OPTO

TRADING INTELLIGENCE

REPORT NO: 01

CMCMARKETS.COM

NEW HIGHS: THE 8 CANNABIS STOCKS TO WATCH

Investors are starting to take notice of cannabis stocks now more than ever. With interest in the sector rapidly growing, we take a closer look at eight companies who are at the forefront of this trend.

Contents

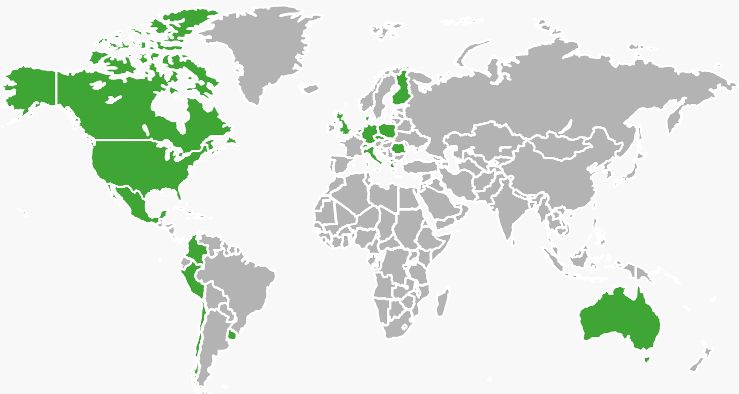
The Story so far

The legal cannabis industry has taken off this year, and with it interest in the sector. California, where the drug is fully legal, is currently home to the biggest cannabis market in the US, and there are plans to legalise the drug elsewhere. Wider legalisation of the drug has been reflected in the markets, and the NASDAQ and NYSE have both accepted the listing of cannabis stocks for the first time this year. With the market showing potential for growth, we take a look at the eight biggest industry players.

More countries than ever are now moving towards the legalisation of cannabis. California, which has legalised medicinal forms of cannabis as well as allowing the drug to be used recreationally, has the biggest marijuana market in the US. Other countries are also opening up to legalisation of the drug. Canada becomes the first G7 nation to legalise the distribution and sale of recreational cannabis in October. Globally, this makes it the second country to introduce such laws, after Uruguay. In the UK, the government has announced plans to allow doctors to prescribe medicines derived from cannabis. The UK will join numerous other countries where medicinal cannabis is legal, including Australia, Chile, Croatia, Finland, Germany, Italy, the Netherlands and Switzerland.

Countries that allow medicinal cannabis

Australia, Canada, Chile, Colombia, Croatia, Cyprus, Czech Republic, Denmark (trials), Finland, Germany, Greece, Israel, Italy, Jamaica, Luxembourg, Macedonia, Mexico, the Netherlands, Peru, Poland, Romania, Switzerland, United Kingdom (pending), Uruguay, United States (at state level).



Given this growing trend of legalisation, the industry is now thought to be worth around $20bn across sales and ancillary business. It's estimated that this figure will have doubled by 2021 according to cannabis research and investment group, ArcView. Geographically, the US is a huge player in the legal cannabis industry, with nearly 90% of global sales in 2017 made in the US. There is also increased potential in European markets. Several European countries have legalised the use of medicinal marijuana, and Germany is now one of the fastest-growing markets for the drug following legalisation in 2017. ArcView and BDS Analytics predict that by 2022, sales in Germany will be worth around $1.6bn, having totalled just $9m last year (a 17,678% increase).

SECTOR CURRENTLY WORTH APPROXIMATELY

$20bn

ACROSS SALES AND ANCILLARY BUSINESSES. BY 2021 THAT FIGURE IS SET TO DOUBLE, ACCORDING TO CANNABIS RESEARCH AND INVESTMENT GROUP ARCVIEW.

