Analyst
John Hester 612 8224 2871

Authorisation
TS Lim 612 8224 2810

Elixinol Global (EXL)

Farm Bill 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
$2.32
Valuation
$3.08 (previously $2.40)
Risk
Speculative

GICS Sector

Healthcare Equipment and Services

Expected Return	
Capital growth	**32.8%**
Dividend yield	**0.0%**
Total expected return	**32.8%**
Company Data & Ratios	
Enterprise value	**$240.9m**
Market cap	**$288.9m**
Issued capital	**124.5m**
Free float	**37%**
Avg. daily val. (52wk)	**$379,000**
12 month price range	**$1.235 - $2.50**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	2.09	1.87	
Absolute (%)	10.0	23.0	
Rel market (%)	12.3	32.2	

Absolute Price

SOURCE: IRESS

Strong Revenue Growth Continues

Last week the 2018 Farm Bill House of Reps/Senate Conference Committee released its conference report which settled the final terms of the 2018 Farm Bill. The Bill has now been approved by both Houses of Congress and is due to go before President Trump for signing within the next few days.

The implications for the Hemp CBD industry are significant. The era of prohibition will end when the Bill is signed as Hemp will be permanently removed from Schedule 1 of the Controlled Substances Act. Hemp will be classified an agricultural product, therefore growers should be able to access crop insurance, water rights, US Department of Agriculture programs and a whole range of additional incentives. Interstate transport of hemp will no longer be illegal.

By implication, all federally regulated services including banking, merchant services and other services including advertising are now likely to begin to become available to the Hemp CBD industry. As we have stated for many months, the legalisation of the cultivation of hemp is a potential game changer of the Hemp CBD industry. This is an important step towards these products becoming available in mainstream retail across the country. Elixinol branded products are only available at this time via the company's ecommerce platform.

The US FDA has not modified its position on safety of Hemp CBD products as either a food or dietary supplement. Nevertheless the market for these products continues to expand rapidly and the cultivation of the crop from which Hemp CBD is derived is about to be legalised. Based on these observations the FDA may reconsider its position. The reality is that the FDA has not taken enforcement action against Hemp CBD products marketed as dietary supplements.

Earnings Upgrades

FY18 EPS is upgrades by 0.3cps. FY19 and FY20 EPS are upgraded by 16% and 9% respectively. Valuation is raised to $3.08 and we retain our Buy recommendation.

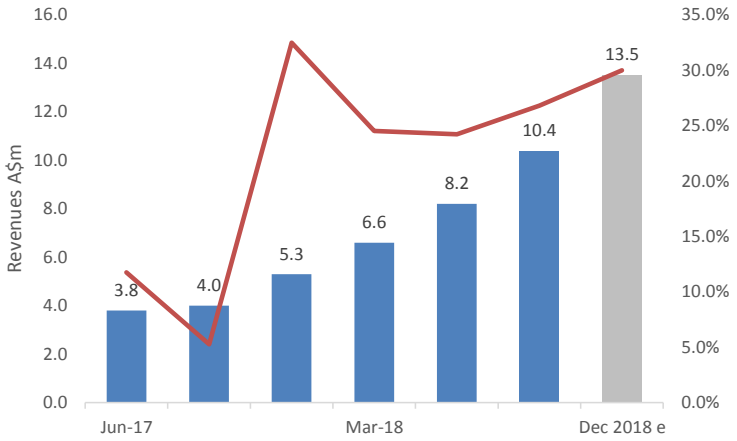
Earnings Forecast

December Year End	FY18e	FY19e	FY20e	FY21e
Revenues	39.8	68.6	95.3	115.0
EBITDA $m	3.5	10.1	15.4	19.5
NPAT (underlying) $m	1.8	6.6	10.6	12.5
NPAT (reported) $m	1.8	6.6	10.6	12.5
EPS underlying (cps)	1.4	5.3	8.5	10.0
EPS growth %	large	270%	60%	18%
PER (x)	na	44	27.3	23.1
FCF yield (%)	-8%	-2%	-2%	3%
EV/EBITDA (x)	69	24	15.6	12.4
Dividend (cps)	-	-	-	-
Franking	0%	0%	0%	0%
Yield %	0.0%	0.0%	0.0%	0.0%
ROE %	1.3%	4.5%	6.7%	7.3%

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

We have upgraded the forecast December quarter revenues by 9% to reflect a continuation of the recent growth trend. Incremental revenues for the quarter (relative to the 3Q18) are $3.1m most of which will be driven out of the US market. The December quarter includes Black Friday sales – one of the largest retail sales days of the year.

IMPLICATIONS FROM 2018 FARM BILL SIGNING

The 2018 Farm Bill is likely to be signed into law over the coming week.

