Analyst
John Hester 612 8224 2871

Authorisation
Tim Piper 612 8224 2825

Elixinol Global (EXL)

US Market Expanding

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
$1.48
Valuation
$2.15 (unchanged)
Risk
Speculative

GICS Sector

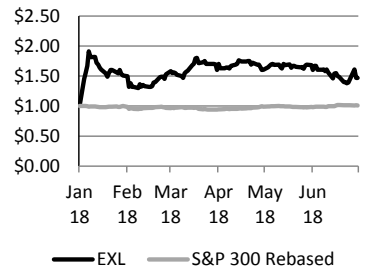
Healthcare Equipment and Services

Expected Return	
Capital growth	**45.2%**
Dividend yield	**0%**
Total expected return	**45.2%**
Company Data & Ratios	
Enterprise value	**$136.2m**
Market cap	**$154.4m**
Issued capital	**102.9m**
Free float	**24%**
Avg. daily val. (52wk)	**$145,000**
12 month price range	**$1.235 - $1.995**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.67	1.70	
Absolute (%)	-11.98	-13.53	
Rel market (%)	-14.68	-20.73	

Absolute Price



SOURCE: IRESS

Hemp Farming Act 2018

The US Senate recently approved the 2018 Farm Bill including measures to legalise the cultivation of industrial hemp. The US House of Representatives also appears to be supporting the Bill, however, it is not yet law. We expect an approvable version of the 2018 Farm Bill to be put before the US President within a period of weeks.

First in Class Approval for Medicinal Cannabis

The US FDA has now approved Epidiolex for the treatment of severe epilepsy in children. The product is a purified extract of a plant derived cannabinoid and its approval is an important breakthrough for the medicinal cannabis industry. The flow on benefit for over the counter CBD products manufactured and marketed by Elixinol and others is expected to be considerable. We believe the FDA approval is an important validation of cannabinoid therapy that should support further expansion of an industry that is already in a period of rapid growth.

The timing of these two events is probably not co-incidental. Epidiolex contains a cannabinoid that is included on schedule 1 of the controlled substances act – and therefore considered illicit. Notwithstanding the FDA has approved the drug for a very specific indication. It does now appear likely that the US Congress will differentiate between high and low levels of THC with the former remaining illicit while the latter is reclassified as an agricultural product, thus paving the way for commercialisation.

The implications of the law change and the FDA validation of CBD therapy for the broader CBD dietary supplements and nutraceuticals industry are immense. This relatively new industry is now significantly closer to mainstream adoption and we believe this will open the industry to further capital inflows and inevitable M&A activity.

There are no changes to earnings. Elixinol remains well capitalised and is expected to generate a small profit in FY18. We maintain our Buy recommendation and price target of $2.15.

Earnings Forecast

December Year End	FY17*	FY18e	FY19e	FY20e
Revenues	16.5	31.5	43.0	59.9
EBITDA $m	0.0	1.4	3.7	7.7
NPAT (underlying) $m	-0.6	0.8	2.1	4.8
NPAT (reported) $m	-1.9	-0.5	0.8	3.5
EPS underlying (cps)	-0.6	0.8	2.1	4.7
EPS growth %	na	large	159%	128%
PER (x)	na	na	71.5	31.4
FCF yield (%)	-1%	-7%	-1%	-7%
EV/EBITDA (x)	6,705	95.1	36.3	17.5
Dividend (cps)	-	-	-	-
Franking	0%	0%	0%	0%
Yield %	0.0%	0.0%	0.0%	0.0%
ROE %	0.0%	-0.5%	0.8%	3.4%

SOURCE: BELL POTTER SECURITIES ESTIMATES, * FY17 RESULTS ARE PRO FORMA

Legislation To Legalise Hemp

The US Senate recently passed the 2018 Farm Bill. The Bill contains numerous measures to incentivise the agricultural sector and most importantly it includes the provision of the previously discussed Hemp Farming Act.

The 2018 Farm Bill is yet to be signed into law. The US House of Representatives has voted on and approved a version of the 2018 Farm Bill, however, we understand there were a number of amendments in the version voted upon by the US Senate including the provision relating to Industrial Hemp.

It is likely that there will be further lobbying required to see the provisions of the Hemp Farming Act finally made into law. While the US Senate vote in favour of the Hemp Farming Act is vitally important, so too is the amalgamation process of the two separate version of the Bill.

We conclude that the legislation to legalise the growing of industrial hemp at Federal level is more certain to become law relative to earlier in the year. The amalgamation process of the two version of the 2018 Farm Bill is likely to be concluded within weeks and we expect will be signed by the US President shortly thereafter.

