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Elixinol Global (EXL)

US Revenues Surge

Speculative

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

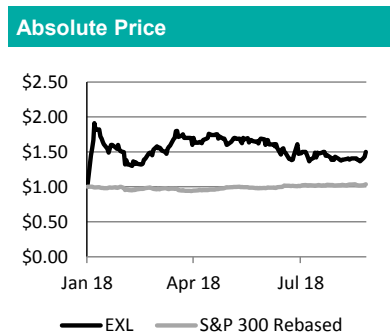
Recommendation
Buy (unchanged)
Price
\$1.50
Valuation
\$2.31 (unchanged)
Risk
Speculative

GICS Sector
Healthcare Equipment and Services

| Expected Return | |
|-----------------------|------------|
| Capital growth | 54% |
| Dividend yield | 0% |
| Total expected return | 54% |

| Company Data & Ratios | |
|------------------------|--------------------------|
| Enterprise value | \$132m |
| Market cap | \$146m |
| Issued capital | 102m |
| Free float | 24% |
| Avg. daily val. (52wk) | \$155,000 |
| 12 month price range | \$1.235 - \$1.995 |

| Price Performance | | | |
|-------------------|------|--------|-------|
| | (1m) | (3m) | (12m) |
| Price (A\$) | 1.45 | 1.67 | |
| Absolute (%) | 3.81 | -10.18 | |
| Rel market (%) | 2.09 | -15.25 | |



SOURCE: IRESS

1H18 Revenues More Than Double

Elixinol revenues more than doubled in 1H18 vs the proforma pcp to \$14.9m allowing the company to report its maiden profit as a combined entity. This was an outstanding result for a small company in the hemp/medicinal cannabis sector. We believe Elixinol is the only profitable operator in the sector in Australia. EXL reported 1H18 EBITDA of \$0.6m and NPAT of \$0.1m. Net cash outflow from operations for the 6 month period was \$1.3m. The cash flow result was driven by a seasonal increase in working capital associated with prepayments for forthcoming crop purchases.

The US based CBD nutraceuticals business was the dominant growth engine. Its revenues grew by 116% to \$12.5m. All four sectors of the US business grew, however, the largest growth was experienced in the lower margin private label business and this resulted in a modest dilution to overall gross profit margins across the group.

Re-investing for Growth

US industry revenues for CBD nutraceuticals and dietary supplements is currently demonstrating double digit annual percentage growth rates and the Elixinol brand is one of the top three or four national brands in the market. The broader market remains highly fragmented with numerous small brands operating in various regions of the US. In order to maximise the long term opportunity in this still early stage industry, Elixinol continues to re-invest significant capital that will allow the business to grow in a sustainable, controlled and profitable manner. This has involved long term plans and financial commitments for securing access to high quality raw material inputs, expansion of the US production facility, upgrades to enterprise level finance systems and other back office assets as well as key hires to lead the US business.

Maintain Buy Rating, Valuation \$2.31

There are no material changes to earnings forecasts. We believe Elixinol remains well positioned for an exciting growth phase over the next three to five years. Valuation remains unchanged at \$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 | 40 | 25.4 | 19.4 |
| FCF yield (%) | -7% | 1% | -6% | 2% |
| EV/EBITDA (x) | 73 | 22 | 14.7 | 11.0 |
| 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 Revenues grow by 116%

We summarise the 1H18 result as follows.

Figure 1 - Elixinol Global 1H18

| \$m | 1H17 | 1H18 | % change | 1H18 | % Diff |
|----------------------|----------|--------|----------|----------|--------|
| | Proforma | Actual | | Forecast | |
| Revenues | 7.1 | 14.9 | 110% | 14.6 | 2% |
| Gross profit | 4.5 | 8.4 | 86% | 8.8 | -4% |
| Margin | 63% | 56% | | 60% | -6% |
| Expenses | 4.6 | 7.8 | 69% | 8.1 | -3% |
| EBITDA | -0.1 | 0.6 | na | 0.7 | -14% |
| NPAT | -0.7 | 0.1 | na | 0.4 | -65% |
| Revenues | | | | | |
| Elixinol US | 5.8 | 12.5 | 116% | | |
| Hemp Foods Australia | 1.3 | 2.3 | 81% | | |
| | 7.1 | 14.9 | 110% | | |

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

US revenue growth was dominated by 278% growth in Private label sales (i.e. white label products). Generally these products are not direct competitors to the direct to consumer products marketed on the Elixinol website.

