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# Elixinol Global (EXL)

## US Revenue Growth

**Speculative**

See key risks on Page 3 and Biotechnology Risk Warning on Page 6. Speculative securities may not be suitable for Retail Clients.

**Recommendation**

**Buy** (Hold)

Price

**\$1.62**

Target (12 months)

**\$2.16** (previously \$2.15)

Risk

**Speculative**

**GICS Sector**

**Healthcare Equipment and Services**

**Expected Return**

Capital growth	<b>33.3%</b>
Dividend yield	<b>0%</b>
Total expected return	<b>33.3%</b>

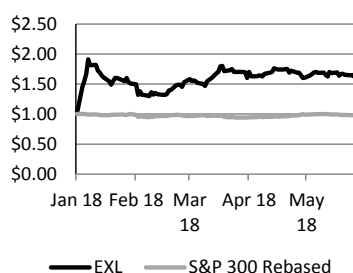
**Company Data & Ratios**

Enterprise value	<b>\$148.5m</b>
Market cap	<b>\$166.7m</b>
Issued capital	<b>102.9m</b>
Free float	<b>24%</b>
Avg. daily val. (52wk)	<b>\$130,000</b>
12 month price range	<b>\$1.235- \$1.995</b>

**Price Performance**

	(1m)	(3m)	(12m)
Price (A\$)	1.69	1.39	
Absolute (%)	-4.14	16.55	

**Absolute Price**



SOURCE: IRESS

### 1Q18 revenue growth likely to continue

Following a period of sustained growth at Elixinol US we have upgraded revenues and earnings in the forecast period to reflect our expectation of continued market expansion and revenue growth from the company.

The company recently reported 1Q18 revenues of \$6.6m, the majority of which was earned from Elixinol US. Quarter on quarter, revenues grew by 24.5%. Based on the revised FY18 forecast which now assumes a more realistic 12% compounding quarterly growth rate, group revenues are likely to increase by ~90% (on a proforma basis) relative to the strong double digit percentage growth achieved in FY2017.

We believe the fundamentals for the CBD nutraceuticals industry continue to strengthen. The FDA is likely to approve the first ever medicinal cannabis product for consumption in the United States later this month. We believe this event will represent an important validation of medicinal cannabis and we expect a flow on effect to sales of over the counter CBD nutraceuticals where the Elixinol brand is a leader in the US market.

Based on our review of pricing on Elixinol's US Website and Hemp Foods Australia, prices for leading products are stable. Elixinol also produces bulk product for other retailers. Both the branded sales and bulk sales continued to grow in 1Q18 hence it is not unreasonable to assume margins should be sustained at close to historical levels depending on the mix of future sales.

### Upgrade recommendation to Buy

FY18 revenues are increased by 19% (\$5.1m) and EBITDA increases by \$1.3m. We now expect Elixinol Global will be modestly profitable in FY18. FY19 and FY20 EPS are largely unchanged. Price target is amended to \$2.16 and we upgrade our recommendation to Buy from Hold.

**Earnings Forecast**

December Year End	FY17*	FY18e	FY19e	FY20e
Revenues	16.5	31.5	43.0	59.9
EBITDA \$m	0.0	1.4	3.7	7.7
NPAT (underlying) \$m	-0.6	0.8	2.1	4.8
NPAT (reported) \$m	-1.9	-0.5	0.8	3.5
EPS underlying (cps)	-0.6	0.8	2.1	4.7
EPS growth %	na	large	159%	128%
PER (x)	na	na	79.8	35.0
FCF yield (%)	-1%	-7%	-1%	-6%
EV/EBITDA (x)	7,580	107	41.0	19.8
Dividend (cps)	-	-	-	-
Franking	0%	0%	0%	0%
Yield %	0.0%	0.0%	0.0%	0.0%
ROE %	0.0%	-0.5%	0.8%	3.4%

SOURCE: BELL POTTER SECURITIES ESTIMATES. \*FY17 revenues and earnings are proforma

# Elixinol revenue set for exciting growth

**Figure 1 - Revenue outlook for FY18 A\$m**

	Proforma 1H17	Proforma 2H17	Proforma FY17	Actual 1Q18	Forecast 2Q18	Forecast 3Q18	Forecast 4Q18	Forecast FY18
Elixinol US	5.8	7.5	13.3					
HFA*	1.6	1.6	3.2					
Elixinol Australia	-	-	-					
Total	7.4	9.1	16.5	6.6	7.4	8.3	9.3	31.5
Q on Q growth				25%	12%	12%	12%	

\* estimates for half year

SOURCE: BELL POTTER SECURITIES ESTIMATES

We expect the revenue growth experienced in 1Q18 has continued in the current quarter. The revenue run rate established in 1Q18 suggests revenues should increase by 90% in 1H18. (1H18 \$14.0m vs \$7.4m). Based on our assumptions as outlined above, FY18 revenues are forecast to increase by ~90% over pro forma FY17.

