

Qusitive Technology Solutions, Inc. (QUIS – V)

May 21, 2020

Not Your Father's Consulting Business

Company Profile

Dallas, Texas-based Qusitive is a premier Microsoft solutions provider that helps enterprise organizations move, operate and innovate in the Microsoft cloud. The company was formed in 2017 as Fusion Agiletech Partners and went public via an RTO in 2018.

Investment Highlight:

- Qusitive's business is tied directly to providing professional services implementing Microsoft cloud solutions (which generates both recurring and non-recurring revenues, currently split ~78% / 22%) and also from licensing proprietary software built on Microsoft's technology stack
- The partner ecosystem is very important to Microsoft as 95% of its business is generated through this 40-year old partner-led ecosystem. We believe Qusitive is a strong member of this network as evidenced by its Microsoft Country Partner of the Year award for the US in 2019. The company also has full cloud capability, which places it in a select 5% of Microsoft partners. It also has Microsoft NSI (National Systems Integrator) status, which places it in the top 0.01% of Microsoft partners worldwide.
- Aside from organic growth in its core consulting business (expected in the ~15% y/y range), Qusitive also has a focused M&A strategy that targets geographic expansion, diversification of Microsoft service capabilities, service capacity, and recurring revenue platforms. To date, the company has completed to transformative acquisitions, which have brought scale, IP, and recurring revenues.
- Aside from its consulting expertise, Qusitive has also invested in proprietary SaaS-based solutions, which leverage the Microsoft cloud and emerging technologies. This is highlighted by products such as CRG emPerform and LedgerPay, the latter of which we believe has the potential to disrupt the multi-billion dollar payment processing and data analytics industry. LedgerPay was only recently launched and as already generated good revenue and partnership traction.
- We are initiating coverage with a Speculative Buy rating and \$1.20 target price, which is based on 2x CY21e EV/Sales for Qusitive's consulting business and 10x for LedgerPay. We view large deals, M&A and a better-than-expected ramp up of LedgerPay bookings as representing upside to our estimates and target price.

Initiating Coverage

Spec. Buy **C\$1.20**

Recent / Closing Price	C\$0.79
12-month Target Price	C\$1.20
Potential Return	52%

Estimates (US\$)

YE: Dec	FY19	FY20E	FY21E
Revenue (M)	18.5	46.0	56.6
EBITDA (M)	1.3	4.6	7.3
EBITDA margins	6.8%	10.0%	12.9%

Valuation

	FY19	FY20E	FY21E
EV/Sales	6.4x	2.6x	2.1x
EV/EBITDA	93.4x	25.7x	16.1x

Stock Data (M)

Shares O/S (Basic)	109.8	
Shares O/S (FD)	182.0	
Market Cap (Basic)	C\$86.7	
Market Cap (FD)	C\$143.8	
Pro-forma Cash	\$5.0	\$0.03/sh
Pro-forma Debt	\$19.2	\$0.11/sh
EV	\$117.7	

All figures in US\$ unless otherwise stated

Company Description

Dallas, Texas-based Qusitive is a premier Microsoft solutions provider that helps enterprise organizations move, operate and innovate in the Microsoft cloud. The company was formed in 2017 as Fusion Agiletech Partners and went public via an RTO in 2018.

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Stock Performance



Who They Are and What Do They Do?

- Dallas, Texas-based Quisitive is a premier Microsoft solutions provider that helps enterprise organizations move, operate and innovate in the Microsoft cloud. The company was formed in 2017 as Fusion Agiletech Partners and went public via an RTO in 2018.
- The company's expertise with Microsoft Azure, Microsoft 365 and Microsoft Dynamics platforms, which include Enterprise Resource Planning are helping industries such as financial services, manufacturing, oil and gas and retail, drive innovation and solve complex business challenges and accelerate their migration to the cloud.
- Aside from its strategic technology and business consulting expertise, Quisitive has also invested in proprietary SaaS-based solutions, which leverage the Microsoft cloud and emerging technologies, such as, big data, artificial intelligence, machine learning and Internet of Things. This is highlighted by products such as CRG emPerform and LedgerPay, the latter of which we believe has the potential to disrupt the massive payment processing and data analytics industry.
- To augment its organic growth, Quisitive also has a focused M&A strategy that targets geographic expansion, diversification of Microsoft service capabilities, service capacity, and recurring revenue platforms.
- We are initiating coverage with a Speculative Buy rating and C\$1.20/sh target price. We view acquisitions and an acceleration in LedgerPay adoption as key catalysts.

