

ALEF - TSX **\$1.11**
Target: **\$3.00**
Proj. Return: **170%**
Valuation: **12x EV/EBITDA**

Share data

Basic shares O/S (mm) 274.8
Fully Diluted (mm) 407.4
Market Cap (\$mm) \$305.0
Enterprise Value (\$mm) \$310.9
Cash (\$mm) \$55.0
Debt (\$mm) \$60.9
Next Reporting Date August

Thomson Chart – One Year



Corporate Profile

Aleafia Health is a vertically integrated cannabis health and wellness company with four primary business units: cannabis cultivation; health & wellness clinics; cannabis education; and retail distribution and provincial supply agreements. The company owns three cannabis product & cultivation facilities in Ontario, two of which are licensed and operational, with the third being in a plant-ready state awaiting final Health Canada licencing. Aleafia Health operates the largest national network of medical cannabis clinics and it maintains a secure medical cannabis dataset with over 10 mm data points.

Upcoming Events

- Q2/19 financial results – August 2019

ALEAFIA HEALTH INC. – BUY

Aleafia Well Positioned For Growth Through 2021

ACTION - Maintain BUY - Target \$3.00

Aleafia Health is well positioned for revenue growth through 2021. The company was recently awarded an amended Health Canada license for its entire outdoor grow operation in Port Perry, Ontario and it has brought its Niagara Greenhouse to a grow-ready state and submitted its evidence package. Aleafia has also positioned itself for “Cannabis 2.0” and it is currently building out 50,000 kg/year of extraction capacity at its processing facility in Paris, Ontario.

DETAILS – Aleafia Positioned For Strong Growth Through 2021

Aleafia closes (June 27) convertible debenture unit financing for total gross proceed of \$40.25 mm. Each convertible debenture unit consisted of one 8.5% unsecured convertible debenture (conversion price \$1.47) and 680 common share purchase warrants (exercise price \$1.55 - 36-months). The company intends to use the majority of the net proceeds to fund working capital and for strategic acquisitions and the balance will be used for general corporate purposes.

Outdoor cultivation license significantly expands company’s production profile: On July 12, Aleafia announced that it had secured a Health Canada licence amendment for the entire 1.1 million ft² Port Perry outdoor cultivation facility: The license immediately increases the company’s licensed and operational outdoor cultivation area from 292,000 ft² to over 1.1 million ft². The company commenced planting of the newly licensed area on July 15 and we forecast that this operation could produce more than 25,000 kg of cannabis per annum.

Aleafia’s 160,000 ft² greenhouse is now at a grow-ready state: Aleafia has brought its Niagara Greenhouse to a grow-ready state and submitted its evidence package to Health Canada, demonstrating that the facility meets all requirements to secure its cultivation licence. We forecast that the company will be awarded a Health Canada cultivation license in Q3/19 and once this facility is fully operational it will add more than 30,000 kg of annual production capacity.

Aleafia positioning itself for Cannabis 2.0: Aleafia’s management believes that derivative products (oils, vape pens, edibles, beverages etc...) will represent at least 50% of legal market demand by early 2020. Extraction capacity will also be critical when edibles and concentrates become legal (Fall 2019) and to better position themselves for this emerging opportunity the company announced that it will add 50,000 kg of extraction capacity at its processing facility in Paris, Ontario. The facility has secured a partial occupancy permit and construction is forecast to be complete in Q3/19.

IMPACT – Maintain BUY And With A \$3.00 Target

We are maintaining our Buy recommendation on Aleafia with a \$3.00 target price. To arrive at our target price, we applied a 12x EV/EBITDA multiple to our 2021 estimate and then discounted the result using a 10% discount rate.

ALEAFIA COMPLETES \$40.25 MM PUBLIC OFFERING OF CONVERTIBLE DEBENTURE UNITS - CASH POSITION STANDS AT APPROXIMATELY \$55 MM

On June 27, Aleafia closed a \$40.25 mm unit offering of convertible debentures. The convertible debentures will have a maturity date of three years from the closing date of the offering and will bear interest from the date of closing at 8.5% per annum, payable semi-annually on June 30 and December 31 of each year. The convertible debentures will be convertible, at the option of the holder, into common shares of the company at any time prior to the close of business on the last business day immediately preceding the maturity date at a conversion price of \$1.47 per common share. The offering also included 680 share purchase warrants for each \$1000 of convertible debentures. These warrants are exercisable at \$1.55 for a period of 36-months. The company intends to use the majority of the net proceeds to fund working capital and for strategic acquisitions and the balance will be used for general corporate purposes.