Industry data strongly suggests the market for Hemp products in the US continues to expand. Data from The Hemp Business Journal indicates total US Hemp Based Product sales were US\$820m in 2017 with a growth rate of 17%.

The largest subcategory is Hemp CBD products at 23% of the total. Sales of Hemp CBD were ~US\$190m in FY17 relative to ~US\$130m in FY16, representing a growth rate of 46%.

Based on these estimates and Elixinol's FY17 revenues, we estimate Elixinol US had ~5.4% market share of the US market for CBD products in 2017.

## INDUSTRY GROWTH CONTINUES

The Hemp Business Journal estimates the Hemp Products category may be worth US\$2.5bn by 2022 inclusive of Hemp CBD revenues of US\$1.3bn. The data suggests a CAGR for Hemp CBD of 14.3%.

The drivers of industry growth are the combined effects of some relaxation of legal and regulatory barriers in addition to improved consumer education. The legal and regulatory barriers to mainstream commercialisation of hemp CBD products remain in place in most US States. One of the initiatives to accelerate access to these services is the proposed Hemp Farming Act 2018. As yet no voting date has been set for either house of the US Congress.

We believe the FDA's approval of Epidiolex will grab significant media attention over the coming months. This may also become a catalyst for market expansion of CBD products in addition to further generating interest from mainstream pharmaceuticals manufacturers and other buyers looking to enter the market for medicinal cannabis and CBD nutraceuticals.

**Figure 2 - Summary of earnings changes**

	2018			2019			2020		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Revenues	31.5	26.4	19%	43.0	43.0	0.0%	59.9	59.7	0.4%
EBITDA	1.4	0.1	1311%	3.7	3.7	0.0%	7.7	7.7	-0.5%
NPAT - underlying	0.8	-0.1	large	2.1	2.1	1.4%	4.8	4.8	1.0%
EPS	0.8	-0.1	large	2.1	2.0	3.4%	4.7	4.7	0.2%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Forecast revenues in FY18 are increased by \$5.1m with NPAT growing by \$0.9m. There are no significant revenue changes or earnings changes in FY19 or FY20. Target price is amended to \$2.16 and we upgrade our recommendation to Buy from Hold.

# Elixinol Global

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.

