

REVISIONS	Rev.	Prior
Rating	Watch List	
Target Price	Watch List	
Revenue F2020E (M)	\$35.8	
Revenue F2021E (M)	\$119.4	

MARKET DATA

Date:	Apr 3, 2020
Current Price (C\$):	\$0.22
52-Week Range:	\$0.14 / \$0.83
Shares O/S (M):	109.1
Mkt Cap (\$M):	\$24.0
EV (\$M):	\$22.2
Avg. Weekly Vol. (M):	3.18

Website: www.nextleafsolutions.com

FINANCIALS

Fiscal Year End:	30-Jun		
	F2019A	F2020E	F2021E
Revenue (\$M)	\$0.0	\$35.8	\$119.4
EBITDA (\$M)	(\$7.1)	\$1.1	\$49.0
	F2019A	FQ1/2020A	
Cash (\$M)		\$4.3	\$2.0
Current Assets (\$M)		\$4.6	\$2.7
Total Assets (\$M)		\$10.0	\$9.2
Debt (\$M)		\$0.2	\$0.2
Total Liabilities (\$M)		\$1.0	\$1.0
Key Shareholders	(M)	% Held	
Mgmt. & Insiders	25.131	23.04%	
Stone Castle Inv. Mgmt.	1.285	1.18%	

Source: Company Reports, S&P Capital IQ, Yahoo!Finance, eResearch Corp.

Patrick Smith
Research Analyst
eResearch Corp.

Nextleaf Solutions Ltd. (CSE:OILS)

Nextleaf Signs Cannabis Extraction Agreement with Potential to Generate up to \$16M in Revenue Over the Next Year

COMPANY DESCRIPTION:

Nextleaf Solutions Ltd. is a Canadian extraction technology company that has developed a portfolio of issued and pending patents. These patents pertain to the Company's unique industrial-scale process of producing purified cannabinoid distillate, a tasteless, odourless cannabis concentrate best suited for infusing premium value-added products. The Company's industrial-scale processing facility, Nextleaf Labs Ltd., is located in Coquitlam, B.C. Based on one shift per day, Nextleaf has the design capacity to process 600 kg per day of dried cannabis biomass into distilled oils.

COMPANY UPDATE:

First Commercial Tolling Contract:

IMPACT: Very Positive

- Nextleaf Labs expects to process 15 tonnes of cannabis biomass into distilled THC and CBD oils for a privately owned licensed producer.
- The licensed producer operations are in Ontario, out of a 10-acre greenhouse.
- The initial term is for 12 months or earlier. After processing the 15 tonnes of biomass, the agreement automatically renews.
- This contract represents only 7.5% of the Company's annual capacity.

TAKEAWAYS:

- Management expects the contract to generate up to \$16M in revenue over the next 12 months, implying a price of \$1.07/gram. We assume the cannabinoid content of the supply biomass is likely within a range of 4-6%.
- We fundamentally believe that Nextleaf secured this contract because of the Company's ability to process at scale and at a lower price point than its competitors. OILS can process the 15 tonnes of biomass in 75 days using one shift. In comparison, processors using CO₂ would require eight machines to achieve the same throughput at higher costs (not scalable).
- Combined with the royalty license agreement announced in Dec. 2019, these two contracts represent \$18M in revenue potential. This does not include any other new revenue, which is highly likely. We estimate that OILS trades at 0.7x 2020 EV/Revenue compared to extraction peers at 1.1x.

FINANCIAL ANALYSIS:

- **The timing and size of this contract is ahead of our expectations. However, our recommendation and target price are pending as we are in the process of transferring coverage to eResearch. For reference, stated below are our sales and EBITDA estimates for the next two years.**
 - **F2020: Revenue \$35.8 million; EBITDA \$1.1 million**
 - **F2021: Revenue \$119.4 million; EBITDA \$49.0 million**

All figures in C\$ unless otherwise stated.

FINANCIAL ANALYSIS: (cont.)