THE US IS BY FAR THE BIGGEST LEGAL CANNABIS INDUSTRY, ACCOUNTING FOR NEARLY

90%

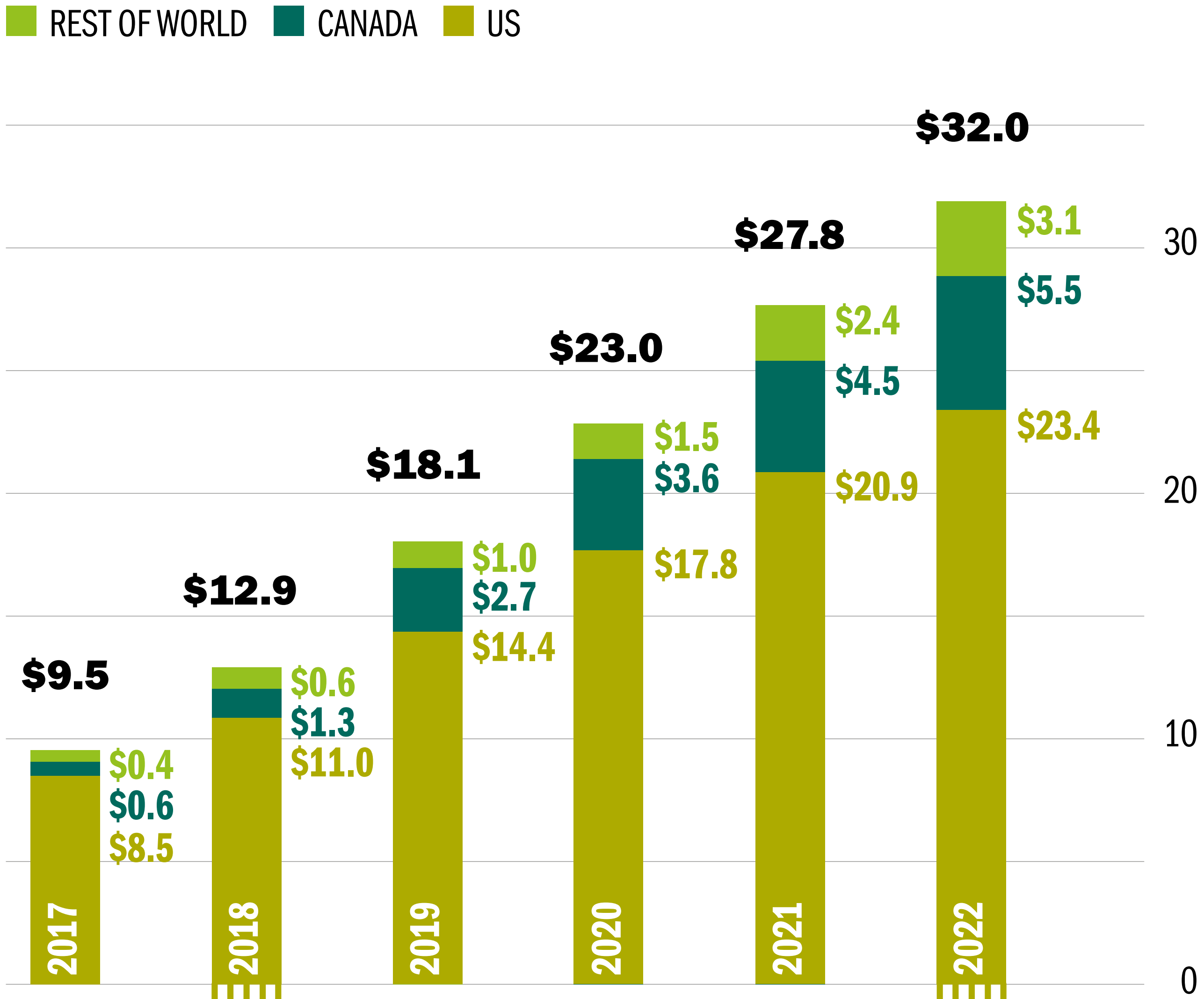
OF GLOBAL SALES IN 2017.

PREDICTED SALES IN GERMANY BY 2022 IN THE REGION OF

$1.6 bn

In this report, we'll take a look at the biggest companies at the forefront of the cannabis industry, including Canopy Growth, who were the first marijuana production company to be federally regulated and publicly traded in Canada. We'll also examine Cronos Group, who own and invest in multiple other cannabis firms, and Tilray, the first cannabis-producing company to float on NASDAQ. As for other companies that pedal the drug, we'll cover the Green Organic Dutchman (TGOD), and one cannabis grower, Aurora, who bought another for a record-breaking $2.5bn. Other industry players we'll overview include Aphria, CannTrust and HEXO.

Legal cannabis spending (bn)



$12.9 billion

Projected world legal cannabis spending in 2018:
(US $11bn; Canada $1.3bn; Rest of world $0.6bn)

$32.0 billion

Projected world legal cannabis spending in 2022:
(US $23.4bn; Canada $5.5bn; Rest of world $3.1bn)

Source: Arcview Market Research/BDS Analytics

1. Canopy Growth

NYSE:CGC | TSX:WEED
FOUNDED: 2014
CEO: BRUCE LINTON

Canopy Growth was the first cannabis company to be federally regulated and publicly traded in Canada, launching with the ticker symbol WEED. It's the only cannabis producer to have cross-listed on the NYSE, and currently markets six cannabis brands.

Source: NASDAQ as at 17 October ■ 50-day SMA ■ 20-day SMA

> *Has been pushing higher since 2016, and if the bullish move continues, it could target 60.00. Support might be found at 36.00. A move below 36.00, might bring the 24.00 region into play.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

There have been some notable developments for Canopy this year. In August, Constellation Brands boosted its overall stake in the company from 10% to 38%, announcing an investment of $4bn. In comparison, previous financing attempts had raised between just £1.1 and 1.3bn over a three-year period.

This has had a significant impact on Canopy's stock price. In November 2017, Constellation acquired a 9.9% stake in Canopy, paying C$48.60 per share.

