

Canopy Growth Corp. (CGC-T)

Received Approval To Acquire Mettrum; What's Next?

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Vahan Ajamian, CPA, CA, CFA

Analyst - (416) 643-3879

vajamian@beaconsecurities.ca

- We attended Canopy's shareholder vote on Friday where **94.18% of shareholders approved the proposed acquisition of Mettrum Health Corp.** (MT-V, not covered). With 99.76% of Mettrum shareholders also granting approval, the transaction is expected to close by the end of this month.
- The combined company will have a **licensed production footprint of 655K sq. ft.**, and represent **40% of industry patients (23% of industry volume)**. Canopy will control six of the 38 cultivation licenses granted by Health Canada.
- Mettrum shareholders will receive 0.7132 common shares of Canopy for each Mettrum share held. We understand that Canopy had pursued Mettrum for some time, and we believe **the terms of a potential share deal became more favourable over the past several months as Canopy grew at a faster rate.**
- After acquiring Bedrocan Canada in 2015 and now Mettrum, with tuck-ins along the way, we wonder what transaction announcements 2017 might bring. On its Q2/FY17 conference call, management indicated that it has "looked at 30 buildings across Canada as possible acquisition targets". We believe some of these may not simply be buildings – rather, like Mettrum, come with patients and revenue.
- 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**; the **release of new products** (management is particularly optimistic about **capsules**, which we believe may be authorized by Health Canada in the near-term); and **Q3/FY17 results** in mid-February (expecting sequential revenue growth to accelerate).
- We have made no changes to our estimates. **We maintain our Buy recommendation and \$14.50 target price.**

Highlights From Shareholder Meeting

BUY (Unch) \$14.50 (Unch)

Previous Close	\$9.92
12-month Target Price	\$14.50
Potential Return	46%
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	114.8x	32.5x	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	\$1,564.9
FD	\$1,660.5
Net Debt	-\$107.3
Enterprise Value	\$1,457.6

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

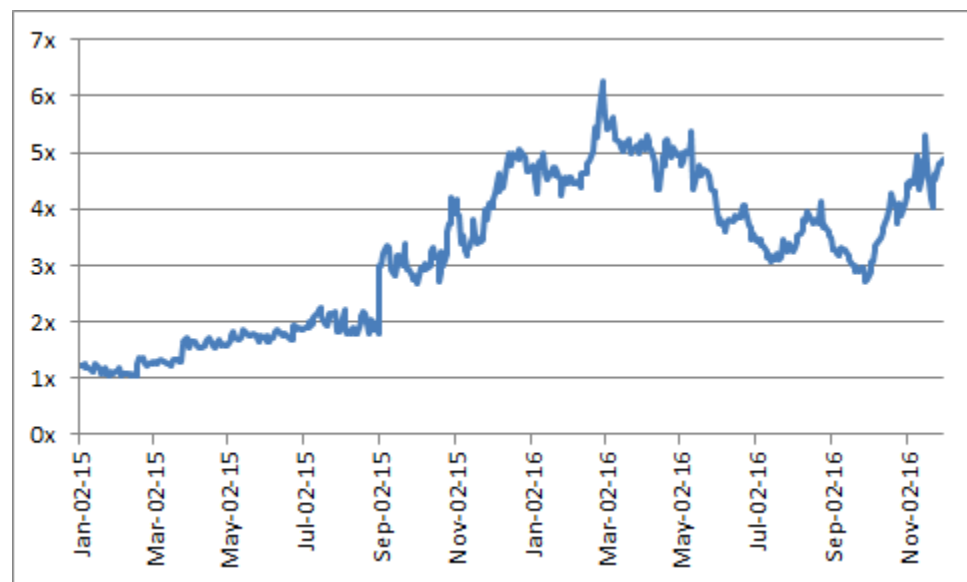


Highlights From Shareholder Meeting

Mettrum Negotiations

- Management disclosed that it had approached Mettrum a number of times previously regarding a possible transaction and was rebuffed.
- As Canopy's market cap accelerated significantly faster than Mettrum's over the past few years (Exhibit 1), we believe that the **terms of a potential deal would have shifted in Canopy's favour over this time**. We note that over the weekend media reports suggested that Mettrum expanded its product recall again.

Exhibit 1. Canopy's Market Cap / Mettrum's



Source: Thomson Reuters.

International Landscape

- Management indicated that **a few more years of "chaos" in the U.S.** (i.e., marijuana being illegal federally, but legal in several states) **is good for Canopy** in that it will allow Canopy to further cement its status as the major global player.
- The company remains **very bullish on Germany** – with CEO Bruce Linton predicting that as it matures **"we may do more medical revenue out of Germany than we do all revenue in Canada"** (emphasis ours). For more information on Canopy's activities in Germany, which just legalized medical marijuana, please refer to our research report dated January 20, 2017.
- Mr. Linton indicated that there was "lots happening in Brazil", and while Canopy has a stake in a company in Australia, it is even more excited about opportunities in South America. Canopy has received

inbounds from companies in all corners of the globe looking to partner, with the exception of Asia.

Pipeline of Many Products Coming

- Canopy is **currently building out all option ideas** representing different forms of marijuana products (edibles, concentrates etc.) and is **committed to producing all forms that the government will allow**. Management indicated that the Canadian public may be positively surprised by the breadth of offerings the government allows – as the government knows that whatever is not produced legally will be produced illegally.
- Management seemed **particularly bullish regarding medical capsules**. Canopy is prepared for mass production of capsules as soon as Health Canada provides the green light authorizing them (we understand this will be soon). We believe being able to provide standardized precise dosing which looks and feels the way medicine traditionally does **may result in significantly higher adoption by doctors**. If/when the company's products are eligible for a Drug Identification Number, we believe many insurance companies would like to cover the cost (as the government in Germany is mandating), seeing as the product would likely be cheaper than opioids they can often replace.
- Recall that Canopy owns ~46% of Canopy Health Innovations (CHI), a marijuana research incubator. Canopy will have the exclusive, first priority right to license and commercialize IP developed by CHI.

Shareholder Base

- While we believe Canopy's shareholder base is currently predominantly retail, we believe this will quickly change if, as we expect, the company is **added to the S&P/TSX Composite Index in this quarter's rebalancing**.
- Management indicated that it is seeing **many more large U.S. funds making day trips to tour its facility** recently.

Maintaining Buy and \$14.50 Target Price

- 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 2. Highlights Of Our DCF

	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	
	Q4/F18E	F2019E	F2020E	F2021E	F2022E	F2023E	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	\$9.92							
Return	46%							

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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