Success Tied To Market Leader Microsoft

- Quisitive's business is tied directly to providing professional services implementing Microsoft cloud solutions (which generates both recurring and non-recurring revenues, currently split ~78% / 22%) and also from licensing proprietary software built on Microsoft's technology stack.
- Microsoft (MSFT – Q, NR) is a company that needs no introduction, being the leading provider of commercial cloud services globally, including brands such as Windows, Office, and Dynamics. The company's cloud computing service called Azure for building, testing, deploying and managing applications and services through Microsoft-managed data centers is also a leading provider ranking just behind Amazon's (AMZN – Q, NR) AWS platform (Amazon at 33% versus Microsoft at 18% according to Synergy Research Group).
- The partner ecosystem is very important to Microsoft as 95% of its business is generated through this 40-year old partner-led ecosystem. We believe Quisitive is a strong member of this network as evidenced by its Microsoft Country Partner of the Year award for the US in 2019.
- Other highlights worth noting include Quisitive's full cloud capability, which places it in a select 5% of Microsoft partners and also its designation with Microsoft NSI (National Systems Integrator) status, which places it in the top 0.01% of Microsoft partners worldwide.

Snapshot of Quisitive Today

- Below, we have provided some of Quisitive's key highlights:
 - Microsoft National Systems Integrator status
 - 10 Microsoft Gold Competencies
 - Complimentary Microsoft Enterprise Cloud Expertise
 - Azure Public and Government Cloud
 - Dynamics 365 ERP and CRM
 - Microsoft 365
 - Offshore Development Center in Hyderabad, India
 - Geographic footprint in 8 key North American Cities
 - 300 employees
 - 500+ global customers.
- Quisitive generates revenues via (non-recurring) professional services fees, but also recurring revenues (currently ~22% of revenues), which comes in several forms including:
 - Azure cloud managed services
 - Cloud license revenue
 - SaaS IP Solutions, including CRG emPerform and LedgerPay

Augmenting Organic Growth With M&A

- Aside from organic growth, Quisitive has an M&A strategy, which focuses on:
 - Geographic expansion in both the US and Canada
 - Diversification of Microsoft service capabilities
 - Skilled consultants to increase its service capacity (utilization rates are currently are in the high-70%)
 - Recurring revenue businesses, which provide managed services licensing and other IP
- Financially, Quisitive is looking for companies in the \$10 – 50M annual revenue range with strong EBITDA margins in the 8 – 12% range
- The company's preferred deal structure include 1/3 cash, 1/3 stock, 1/3 earnout (2- 3 years)
- Valuation-wise, it is looking to acquire companies in the 6 – 9x TTM EBITDA range.
- The company's two key acquisitions-to-date include its June 2019 acquisition of Corporate Renaissance Group ("CRG") and the January 2020 acquisition of Menlo Technologies.

Recent Acquisitions - CRG

- In June 2019, Quisitive closed the acquisition of Corporate Renaissance Group (CRG) for i) cash of \$5,650,000, ii) 4,473,684 shares valued at C\$850,000, iii) a secured promissory note of C\$6.5M (10% with a 36 month term), and iv) 19.5M warrants with a C\$0.35/sh strike price (expires June 1, 2021). There were also C\$6.5M in potential (max) earnouts. The acquisition was valued at ~6.5x TTM EBITDA.
- Ottawa-based CRG has over 4,500 customers worldwide and are experts in business management, financial management, management consulting and software development. CRG generated revenues of C\$7.8M (30% recurring) and EBITDA margins of 38.5% in 2018.
- Like Quisitive, CRG is also an award-winning Microsoft partner with deep expertise in Microsoft Dynamics. CRG also introduced a recurring revenue stream driven through its Microsoft license subscriptions and CRG emPerform proprietary performance management subscription software solution.
- emPerform has over 200 active customers representing over 200,00 active users across North America, the Caribbean and the UK.
- This product, combined with Dynamics 365 for Talent, allows Quisitive to provide a total solution around Human Resource management.