C$14.06bn

MARKET CAP

84.6%

EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

However, the majority of companies in the industry are as yet struggling to turn a profit. In spite of recent success, Canopy Growth made a loss of $7.1m in Q2 2018, up from $1.4m in the second quarter of last year. The company is rapidly burning through cash as it covers operational expenses, numerous acquisitions and the development of facilities, among other things. Nonetheless, Canopy's overall balance sheet still looks positive – it finished 2017 with net cash holdings of $229m.

Despite the large expenditures, Canopy has acknowledged that it never planned to be profitable before the legalisation of recreational cannabis in Canada. As CEO Bruce Linton stated, "we had no plans to be profitable before the party started". All in all, the future looks promising for the company, with growth rate in terms of sales in MRQ estimated at 63.27% versus the same quarter last year (Reuters).

What's next for Canopy?

Following its acquisition of the medical marijuana producer Spectrum Cannabis Columbia, Canopy launched a Latin American subsidiary in July. This adds to forays it has already made into the Chilean and Brazilian markets. Canopy also has interests in European markets, with partners based in Spain and Denmark, for example. Given that Canopy are a Canada-based firm, and with US legislature operating on a state-by-state basis, it is possible Europe could provide greater opportunity in the mid-term. However, despite initial European interest, a significant shift towards a more diverse investor base is yet to materialise. According to Reuters, Canopy has just four active investors based in Europe who are using a common long-term investment strategy.

“We had no plans to be profitable before the party started” Bruce Linton, Canopy Growth CEO

2. Cronos Group

NASDAQ:CRON | TSX:CRON
FOUNDED: 2012
CEO: MICHAEL GORENSTEIN

The cannabis investment firm owns and invests in other cannabis companies. Its three core assets are Peace Naturals, Original BC and Whistler Medical Marijuana Company. Cronos was the first cannabis company to start trading on NASDAQ in February 2018.

Source: NASDAQ as at 17 October 50-day SMA 20-day SMA

> *While it remains below its 50-day moving average at 9.59, its outlook could be negative, and further declines might find support at 7.50. A rally might run into resistance at 12.50.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

Cronos Group has been on a bit of a rollercoaster ride this year. Its share price reached an all-time high, at the time, of $11.25 in January, before dropping half of its value by early February. It rallied back to around $10 shortly after listing on the NASDAQ.

C$2.01bn

MARKET CAP

93.2%

EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

The company's revenue was just $3.4m for Q2 this year, although this is up from $600,000 in the same period last year, a 466% increase. Despite small revenues, Cronos is busy planning capacity expansion, which will be key for its growth in the near term. The company's annual capacity stands at just 6,650kg, but with plans to scale up its medical marijuana arm Peace Naturals, overall capacity is expected to exceed 47,000kg by early 2019. Based on this projection and a price to sales multiple of 17.5%, Reuters estimates the company will be valued at around C$2.7bn by 2019. Cronos' core business is in the medical marijuana sector under the Peace Naturals brand, which offers both dried cannabis and oils. The latter are significantly more profitable, so the company is looking at increasing sales in this area.

Arguably, a huge 70% share price increase in August could be attributed to increased legalisation of the drug. However, Cronos' core medical marijuana business will probably remain the true growth driver, and capacity expansion in this area is likely to give the company a competitive advantage in the market.

What's next for Cronos?

As well as partnering with Canadian producers, there is also potential for Cronos to expand on a global scale. The company is focused on growing its business in Israel and Australia, having recently been granted a manufacturing licence in the latter as part of a joint venture with Australian-based NowSouthern Capital. Anna Shlimak, head of investor relations at