The key provision of the legislation are:

- Federal and State laws regarding the growing of Industrial Hemp will be aligned. Almost half the 50 US states have passed state laws permitting the farming of industrial hemp;
- Industrial Hemp (i.e. THC content less than 0.3%) will be removed from Schedule 1 of the Controlled Substances Act (the CSA); and
- The United States Department of Agriculture will become the Federal body responsible for regulating the control of Industrial Hemp. It is likely that it will work with the various State departments.

The commercial implication for the sector are crucial. As industrial hemp is legalised the barriers to banking, insurance, water rights and marketing should dissolve.

The US industry for hemp based dietary supplements has evolved despite not having access to many of these services. In Colorado where the US industry is based, local banks have been able to accommodate the industry, however, Elixinol and others do not have access to mainstream payments technology – including paypal. Similar exclusions apply to other financial services including crop insurance for farmers and water rights. Advertising in mainstream journals and newspapers has also been refused.

While we do not expect the passing of Federal legislation will change these restrictions over-night, we do expect they will begin to soften eventually. As marketing spend across the industry expands this will inevitably lead to an expansion in market size.

In these circumstances we believe industry M&A activity is inevitable with large tobacco and alcohol corporates becoming likely buyers.

Northern Colorado High Plains Producers

Elixinol has previously announced a small investment of US$1.8m in this newly formed Joint Venture. It will partner with Kersey Ag Company LLC to cultivate high CBD strains of hemp. Assuming the cultivation of hemp is legalised at the Federal level, hemp will become another commodity with prices determined by normal market forces of supply and demand. We expect Elixinol will continue with its investment in the JV.

FDA APPROVES FIRST MEDICINAL CANNABIS PRODUCT

In late June the FDA approved Epidiolex for the treatment of severe forms of epilepsy. The active ingredient is a plant derived cannabinoid. This approval marks the first time any cannabis extract has been approved as a medicine in the US. We note the following key points from the FDA's commentary on the approval.

- The FDA has not approved marijuana as a safe and effective drug for any indication. The agency has, however, approved one specific drug (Epidiolex) that contains a highly purified cannabidiol for the treatment of seizures associated with Lennox-Gastaut syndrome or Dravet syndrome in patients 2 years of age and older.
- The active cannabinoid(s) in Epidiolex do not induce euphoria. The cannabinoid(s) in Epidiolex is extracted from plants, accordingly the drug is purified to remove all but the elements intended for the drug.
- Epidiolex's effectiveness was studied in three randomized, double-blind, placebo-controlled clinical trials involving 516 patients with either Lennox-Gastaut syndrome or Dravet syndrome. Epidiolex, taken along with other medications, was shown to be effective in reducing the frequency of seizures when compared with placebo.
- Because of the adequate and well-controlled clinical studies that supported this approval, prescribers can have confidence in the drug's uniform strength and consistent delivery that support appropriate dosing needed for treating patients with these complex and serious epilepsy syndromes.
- The FDA has also approved two drugs containing a synthetic version of a substance that is present in the marijuana plant and one other drug containing a synthetic substance that acts similarly to compounds from marijuana but is not present in marijuana.
- Epidiolex was 3.5yrs from NDA submission to NDA submission.
- The drug has 8 granted patents in the US.

IMPLICATION FOR ELIXINOL

In GW Pharma's view the approval of Epidiolex necessitates a reclassification of the product out of Schedule I of the CSA. In the absence of the 2018 Farm Bill approval, the DEA would have 90 days to issue an interim final rule on this matter.

The FDA's approval of these drugs including both synthetic and plant derived formulations is the clearest signal yet that further drug development of cannabinoids will continue. Mainstream pharmaceutical developers have not engaged in the development of cannabinoid products and this is most likely due to the skepticism regarding efficacy. GW Pharmaceuticals has >50 phase II/III trials in progress in additional indications.

First mover advantage for Medicinal Cannabis has now gone to GW Pharma. Meanwhile Elixinol's various licence applications that are necessary to commence development work of medicinal products in Australia remain firmly bound in red tape within the TGA's Office of Drug Control – despite the company's best efforts to speed up the process.

Eventually Elixinol will have a product available for testing in clinical trials. Nevertheless the only way to have these products approval and prescribed is via this exhaustive clinical trial process. The rewards for success are considerable - GW Pharma has a market capitalisation of US$4.0bn.

