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Elixinol Global (EXL)

Sector Update

Speculative

Refer to key risks on page 5 and Biotechnology Risk Warning on page 8. Speculative securities may not be suitable for retail clients.

Recommendation

Buy (unchanged)

Price

\$1.93

Valuation

\$2.31 (unchanged)

Risk

Speculative

GICS Sector

Healthcare Equipment and Services

Expected Return

Capital growth	19.7%
Dividend yield	0%
Total expected return	19.7%

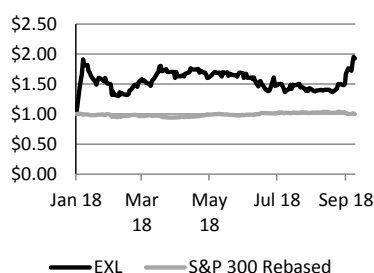
Company Data & Ratios

Enterprise value	\$184.1m
Market cap	\$198.1m
Issued capital	102m
Free float	24%
Avg. daily val. (52wk)	\$185,000
12 month price range	\$1.235 - \$1.995

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	1.39	1.61	
Absolute (%)	38.49	19.94	
Rel market (%)	40.79	18.65	

Absolute Price



SOURCE: IRESS

US Farm Act Update

The US Farm Bill remains an important catalyst for the Hemp CBD sector. Many of the funding mechanisms under the current 2014 Bill will expire on 30 September 2018 and the US Congress is yet to vote on an amalgamated Bill that is capable of being signed into law. Notwithstanding that the Bill may be delayed, it is virtually inevitable that some version of the US Farm Bill will become law. To the best of our knowledge, the areas of resistance remain the provision of the 2018 Bill relating to nutrition assistance (food stamps) rather than the Hemp Farming Act, therefore we remain reasonably certain the Hemp Farming Act will become law – eventually.

Elsewhere, we note the spectacular stock market debut of Charlotte's Web (CWEB.CN) on the Canadian stock exchange. This note summarises the key financial data and valuation metrics of both CWEB and CVSI. Both operate at a greater scale than Elixinol in the US, however, gross profit margins are not dissimilar between all three. We remain confident the market can be expanded beyond current estimates when the US Farm Bill 2018 becomes law.

Both US peers utilise a retail strategy in the US in addition to an ecommerce platform. We note that Elixinol has not committed to a retail strategy at this time and will only do so if the business case provides an adequate return. Our analysis of the gross profit margins of the peers suggests the retail strategy margins are in line with other distribution channels.

We no longer include valuation comparisons to hemp company's operating in Canada. Each of these are distributors of high THC products including for recreational use – quite a different market from the CBD nutraceuticals and dietary supplements markets in which Elixinol operates.

There are no significant changes to forecast earnings. Our valuation remains \$2.31.

Earnings Forecast

December Year End	FY18e	FY19e	FY20e	FY21e
Revenues	33.1	45.2	63.0	76.3
EBITDA \$m	1.8	6.1	9.0	12.1
NPAT (underlying) \$m	0.5	3.6	5.7	7.5
NPAT (reported) \$m	0.5	3.6	5.7	7.5
EPS underlying (cps)	0.5	3.5	5.6	7.3
EPS growth %	large	581%	58%	31%
PER (x)	na	55	34.6	26.4
FCF yield (%)	-5%	1%	-5%	1%
EV/EBITDA (x)	102	30	20.6	15.3
Dividend (cps)	-	-	-	-
Franking	0%	0%	0%	0%
Yield %	0.0%	0.0%	0.0%	0.0%
ROE %	0.5%	3.5%	5.3%	6.5%

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

US Farm Bill – potentially a few days away

Many of the funding mechanisms in the current US Farm Bill (2014) expire in a few days time on 30 September 2018. The final version of the US Farm Bill 2018 remains in Joint Conference Committee. This Committee is responsible for merging two draft bills – the first approved by the US Senate, the second approved by the House of Representatives.

The main area of disagreement is over the Supplemental Nutrition Assistance Program (SNAP) responsible for providing food stamps to more than 41 million Americans. The Democrats want no further changes to work programs for food stamps. Conversely the Republican Party wants to increase the requirements of the work programs. The nutrition component of the US Farm Bill represents ~80% of the overall spending and ten of billions of dollars annually.

Ironically, none of the debate is in relation to the Hemp Farming Act. In the event that terms of the US Farm Bill 2018 are not agreed and brought into law, the US Congress will probably vote to extend the current program (as occurred in 2012 when Congress was similarly unable to agree on the 2014 Farm Bill).

Unfortunately this would mean the Hemp Farming Act would also be delayed. While a delay is unhelpful, ultimately a version of the Farm Bill will be brought into law.

The US Farm Bill represents a major annual funding commitment by the US Government that was first introduced during the great depression. The Bill is broadly aimed at providing stability in the farming sector as well as feeding the under privileged and imposing some environmental protections.

SUMMARY OF PEER PERFORMANCE

In the following table we summarise the 1H18 performance of Elixinol and its listed US peers. We note the recent listing of Charlotte's Web on the CSE where both it and CV Science are now listed. Both companies report earnings in US\$. Stock prices are quoted in C\$.

