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Elixinol Global (EXL)

Activity Levels Increasing

Speculative

Refer to key risks on page 4 and Biotechnology Risk Warning on page 7. Speculative securities may not be suitable for retail clients.

Recommendation

Hold (unchanged)

Price

\$3.55

Valuation

\$3.39 (previously \$3.36)

Risk

Speculative

GICS Sector

Healthcare Equipment and Services

Expected Return

Capital growth	-4.5%
Dividend yield	0.0%
Total expected return	-4.5%

Company Data & Ratios

Enterprise value	\$400.3m
Market cap	\$442.3m
Issued capital	124.5m
Free float	37%
Avg. daily val. (52wk)	\$546,000
12 month price range	\$1.34 - \$3.69

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.00	1.98	1.33
Absolute (%)	18.3	79.7	166.9
Rel market (%)	13.4	71.2	164.0

Absolute Price



SOURCE: IRESS

Further Revenue Catalysts Ahead

The company reported its FY18 financial results today. Revenues were \$37.1m and grew by 125% over FY17. Underlying EBITDA was \$0.7m relative to breakeven in FY17 and our forecast EBITDA profit of \$3.3m.

The key driver of the modestly weaker than expected EBITDA result was gross profit margin shrinkage from 64% in FY17 to 54% in FY18. A shift in channel mix to a greater proportion of private label sales cause this margin contraction.

The US market continues to be the most important driver of short term revenue growth, notwithstanding that Elixinol continues to expand its presence in multiple markets around the world including in Europe where it has made a number of recent senior appointments. We expect these to at least cover their cost in FY19.

The most important short term focus will continue to be in the US market where the recent investment in manufacturing capacity, supply chain management and brand marketing have absorbed significant capital. It is critical that the brand maintains its market share in the key direct to consumer channel over the course of FY19. During FY18 revenues from Direct to Consumer expanded by 112% to approximately \$7.5m. While this is impressive growth, the major peers in the space are considerably larger. The direct to consumer channel is highest margin business and is an important driver of earnings growth and cash.

At least one distribution deal with a large national retailer is a possibility for later in calendar 2019. The catalyst for such a deal is a safety announcement by the FDA regarding Hemp CBD products.

Maintain Hold (Speculative)

Our valuation is amended to \$3.39 from \$3.36. The forecast EBITDA for FY19 modestly lowered following a revision to the expected gross profit margin. FY20/FY21 earnings are upgraded by 5% and 15% respectively. We maintain our Hold (Speculative) recommendation.

Earnings Forecast

December Year End	FY18	FY19e	FY20e	FY21e
Revenues	37.1	69.6	116.8	136.9
EBITDA \$m	0.7	7.7	19.7	24.2
NPAT (underlying) \$m	0.7	5.2	14.2	17.4
NPAT (reported) \$m	-0.9	4.9	13.9	17.1
EPS underlying (cps)	0.6	4.1	11.4	14.0
EPS growth %	large	570%	175%	23%
PER (x)	na	85.7	31.2	25.4
FCF yield (%)	-4%	-2%	-1%	3%
EV/EBITDA (x)	571	52	20.3	16.5
Dividend (cps)	-	-	-	-
Franking	0%	0%	0%	0%
Yield %	0.0%	0.0%	0.0%	0.0%
ROE %	-0.7%	3.4%	8.9%	9.9%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Step change in activity levels ahead

We summarise the FY18 result for Elixinol as follows.

Figure 1 - FY18 Result Summary

\$m	2017	2018	% Change	2018	% Difference
	Actual	Actual		Forecast	
Revenues	16.5	37.1	125%	37.2	0%
Gross profit	10.5	20.0	90%	23.4	-15%
Margin	64%	54%	-15%	63%	-14%
Expenses	10.5	19.3	84%	20.1	-4%
EBITDA - underlying	0.0	0.7	na	3.3	-79%
NPAT - underlying	-0.6	0.7	na	1.7	-58%
NPAT - statutory	-1.3	-0.9	na	1.7	-153%

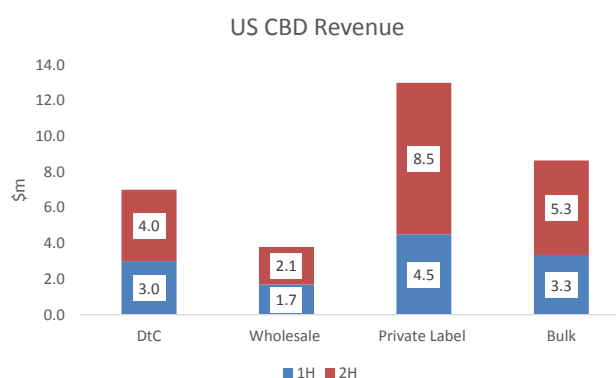
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Revenues had previously been disclosed in the recent cash flow statement.

Gross profit margin declined due to a changing channel mix which has seen a higher proportion of private label sales (one large customer in the pet space is driving most of the private label growth). Private label is generally lower margin than retail, hence the overall GP margin has declined.

The company reiterated that it is not seeing any significant pressure on pricing for e-commerce (direct to consumer) sales.

