

Canopy Growth Corp. (CGC-T)

Buying Headquarters On Hershey Drive

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- Canopy announced that it has **acquired the property at 1 Hershey Drive** – home to the Tweed facility and Canopy Growth's headquarters. Whereas the company previously leased 168K sq. ft., it has now purchased the entire 472K sq. ft. building on a 40 acre footprint.
- Canopy is clearly in expansion mode. Tweed has planned to have 39 growing rooms in the currently-licensed 168k sq. ft. area. 12 of these rooms are already operational and another 12 multi-level (i.e., stacked) rooms are nearing completion which we expect will contribute to revenue in the second half of calendar 2017. With the acquisition of the building, **Tweed has effectively tripled its production potential in terms of existing square footage**, and there remains **significant potential to eventually construct more buildings on the property** as needed in the future.
- The purchase price for the property was \$6.6MM. Of this, \$5.7MM was paid in cash (part of the \$12.6MM use of proceeds from its recent financing earmarked towards "identified potential real estate acquisitions") and the remainder was paid in shares. We note that Mr. Bruce Linton (Canopy's CEO) agreed to take all of his portion of proceeds (he was a part owner of the building) in Canopy shares valued at the 5-day VWAP of \$9.7882/share – which we see as a positive signal.
- The company referenced its ability to 'recycle' the equity invested in the property by one day using it as collateral to fund future expansion.
- Lyrics to a song by Snoop Dogg, Canopy's business partner, include the words "buy it, never rent it." It appears Canopy's management/board has taken this advice as it relates to its head office facility. However, we do not believe this represents a wholesale change in the company's 'lease vs. buy' approach. Recall that Canopy has an agreement with The Goldman Group whereby Goldman has agreed to buy/build facilities to Canopy's specifications and enter into long-term leases. On its Q2/FY17 conference call, management indicated that it has "looked at 30 buildings across Canada as possible acquisition targets."
- More M&A was one of Canopy's potential catalysts for this quarter we outlined in our report dated January 10, 2017. **Other potential catalysts** to look forward to include: **inclusion in the S&P/TSX Composite Index** (effective March 17, 2017); **licensing of Vert Medical**; **closing of acquisition of Mettrum Health Corp.** (MT-V, not covered); and **Q3/FY17 results** in mid-February (expecting sequential revenue growth to accelerate).
- **We maintain our Buy recommendation and \$14.50 target price.**

Acquisition of 1 Hershey Drive

BUY (Unch) **\$14.50** (Unch)

Previous Close	\$9.88
12-month Target Price	\$14.50
Potential Return	47%
52 Week Price Range	\$2.40 - \$17.86

Estimates

YE: Mar 31	FY16A	FY17E	FY18E
Revenue (\$MM)	\$12.7	\$44.8	\$119.1
EBITDA (\$MM)	-\$6.4	-\$7.6	-\$10.2
FD EPS	-\$0.05	-\$0.08	-\$0.13

Valuation

	FY16A	FY17E	FY18E
EV/Sales	114.3x	32.4x	12.2x
EV/EBITDA	nmf	nmf	nmf
P/E	nmf	nmf	nmf

Stock Data (MM)

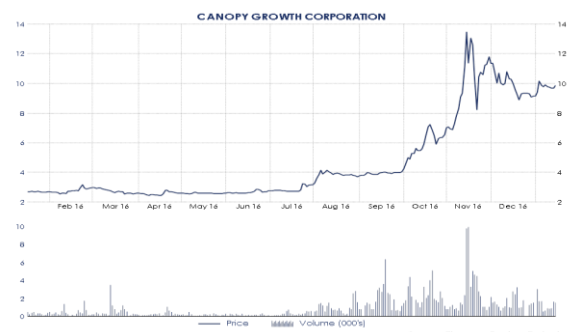
Shares Outstanding	
Basic	157.7
FD	167.4
Market Cap	
Basic	\$1,558.5
FD	\$1,653.8
Net Debt	-\$107.3
Enterprise Value	\$1,451.3

About the Company

Canopy Growth is in the business of producing and selling medical marijuana in Canada and is positioning itself for the pending legalization of the recreational market. The company's brands include: Tweed; DNA Genetics; Leafs By Snoop; and Bedrocan. Canopy has reached an agreement to acquire Mettrum Health Corp. (MT-V, not covered). Canopy is headquartered in Smiths Falls, Ontario.

All figures in C\$ unless otherwise indicated.

Stock Performance



Maintaining Buy and \$14.50 Target Price

- We suspect that the monthly rent saved on the 168k sq. ft. previously leased may be somewhat offset by the carrying costs (property tax etc.) of the entire property Canopy now owns. Accordingly, we have made no changes to our model – other than the issuance of shares and use of cash directly attributable to this transaction.
- Our \$14.50 target price for Canopy is derived by a DCF. Highlights from our DCF include: achieving 24% market share by FY22; revenue realized per gram rising to \$8.50 shortly after legalization, then falling to \$7.00 longer-term; adjusted cost of goods sold falling to \$2.10 longer-term; a discount rate of 10%; and a zero terminal growth rate post FY24.

Exhibit 1. Highlights Of Our DCF

	Mar-18 Q4/F18E	Mar-19 F2019E	Mar-20 F2020E	Mar-21 F2021E	Mar-22 F2022E	Mar-23 F2023E	Mar-24 F2024E	Terminal Value
(000's - expect share prices and share count)								
Revenue	\$35,546	\$248,707	\$495,522	\$878,661	\$1,385,728	\$1,802,560	\$1,923,372	
Adjusted Gross Margin	\$25,233	\$179,947	\$361,439	\$639,026	\$997,903	\$1,285,826	\$1,346,361	
EBITDA	-\$2,031	\$3,442	\$49,428	\$158,444	\$317,368	\$475,768	\$519,311	
Net Income	-\$5,128	-\$9,052	\$27,136	\$108,409	\$227,658	\$347,219	\$381,439	
Free Cash Flow	-\$13,535	-\$49,440	-\$19,444	\$53,976	\$168,414	\$314,036	\$366,940	\$3,669,404
PV of Free Cash Flow	-\$13,217	-\$45,626	-\$16,566	\$40,400	\$115,827	\$196,823	\$209,577	\$1,928,390
Discount Rate	10%							
Total PV of FCF	\$2,382,836							
Net Cash as at Valuation Date (Q3/FY18)	\$63,533							
Total Value	\$2,446,369							
Shares outstanding at Valuation Date	167,752,982							
Value per Share (Rounded)	\$14.50							
Current Price	\$9.88							
Return	47%							

Source: Thomson Reuters, Company reports, Beacon Securities.

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As at December 31, 2016	#Stocks	Distribution
Buy	67	77%
Speculative Buy	12	14%
Hold	3	3%
Sell	0	0%
Under Review	5	6%
Tender	0	0%
Total	87	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
Tender	Clients are advised to tender their shares to a takeover bid or similar offer

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