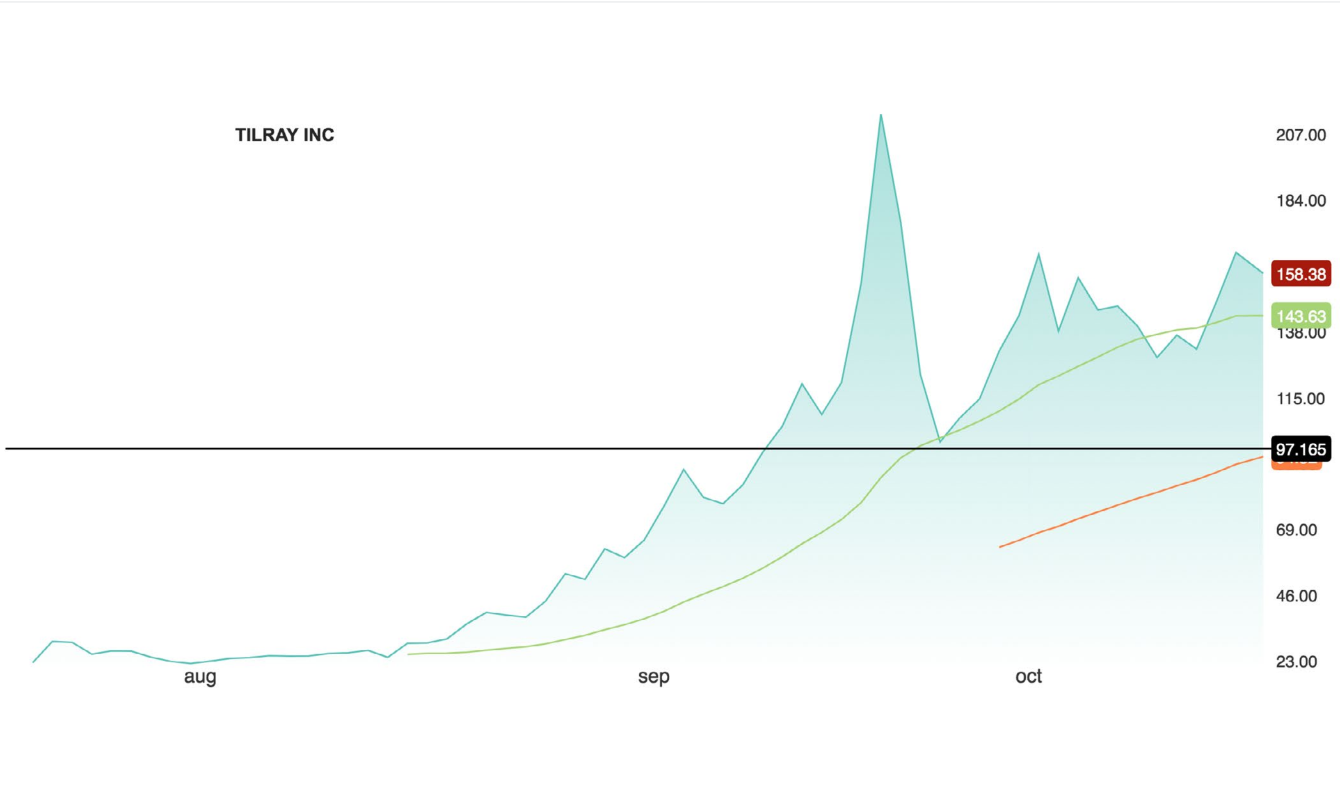
Cronos, commented that the company's future will focus on more than just production: "We don't necessarily need to build a one million square feet production facility [right now], we're not simply looking to act like farmers; that would be a narrow outlook. We're developing the intellectual property (IP), genetics, growing methodologies and R&D that can then be utilised through partnerships, co-manufacturing and global distribution channels."

"We're not simply looking to act like farmers; that would be a narrow outlook." Anna Shlimak, head of investor relations

3. Tilray

NASDAQ:TLRY
FOUNDED: 2013
CEO: BRENDAN KENNEDY

The first cannabis production company to IPO on the NASDAQ, licensed medical cannabis producer Tilray raised $153m to improve on its Ontario facilities and now has a market cap of $12.87bn.



Source: NASDAQ as at 17 October ■ 50-day SMA ■ 20-day SMA

> *Despite the major sell-off since September, the stock's outlook could remain positive if it holds above the 97.00 mark. A break above the 173.00 area could pave the way for 200.00 to be retested.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

Tilray was the first cannabis-producing company to raise capital via a NASDAQ listing. It was listed in July 2018, with its IPO priced at $17 a share. Since then it has experienced rapid growth, but also massive swings – it has seen huge gains of 1,200% since the IPO, and was up a still significant, but less impressive 870% at the start of October.

$12.87bn
MARKET CAP

90.5%
EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

The US Drug Enforcement Administration has given approval for the company to import cannabis for medical research, which will be undertaken alongside the University of California's Center for Medical Cannabis Research. As well as undertaking clinical trials, the company is licensed by the federal government of Canada and has passed numerous quality control inspections, by both governments and pharmaceutical distributors. Tilray's product is pharmaceutical grade, and investors will be curious to know if the company applies a similarly meticulous approach to its financial management.

In Q2 2018, Tilray generated $9.7m, up 95.2% compared to the same period last year. Average net selling per gram grew from $6.2 to $6.38 for the three months ended June 2017 and 2018 respectively. However, Tilray also reported a net loss for the quarter; $12.8m compared to just $2.4m for the second quarter in 2017. This was mostly down to increased operating expenses as attributed to continued growth, international expansion and IPO costs. Having entered the cannabis industry later than many of the other large producers, it will be Tilray's ability to successfully manage these operational expenses that will help it stand out from competitors.

"In the second quarter, we generated significant revenue growth as a result of our global strategy, our multinational distribution network and our commitment to research, innovation, quality and operational excellence."