Figure 2 - US CBD Revenues 1H/2H Revenue Split



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The US business continued to grow strongly in 2H18 with all segments showing material growth. Second half revenues were ~\$20m relative to \$12.2m in the first half. US revenues were \$32.5m up 141% over FY17.

During FY19, the investment in the retail strategy is expected to begin to gain traction, hence we do anticipate gross margin improvement over the course of the next year. We expect the margin will begin to move back towards 60% from the current 52%.

The major driver of the margin improvement is the investment in the US retail strategy centred around the re-engineered e-commerce site and a vastly expanded marketing and advertising budget, to drive brand recognition and ultimately revenues. The company has made multiple hires of senior personnel to drive this process in the US.

In FY18, sales and marketing costs grew by 155% to \$7.4m. We expect similar percentage growth in sales and marketing spend in FY19.

Hemp Foods Australia generated FY19 revenues of ~\$4.9m including approximately \$2.7m in 2H19 representing growth of ~\$0.7m over 1H19.

Net cash flow from operations was -\$5.7m. Working capital expanded by ~\$5.4m with most of that increase due to an expansion in inventory and other debtors. The working capital expansion includes hemp supply prepayments to support an expected 200%+ production increase by FY19.

Working capital is expected to continue to increase in the long term in line with the demand increases.

The company finished the year with cash of \$42.9m, accordingly it has ample capital to fund further growth opportunities as they arise.

Outlook

The US market for CBD products remains in its infancy, however, the legalisation of hemp cultivation via the 2018 Farm Bill was a major catalyst. The industry is now anticipating a statement on safety (of CBD products) from the FDA. Once in place, this is likely to become a signal for large retail groups to carry a range of CBD product.

In the interim, Elixinol US has continued to build out its supply capability via a doubling of its production capacity and investment in working capital. The company has spent \$2.3m on the new plant to date with a further \$2.3m to spend in the lead up to commissioning later in the year. The supply of raw material is also subject to lower volatility because of the company's direct investment in primary production.

Hemp Foods Australia revenues continued to grow in 2H19. The company continues to invest in product development and recently launched a range of branded hemp patties. EXL is now marketing a selection of HFA products in Europe and Australia. We are confident revenues will continue to expand as these initiatives gain traction.

The recently renamed Elixinol Australia – now Nunyara Pharma (Australia) is planning the construction of a 5,000m² glasshouse production facility on the NSW north coast in 2019. The plan is subject to the granting of the required licences. All going to plan, production and formulation may commence in FY20. At this time we have no revenues from medicinal cannabis sales in the forecast.

Figure 3 - Summary of earnings changes

	2019			2020			2021		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Revenues	69.6	68.6	1%	116.8	115.3	1%	136.9	135.0	1%
EBITDA	7.7	10.1	-24%	19.7	19.4	2%	24.2	23.5	3%
NPAT - underlying	5.2	6.6	-22%	14.2	13.6	4%	17.4	15.2	15%
EPS	4.1	5.3	-22%	11.4	10.9	5%	14.0	12.2	15%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The forecast for FY20 assumes a gross profit margin of 56% and operating expenses increasing by \$11m, mainly in the area of marketing spend to drive the top line revenue growth. The gross margin assumption may be conservative if the marketing spend leads to improving market share.

Elixinol's major competitors in the US are yet to report December quarter revenues, hence we have other recent data regarding market share.

Our forecast implies 84% revenue growth for the year in FY19 followed by 69% growth in FY20.

We anticipate quarter on quarter growth of 12% for March 2019. Earnings are expected to be strongly skewed to the latter half of the year as the marketing message takes further traction after the northern hemisphere summer.

Our valuation is modestly raised to \$3.39 (from \$3.36) and we retain our Hold (Speculative) rating.

Elixinol Global

Elixinol Global is a manufacturer and retailer of Hemp CBD products. Both Elixinol US and Hemp Foods Australia 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.

