Initiation of Coverage

A research initiative by Canaccord Genuity

12 May 2021

Little Green Pharma Ltd
COLTS - Cannabis

Rating	Price Target
SPECULATIVE BUY	**A$1.10**
LGP-ASX	Price **A$0.65**

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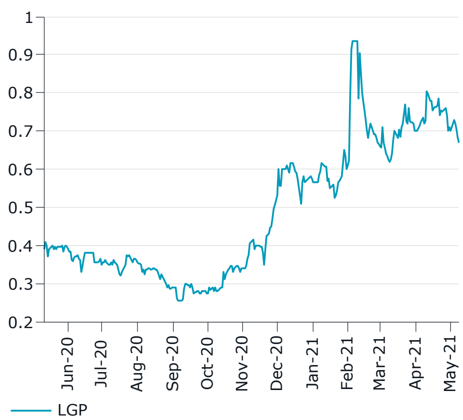
Market Data

52-Week Range (A$) :	0.25 - 1.02
Avg Daily Vol (M) :	0.7
Market Cap (A$M) :	122.3
Shares Out. (M) :	188.1
Enterprise Value (A$M) :	103
Cash (A$M) :	19.5
Long-Term Debt (A$) :	0.0

FYE Jun	2020A	2021E	2022E	2023E
Sales (A$M)	2.2	9.2	20.7	29.6
EBITDA (A$M)	(6.3)	(3.0)	0.8	4.6
Net Income (A$M)	(6.8)	(3.3)	0.1	2.6
EV/EBITDA (x)	(18.8)	(34.0)	136.6	24.6
P/E (x)	(9.7)	(31.4)	1,064.1	46.9
EV/Sales (x)	53.5	11.2	5.5	3.8
Net Debt (Cash) (A$M)	(4)	(20)	(8)	(9)



Source: FactSet

Priced as of close of business 10 May 2021

Little Green Pharma is a vertically integrated medicinal cannabis company. Its operations span cultivation, manufacturing, extraction, distribution and its owns its own brand that has strong market share in multiple countries.

Canaccord Genuity (Australia) Limited has received a fee as Lead Manager to the Little Green Pharma Ltd Capital Raising announced 8 February 2021.

It won't be little for long

Investment Recommendation

Little Green Pharma (LGP) is the most derisked business in an industry that has exceptionally strong growth tailwinds, in our view. LGP is a vertically integrated medicinal cannabis company that operates across the full value chain and its track record to date suggests that the strategy is proving highly effective with revenue growth, market share and margins among the highest in Australia. Large international orders appear likely to underpin impressive results in FY22E and beyond, in our view, and following a recent equity raise LGP is also well funded. We initiate coverage of LGP with a SPECULATIVE BUY rating and $1.10 price target.

LGP is an Australian medicinal cannabis company. Its operations span cultivation (currently 3t capacity of biomass which can be increased substantially in time), manufacturing (the company has a GMP certified facility in Western Australia) and branded products. We believe the cultivation and manufacturing are likely drivers of early stage value creation but that a strong product/brand increases the strength and defensibility of a cannabis business in the long run.

Our positive thesis on LGP is based on:

- **LGP's business model:** We believe LGP has one of the strongest models in the industry. The company's vertically integrated structure has meant that it can expand each area of its supply chain as the market requires. In an immature industry that is experiencing massive growth, we view this is crucial to success
- **Regulatory landscape:** Very few cannabis companies have LGP's level of regulatory approvals globally. The company has the full suite of Australian licences and permits, its operations are GMP certified and it has successfully undertaken the approval process to ensure compliance with the applicable EU, German and Australian regulatory requirements for the import/export of product. Given the time, cost and difficulty involved, this creates a natural competitive moat around LGP's business.
- **Medicinal cannabis TAM:** The cannabis industry is experiencing rapid growth as governments around the world relax laws around the access to products. We estimate the TAM of LGP's current markets at A$23b, but this appears likely to increase as new target countries are announced or as regulations relax further.
- **Results and execution:** As supporting evidence of the quality of its business model and its execution, LGP is growing faster than most peers, with high margins, and low overheads. After generating ~$0m revenue in FY19, the company reported ~$2m in FY20 and we estimate it is on track to generate ~$9m in FY21E. We are forecasting this to more than double to ~$21m in FY22E.
- **German order underpins near-term growth:** Berlin-based DEMECAN is driving near-term sales growth. We estimate the DEMECAN order saw ~1,000 units sold in 3Q21 and the company has guided to 9,000 being sold in 4Q21 followed by 17,000 in 1Q22. Based on already secured orders and no additional growth, the company is already run rating an FY22E revenue of $17.6m. This is purely a base case, and we expect additional orders and organic growth to be secured, and as such we currently forecast FY22E revenue of $20.7m with gross margins at close to ~50%.

Valuation and recommendation

We initiate with a SPECULATIVE BUY rating and $1.10 target based on a DCF model which assumes a 1.5 equity beta, 10.0% WACC and a terminal growth rate of 3%.

For important information, please see the Important Disclosures beginning on page 17 of this document.