Brendan Kennedy, president and CEO of Tilray

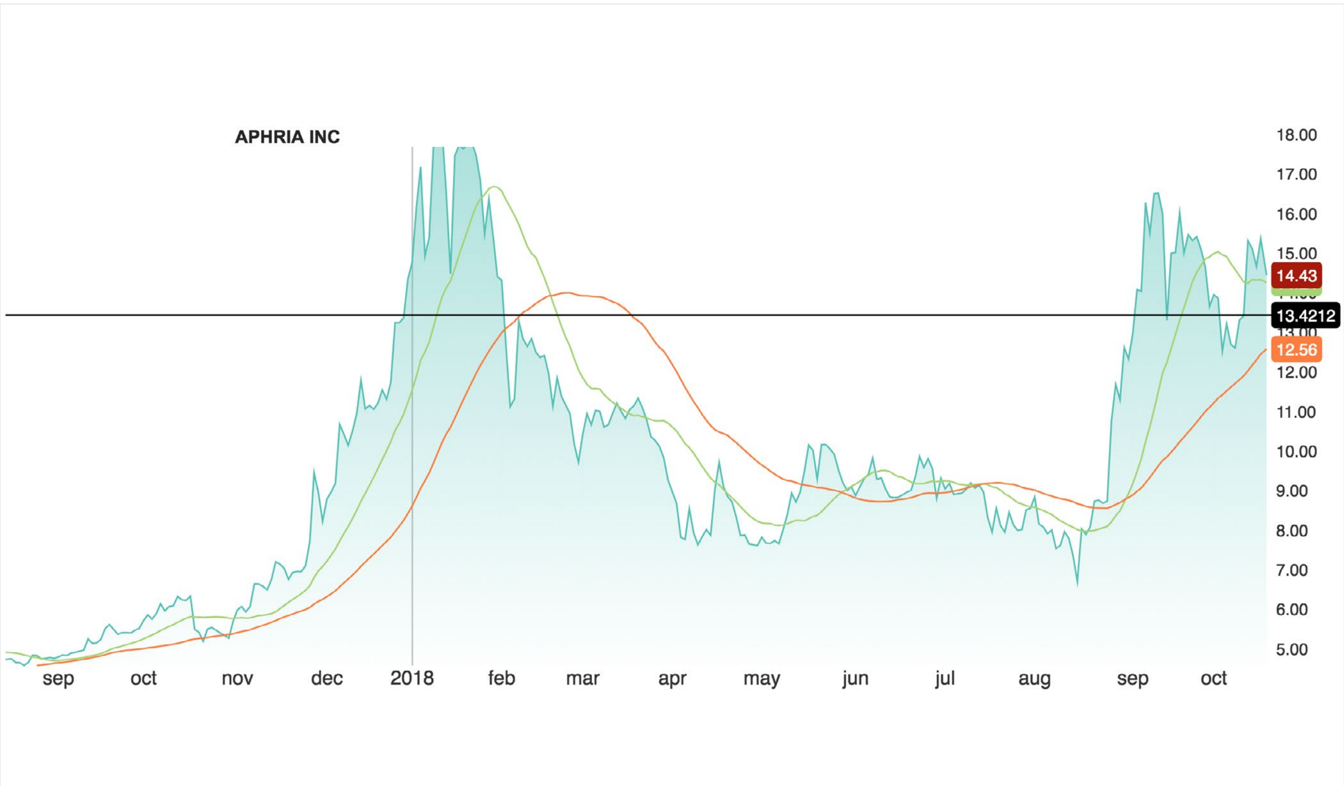
What's next for Tilray?

In August, Tilray signed a deal with Canadian Nova Scotia Liquors, one of 14 cannabis producers to supply Canada via the state-owned alcoholic distribution and retail outlet. The company also plans to expand by developing a second cultivation and processing facility in Ontario. Its two facilities combined would generate a capacity of up to 51 metric tonnes of product per year. Expanding production will allow Tilray a return on the projected growth in demand for its products, both domestically, as well as in the EU, Australia, New Zealand and Latin America.

4. Aphria

TSX:APH
CEO: VIC NEUFELD
FOUNDED: 2014

Aphria has been trading as APH on the Toronto stock exchange (TSX) since 2014. It has an international outlook following its acquisition of Nuuvera earlier this year. Its stock spiked in April after reaching a deal to sell its products through an online pharmacy chain, Shoppers Drug Mart.



Source: NASDAQ as at 17 October ■ 50-day SMA ■ 20-day SMA

> *Has been in an upward trend since August, and while it holds above the 50-day moving average at 15.70, it could target 20.00. Support might be found in the 13.40 region.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

TSX-listed Aphria has experienced significant growth, the stock jumping from C$5 a share in January 2017, to C$22 a share by January the following year. The stock slumped back to just below C$10 in May but has rallied since then. The company plans to expand internationally and increase capacity, in order to cater for growing demand due to the full legalisation of cannabis in Canada. Its international expansion will encompass operations in Australia, Africa, Europe, Latin America and Caribbean markets.