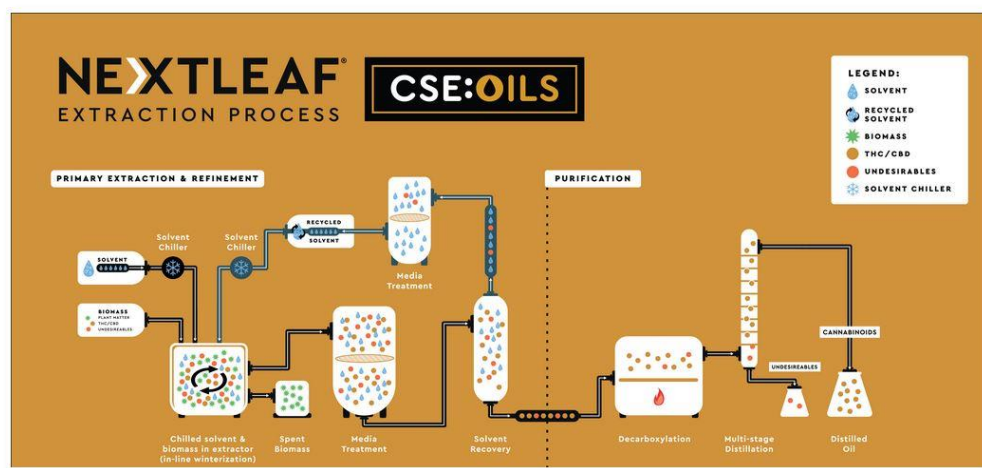
- Based on our previously published estimates, OILS now trades at 0.2x 2021 EV/Revenue and 0.4x EV/EBITDA, respectively, versus extraction comps at 0.7x 2021 EV/Revenue and 2.4x 2021 EV/EBITDA (see Appendix A).
- Recent share price weakness not justified. We believe Nextleaf's share price weakness over the past few months was driven by several factors. The first factor was a sector-wide selling correction caused by poor financials, layoffs, and bankruptcies. This was then followed by a black swan event, the Covid-19 pandemic, that drastically reduced global supply and demand, and sunk the S&P 500 by 17%, TSX by 21% and Nextleaf by 20% in the past month (see Appendix B).
- Companies with strong fundamentals were affected regardless of what segment of the cannabis market they operated in. To illustrate, we have a US and Canadian publicly traded sample sets in Appendix A. Year-to-date, both sample sets are down 42% and 41%, respectively. We estimate that over the next few months, as retailers and consumers' interest in Cannabis 2.0 spark up, and negative commentary falters, the whole space should benefit. In addition, companies focused on extraction like MediPharm Labs, Valens, and Nextleaf will continue to report strong cash flowing quarters, and fundamentals will begin to lead the way.

COMPANY SUMMARY

Nextleaf Solutions Ltd. is a Canadian extraction technology company that has developed a portfolio of issued and pending patents. These patents pertain to the Company's unique industrial-scale process of producing purified cannabinoid distillate, a tasteless, odourless cannabis concentrate best suited for infusing premium value-added products. The Company's industrial-scale processing facility, Nextleaf Labs Ltd., is located in Coquitlam, B.C. Based on one shift per day, Nextleaf has the design capacity to process 600 kg per day of dried cannabis biomass into distilled oils.

Nextleaf has a patented ethanol extraction process that handles large amounts of biomass at scale, leading to lower CAPEX and OPEX, and higher efficiencies than its direct competitors do. Nextleaf ethanol extraction process scales at a lower CAPEX price point versus a comparably-sized supercritical CO₂ extraction system and the difference appears significant. As legal cannabis production in Canada and the United States continues to increase, scalable and cost-effective cannabis extraction and processing technology is likely going to be required to support a rapidly-growing demand for value added cannabis products, such as beverages, edibles, topicals and vape cartridge.

Figure 1: Nextleaf Extraction Process



Source: Company website

Nextleaf's patented extraction process improves upon traditional extraction methods and produces a refined, high-purity oil that is tasteless and odourless, which can be standardized and/or water soluble. Cannabinoid dose standardization is important for public safety and compliance with Health Canada requirements. Looking towards the future from a pharmaceutical perspective, in order to be issued a drug identification number (DIN) from Health Canada, or the FDA, every single capsule/tablet must meet specific dosage requirements, and each pill must have an effect that is consistent. Additionally, a standardized dosage enables patients and recreational users to have confidence in the consistency of the product. This is important from a dosage perspective to insure the correct amount of drug is in the medicine.

Location, location, location. Within a one-hour drive of Nextleaf's processing facility in Coquitlam, B.C., there is an estimated 9 million square feet of licensed and proposed cannabis greenhouse space that is anticipated to yield 108 tonnes of waste trim and 300 tonnes of dried flower per year. An abundant supply of cannabis biomass provides a significant opportunity for Nextleaf to contract out toll processing and white label production. We believe there will be excessive supply in the market, so small and large cannabis cultivators are likely to sell their dry cannabis for extraction rather than for retail distribution. This is because the biomass needs to be processed, otherwise the value of the dry cannabis is quickly depreciated and cultivators lack extraction and processing capacity due to CAPEX requirements and extraction expertise.