Recent Acquisitions - Menlo Technologies

- In January 2020, Quisitive completed the acquisition of Menlo Park, California-based Menlo Technologies.
- Menlo is a global Microsoft technology services company specializing in cloud development, data analytics, mobile technology and enterprise business application services. The company offers managed onshore and offshore development services from its Silicon Valley headquarters and offshore development center in Hyderabad, India.
- The company generated September 2019 TTM revenues of \$17.5M and EBITDA of \$2.4M.
- Quisitive paid i) cash of \$3,774,190, ii) shares of 19,784,981, iii) a \$5M convertible debenture (10% coupon, 36-month term, convertible at C\$0.20, including a force conversion feature if the volume weighted average trading price is greater than or equal to C\$0.40 for 20 consecutive trading days. There was also a (max) earn-out of \$3.5M plus an additional incentive amount of \$1M.
- The acquisition price represented 6.2x TTM EBITDA.

LedgerPay – The Sizzle To The Steak

- In addition to its core Microsoft technology consulting business, Quisitive also launched LedgerPay (89% owned by Quisitive) in March 2020. Note there are an additional 1M shares of LedgerPay authorized, but not yet issued, which may be issued to third parties as employee incentives from time to time subject to TSXV approval (which shall be convertible into 2.124M QUIS shares). Upon issuance of those additional 1M shares of LedgerPay, Quisitive's indirect interest in LedgerPay would be reduced from 89% to 80%.
- LedgerPay is a secure Microsoft cloud-based payment processing and data insights product platform. It was incubated under Quisitive with ~\$3M having been invested over the past three years and operating expenses currently running at ~\$1M.
- LedgerPay represents the first payment solution optimized for Microsoft Azure making integration simple and seamless for merchants. The platform provides merchants with a fast, highly reliable and cost effective processing direct to Visa, MasterCard, etc with no intermediaries.
- Aside from traditional payment processing services, LedgerPay APIs also funnel live, tokenized SKU level non-cash purchase data securely and provide privately into its real-time marketing engine enabling frictionless access to the full suite of Microsoft data analysis business intelligence and AI tools. These tools enable merchants to use payment data to provide personalized consumer promotions, all in real-time without requiring consumers to enrol (unlike traditional loyalty programs).

LedgerPay - Good Early Traction

- LedgerPay has already generated strong early traction as evidenced by:
 - A March 26, 2020 announcement of a strategic partnership and software licensing agreement between LedgerPay and Rev19, which is a merchant services and financial technology company with over 4,000 customers.
 - Under the agreement, Rev19 is licensing LedgerPay's payment processing and payment tokenization platform to provide added value and insights to its merchant base. The contract value was undisclosed although we believe it is worth several million dollars (including license and annual maintenance) initially and could grow as LedgerPay's platform is adopted by Rev19's merchant base driving increased transaction volumes.
 - On April 7, 2020, LedgerPay announced a strategic go-to-market relationship with dunnhumby, which is a global leader in customer data science (and owned by Tesco). We believe this partnership could help LedgerPay to address larger organizations, which might be interested in its tokenization platform and then ultimately payment processing.
- In terms of the potential opportunity for LedgerPay, as an example, we would note that a top 15 grocer in the US with \$1.6B in non-cash payments could translate into a \$30M annual revenue opportunity leveraging LedgerPay's payment processing and tokenization solutions.