C$4.5bn

MARKET CAP

46.3%

EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

The legalisation of cannabis in Canada has also increased M&A activity. Aphria acquired Nuuvera and Broken Coast earlier this year to help facilitate the necessary increase in production. It is expected that the company's expansion will increase combined production capacity from 35,000kg to 225,000kg in early 2019, which should significantly boost future revenues. This aggressive expansion of its production capabilities has coincided with earnings growth of 117% y/y and 11% q/q. With expansion work due to be finalised by January 2019, Aphria is likely to complete earlier than key rivals such as Canopy Growth and Aurora Cannabis. Aphria has one of the stronger balance sheets in the cannabis sector. It has had 11 consecutive quarters of positive adjusted EBITDA, with its balance sheet showing close to C$350m in cash, cash equivalents, and marketable securities.

What’s next for Aphria?

Aphria’s solid financial footing could allow the firm to further its M&A activity and acquire other small to medium-size cannabis companies within or outside Canada. For example, Aphria acquired LATAM Holdings Inc., a subsidiary of Scythian Biosciences, this September. The LATAM purchase gives Aphria stakes in several cannabis-related companies based in other regions, such as Brazil and Jamaica.

“This [LATAM] **acquisition firmly cements Aphria’s leadership in the region and on the global cannabis stage.”** Vic Neufeld, Aphria CEO

---

5. Aurora Cannabis

NASDAQ:ACBFF | TSX:ACB
CEO: TERRY BOOTH
FOUNDED: 2013

The third-largest cannabis company by market cap, Aurora was founded in 2013 and debuted on the TSX in October 2016. It also owns Germany's largest medical cannabis distributor.

Source: NASDAQ as at 17 October 50-day SMA 20-day SMA

> *Has been pushing higher since August, and if it holds above 10.00, it could look to retest the 15.00 region. A break below 10.00 might bring 7.50 into sight.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

In May of this year, Aurora bought MedReleaf for a record-breaking $2.5bn. Both companies are TSX-listed, and at the time MedReleaf was the fourth largest global grower of cannabis by market cap. This purchase followed Aurora's hostile takeover of CanniMed for $765m in March. Such M&A activity has increased Aurora's growing capacity, allowing them to crop around 570,000kg of cannabis a year. This is in an attempt to meet the demand created by the legalisation of recreational cannabis in Canada. After dropping to a six-month low in mid-August, since then the stock has made impressive gains with the share price standing at C$12.46 at the start of October.

C$11.81bn

MARKET CAP

44%

EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

Aurora has been able to supplement its own revenue by investing in other cannabis businesses; the total value of its investments in public companies was worth more than C$700m as of September. Aurora has primarily invested in companies within the cannabis industry value chain, partnerships that should be useful as the drug is increasingly legalised.

The latest surge in pot stocks has lifted Aurora's profit. The company recorded earnings of C$79.9m in the final quarter of its fiscal year, up from losses of C$19.2m in the same period last year. However, the company's gross profit was much lower at C$20.6m, though still a strong improvement from C$5.8m in the same quarter in 2017. Overall Aurora saw revenue grow by 206% for its fiscal year in 2018, and investors will be keeping a keen eye on the company to see if a planned listing on a premier US stock exchange comes to fruition later this year.

"[Aurora has] supply arrangements with just about every province and territory." Chief Corporate Officer, Cameron Battley

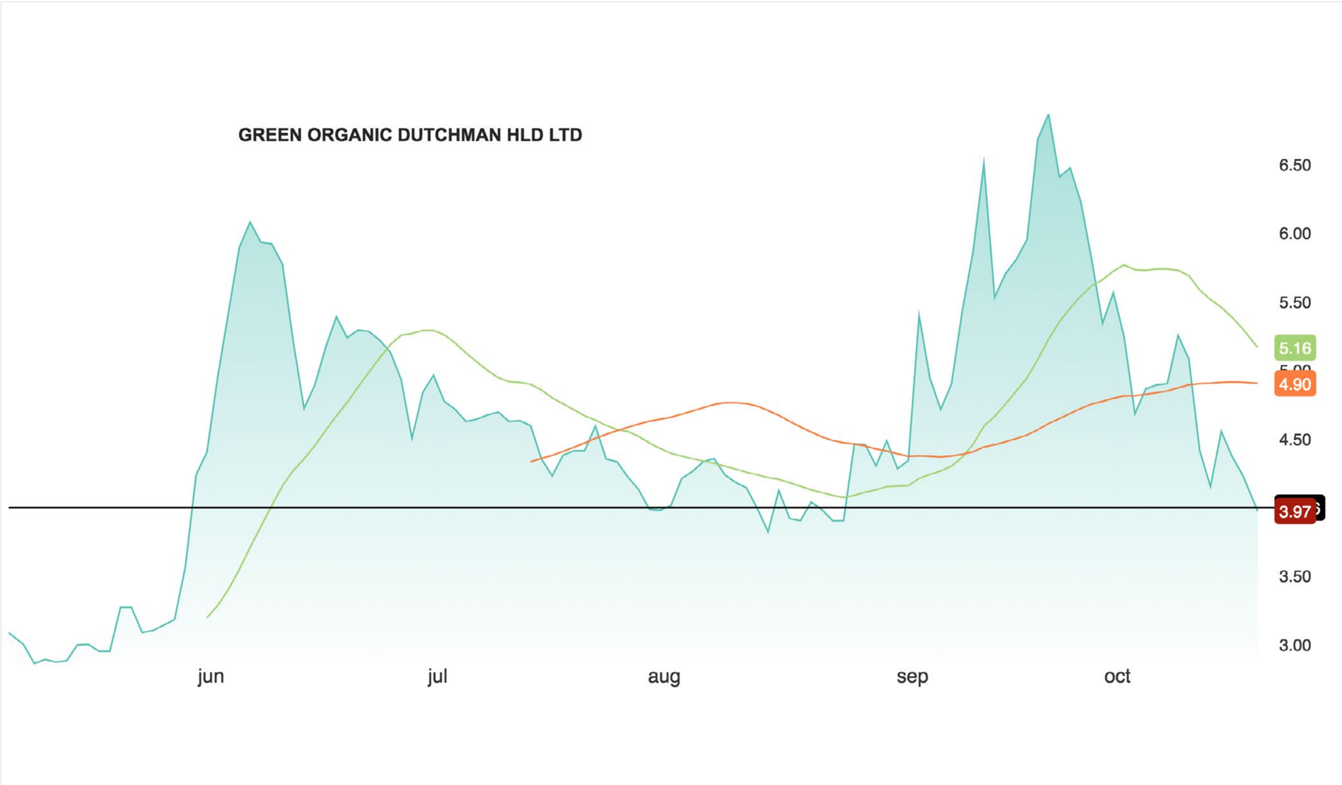
What's next for Aurora?