The Bill includes language that officially removes hemp and all of its derivatives from the Controlled Substances Act (CSA). Both marijuana and hemp derive from the plant Cannabis Sativa L and until now, no distinction has been made in the CSA between the two plants. The Bill clearly defines hemp as Cannabis Sativa L plants with a THC level in the flower below 0.3%. Plants with THC in the flower greater than 0.3% are still considered marijuana, and therefore still illegal.

The Bill should remove all ambiguity regarding the cultivation of industrial hemp and the sale of products derived from this crop, paving the way for a more efficient, larger scale Hemp CBD products industry.

The cultivation of industrial hemp will not be unfettered. Under the provisions of the Farm Bill, the Federal Government (via the US Department of Agriculture) and States will share control over hemp cultivation. States will submit their programs for monitoring cultivation to the USDA for approval, effectively giving each state a right to regulate production. Each state will also have right to regulate the sale of Hemp CBD products – effectively mirroring the laws on the sale of alcohol.

FDA POSITION

Another key point is that in most states hemp remains illegal in food and alcohol products. As we understand the States will look to the FDA for guidance on this matter and each state will most likely change the law as required.

According to the FDA's website (which is yet to be updated following the imminent passage of the 2018 Farm Bill) CBD products can't be sold either as a food or a dietary supplement. Manufacturers and distributors of dietary supplements and dietary ingredients are prohibited from marketing products that are adulterated or misbranded. That means these companies are responsible for evaluating the safety and labelling of their products before

marketing to ensure they meet all the requirements of the Dietary Supplement Health and Education Act of 1994 (DSHEA) and FDA regulations.

The Farm Bill clearly differentiates between hemp and cannabis. We speculate that the FDA may use this distinction to review its current position with relation to CBD products. What is clear at the moment is that the FDA has not taken enforcement action regarding CBD products that are marketed as dietary supplements. As it seems there is little or no threat to public health from these products, the likelihood of enforcement action is close to zero.

The removal of hemp from the CSA is the major catalyst for an expansion of the Hemp CBD industry. While the FDA may take some time to determine its position with regards to safety, it is probable that the major national retail groups will be considering plans to introduce these products.

The scale of the revenue opportunity with 2 or 3 national distributors (e.g. Kmart, Walgreens) each with hundreds of stores is highly material. Based on our initial estimates each account may easily drive revenues in excess of US$20m.

In our view Elixinol is well positioned to take full advantage of multiple retail distribution deals. Most importantly the company is not restrained by either capital or supply of product.

- Elixinol has multiple grower partnerships to minimise the risk of a supply shortfall;
- The company's new plant will shortly be commissioned with further production capacity able to be added if required;
- The Elixinol products and brand are well regarded by consumers.

We are yet to include the potential revenues from a large national retailer account(s) in our forecast. We note that both CVSI and CWEB have large retail distribution platforms in the US. These are mainly via specialty retail (health food stores, gyms etc). The gross profit margins in both these businesses are considerably ahead of Elixinol.

Conversely, Elixinol US revenues are dominated by Private Label and Bulk Sales. In 1H18 these two categories represented two-thirds of the US revenue base. As the proportion of direct to consumer increases, margins are expected to improve towards approximately 70% from the current ~63%.

We believe the signing of the Farm Bill will be a significant catalyst for revenue growth. We continue to forecast double digit percentage growth each quarter for the duration of FY19. While the company remains focused on revenue growth, we also expect it will significantly increase its marketing expenditure. The marketing spend of its large peers is considerably higher on a quarterly basis and this translates directly into sales growth.

Figure 2 – 3Q18 Peer Review

US$m 3Q18	CWEB	CVSI	Elixinol (est)
Revenue	17.7	13.6	6.8
Quarter on Quarter growth	13%	11%	27%
Gross profit	13.8	9.9	NR
GP Margin	78.0%	72.8%	NR
SG&A Spend	8.4	6.3	NR
EBITDA	5.4	3.6	NR
Margin	31%	26%	NR

SOURCE: BELL POTTER SECURITIES ESTIMATES

CWEB and CVSI spent US$8.4m and US$6.3m respectively on SG&A in 3Q18, relative to approximately US$2.8m by Elixinol[1]. The revenue estimate for EXL (in figure 2) relates to its US business only. The company reported revenues of A$10.4m for the quarter inclusive of Hemp Foods Australia.

[1] Estimate based on the company's quarterly cash flow statement.

EARNINGS REVISIONS

FY19 revenues are forecast to increase by 72% to $68.6m while operating costs are forecast to increase by 61% to $34m. We envisage EXL will be profitable in FY19 with the share price growth driven by top line sales growth.

The forecast does not include allowances for revenues from any distribution agreement with a large retail group.