Financial Analysis

- From a financial perspective, Quisitive's last reported quarter Q4 2019 included revenues of \$5.4M, which was up 39% y/y. EBITDA was \$324k (or 6% EBITDA margins) versus negative \$730k a year ago. Q4 EBITDA included a \$460k discretionary bonus expense. Q4 2019 also benefited from the CRG acquisition, which closed in June 2019.
- For Q1 2020, the company guided to revenues of \$10.9 – 11.0M (versus \$4M a year ago), gross profit of \$4.1 – 4.3M (versus \$1.6M a year ago) and EBITDA of \$1.0 – 1.2M (versus \$0.65M a year ago). Q1 results will include almost a full quarter contribution from the acquisition of Menlo, which was acquired on January 2nd. Recall that Menlo generated TTM revenues of \$17.5M and EBITDA of \$2.4M.
- Q1 will not include contributions from LedgerPay's license agreement with Rev19, which we believe will begin contributing in late Q2 (in the form of upfront license revenues followed by annual maintenance once deployed). Recall that LedgerPay's annual (pre-revenue) cash burn was ~\$1M, although this could trend higher as marketing initiatives ramp up.
- On the balance sheet, post the acquisition of Menlo Technologies we estimate that Quisitive will have net debt of ~\$15M representing a net debt/EBITDA (CY20e) ratio of 3.3x. Cost of debt is ~10% and we expect that the company will likely look to refinance its debt over the near-term. There are also potential earn-outs from past acquisitions including CRG (~\$4.8M) and Menlo (~\$4.5M). We have not included a C\$6.5M purchase price note associated with CRG to debt as we expect it will be paid off with 19.5M share purchase warrants (C\$0.35 strike), which were issued to as part of the transaction. There are 21M warrants (including the aforementioned 19.5M warrants) and 3.7M options, which are all in the money and could represent cash in-flow of C\$8.6M if exercised. There is also a \$5M convertible debenture from the Menlo acquisition with a C\$0.20/sh conversion feature, which we have included in fully diluted share count (we expect the company to force convert this debenture in 2020). There are also 10.5M shares related to past contingent consideration expected to be issued in July 2020.

Initiating Coverage With a Spec. Buy Rating and C\$1.20 Target

- For our financial forecasts, we have modeled \$46M in revenues for CY20 and \$56.6M for CY21.
- We assume that revenue growth is relatively flat q/q in CY20 within Quisitive's core business (i.e. ex-LedgerPay to reflect the COVID-19 impact). We have also modeled ~\$2M contribution from LedgerPay. We have modeled ~15% organic revenue growth (in the core business) in CY21, along with ~\$6M in contribution from LedgerPay.
- We have modeled EBITDA margins of 10% in CY20 and improving to 12.9% in CY21 largely due to better professional services utilization, along with contributions from higher margin IP solutions (i.e. CRM emPerform and LedgerPay). The company's goal is to ultimately reach 15 – 20% EBITDA margins. We are also modeling a 25% effective tax rate keeping in mind that the company has ~\$4.7M in non-capital tax loss carry forwards.
- We are initiating coverage with a Speculative Buy rating and C\$1.20 target price, which is based on 2x CY21e EV/Sales for Quisitive's consulting business and 10x for LedgerPay. We view large deals, M&A and a better-than-expected ramp up of LedgerPay bookings as representing upside to our estimates and target price.