Figure 1 - Summary of US Peer performance

US\$m	2017 Actual	1H18 Actual	2018e Forecast
Charlottes Web			
Revenues	40	30	75
Growth	172%	87%	88%
EBITDA	14	11	31
CV Science			
Revenues	21	20	52
Growth	86%	162%	151%
EBITDA	-1.2	4.0	13.0
Elixinol			
Revenues	12.8	11.1	23.9
Growth	na	110%	86%
EBITDA	-	0.4	1.3

SOURCE: COMPANY ANNOUNCEMENTS

Charlotte's Web (CWEB.CN) have provided the following guidance:

For the year ended December 2018:

- Revenues US\$65 - \$80m

- Adjusted EBITDA of US\$23m to \$30m

For the year ended December 2019:

- Revenues US\$120 - \$170m
- EBITDA as a percentage of revenues of 35% to 37% (i.e. mid point of US\$52m).

CWEB's current market capitalisation is ~\$1.4bn, hence by conventional multiples valuation methodologies, even on a 2 year outlook basis the multiples are sky high.

CV Science (CVSI.CN) has not provided earnings guidance. The forecast provided in figure 1 above has been prepared by BP based on the company's most recent operating performance and expected growth rates. This forecast is provided for illustrative purposes only and is not intended to be relied upon. We express no opinion on either CV Science or CWEB.

Figure 2 - Valuation comparisons

US\$m	Elixinol	CWEB	CVSI
Enterprise value (estimates)	138.5	1,396.8	448.2
FY18 Revenues	24.0	75.0	52.0
Multiple (x)	5.8	18.6	8.6

SOURCE: BELL POTTER SECURITIES ESTIMATES

Of these three, CWEB is the only company to provide long term revenue guidance. On an FY19 basis, and assuming the company meets the mid-point of the guidance, the EV/revenue multiple reduced to 9.6x.

Elixinol is certainly the best value of these three based on this (crude) valuation metric.

The US market for Hemp Derived CBD products is estimated at ~US\$500m of which these three companies represent 25% collective market share. The remainder of the market is split between a myriad of small unlisted market participants, many of whom have regional markets. We estimate Elixinol has ~4% share. Consultants Brightfield Group estimate the US Hemp Derived CBD market to reach \$US\$1.5bn in revenues by 2021. If achieved the implied CAGR is ~47% over three years.

CWEB completed a private placement on Canadian Stock exchange last month at an issue price of C\$7. The stock is now trading at ~C\$17. While this performance sends a strong signal for the growth of the sector, it also practically guarantees some fast followers and further investment in capacity for the sector. Also we note that despite being based in Colorado, CWEB trades on the Canadian Stock Exchange rather than in US. In the current environment where Hemp remains on Schedule 1 of the Controlled Substances Act, a US listing is most likely considered impractical. This is unlikely to change until the Hemp Farming Act becomes law.

US STRATEGY

As the US market continues to grow rapidly, Elixinol has announced further investment in numerous aspects of its US business including plant expansion, ecommerce upgrades and headcount expansion particularly in key leadership positions.

Both CWEB and CVSI have considerably larger distribution capability in the US relative to Elixinol. While each company has a significant ecommerce presence, both CWEB and CVSI sell through thousands of retail outlets. CWEB for example sell via 2,700 retail locations and expects this number to grow to more than 3,000 by year end. The retail strategy represented 36% of revenues in FY17 i.e. revenues of US\$14.4m.

Elixinol has alluded to optimising existing distribution channels, however, the company's products are not available in retail outlets. The company has left open options to pursue a retail strategy, however, any decision in this regard will depend on margins and earnings. We would not expect the company to pursue a retail strategy unless the return are

adequate. For the moment, the company is intent on boosting its on line presence (which returns the highest margins) while also continuing with the bulk format.

The recent listing of CWEB has provided further insight to its recent earnings.

Figure 3 - Charlotte's Web Earnings

Charlottes Web	2016	1H17	2H17	2017	1H18
31 December Year End					
US\$m					
Revenues	14.7	16.2	23.8	40.0	30.3
Gross profit	9.6	11.6	18.3	29.9	23.7
Margin	65%	72%	77%	75%	78%
EBITDA	2.0	4.9	9.2	14.1	10.7

SOURCE: CWEB COMPANY DATA

The 1H18 GP margin for CV Science was 72%. By comparison, Elixinol's 1H18 margin was 56%. Based on the financial result of peers it is not unreasonable to conclude that their retail gross margins are approximately 70% (i.e. modestly lower than the larger online sales channel). We understand the current retail strategy of the peers is limited to Specialty groups rather than large grocery.

Changes to earnings are not material. We maintain our valuation at \$2.31.

Elixinol Global

The Company operates in the industrial hemp industry in Australia and the United States and intends to operate in the medicinal cannabis sector in Australia. Within the industrial hemp sector, the Company has operations in the nutraceuticals and food products segments, including healthcare products, hemp food products, retail, processing, manufacturing and distribution.