CULTIVATION UPDATE – NIAGARA GREENHOUSE AND PORT PERRY OUTDOOR CULTIVATION

Niagara Greenhouse Facility: In July 2018, Aleafia completed the acquisition of a 160,000 ft² fully-automated greenhouse in the Niagara region of Ontario for \$9.6 mm. The company began retrofitting the facility in August 2018 and it has nearly completed all required modifications and capital improvements in order to be eligible for license by Health Canada. The retrofit included state-of-art, automated systems including moving container benches which will increase yields, limit costs, reduce risks and allow for a perpetual, year-round harvest. The total aggregate cost to retrofit the facility is approximately \$14.5 mm and once it is fully operational (Q3/19) it will be capable of producing more than 30,000 kg of cannabis per year.

Figure 1 – Niagara Greenhouse Facility



Port Perry – Outdoor Cultivation: In May 2019, Aleafia completed the requisite capital improvements to the company’s 26-acre secure outdoor grow expansion at its Port Perry Facility for a total aggregate cost of approximately \$500,000. On July 12, Aleafia Farms Inc., secured a License Amendment under Health Canada’s Cannabis Regulations authorizing cannabis cultivation for the entirety of the company’s Port Perry Outdoor Grow facility. The licence immediately increased the company’s licensed and operational outdoor cultivation area from 292,000 ft² to over 1.1 million ft². As previously announced (June 10), Aleafia Farms received approval for cultivation in Zone 1 of the outdoor grow facility, and on June 13 it had completed the planting of its large-scale outdoor crop. To minimize the period between regulatory approval and planting, the company leveraged its vertically integrated supply chain across three Ontario cannabis production facilities. The 13,000 starter clones grown specifically for outdoor cultivation were propagated at the company’s Paris indoor and processing facility. The license amendment adds Zones 2, 3 and 4 which encompasses the full 1.1 million ft² cultivation area. Planting the newly licensed area commenced on July 15 and the company utilized approximately 7,000 cannabis plants that were currently growing in pots in Zone 1. It is intended that the cannabis grown at the company’s Outdoor Grow facility will be processed at the company’s Paris Facility, for the extraction and production of high-margin products. We currently forecast that the company’s outdoor operation could produce more than 25,000 kg of cannabis per annum once it is fully scaled up.

Figure 2 – Port Perry – Outdoor Cultivation



Over 6,000 plants growing in Zone 1 of the Port Perry facility. 7,000 additional plants are being planted in the newly licensed Zone 2 area.



The Zone 1 crop was planted on June 13, 2019.

WHOLESALE AGREEMENTS COULD AUGMENT ALEAFIA'S ABILITY TO SOURCE CANNABIS

175,000 kg cannabis supply agreement with Aphria Inc.: In September 2018, Emblem entered into a five-year wholesale supply agreement with Aphria Inc. The agreement will see the company purchase up to an aggregate of 175,000 kg equivalents of cannabis products from Aphria over a five-year term, with the opportunity for five-year renewals. Pursuant to the agreement, Aphria received a non-refundable deposit of \$22.8 million, which is comprised of \$12.8 million in cash, and 6,952,169 of common shares of Emblem. Initial product deliveries were expected to commence in May 2019, with a total of 25,000 kg equivalent deliverable for the balance of the first year of product deliveries.

9,000 kg cannabis supply agreement with Natura Naturals: In July 2018, Emblem announced it had signed a three-year cannabis supply agreement with Natura Naturals to provide Emblem up to 3,000 kilograms of cannabis flower per year at preferred wholesale pricing. Initial product deliveries to Emblem were expected to commence in October 2018 with a total of 750kg deliverable for the balance of 2018. On February 19, Natura Naturals was acquired by Tilray Inc. for approximately \$70 mm and it became a wholly-owned subsidiary of the company.

ALEAFIA POSITIONED FOR CANNABIS 2.0 – COMPANY WILL ADD 50,000 KG OF EXTRACTION CAPACITY AT ITS PARIS, ONTARIO FACILITY

Aleafia will add 50,000 kg of extraction capacity at its Paris, Ontario processing facility: Aleafia's management believes that derivative products (oils, vape pens, edibles, beverages etc...) will represent at least 50% of legal market demand by early 2020. Extraction capacity will also be critical when edibles and concentrates become legal (Fall 2019) and to better position themselves for this emerging opportunity the company announced that it will add 50,000 kg of extraction capacity at the company's processing facility in Paris, Ontario. The expansion is expected to significantly increase the processing, extraction and packaging of high-margin derivative products including oils, capsules, sprays and other future formats under the company's adult-use Symbal and medical Emblem brands. Additionally, the company will offer tolling and white label services to other Licensed Producers looking to leverage the company's extraction and packaging capabilities. Aleafia is currently purchasing the necessary equipment to meet or exceed the 50,000 kg capacity expansion, including milling, decarboxylation, and CO2 extraction and winterization machinery. The company believes that the 30,000 sq. ft. building expansion will provide significantly more space than is necessary to operate the new cannabis production lines. The facility is expected to be completed in Q3/19. To date the company has spent \$11.5 mm on the expansion with approximately \$10.5 mm remaining. Commencement of operations at the Paris facility remain subject to the receipt of Health Canada licensing, and receipt of municipal licensing.