## KEY RISKS

**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**

<b>Profit &amp; Loss (A\$m)</b>						<b>Valuation Ratios (A\$m)</b>					
	FY17	FY18e	FY19e	FY20e	FY21e	FY17	FY18e	FY19e	FY20e	FY21e	
<b>Year Ending December</b>	Proforma					Reported EPS (cps)	-1.8	-0.5	0.8	3.4	5.9
<b>Total Revenues</b>	16.5	31.5	43.0	59.9	72.6	Normalised EPS (cps)	-0.6	0.8	2.1	4.7	7.2
<b>COGS</b>	-6.0	-11.8	-15.3	-20.6	-25.0	EPS growth (%)	na	large	159%	128%	52%
<b>Gross profit</b>	10.5	19.7	27.7	39.3	47.6	<b>PE(x)</b>	<b>na</b>	<b>na</b>	<b>79.8</b>	<b>35.0</b>	<b>23.0</b>
<b>GP margin</b>	63.7%	62.6%	64.5%	65.6%	65.6%	<b>EV/EBITDA (x)</b>	7579.7	107.5	41.0	19.8	13.4
Operating expenses	(10.5)	(18.3)	(24.0)	(31.6)	(36.3)	<b>EV/EBIT (x)</b>	-618.8	138.4	53.4	23.5	15.4
<b>EBITDA</b>	<b>0.0</b>	<b>1.4</b>	<b>3.7</b>	<b>7.7</b>	<b>11.3</b>	NTA (cps)	23.8	25.8	28.6	34.4	42.5
Depreciation and Amortisation	-0.3	-0.3	-0.9	-1.2	-1.5	P/NTA (x)	6.9	6.4	5.8	4.8	3.9
<b>EBIT</b>	-0.2	1.1	2.8	6.5	9.9	Book Value (cps)	96.3	95.8	96.6	100.1	106.0
<b>EBIT margin</b>	-1.5%	3.5%	6.6%	10.8%	13.6%	Price/Book (x)	1.7	1.7	1.7	1.6	1.6
Pre tax profit	-0.2	1.1	2.8	6.5	9.9	DPS (cps)	0.0	0.0	0.0	0.0	0.0
Tax expense	-0.3	-0.3	-0.7	-1.6	-2.5	Payout ratio %	0%	0%	0%	0%	0%
<b>NPAT - normalised</b>	<b>-0.6</b>	<b>0.8</b>	<b>2.1</b>	<b>4.8</b>	<b>7.4</b>	Dividend Yield %	0%	0%	0%	0%	0%
Amortisation - acquired intangibles	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)	Net debt/Equity	0%	0%	0%	0%	0%
<b>Reported NPAT</b>	<b>-1.9</b>	<b>-0.5</b>	<b>0.8</b>	<b>3.5</b>	<b>6.1</b>	Net debt/Assets	0%	0%	0%	0%	0%
<b>Cashflow (A\$m)</b>						Gearing	net cash	net cash	net cash	net cash	net cash
Gross cashflow	-0.6	-0.7	2.2	5.4	9.6	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	-0.3	-0.7	-1.6	-2.5	<b>Division Earnings</b>					
<b>Operating cash flow</b>	<b>-1.2</b>	<b>-1.0</b>	<b>1.5</b>	<b>3.8</b>	<b>7.1</b>	<b>FY17</b>	<b>FY18e</b>	<b>FY19e</b>	<b>FY20e</b>	<b>FY21e</b>	
Capital expenditure	-0.5	-5.2	-1.2	-7.0	-2.5	<b>Elixinol US</b>					
Other capitalised intangibles	0.0	0.0	0.0	0.0	0.0	Revenues A\$	13.3	27.7	38.4	53.0	63.6
<b>Free cash flow</b>	<b>-1.6</b>	<b>-6.2</b>	<b>0.3</b>	<b>-3.2</b>	<b>4.6</b>	EBITDA	2.5	4.3	6.0	9.2	12.2
Business acquisitions	0.0	0.0	0.0	0.0	0.0	Margin	19%	15%	16%	17%	19%
Proceeds from issuance	20.0	0.0	0.0	0.0	0.0	<b>Elixinol Australia</b>					
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)
<b>Change in cash held</b>	<b>18.4</b>	<b>(6.2)</b>	<b>0.3</b>	<b>(3.2)</b>	<b>4.6</b>	<b>Hemp Foods Australia</b>					
Cash at beginning of period	4.2	18.8	12.7	13.0	9.8	Revenues	3.2	3.8	4.6	6.9	9.0
<b>Cash at year end</b>	<b>18.8</b>	<b>12.7</b>	<b>13.0</b>	<b>9.8</b>	<b>14.4</b>	EBITDA	(0.6)	(1.0)	(0.4)	0.4	2.5
<b>Balance Sheet (A\$m)</b>						Margin	-19%	-26%	-10%	5%	27%
Cash	18.8	12.7	13.0	9.8	14.4	<b>Elixinol Global</b>					
Receivables	1.2	2.3	3.2	4.4	5.3	EBITDA	(1.5)	(1.5)	(1.5)	(1.5)	(3.0)
Inventory	2.5	4.7	6.1	8.3	10.0	<b>Group revenues</b>	<b>16.5</b>	<b>31.5</b>	<b>43.0</b>	<b>59.9</b>	<b>72.6</b>
Other current assets	0.8	0.8	0.8	0.8	0.8	<b>Group EBITDA</b>	<b>0.0</b>	<b>1.4</b>	<b>3.7</b>	<b>7.7</b>	<b>11.3</b>
Property, Plant and Equipment	1.1	5.9	6.3	12.1	13.1	<b>Interim Earnings</b>					
Intangible assets	79.1	77.8	76.5	75.2	73.9	<b>1H18</b>	<b>2H18</b>				
Deferred tax assets	0.1	0.1	0.1	0.1	0.1	Revenues	13.9	17.6			
<b>Total assets</b>	<b>103.6</b>	<b>104.4</b>	<b>105.9</b>	<b>110.6</b>	<b>117.6</b>	EBITDA	0.6	0.8			
Trade payables	1.3	2.5	3.2	4.3	5.3	D&A	-	-			
Debt	0.3	0.3	0.3	0.3	0.3	EBIT	-	-			
Tax payable	-	-	-	-	-	Tax	-	-			
Other liabilities	2.8	2.8	2.8	2.8	2.8	NPAT	-	-			
Deferred income tax liability	-	-	-	-	-						
Provisions	0.2	0.2	0.2	0.2	0.2						
<b>Total Liabilities</b>	<b>4.5</b>	<b>5.7</b>	<b>6.5</b>	<b>7.6</b>	<b>8.5</b>						
<b>Net Assets</b>	<b>99.1</b>	<b>98.6</b>	<b>99.5</b>	<b>103.0</b>	<b>109.1</b>						
Share capital	101.8	101.8	101.8	101.8	101.8						
Retained earnings	(2.7)	(3.2)	(2.4)	1.2	7.3						
Reserves	-	-	-	-	-						
<b>Shareholders Equity</b>	<b>99.1</b>	<b>98.6</b>	<b>99.4</b>	<b>103.0</b>	<b>109.1</b>						

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 2018 IPO and received fees for that service.****Biotechnology Risk Warning:**

The fact that the intellectual property base of a typical biotechnology company lies in science not generally regarded as accessible to the layman adds further to the riskiness with which biotechnology investments ought to be regarded. 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 diseases not previously diagnosed. Furthermore, the Australian exchange listed biotechnology sector is subject to influence by the global biotechnology sector, particularly that in the USA. Consequently, Australian exchange listed biotechnology stocks can experience sharp movements, both upwards and downwards, in both valuations and share prices, as a result of a re-rating of the sector both globally and in the USA, in particular. Investors are advised to be cognisant of these risks before buying such a stock.

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