Strong management with solid record of accomplishment. Management has over 20 years of experience in the cannabis industry and financing emerging growth companies. Paul Pedersen, the CEO and CFO of Nextleaf, previously worked for Greywood Partners, which advised Peace Naturals, the first Licensed Producer ("LP") that was licensed to produce cannabis oil under the Marihuana for Medical Purposes Regulations ("MMPR") in 2015. In addition, Nextleaf's operations are managed by Tom Ulanowsk, the former Quality Assurance Person (QAP), Quality Assurance Manager, and Qualified Person in Charge (QPIC) at Canna Farms Ltd (British Columbia's first LP). We are confident that management can execute on their business plan given their extensive experience in emerging growth companies and relevant industry experience.

Tight capital structure. On March 14, 2019, the Company closed its reverse takeover (RTO) financing of \$5.0M at \$0.35/unit, which was used to complete the build out of its 6,540 square feet processing facility located in the Greater Vancouver Area, B.C. On May 15, 2019, Nextleaf closed a \$4.0 million financing at \$0.40/unit. Currently, there are 109.1 million basic shares outstanding with 23% Management & Insider ownership.

Figure 2: Examples of Consumer Products from Cannabis Extracts



Source: Pixabay

CANNABIS EXTRACTS MARKET

Cannabis 2.0: the extracts market for beverages, edibles, topicals, vape cartridges, and more. Canada legalized cannabis derivatives in October 2019, and these new products are expected to outsell dried cannabis sales over the next five years.

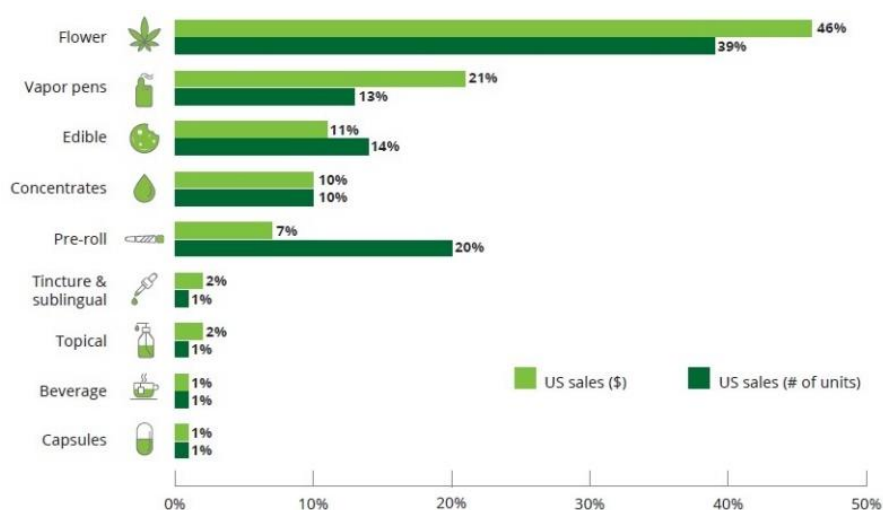
According to Ernst and Young's "Defining the Cannabis Sector in Canada by 2025", the size of the legal cannabis market in Canada is estimated to grow from \$6.5 billion in 2019 to \$11 billion in 2025. EY estimates that 54% of revenue could come from concentrates (extracts, edibles, and derivatives), and by extrapolating, we can estimate a market value for concentrates of approximately \$6 billion by 2025.

According to Deloitte's updated Cannabis Report 2.0, the Canadian market for edibles and alternative cannabis products is estimated to be C\$2.7 billion annually, in-line with EY's estimate for 2019. In addition, the variety of cannabis derivatives opens opportunities for new users who would prefer an alternative to inhaling cannabis. Approximately one in four Canadians either already consumes cannabis edibles or would like to.

Data from BDS Analytics estimates an even faster ramp-up with cannabis concentrates and vape markets having the potential to reach revenues of US\$14.9 billion in North America by 2022.

Recent usage in Colorado shows that dried cannabis sales dropped to 44% of total cannabis sales in 2018 compared to 67% in 2014, even though total cannabis sales increased. According to Zion Market Research, the cannabis oils market generated US\$147 million in 2018 and is expected to reach US\$2.4 billion by 2025 (CAGR of 49.5%).

Figure 3: 2018 U.S. Cannabis Sales (Value vs No. of Units)



Source: Deloitte Cannabis Report 2.0 (2019)

This new segment is attractive for cannabis companies due to its higher margins, diversity in product channels, and speed in product development. However, high demand for cannabis derivatives requires immense scaling of oil extraction, which is too capital intense for cannabis production companies to invest into R&D for yield efficiency and infrastructure to support the separate operation.