Aurora is well positioned to serve the legal cannabis market given its acquisition-based strategy, which is supplemented by investments in companies in the cannabis industry value chain. They are particularly well placed in Canada, where they have "supply arrangements with just about every province and territory" (Cameron Battley, chief corporate officer, Aurora). In May, the company launched a new cannabis brand in Germany called Cannabis Klenk. By partnering with one of Europe's largest medical plant companies, it plans to sell medical products to German pharmacies via Klenk's wide-reaching pharmaceutical wholesale distribution network. Given Germany is the world's largest federally regulated medicinal marijuana market, and one that is growing at a rapid pace, this could hugely benefit Aurora.

6. The Green Organic Dutchman

TSX:TGOD
CEO: BRIAN ATHAIDE
FOUNDED IN: 2012

Produces high-quality organic medical cannabis. The company grows cannabis at its facility in Ancaster, Ontario, and the construction of sites in additional Canadian provinces, as well as Jamaica, are underway.



Source: NASDAQ as at 17 October 50-day SMA 20-day SMA

> *Has been in decline since mid-September, and a break below 4.00 could bring 3.80 into play. Resistance might be found at 5.25 or 5.50.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

The Green Organic Dutchman (TGOD) proved to be an impressive cannabis float, raising $90m on the TSX. The IPO was originally priced at C$3.65 per share, but its value rocketed at the end of May when the company announced an exclusive agreement with Stillwater Brands. The share price reached a high of C$8.28, before settling around C$6. The agreement included the licensing of RIPPLE SC (Soluble Cannaboids) ingredient technology, among other proprietary beverage technologies.

C$1.41bn
MARKET CAP

160.8%
EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

TGOD continues to make good progress on the construction of new production facilities on four Canadian sites (Ontario, Ancaster, Quebec and Valleyfield). The company is spending a total of $20,734,000 on these initiatives, with cultivation expected in the first six months of 2019.

During this expansion period, it will be important for TGOD to maintain a healthy balance sheet. For the second quarter of fiscal 2018, its balance sheet (with cash and cash equivalents) stood at $261,816,000. The total cash used on operating activities for the three months ended 30 June was $7,196,000 – expansion and increased operating capacity are clearly the company's aims. This spend included consumer research and brand building in anticipation of TGOD's entry into the recreational market, as it prepares to launch its "high quality, consumer-preferred, premium organic brand." (TGOD's Q2 earnings report)

"The announcement of the partnership with Jamaica is just the beginning for our international expansion plans"

Csaba Reider, TGOD president

What's next for TGOD?

The company's pursuit of international business has prompted a partnership with, and 49% investment in, Epican Medicinals. Epican is a Jamaican-based cannabis company, and an early mover in this market. This partnership includes plans for the construction of a second 125,000 square foot facility. Csaba Reider, TGOD's president, commented, "The announcement of the partnership with Jamaica is just the beginning for our international expansion plans. TGOD's business plan calls for operations in 12 countries on three continents by the end of 2018."

7. HEXO Corp

TSE: HEXO
FOUNDED: 2013
CEO: SEBASTIEN G. ST-LOUIS

HEXO creates and distributes easy-to-use cannabis products for the Canadian cannabis market. The company, formerly known as Hydropothecary, has had a good year so far, with the stock up more than 95% at the start of October.