INTERNATIONAL EXPANSION – GERMANY AND AUSTRALIA

Germany: On May 6, Aleafia announced that it had entered the German medical cannabis market via its joint venture with German pharmaceutical wholesaler Acnos Pharma GmbH. Acnos is an Aachen & Berlin-based pharmaceutical wholesaler and distribution logistics company which specializes in branded prescription pharmaceuticals, controlled drugs, and clinical trial supply. Through its extensive German network, they have access to 110 distribution centres and 20,000 pharmacies, along with extensive distribution channels across Europe. The JV entity will purchase Aleafia Health branded cannabis oils for distribution to German pharmacies and for clinical trial usage. Aleafia Health's wholly owned subsidiary Emblem Cannabis Corp. is the majority shareholder of the JV with 60% ownership with Acnos owning the remaining 40%. The first phase of orders will meet or exceed 22,500 30mL and 60 mL bottles, with a significant ramp-up in supply expected in subsequent quarters. Both parties will provide initial funding to the JV in the amount of €700,000, proportionate to their respective ownership stakes. Oils exported and sold to the JV will be grown and produced by Aleafia Health. Extraction and packaging will occur in the Phase II expansion of its Paris Facility, which includes a 5,000 sq. ft. laboratory designed and being built to Good Manufacturing Practices standards, a requirement for pharmaceutical products to be sold in the European Union market. Market advantages in Germany include significantly higher margins compared to the Canadian market and reimbursement of patient purchasing costs through private and public health insurance, which is almost entirely non-existent in North America.

Australia: Aleafia makes strategic investment in Australian LP CannaPacific Pty. Limited and secures Health Canada permits to export cannabis products to Australia:

- On January 18, Aleafia closed its previously announced investment in CannaPacific Pty. Limited. CannaPacific is licensed by the Office of Drug Control of Australia to cultivate medical cannabis and to research medical cannabis. CannaPacific has also applied for a manufacturer's license which has been reviewed by the ODC. Under the terms of the investment agreement, Aleafia acquired 10% of the ordinary shares of CannaPacific from the founder for A\$100 and agreed to contribute to CannaPacific US\$150,000 in working capital in two tranches of US\$75,000 over a six month period.
- On April 11, Aleafia announced that it had invested an additional A\$540,000 in ordinary shares of CannaPacific in connection with CannaPacific's A\$4.5 mm capital financing. The strategic investment immediately follows the closing of CannaPacific's acquisition of a 108,000 ft² greenhouse located in the Byron Bay region of New South Wales, Australia. The greenhouse facility will be used for cannabis cultivation grown for eventual sale to medical patients and global export. Aleafia will assist

CannaPacific in the establishment of dedicated medical cannabis clinics, with shared expertise across patient treatment and education, physician recruitment and training, treatment best practices and clinic operations.

- On July 2, Aleafia announced that it received multiple Export Permits from Health Canada, which allows the company to begin its first international cannabis product shipment. The permits allow specifically for the export of the company's branded medical cannabis oils, including drops and sprays. The company expects to ship its branded medical cannabis oils in Q3/19 and they will be distributed by its Australian partner - CannaPacific.

FINANCIAL FORECAST

We are making adjustments to our financial forecasts through 2021 to take into account the company's \$40.25 mm convertible unit financing and updated discussions with management. Our new estimates are outlined below:

Figure 3: Financial Forecast

YE December 31	2018	2019E	2020E	2021E
Revenue	\$3,330	\$16,383	\$156,548	\$300,024
EBITDA	(\$8,509)	(\$36,049)	\$31,477	\$94,440
EBITDA margin	-255.5%	-220.0%	20.1%	31.5%
Net income	(\$18,533)	(\$55,022)	\$7,080	\$50,071
Net margin	-556.5%	-335.8%	4.5%	16.7%
EPS f.d.	(\$0.16)	(\$0.22)	\$0.02	\$0.12

Source: MRCC

POSITIONED FOR GROWTH THROUGH 2021 – MAINTAIN BUY AND WITH A \$3.00 TARGET

We are maintaining our **BUY** recommendation on Aleafia with a \$3.00 target price. To arrive at our \$3.00 price, we applied a 12x EV/EBITDA multiple to our 2021 estimate and then discounted the result using a 10% discount rate.

RISKS TO TARGET

Risks to target include: International treaties, provincial concerns, retail channels and supply/demand

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