Competition in the cannabis consumer products space is coming from multi-national consumer package companies that are developing relationships and acquiring assets, either to take advantage and develop new cannabis derived products or to hedge their own products, such as alcohol, that may be cannibalized by cannabis products.

In August 2018, Constellation Brands, Inc. (NYSE: STZ), international distributor of Corona, invested C\$5 billion for a 38 percent ownership stake of Canopy Growth Corp. (TSE: WEED), the largest cannabis company in the world by market capitalization. Similarly, Molson Coors Brewing Co. (NYSE: TAP), the world's seventh largest brewer by volume, developed a joint venture with Quebec based cannabis company, Hexo Corp. (TSE: HEXO), with a 57.5 percent controlling stake. These two collaborations between alcohol companies and cannabis companies will explore opportunities in developing Canada's first cannabis-infused, non-alcoholic beverages.

APPENDIX A: CANNABIS COMPARABLES

Figure 4: Cannabis Extraction and Canadian Majors Comparables

Company Name	Last Price (\$CAD)	Mrkt Cap (\$CAD)	EV (\$CAD)	Cash (\$CAD)	Debt (\$CAD)	EV/Revenues			EV/EBITDA		
						2019E	2020E	2021E	2019E	2020E	2021E
Nextleaf Solutions Ltd	\$0.22	\$23.7	\$21.3	\$2.0	\$0.2	n/a	0.7x	0.2x	n/m	n/m	0.4x
<u>Pure Play Cannabis Extraction Companies</u>											
MediPharm Labs Corp.	\$1.53	\$206.1	\$178.1	\$38.6	\$10.6	1.5x	0.9x	0.8x	10.3x	3.4x	2.5x
Valens GroWorks Corp.	\$2.16	\$275.9	\$226.0	\$49.9	\$0.0	1.4x	1.0x	0.7x	3.3x	2.6x	2.4x
Neptune Wellness Solutions Inc.	\$1.65	\$156.9	\$141.5	\$20.8	\$5.4	4.4x	1.4x	0.7x	n/m	19.3x	2.3x
Radiant Technologies Inc.	\$0.17	\$47.2	\$57.3	\$0.6	\$10.6	n/a	n/a	n/a	n/m	n/m	n/m
Mean Cannabis Extraction						2.4x	1.1x	0.7x	6.8x	8.4x	2.4x
<u>Canadian Majors</u>											
Canopy Growth Corporation	\$18.73	\$6,549.0	\$5,654.7	\$1,561.7	\$667.4	13.2x	8.0x	5.2x	n/m	n/m	n/m
Aurora Cannabis Inc.	\$1.13	\$1,375.5	\$1,821.3	\$156.3	\$602.1	6.6x	4.1x	2.8x	n/m	86.9x	17.0x
Cronos Group Inc.	\$7.84	\$2,734.7	\$1,187.9	\$1,556.0	\$9.2	15.4x	5.1x	3.1x	n/m	n/m	23.8x
Tilray, Inc.	\$7.83	\$871.5	\$1,354.5	\$125.5	\$608.5	4.0x	2.5x	1.6x	n/m	n/m	13.2x
Aphria Inc.	\$3.97	\$1,061.0	\$1,068.8	\$497.7	\$505.5	2.0x	1.5x	1.3x	39.5x	11.1x	8.2x
HEXO Corp.	\$0.94	\$267.1	\$295.9	\$80.4	\$109.2	3.9x	2.1x	1.5x	n/m	n/m	21.4x
OrganiGram Holdings Inc.	\$2.28	\$394.6	\$447.0	\$34.0	\$86.4	3.5x	2.2x	1.9x	14.7x	7.2x	6.7x
The Green Organic Dutchman Holdings Ltd.	\$0.29	\$89.4	\$82.8	\$27.6	\$21.0	2.4x	1.1x	0.6x	n/m	n/m	3.4x
Village Farms International, Inc.	\$3.47	\$195.2	\$229.0	\$15.6	\$49.4	1.0x	0.9x	0.8x	11.0x	3.6x	3.2x
Mean Canadian Majors						5.8x	3.1x	2.1x	21.7x	27.2x	12.1x

Source: S&P Capital IQ; eResearch Corp.