Figure 3 - Summary of earnings changes

	2018			2019			2020		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Revenues	39.8	37.8	5%	68.6	52.2	31%	95.3	72.6	31%
EBITDA	3.5	3.0	16%	10.1	8.9	14%	15.4	14.2	9%
NPAT - underlying	1.8	1.4	28%	6.6	5.7	16%	10.6	9.7	9%
EPS	1.4	1.1	31%	5.3	4.6	16%	8.5	7.8	9%

SOURCE: BELL POTTER SECURITIES ESTIMATES

The upgrade to FY18 revenues is partly currency and partly volume. There are no price increases included in our estimates.

The upgrades to FY19 and FY20 are also volume based. We assume pricing is stable. The forecast for FY19 implies quarter on quarter growth of 10% throughout the course of FY19.

Following the upgrade to earnings our valuation is amended to $3.08 and we retain our Buy (Speculative) rating.

PEER VALUATIONS

The peer group includes just two stocks being Charlotte's Web (CN:CWEB) and CV Science (OTC US: CVSI). We exclude the Canadian listed hemp stocks as they do not sell product in the US and deal mainly in the sale of recreational product and dried leaf product including cannabis – generally not available in the US.

CV Science is not listed on the main boards in the US, hence there are no broker forecasts for revenues and earnings, however, the company does report quarterly. The estimates for FY19 in the table below are based on our forecast for 4Q18 extrapolated for FY19. We do not provide research on CVSI and the estimates included here for CVSI are for demonstrative purposes only and should not be relied upon. The estimates for CWEB are extracted from Bloomberg. The FY19 estimates for Elixinol are our own, translated into US$.

Figure 4 - Valuation comparables

US$m	Elixinol	CWEB	CVSI
Enterprise value (Actuals)	172.2	1,180.4	434.5
Revenue forecast FY19	50.1	160.0	100.0
EV/Revenue Multiple (x)	*3.4*	*7.4*	*4.3*
EBITDA Forecast FY19	7.4	24.7	26.0
EV/EBITDA Multiple (x)	*23.3*	*47.8*	*16.7*

SOURCE: BELL POTTER SECURITIES ESTIMATES, BLOOMBERG

Charlotte's Web has provided guidance for FY19 revenues of US$120m - $170m. 3Q18 revenues were US$17.7m. In order to reach the bottom end of the guidance range, CWEB requires compounding revenue growth each quarter of ~16% between now and the end of CY19 relative to the historical compounding growth of ~11% over the last year.

The valuation multiples from EXL remain below CWEB and comparable to CV Science.

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.

Elixinol Global

as at 18 December 2018

Recommendation	Buy, Speculative
Price	$2.32
Valuation	$3.08

Table 1 - Financial summary

Profit & Loss (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Year Ending December	Proforma				
Total Revenues	16.5	39.8	68.6	95.3	115.0
Growth	na	142%	72%	39%	21%
COGS	-6.0	-14.7	-24.2	-33.0	-39.8
Gross profit	10.5	25.1	44.4	62.3	75.2
GP margin	63.7%	63.1%	64.7%	65.4%	65.4%
Operating expenses	(10.5)	(21.6)	(34.2)	(46.8)	(55.7)
EBITDA	**0.0**	**3.5**	**10.1**	**15.4**	**19.5**
Depreciation and Amortisation	-0.3	-1.1	-1.3	-1.3	-2.8
EBIT	-0.2	2.4	8.8	14.1	16.7
EBIT margin	-1.5%	6.0%	12.9%	14.8%	14.5%
Pre tax profit	-0.2	2.4	8.8	14.1	16.7
Tax expense	-0.3	-0.6	-2.2	-3.5	-4.2
NPAT- normalised	-0.6	1.8	6.6	10.6	12.5
Amortisation - acquired intangibles	(1.3)	-	-	-	-
Reported NPAT	-1.9	1.8	6.6	10.6	12.5

Cashflow (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Gross cashflow	-0.6	0.7	6.6	12.2	17.0
Net interest	0.0	0.0	0.0	0.0	0.0
Tax paid	-0.6	-0.6	-2.2	-3.5	-4.2
Operating cash flow	-1.2	0.1	4.4	8.6	12.8
Capital expenditure	-0.5	-11.2	-5.2	-7.0	-2.5
Other capitalised intangibles	0.0	0.0	0.0	0.0	0.0
Free cash flow	-1.6	-11.1	-0.8	1.6	10.3
Business acquistions	0.0	0.0	0.0	0.0	0.0
Proceeds from issuance	20.0	40.0	0.0	0.0	0.0
Movement in debt	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Change in cash held	18.4	28.9	(0.8)	1.6	10.3
Cash at beginning of period	4.2	18.8	47.7	46.9	48.5
Cash at year end	18.8	47.7	46.9	48.5	58.9

