%	0%	0%	0%	0%
Reported NPAT	-1.9	1.4	5.7	9.7	11.8	Net debt/Assets	0%	0%	0%	0%	0%
Cashflow (A\$m)						Gearing	net cash	net cash	net cash	net cash	net cash
Gross cashflow	-0.6	0.4	7.2	11.7	16.1	Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Net interest	0.0	0.0	0.0	0.0	0.0	Interest cover (x)	n/a	n/a	n/a	n/a	n/a
Tax paid	-0.6	-0.5	-1.9	-3.2	-3.9	Division Earnings					
Operating cash flow	-1.2	0.0	5.3	8.5	12.2	FY17	FY18e	FY19e	FY20e	FY21e	
Capital expenditure	-0.5	-11.2	-1.2	-7.0	-2.5	Elixinol US					
Other capitalised intangibles	0.0	0.0	0.0	0.0	0.0	Revenues A\$	13.3	34.0	47.6	65.7	78.8
Free cash flow	-1.6	-11.2	4.1	1.5	9.7	EBITDA	2.5	5.8	11.2	15.7	18.9
Business acquisitions	0.0	0.0	0.0	0.0	0.0	Margin	19%	17%	23%	24%	24%
Proceeds from issuance	20.0	40.0	0.0	0.0	0.0	Elixinol Australia					
Movement in debt	0.0	0.0	0.0	0.0	0.0	Revenues	-	-	-	-	-
Dividends paid	0.0	0.0	0.0	0.0	0.0	EBITDA	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Change in cash held	18.4	28.7	4.1	1.5	9.7	Hemp Foods Australia					
Cash at beginning of period	4.2	18.8	47.6	51.6	53.1	Revenues	3.2	3.8	4.6	6.9	9.0
Cash at year end	18.8	47.6	51.6	53.1	62.8	EBITDA	(0.6)	(1.0)	(0.4)	0.4	2.5
Balance Sheet (A\$m)						Margin	-19%	-26%	-10%	5%	27%
Cash	18.8	47.6	51.6	53.1	62.8	Elixinol Global					
Receivables	1.2	2.8	3.8	5.3	6.5	EBITDA	(1.5)	(1.5)	(1.5)	(1.5)	(3.0)
Inventory	2.5	5.6	7.4	10.0	12.1	Group revenues	16.5	37.8	52.2	72.6	87.8
Other current assets	0.8	0.8	0.8	0.8	0.8	Group EBITDA	0.0	3.0	8.9	14.2	18.0
Property, Plant and Equipment	1.1	11.7	12.1	18.3	19.0	Interim Earnings					
Intangible assets	80.6	80.1	79.6	79.1	78.6	1H18e	2H18e				
Deferred tax assets	0.1	0.1	0.1	0.1	0.1	Revenues	14.9	23.0			
Total assets	105.1	148.6	155.4	166.7	179.9	EBITDA	0.6	2.4			
Trade payables	1.1	3.5	4.6	6.3	7.6	D&A	(0.4)	(0.7)			
Debt	0.3	0.3	0.3	0.3	0.3	EBIT	0.4	1.7			
Tax payable	-	-	-	-	-	Tax	(0.3)	(0.4)			
Other liabilities	1.2	1.0	1.0	1.0	1.0	NPAT	0.1	1.3			
Deferred income tax liability	3.2	3.2	3.2	3.2	3.2						
Provisions	0.2	0.2	0.2	0.2	0.2						
Total Liabilities	5.9	8.2	9.3	10.9	12.3						
Net Assets	99.1	140.5	146.2	155.8	167.6						
Share capital	101.8	141.8	141.8	141.8	141.8						
Retained earnings	(2.7)	(1.3)	4.4	14.0	25.8						
Reserves	-	-	-	-	-						
Shareholders Equity	99.1	140.5	146.1	155.8	167.6						

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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Disclosure: Bell Potter Securities acted as Lead manager of the company's 2017 IPO and lead manager of the 2018 \$40m placement and received fees for that service.

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The stocks of biotechnology companies without revenue streams from product sales or ongoing service revenue should always be regarded as speculative in character. Since most biotechnology companies fit this description, the speculative designation also applies to the entire sector. The fact that the intellectual property base of a typical biotechnology company lies in science and not generally regarded as accessible to the layman adds further to the riskiness with which biotechnology investments ought to be regarded. Stocks with 'Speculative' designation are prone to high volatility in share price movements. Clinical and regulatory risks are inherent in biotechnology stocks. Biotechnology developers usually seek US FDA approval for their technology which is a long and arduous three phase process to prove the safety, effectiveness and appropriate application or use of the developed drug, and even after approval a drug can be the subject of an FDA investigation of subsequently discovered possible links between the drug and other un-previously diagnosed diseases. Investors are advised to be cognisant of these risks before buying such a stock including **Elixinol Global** (of which a list of specific risks is highlighted within).

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