Figure 5: US Cannabis Companies, Beverages, and Outdoor Cultivators Comparables

Company Name	Last Price (\$CAD)	Mrkt Cap (\$CAD)	EV (\$CAD)	Cash (\$CAD)	Debt (\$CAD)	EV/Revenues			EV/EBITDA		
						2019E	2020E	2021E	2019E	2020E	2021E
US Based Operations											
Curaleaf Holdings, Inc.	\$5.14	\$2,705.7	\$2,907.8	\$54.9	\$257.0	3.1x	1.8x	1.7x	13.3x	5.7x	5.1x
Green Thumb Industries Inc.	\$8.00	\$1,779.0	\$1,916.0	\$60.5	\$197.5	3.2x	2.0x	1.8x	12.5x	6.5x	6.0x
Trulieve Cannabis Corp.	\$13.18	\$1,454.4	\$1,581.3	\$41.1	\$168.0	2.8x	2.2x	1.9x	7.2x	5.6x	4.3x
Charlotte's Web Holdings, Inc.	\$5.68	\$605.5	\$547.8	\$88.9	\$31.2	3.5x	2.2x	2.2x	n/m	13.9x	10.9x
Cresco Labs Inc.	\$3.76	\$768.2	\$737.1	\$97.5	\$66.4	1.0x	0.6x	0.4x	5.0x	2.0x	1.3x
Acreage Holdings, Inc.	\$2.37	\$215.5	\$268.7	\$0.0	\$53.2	0.7x	0.4x	n/a	n/m	2.6x	3.1x
MedMen Enterprises Inc.	\$0.30	\$186.7	\$861.9	\$34.0	\$709.2	3.2x	2.1x	1.6x	n/m	91.3x	10.9x
iAnthus Capital Holdings, Inc.	\$0.67	\$115.1	\$252.2	\$37.0	\$174.2	0.8x	0.5x	0.6x	5.1x	1.9x	n/m
Mean US Based Operations						2.3x	1.5x	1.5x	8.6x	16.2x	6.0x
Beverage Companies											
New Age Beverages Corporation	\$1.48	\$126.2	\$132.0	\$78.9	\$84.7	0.4x	0.3x	n/a	n/m	10.1x	n/m
The Alkaline Water Company Inc.	\$0.76	\$38.5	\$37.0	\$5.4	\$3.9	0.7x	0.5x	n/a	n/m	n/m	n/m
Sproutly Canada Inc.	\$0.09	\$20.5	\$29.7	\$0.5	\$9.6	n/a	n/a	n/a	n/m	n/m	n/m
The Tinley Beverage Company Inc.	\$0.32	\$33.7	\$33.7	\$2.6	\$2.6	n/a	n/a	n/a	n/m	n/m	n/m
BevCanna Enterprises Inc.	\$0.24	\$14.7	\$11.7	\$3.0	\$0.0	0.2x	0.2x	0.1x	1.2x	0.8x	0.8x
Mean Beverage Companies						0.4x	0.3x	0.1x	n/m	5.4x	0.8x
Outdoor Cultivators											
48North Cannabis Corp.	\$0.15	\$25.8	-\$5.9	\$32.6	\$0.9	n/a	n/a	n/a	n/m	n/m	n/m
Speakeasy Cannabis Club Ltd.	\$0.42	\$42.2	\$41.5	\$1.0	\$0.3	n/a	n/a	n/a	n/m	n/m	n/m
WeedMD Inc.	\$0.40	\$84.1	\$115.8	\$13.7	\$45.4	1.1x	0.7x	n/a	4.9x	2.3x	n/m
Aleafia Health Inc.	\$0.36	\$100.0	\$111.0	\$41.2	\$52.2	1.6x	0.7x	0.6x	38.0x	2.8x	n/m
Mean Canadian Outdoor Cultivators						1.3x	0.7x	0.6x	n/m	2.5x	n/m
Outdoor Cultivators											
Dixie Brands Inc.	\$0.19	\$22.9	\$23.1	\$1.2	\$1.3	n/a	n/a	n/a	n/m	n/m	n/m
Plus Products Inc.	\$0.60	\$31.7	\$25.7	\$29.5	\$23.5	0.4x	0.2x	n/a	n/m	1.4x	n/m
Harvest One Cannabis Inc.	\$0.09	\$19.4	\$21.3	\$0.8	\$2.7	1.7x	0.5x	n/a	n/m	n/m	n/m
Mean US Outdoor Cultivators						1.0x	0.4x	n/m	n/m	1.4x	n/m

Source: S&P Capital IQ; eResearch Corp.

APPENDIX B: 1-MONTH STOCK CHART – NEXTLEAF, SPX AND TSX

Figure 6: 1-Month Stock Chart – Nextleaf, S&P 500 and S&P/TSX Composite Index



Source: TradingView

APPENDIX C: ERESEARCH DISCLOSURE

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ANALYST ACCREDITATION

eResearch Analyst on this Report: Patrick Smith.

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