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 4 July 2018

Recommendation	Buy, Speculative
Price	$1.48
Valuation	$2.15

Table 1 - Financial summary

Profit & Loss (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Year Ending December	Proforma				
Total Revenues	16.5	31.5	43.0	59.9	72.6
COGS	-6.0	-11.8	-15.3	-20.6	-25.0
Gross profit	10.5	19.7	27.7	39.3	47.6
GP margin	63.7%	62.6%	64.5%	65.6%	65.6%
Operating expenses	(10.5)	(18.3)	(24.0)	(31.6)	(36.3)
EBITDA	**0.0**	**1.4**	**3.7**	**7.7**	**11.3**
Depreciation and Amortisation	-0.3	-0.3	-0.9	-1.2	-1.5
EBIT	-0.2	1.1	2.8	6.5	9.9
EBIT margin	-1.5%	3.5%	6.6%	10.8%	13.6%
Pre tax profit	-0.2	1.1	2.8	6.5	9.9
Tax expense	-0.3	-0.3	-0.7	-1.6	-2.5
NPAT- normalised	-0.6	0.8	2.1	4.8	7.4
Amortisation - acquired intangibles	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)
Reported NPAT	-1.9	-0.5	0.8	3.5	6.1

Cashflow (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Gross cashflow	-0.6	-0.7	2.2	5.4	9.6
Net interest	0.0	0.0	0.0	0.0	0.0
Tax paid	-0.6	-0.3	-0.7	-1.6	-2.5
Operating cash flow	-1.2	-1.0	1.5	3.8	7.1
Capital expenditure	-0.5	-5.2	-1.2	-7.0	-2.5
Other capitalised intangibles	0.0	0.0	0.0	0.0	0.0
Free cash flow	-1.6	-6.2	0.3	-3.2	4.6
Business acquistions	0.0	0.0	0.0	0.0	0.0
Proceeds from issuance	20.0	0.0	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	(6.2)	0.3	(3.2)	4.6
Cash at beginning of period	4.2	18.8	12.7	13.0	9.8
Cash at year end	18.8	12.7	13.0	9.8	14.4

Balance Sheet (A$m)	FY17	FY19e	FY19e	FY20e	FY21e
Cash	18.8	12.7	13.0	9.8	14.4
Receivables	1.2	2.3	3.2	4.4	5.3
Inventory	2.5	4.7	6.1	8.3	10.0
Other current assets	0.8	0.8	0.8	0.8	0.8
Property, Plant and Equipment	1.1	5.9	6.3	12.1	13.1
Intangible assets	79.1	77.8	76.5	75.2	73.9
Deferred tax assets	0.1	0.1	0.1	0.1	0.1
Total assets	103.6	104.4	105.9	110.6	117.6
Trade payables	1.3	2.5	3.2	4.3	5.3
Debt	0.3	0.3	0.3	0.3	0.3
Tax payable	-	-	-	-	-
Other liabilities	2.8	2.8	2.8	2.8	2.8
Deferred income tax liability	-	-	-	-	-
Provisions	0.2	0.2	0.2	0.2	0.2
Total Liabilities	4.5	5.7	6.5	7.6	8.5
Net Assets	99.1	98.6	99.5	103.0	109.1
Share capital	101.8	101.8	101.8	101.8	101.8
Retained earnings	(2.7)	(3.2)	(2.4)	1.2	7.3
Reserves	-	-	-	-	-
Shareholders Equity	99.1	98.6	99.4	103.0	109.1

Valuation Ratios (A$m)	FY17	FY18e	FY19e	FY20e	FY21e
Reported EPS (cps)	-1.8	-0.5	0.8	3.4	5.9
Normalised EPS (cps)	-0.6	0.8	2.1	4.7	7.2
EPS growth (%)	na	large	159%	128%	52%
PE(x)	**na**	**na**	**71.5**	**31.4**	**20.6**
EV/EBITDA (x)	6705.0	95.1	36.3	17.5	11.9
EV/EBIT (x)	-547.3	122.4	47.2	20.7	13.6
NTA (cps)	23.8	25.8	28.6	34.4	42.5
P/NTA (x)	6.2	5.7	5.2	4.3	3.5
Book Value (cps)	96.3	95.8	96.6	100.1	106.0
Price/Book (x)	1.5	1.5	1.5	1.5	1.4
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	27.7	38.4	53.0	63.6
EBITDA	2.5	4.3	6.0	9.2	12.2
Margin	19%	15%	16%	17%	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**	**31.5**	**43.0**	**59.9**	**72.6**
Group EBITDA	**0.0**	**1.4**	**3.7**	**7.7**	**11.3**

Interim Earnings	1H18	2H18
Revenues	13.9	17.6
EBITDA	0.6	0.8
D&A	-	-
EBIT	-	-
Tax	-	-
NPAT	-	-

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
Tim Piper	Industrials	612 8224 2825	tpiper
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