Comparable Valuation Analysis

Quisitive Comparable Analysis				EV/Sales		2-Year	
	Ticker	S/O (M)	Mkt Cap (\$M)	FY - 1	FY1	FY + 1	Revenue CAGR
Comps							
IT Services							
Accenture	ACN-US	637.03	124,334.93	2.8 x	2.8 x	2.7 x	3%
CGI Inc.	GIB.A-TSE	230.17	19,697.69	1.9 x	2.0 x	1.9 x	2%
DXC Technology	DXC-US	253.72	4,308.18	0.6 x	0.6 x	0.7 x	-7%
EPAM Systems	EPAM-US	55.64	12,461.01	5.2 x	4.6 x	3.7 x	17%
ManTech International	MANT-US	27.07	1,953.66	0.9 x	0.9 x	0.8 x	8%
Perficient Inc	PRFT-US	33.08	1,140.02	2.2 x	2.2 x	2.0 x	5%
Average				2.3 x	2.2 x	2.0 x	4.7%
Payment Processing							
Automatic Data Processing	ADP-US	429.77	57,924.99	4.1 x	4.0 x	4.0 x	1%
ACI Worldwide	ACIW-US	115.94	3,066.74	3.5 x	3.1 x	2.9 x	10%
Bottomline Technologies	EPAY-US	43.92	2,222.14	5.3 x	5.1 x	4.8 x	6%
Fidelity National Information Services	FIS-US	617.83	85,329.03	10.1 x	8.4 x	7.7 x	15%
Fiserv	FISV-US	669.48	70,831.43	6.4 x	6.5 x	6.1 x	2%
FleetCor Technologies	FLT-US	83.80	20,161.98	9.0 x	9.7 x	8.6 x	2%
Global Payments	GPN-US	299.11	53,979.61	13.6 x	9.4 x	8.4 x	27%
Jack Henry & Associates	JKHY-US	76.62	14,592.94	9.4 x	8.6 x	8.1 x	7%
PayPal	PYPL-US	1,173.98	177,200.80	9.8 x	8.7 x	7.4 x	15%
Square Inc.	SQ-US	362.99	29,779.56	13.0 x	12.1 x	9.4 x	18%
Average				8.4 x	7.6 x	6.7 x	10.4%
Total Average				5.4 x	4.9 x	4.4 x	7.5%
Quisitive	QUIS-CA	182.00	102.08	6.3 x	2.5 x	2.1 x	75%

Source: FactSet, Company filings, Beacon Securities

Risks To Our Analysis

Competition – The technology services industry is a competitive and very fragmented, including local boutique services firms and national/global IT consultancies. Competitors include Avanade, Slalom Consulting, Accenture and Catapult Systems. We believe Quisitive’s close relationship with Microsoft as evidenced by its National Solution Provider status (top 1%) and 2019 Country Partner of the Year award represents an important differentiator in the eyes of its potential customers. Within LedgerPay, the company will need to compete with larger incumbents such as Global Payments, Vantiv, Chase Paymentech, and Fiserv by leveraging its cloud-based payment processing and data monetization platform.

Customer concentration – The company does have some customer concentration with its top customer at ~15% and its top 10 at ~40%

Debt Position – While we believe Quisitive’s current net debt/EBITDA ratio of ~3.3x is manageable, we would note that its cost of debt is ~10%, which we view as high, although we believe it is looking to refinance its debt portfolio. We would also note that there are two relatively large loans ~\$7.5M and \$5.2M due in December 2020 and September 2020 respectively, which will need to be addressed over the near-term. There are also potential earnouts from past acquisitions, including CRG (~\$4.8M) and Menlo (\$4.5M).

Growing Profitably / Financing Risk – While the company’s consulting business is a relatively mature one, we would note that LedgerPay is still in the early stages of revenue growth, which creates forecasting risk. That said, we believe early successes with Rev19 and dunnhumby helps to alleviate some of this risk. Furthermore, there is a risk of potential dilution if the company does accelerate its growth plan either organically or via acquisitions or look to reduce debt.

Seasoned Management Team

Mike Reinhart, CEO, was formerly Co-founder, President and COO of RBA Inc, along with being an executive from BORN Information Services.

Michael Murphy, CFO, was formerly a VP at Docebo, Interim Chief Financial Officer at Acasta Enterprises, and CFO of Transeastern Power Trust.

Dr. Vijay Jog, President was the founder of Corporate Renaissance Group and a Chancellor Professor Emeritus and Distinguished Research Professor of Carleton University

Gary Prioste, President, was CEO of Menlo Technologies and formerly VP of Welocalize

Steve Balusek, Senior VP (Services), was previously an executive from RBA Inc.