Direct to consumer grew by 168% - second only to private label sales. Wholesale and Bulk product sales grew by 79% and 36% respectively.

Margin declined as the mix of sales was further skewed to white label product. We expect the mix will remain at about the same level for the remainder of FY18 before direct to consumer sales begin to grow at a faster rate in FY19.

Expenses increased by ~\$3.2m. The company is investing in headcount growth particularly in leadership positions in both the US and for Hemp Foods Australia (HFA). Marketing expenses are also increasing rapidly.

HFA revenues also increased rapidly albeit off a small base. We expect this growth rate will continue into the second half with further new product releases and the introduction of certain products into the FMCG channel.

Elixinol Australia - The company continues to progress its various licence applications with the Office of Drug Control. Progress is unfortunately at glacial pace, notwithstanding EXL's efforts to move things along. There is no time line for the licenses to be granted.

Cash at the end of the period was \$14.2m. Net operating cash burn was a mere \$1.3m. The company invested a combined \$3.6m in the Norther Colorado JV and in new plant. There are no changes to our previous estimates for investing capital cash flows in FY18.

LONG TERM PLANNING INITIATIVES

Since listing in January 2018, Elixinol has spent considerable time and capital planning for long term industry growth. We agree that the forthcoming changes to US Federal laws controlling the cultivation of industrial hemp are likely to transform the industry from its current highly fragmented/cottage industry state to becoming mainstream with major upgrades to capacity, fulfilment and distribution. Maintaining the quality of the brand will be perhaps the # 1 priority in this new environment.

Going forward, in the short term the company is focussed on the growth of its highest margin Direct to consumer business. To facilitate this growth the company has made numerous high calibre hires in marketing, IT and sales in addition to planned upgrades to its ecommerce capability. We expect the headcount growth will be funded from operating cash flows. Elixinol is committed to controlled, sustainable and profitable growth of the business in the US. We expect to see the benefits of these investment over the course of

the next 12 months via revenue growth with margins sustained at current levels, if not slightly higher.

Product pricing in the US has remained stable across the industry over 1H18. Unlike the generic medicines industry, Hemp CBD products are not generic. Each product has unique characteristics that are unavoidable with non pure, plant derived substances. For this reason brand loyalty is thought to continue to remain high and this factor continues to provide pricing support.

Sustainable access to high quality raw material

Northern Colorado High Plains Producers has 173 acres of hemp crop currently under cultivation with the off take exclusively for the use of Elixinol. We understand this crop is by far the largest single hemp crop ever committed to by the company.

The crop will be processed in the company's new GMP certified production facility which is due to be commissioned shortly. The facility has ample capacity to process this crop with nameplate capacity of up to 8,000 kg (17,600 pounds) of CBD extract. This plant which we estimate has ~4x the capacity of the existing facility will guaranteed the company's ability to meet demand growth in the foreseeable future.

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 | 40.3 | 25.4 | 19.4 |
| GP margin | 63.7% | 62.7% | 64.5% | 65.5% | 65.6% | EV/EBITDA (x) | 6606.3 | 73.0 | 21.5 | 14.7 | 11.0 |
| Operating expenses | (10.5) | (19.0) | (23.0) | (32.3) | (38.0) | EV/EBIT (x) | -539.3 | 185.9 | 27.3 | 17.2 | 13.2 |
| 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) | 6.0 | 5.4 | 4.5 | 3.7 | 3.0 |
| 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) | 1.5 | 1.5 | 1.4 | 1.3 | 1.3 |
| 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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