Key Risk Areas

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	FY18	FY19e	FY20e	FY21e		FY17	FY18	FY19e	FY20e	FY21e
Year Ending December	Proforma					Reported EPS (cps)	-1.8	-0.8	3.9	11.2	13.8
Total Revenues	16.5	37.1	69.6	116.8	136.9	Normalised EPS (cps)	-0.6	0.6	4.1	11.4	14.0
Grow th	na	125%	88%	68%	17%	EPS grow th (%)	na	large	570%	175%	23%
COGS	-6.0	-17.1	-30.4	-45.9	-53.7	PE(x)	na	na	86	31	25
Gross profit	10.5	20.0	39.2	70.9	83.3	EV/EBITDA (x)	20,013	570.9	52.1	20.3	16.5
GP margin	63.7%	54.0%	56.3%	60.7%	60.8%	EV/EBIT (x)	(1,633.7)	665.9	58.2	21.2	17.2
Operating expenses	(10.5)	(19.3)	(31.5)	(51.2)	(59.0)	NTA (cps)	23.8	54.7	62.4	77.5	93.6
EBITDA	0.0	0.7	7.7	19.7	24.2	P/NTA (x)	14.9	6.5	5.7	4.6	3.8
Depreciation and Amortisation	-0.3	-0.5	-0.8	-0.8	-1.0	Book Value (cps)	96.3	110.7	114.5	125.2	138.9
EBIT	-0.2	0.2	6.9	18.9	23.2	Price/Book (x)	3.7	3.2	3.1	2.8	2.6
EBIT margin	-1.5%	0.5%	9.9%	16.2%	17.0%	DPS (cps)	0.0	0.0	0.0	0.0	0.0
Pre tax profit	-0.2	0.6	6.9	18.9	23.2	Payout ratio %	0%	0%	0%	0%	0%
Tax expense	-0.3	0.1	-1.7	-4.7	-5.8	Dividend Yield %	0%	0%	0%	0%	0%
NPAT- normalised	-0.6	0.7	5.2	14.2	17.4	Net debt/Equity	0%	0%	0%	0%	0%
Amortisation - acquired intangibles	(1.3)	(1.6)	(0.3)	(0.3)	(0.3)	Net debt/Assets	0%	0%	0%	0%	0%
Reported NPAT	-1.9	-0.9	4.9	13.9	17.1	Gearing	net cash	net cash	net cash	net cash	net cash
Cashflow (A\$m)						Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
	FY17	FY18	FY19e	FY20e	FY21e	Interest cover (x)	n/a	n/a	n/a	n/a	n/a
Gross cashflow	-0.6	-4.9	3.9	14.5	21.9	Division Earnings					
Net interest	0.0	0.3	0.0	0.0	0.0	FY17	FY18	FY19e	FY20e	FY21e	
Tax paid	-0.6	-1.1	-1.7	-4.7	-5.8	Elixinol US					
Operating cash flow	-1.2	-5.7	2.2	9.8	16.1	Revenues A\$	13.3	32.4	64.0	108.3	126.0
Capital expenditure	-0.5	-4.0	-6.2	-6.0	-2.5	EBITDA	2.5	2.4	9.9	20.9	24.4
Other capitalised intangibles	0.0	0.0	0.0	0.0	0.0	Margin	19%	7%	15%	19%	19%
Free cash flow	-1.6	-9.7	-4.0	3.8	13.6	Elixinol Australia					
Business acquisitions	0.0	0.0	0.0	0.0	0.0	Revenues	-	-	-	-	-
Proceeds from issuance	20.0	37.9	0.0	0.0	0.0	EBITDA	(0.4)	-	(0.4)	(0.4)	(0.4)
Movement in debt	0.0	0.0	0.0	0.0	0.0	Hemp Foods Australia					
Dividends paid	0.0	0.0	0.0	0.0	0.0	Revenues	3.2	4.7	5.6	8.4	10.9
Change in cash held	18.4	28.2	(4.0)	3.8	13.6	EBITDA	(0.6)	(0.7)	(0.3)	0.7	3.2
Cash at beginning of period	4.2	18.8	42.9	38.8	42.6	Margin	-19%	-15%	-6%	8%	30%
Cash at year end	18.8	42.9	38.8	42.6	56.2	Elixinol Global					
Balance Sheet (A\$m)						EBITDA	(1.5)	(1.0)	(1.5)	(1.5)	(3.0)
	FY17	FY18	FY19e	FY20e	FY21e	Group revenues	16.5	37.1	69.6	116.8	136.9
Cash	18.8	42.9	38.8	42.6	56.2	Group EBITDA	0.0	0.7	7.7	19.7	24.2
Receivables	1.2	3.4	6.3	10.6	12.4	Interim Earnings					
Inventory	2.5	6.9	12.2	18.3	21.5		1H18e	2H18e			
Other current assets	0.8	3.7	3.7	3.7	3.7	Revenues	14.9	22.2			
Property, Plant and Equipment	1.1	5.9	11.3	16.5	18.0	EBITDA	0.6	0.1			
Intangible assets	80.6	80.3	80.0	79.7	79.4	D&A	(0.4)	(0.1)			
Deferred tax assets	0.1	0.7	0.7	0.1	0.1	EBIT	0.4	0.0			
Other	-	4.7	4.7	4.7	4.7	Tax	(0.3)	(0.0)			
Total assets	105.1	148.4	157.7	176.2	196.0	NPAT	0.1	0.0			
Trade payables	1.1	5.9	10.3	15.5	18.2						
Debt	0.3	0.3	0.3	0.3	0.3						
Tax payable	-	-	-	-	-						
Other liabilities	1.2	1.2	1.2	1.2	1.2						
Deferred income tax liability	3.2	3.1	3.1	3.1	3.1						
Provisions	0.2	0.2	0.2	0.2	0.2						
Total Liabilities	5.9	10.7	15.1	20.3	23.0						
Net Assets	99.1	137.8	142.6	155.9	173.0						
Share capital	101.8	139.6	139.6	139.6	139.6						
Retained earnings	(2.7)	(3.6)	1.2	15.1	32.3						
Reserves	-	1.8	1.7	1.1	1.1						
Shareholders Equity	99.1	137.8	142.6	155.9	173.0						

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 lead manager of the 2018 \$40m Capital Raising 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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