Source: NASDAQ as at 17 October 50-day SMA 20-day SMA

> *Has been in a strong upward trend since August, and if it holds above 5.59, the bullish move could continue. A break above 7.00 could point to further gains. A large pullback might find support at 4.20.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

HEXO's IPO was priced at C$5.60 a share, but jumped to C$8.73 in September after the company announced a joint venture with beverage company Molson Coors.

C$1.59bn

MARKET CAP

67.6%

EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

The company currently operates with around 310,000 square foot of production capacity, but as one of Canada's lowest-cost producers, it plans to dramatically increase its production capacity for the adult-use market. Construction has started for a 1,000,000 square foot expansion, which is set to be completed by the end of the year. The adult-use market will sit under the HEXO brand, while medicinal markets will continue to be served by the Hydropothecary brand.

HEXO has entered into a joint venture with Molson Coors Brewing Company, who will have a 57.5% controlling share in the venture, while HEXO will own the rest. The aim of the venture is to develop non-alcoholic, cannabis-infused beverages, making use of Molson's experience in that space. HEXO also has a five-year, $1bn contract as the preferred supplier of cannabis to Quebec, including online distribution rights. The agreement accommodates for around 200,000kg of cannabis over the period. The company is also working to secure distribution rights in other Canadian provinces, including British Columbia and Ontario.

As one of the lowest-cost producers of cannabis in Canada, HEXO are reported to be operating at C$0.88 per gram of dried inventory. This has decreased 57% year-over-year compared to the third quarter of fiscal 2017. Overall revenue increased 5% to C$1,240,172, although sales volume actually decreased 2% to 134,253 gram (equivalents) for the three months ending 30 June. HEXO attribute this to an increase in demand for their higher value oil-based products.

What's next for HEXO?

The company has secured a significant stake in Fire and Flower, a leading cannabis retail outlet. It is poised to capture a large section of the Canadian market once the legalisation of recreational cannabis in Canada takes hold, and expects to serve all Canadian market segments in the near future. HEXO doesn't currently operate internationally, but management plan to expand into Latin America and Europe in 2019. There is also the possibility of US activity if federal anti-marijuana laws are altered.

"We look forward to continuing to provide high-quality products and client experiences as we continue our expansion throughout Canada and beyond." Sonia Isabel, vice-president of Sales at HEXO

---

8. CannTrust

OTCMKTS: CNTTF
CEO: ERIC PAUL
FOUNDED: 2015

Since its inception in 2014, CannTrust has been a leading producer of pharmaceutically-standardised cannabis products. The company brings more than 40 years of pharmacy and healthcare experience to the medical cannabis industry.

Source: NASDAQ as at 17 October 50-day SMA 20-day SMA

> *Began a bullish move in August, and if it continues resistance might be found at 11.00, and pullbacks might find support in the 8.00 region.*
>
> DAVID MADDEN, ANALYST, CMC MARKETS

Stock analysis

CannTrust IPO'd on 21 August 2017. The company has more conservative growth plans compared to competitors, but holds a solid position in the medical cannabis sector. Despite this, its share price has more than doubled since its IPO, reaching C$12.45 at the start of October.

C$1.38bn
MARKET CAP

67.6%
EXPECTED ANNUAL GROWTH IN EARNINGS

SOURCE: SIMPLY WALL ST AS AT 12/10

The company has a strong pharmaceutical background, holding an exclusive partnership with Apotex, the largest Canadian-owned pharmaceutical company. As part of this venture, CannTrust are developing alternate dosage formats for medical cannabis products. With 40 years of experience in pharmaceuticals, the company retains a strong medical focus when compared to its competitors. While this may be seen as a more conservative approach, CannTrust is likely to hold an established, trusted position in the industry.

CannTrust posted a record revenue of C$9m in Q2 2018, a huge 99% increase on the same period last year. This result was supplemented by a positive net income for the fifth consecutive quarter. A newly opened 450,000 square foot hydroponic greenhouse facility helped to increase production capacity. This facilitated an increase in cannabis extracts which contributed to 60% of cannabis sales. The number of active patients using CannTrust products also increased by 117% since last year, up to 45,000 in Q2 2018.

What's next for CannTrust?

The company are pursuing Drug Identification Number (DIN) registration for its products as part of the Apotex partnership, although they will have to wait for clinical trials to be successfully completed. With DIN registration, CannTrust would be able to operate in global markets (including the 85 countries in which Apotex is present), aiding its global expansion. It has also entered into a joint venture with Grey Animal Wolf Health, which would expand its outreach beyond just human usage by focusing on medical cannabis products for the global pet market.

"With Bill C-45 receiving royal assent, legalising cannabis for adult consumer use on 17 October, 2018, our Perpetual Harvest facility offers CannTrust even more opportunities to lead the industry with its disciplined, scientific approach." Brad Rogers, president, CannTrust

---

OPTO