The group consists of the following companies:

Elixinol LLC (Elixinol US) founded in 2014 and manufactures and distributes hemp based nutraceutical, dietary supplements and skincare products, with operations based in Colorado;

Hemp Foods Australia (HFA) – founded in 1999 and manufactures and distributes industrial hemp derived food products in Australia; and

Elixinol Australia – intends to participate in the Australian market for medicinal cannabis. The company is yet to commence operations and its future is dependent upon the granting of multiple licences in this heavily regulated sector.

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	0.5	3.5	5.6	7.3
Total Revenues	16.5	33.1	45.2	63.0	76.3	Normalised EPS (cps)	-0.6	0.5	3.5	5.6	7.3
COGS	-6.0	-12.4	-16.1	-21.7	-26.2	EPS growth (%)	na	large	581%	58%	31%
Gross profit	10.5	20.8	29.2	41.3	50.0	PE(x)	na	na	54.7	34.6	26.4
GP margin	63.7%	62.7%	64.5%	65.5%	65.6%	EV/EBITDA (x)	9230.4	101.9	30.1	20.6	15.3
Operating expenses	(10.5)	(19.0)	(23.0)	(32.3)	(38.0)	EV/EBIT (x)	-753.5	259.7	38.1	24.1	18.4
EBITDA	0.0	1.8	6.1	9.0	12.1	NTA (cps)	23.8	26.5	31.4	38.9	47.8
Depreciation and Amortisation	-0.3	-1.1	-1.3	-1.3	-2.0	P/NTA (x)	8.1	7.3	6.1	5.0	4.0
EBIT	-0.2	0.7	4.8	7.7	10.0	Book Value (cps)	96.3	96.8	100.3	105.9	113.2
EBIT margin	-1.5%	2.1%	10.7%	12.2%	13.2%	Price/Book (x)	2.0	2.0	1.9	1.8	1.7
Pre tax profit	-0.2	0.7	4.8	7.7	10.0	DPS (cps)	0.0	0.0	0.0	0.0	0.0
Tax expense	-0.3	-0.2	-1.2	-1.9	-2.5	Payout ratio %	0%	0%	0%	0%	0%
NPAT - normalised	-0.6	0.5	3.6	5.7	7.5	Dividend Yield %	0%	0%	0%	0%	0%
Amortisation - acquired intangibles	(1.3)	-	-	-	-	Net debt/Equity	0%	0%	0%	0%	0%
Reported NPAT	-1.9	0.5	3.6	5.7	7.5	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	-0.1	4.7	6.8	10.4	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	-0.2	-1.2	-1.9	-2.5	Division Earnings					
Operating cash flow	-1.2	-0.3	3.5	4.9	7.9	FY17	FY18e	FY19e	FY20e	FY21e	
Capital expenditure	-0.5	-5.2	-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	29.3	40.6	56.1	67.3
Free cash flow	-1.6	-5.5	2.3	-2.1	5.4	EBITDA	2.5	4.7	8.4	10.5	13.0
Business acquisitions	0.0	0.0	0.0	0.0	0.0	Margin	19%	16%	21%	19%	19%
Proceeds from issuance	20.0	0.0	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	(5.5)	2.3	(2.1)	5.4	Hemp Foods Australia					
Cash at beginning of period	4.2	18.8	13.3	15.6	13.5	Revenues	3.2	3.8	4.6	6.9	9.0
Cash at year end	18.8	13.3	15.6	13.5	18.9	EBITDA	(0.6)	(1.0)	(0.4)	0.4	2.5
Balance Sheet (A\$m)						Margin	-19%	-26%	-10%	5%	27%
Cash	18.8	13.3	15.6	13.5	18.9	Elixinol Global					
Receivables	1.2	2.4	3.3	4.6	5.6	EBITDA	(1.5)	(1.5)	(1.5)	(1.5)	(3.0)
Inventory	2.5	4.9	6.4	8.7	10.5	Group revenues	16.5	33.1	45.2	63.0	76.3
Other current assets	0.8	0.8	0.8	0.8	0.8	Group EBITDA	0.0	1.8	6.1	9.0	12.1
Property, Plant and Equipment	1.1	5.7	6.1	12.3	13.2	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	18.3			
Total assets	105.1	107.4	111.9	119.1	127.8	EBITDA	0.6	1.2			
Trade payables	1.1	3.1	4.0	5.4	6.6	D&A	(0.4)	(0.7)			
Debt	0.3	0.3	0.3	0.3	0.3	EBIT	0.4	0.5			
Tax payable	-	-	-	-	-	Tax	(0.3)	(0.1)			
Other liabilities	1.2	1.0	1.0	1.0	1.0	NPAT	0.1	0.4			
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	7.7	8.7	10.1	11.2						
Net Assets	99.1	99.6	103.3	109.0	116.5						
Share capital	101.8	101.8	101.8	101.8	101.8						
Retained earnings	(2.7)	(2.2)	1.5	7.2	14.7						
Reserves	-	-	-	-	-						
Shareholders Equity	99.1	99.6	103.3	109.0	116.5						

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 received fees for that service.

Biotechnology Risk Warning:

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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