Balance Sheet (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Cash	18.8	47.7	46.9	48.5	58.9
Receivables	1.2	2.9	5.0	7.0	8.5
Inventory	2.5	5.9	9.7	13.2	15.9
Other current assets	0.8	0.8	0.8	0.8	0.8
Property, Plant and Equipment	1.1	11.7	16.1	22.3	22.5
Intangible assets	80.6	80.1	79.6	79.1	78.6
Deferred tax assets	0.1	0.1	0.1	0.1	0.1
Total assets	105.1	149.2	158.2	171.0	185.2
Trade payables	1.1	3.7	6.1	8.2	9.9
Debt	0.3	0.3	0.3	0.3	0.3
Tax payable	-	-	-	-	-
Other liabilities	1.2	1.0	1.0	1.0	1.0
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	8.3	10.7	12.9	14.6
Net Assets	99.1	140.8	147.5	158.1	170.6
Share capital	101.8	141.8	141.8	141.8	141.8
Retained earnings	(2.7)	(0.9)	5.7	16.3	28.8
Reserves	-	-	-	-	-
Shareholders Equity	99.1	140.8	147.5	158.1	170.6

Valuation Ratios (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Reported EPS (cps)	-1.8	1.4	5.3	8.5	10.0
Normalised EPS (cps)	-0.6	1.4	5.3	8.5	10.0
EPS growth (%)	na	large	270%	60%	18%
PE(x)	**na**	**na**	**43.6**	**27.3**	**23.1**
EV/EBITDA (x)	12045.1	69.1	23.8	15.6	12.4
EV/EBIT (x)	-983.3	101.0	27.3	17.1	14.5
NTA (cps)	23.8	55.5	63.1	73.8	85.6
P/NTA (x)	9.8	4.2	3.7	3.1	2.7
Book Value (cps)	96.3	113.1	118.4	126.9	137.0
Price/Book (x)	2.4	2.1	2.0	1.8	1.7
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Payout ratio %	0%	0%	0%	0%	0%
Dividend Yield %	0%	0%	0%	0%	0%
Net debt/Equity	0%	0%	0%	0%	0%
Net debt/Assets	0%	0%	0%	0%	0%
Gearing	net cash	net cash	net cash	net cash	net cash
Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Interest cover (x)	n/a	n/a	n/a	n/a	n/a

Division Earnings	FY17	FY18e	FY19e	FY20e	FY21e
Elixinol US					
Revenues A$	13.3	36.0	64.0	88.3	106.0
EBITDA	2.5	6.3	12.4	16.9	20.4
Margin	19%	18%	19%	19%	19%
Elixinol Australia					
Revenues	-	-	-	-	-
EBITDA	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Hemp Foods Australia					
Revenues	3.2	3.8	4.6	6.9	9.0
EBITDA	(0.6)	(1.0)	(0.4)	0.4	2.5
Margin	-19%	-26%	-10%	5%	27%
Elixinol Global					
EBITDA	(1.5)	(1.5)	(1.5)	(1.5)	(3.0)
Group revenues	**16.5**	**39.8**	**68.6**	**95.3**	**115.0**
Group EBITDA	**0.0**	**3.5**	**10.1**	**15.4**	**19.5**

Interim Earnings	1H18e	2H18e
Revenues	14.9	25.0
EBITDA	0.6	2.9
D&A	(0.4)	(0.7)
EBIT	0.4	2.2
Tax	(0.3)	(0.5)
NPAT	0.1	1.6

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.

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
TS Lim	Head of Research	612 8224 2810	tslim
Industrials			
Sam Haddad	Industrials	612 8224 2819	shaddad
John O'Shea	Industrials	613 9235 1633	joshea
Chris Savage	Industrials	612 8224 2835	csavage
Jonathan Snape	Industrials	613 9235 1601	jsnape
John Hester	Healthcare	612 8224 2871	jhester
Tanushree Jain	Healthcare/Biotech	612 8224 2849	tnjain
Financials			
TS Lim	Banks/Regionals	612 8224 2810	tslim
Lafitani Sotiriou	Diversified	613 9235 1668	lsotiriou
Resources			
Peter Arden	Resources	613 9235 1833	parden
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9235 1856	showe
Associates			
James Filius	Analyst	613 9235 1612	jfilius
Alex McLean	Analyst	612 8224 2886	amclean
Damien Williamson	Analyst	613 9235 1958	dwilliamson

Bell Potter Securities Limited
ACN 25 006 390 7721
Level 38, Aurora Place
88 Phillip Street, Sydney 2000
Telephone +61 2 9255 7200
www.bellpotter.com.au