Scotty Perkins, Senior VP (Product), was previously an executive from PayNearMe

Tami Anders, VP (Marketing), Formerly US Commercial ISV Go-to-Mark Lead and Business Development Manager, National Systems Integrator at Microsoft

Kevin Castillo, VP (Sales), was previously VP of Digital Solutions at Hitachi Consulting and Director of Enterprise Sales at Microsoft

Board of Directors

Michael Reinhart (Chairman), CEO of Quisitive

Gordon McMillan, Co-founder and Board Chair of Converge Technology Solutions (CTS – CSE, NR)

David Guebert, CFO of Mount Logan Capital, previously CFO of Clarocity

Philip Sorgen, Chief Revenue Officer at RingCentral, previously Corporate VP at Microsoft

Dr. Vijay Jog, President of Corporate Renaissance Group (part of Quisitive)

Collectively, Board and key officers own 23% of basic shares outstanding or 40% on a fully diluted basis

Capital Structure

Quisitive Technology Solutions - Capital Structure

	Shares	
Basic Shares Outstanding	109,839,678	
Warrants	21,391,997	Strike Price ranges between C\$0.35 - 0.50
Options	3,705,000	Strike Price ranges between C\$0.15 - 0.35
RSU	4,325,301	
Convertible Debenture from Menlo Acquisition	35,000,000	Expected to be converted into shares in 2020
Earnout (in shares) from past acquisitions	10,500,000	To be issued in July 2020
Fully Diluted Shares	<u>184,761,976</u>	Ignoring Strike Price

On a fully exercised basis, the company's outstanding options and warrants could bring in C\$8.6M of cash. C\$6.5M of the proceeds is expected to be used to repay a purchase price note from the CRG acquisition.

Source: Company filings, Beacon Securities

Quisitive Technology Solutions - Income Statement (US\$)				
	2018	2019	2020e	2021e
Revenue	12,606,724	18,525,288	46,000,000	56,600,000
Cost of revenue	7,933,300	10,588,212	28,520,000	35,092,000
Gross profit	4,673,424	7,937,076	17,480,000	21,508,000
Gross margins	37.1%	42.8%	38.0%	38.0%
Operating expenses:				
Sales and marketing	2,056,445	3,294,509	7,600,000	8,000,000
General and administrative	3,569,533	3,236,831	4,900,000	5,600,000
Development	0	136,496	400,000	600,000
Amortization	1,488,101	2,423,368	3,646,872	3,646,872
Interest expense	735,544	1,624,398	2,681,180	2,681,180
Finance costs		0	-65,048	-65,048
Earnout settlement loss		1,617,736	0	0
Stock-based compensation	403,864	289,604	644,932	644,932
Acquisition related expenses	327,463	2,119,177	0	0
Foreign exchange		-161,995	0	0
Listing expenses	2,570,700		0	0
Depreciation	94,787	664,226	701,056	701,056
Total operating expenses	11,246,437	15,244,350	20,508,992	21,808,992
EBITDA	-952,554	1,269,240	4,580,000	7,308,000
EBITDA margins	-7.6%	6.9%	10.0%	12.9%
Pre-tax income	-6,573,013	-7,307,274	-3,028,992	-300,992
Current income tax	38,187	245,379	-757,248	-75,248
Deferred income tax	0	-175,946	0	0
	38,187	69,433	-757,248	-75,248
Tax rate	-0.6%	-1.0%	25.0%	25.0%
Net income	-6,611,200	-7,376,707	-2,271,744	-225,744
Owners of the corporation	-6,594,814	-7,307,292		
Non-controlling interest	-16,386	-69,415		
EPS:				
Basic	-0.09	-0.08	-0.02	0.00
FD	-0.09	-0.08	-0.01	0.00
Shares outstanding:				
Basic	70,243,772	87,813,530	109,839,678	109,839,678
FD	70,243,772	87,813,530	182,027,261	182,027,261

Source: Company filings, Beacon Securities

Disclosure Requirements

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Does the analyst who prepared this research report have a position, either long or short, in any of the issuer's securities? Yes No

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Did the issuer pay for or reimburse the analyst for the travel expenses? Yes No

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As at April 30th, 2020	#Stocks	Distribution
BUY	56	69.1%
Speculative Buy	8	9.9%
Hold	4	4.9%
Sell	0	0.0%
Under Review	13	16.0%
Tender	0	0.0%
Total	81	100%

BUY Total 12-month return expected to be > 15%
 Speculative Buy Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
 Hold Total 12-month return is expected to be between 0% and 15%
 Sell Total 12-month return is expected to be negative
 Under Review
 Tender Clients are advised to tender their shares to a takeover bid or similar offer

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