Figure 1: LGP financial summary

Profit & Loss (A$m)	2020A	2021F	2022F	2023F
Sales Revenue	**2.2**	**9.2**	**20.7**	**29.6**
EBITDA	**-6.3**	**-3.0**	**0.8**	**4.6**
Depreciation	-0.1	-0.2	-0.6	-0.8
EBITA	**-6.4**	**-3.3**	**0.2**	**3.8**
Amortisation	-0.1	-0.1	-0.1	-0.1
EBIT	**-6.5**	**-3.3**	**0.2**	**3.8**
Net Interest Expense	-0.4	0.0	0.0	0.0
NPBT	**-6.8**	**-3.3**	**0.2**	**3.7**
Tax expense	0.0	0.0	0.0	-1.1
NPAT (Normalised)	**-6.8**	**-3.3**	**0.1**	**2.6**
Significant items	-2.5	-0.7	0.0	0.0
NPAT (Reported)	**-9.3**	**-4.0**	**0.1**	**2.6**

Cash Flow	2020A	2021F	2022F	2023F
Operating EBITDA	**-6.3**	**-3.0**	**0.8**	**4.6**
- Interest & Tax Paid	-0.4	0.0	-0.1	-1.1
+/- change in Work. Cap.	-0.8	-2.1	-2.9	-1.3
- other	1.4	0.0	0.0	0.0
Operating Cashflow	**-6.0**	**-5.1**	**-2.1**	**2.1**
- Capex	-6.3	-7.6	-9.1	-1.6
- Aquisitions/divestments	-0.5	0.0	0.0	0.0
- other	-0.3	0.0	0.0	0.0
Free Cashflow	**-13.1**	**-12.7**	**-11.2**	**0.6**
- Ord Dividends	0.0	0.0	0.0	0.0
- Equity /other	16.9	28.0	0.0	0.0
Net Cashflow	**3.8**	**15.3**	**-11.2**	**0.6**
Cash at beginning of period	0.5	4.3	19.5	8.3
+/- borrowings / other	0.0	0.0	0.0	0.0
Cash at end of period	**4.3**	**19.5**	**8.3**	**8.9**

Balance Sheet	2020A	2021F	2022F	2023F
Cash	4.3	19.5	8.3	8.9
Inventories	1.3	3.3	5.5	6.2
Debtors	0.6	2.0	4.9	6.2
PPE	7.5	13.9	21.5	22.1
Intangibles	0.6	0.8	1.7	1.8
Other assets	2.0	2.0	0.4	0.4
Total Assets	**16.4**	**41.5**	**42.2**	**45.5**
Borrowings	0.0	0.0	0.0	0.0
Trade Creditors	2.1	3.3	5.5	6.2
Other Liabilities	1.8	1.8	1.8	1.8
Total Liabilities	**4.1**	**5.3**	**7.6**	**8.2**
NET ASSETS	**12.3**	**36.2**	**34.7**	**37.3**

Board of Directors / Substantial Shareholders		
Board of Directors & Management	**Shareholding**	**%**
Fleta Solomon - Managing Director	20.3	10.8%
Angus Caithness - Executive Director	6.4	3.4%
Michael Lynch-Bell - Non Executive Chair	1.1	0.6%
Neale Fong - Non Executive Director	0.9	0.5%
Major Shareholders	**Shareholding**	**%**
Elixxer	27.4	14.6%
Fleta Solomon - Managing Director	20.3	10.8%
Top 20 Shareholders	**76.6**	40.7%

Description

Little Green Pharma is a vertically integrated medicinal cannabis company. Its operations span cultivation, manufacturing, extraction, distribution and its owns its own brand that has strong market share in multiple countries.

Valuation ratios	2020A	2021F	2022F	2023F
EPS	-6.7	-2.1	0.1	1.4
P/E (x)	-9.7	-31.4	1064.1	46.9
PER Rel - All Ords.	-160%	-296%	6635%	201%
PER Rel - Small Ind.	-156%	-300%	6900%	217%
Enterprise Value ($m)	118.0	102.7	114.0	113.4
EV / EBITDA (x)	-18.8	-34.0	136.6	24.6
EV / EBIT (x)	-18.2	-31.1	585.0	30.2
DPS (AU$ cps)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
Franking (%)	100%	100%	100%	100%
CFPS (cps)	-6.0	-3.2	-1.1	1.1
P / CFPS (x)	-10.9	-20.3	-57.4	57.8

Profitability ratios	2020A	2021F	2022F	2023F
EBITDA Margin (%)	-285.5	-33.0	4.0	15.6
EBIT Margin (%)	-293.9	-36.1	0.9	12.7
ROE (%)	-55.5	-9.2	0.3	7.0
ROA (%)	-41.6	-8.0	0.3	5.7
ROIC (%)	-80.1	-19.5	0.7	9.4

Balance Sheet ratios	2020A	2021F	2022F	2023F
Net Debt (cash)	-4.3	-19.5	-8.3	-8.9
Net Gearing (ND/E%)	-34.8%	-54.0%	-24.0%	-23.8%
Interest Cover (x)	-18.4	-107.7	6.4	122.5
ND/EBITDA (x)	0.7	6.5	-10.0	-1.9
NTA per share (AU$)	0.17	0.27	0.18	0.19
Price / NTA (x)	3.9	2.5	3.7	3.4
EFPOWA (m)	101.5	160.8	188.1	188.1

Growth ratios	2020A	2021F	2022F	2023F
Sales revenue ($m)	786.9%	315.3%	125.6%	43.1%
EBITDA ($m)	34.1%	-52.0%	-127.6%	451.8%
EBIT ($m)	35.8%	-49.0%	-105.9%	1828.2%
NPAT ($m)	43.2%	-51.2%	-103.4%	2169.6%
Adj EPS (cps)	-2.2%	-69.2%	-102.9%	2169.6%
DPS (cps)	n/a	n/a	n/a	n/a

Interim Analysis	1H20A	2H20A	1H21A	2H21F
Revenues	1.3	1.8	5.6	5.4
EBITDA	-3.4	-2.9	0.2	-3.2
EBITDA margin (%)	-256.7%	-161.1%	3.7%	-60.0%
EPS	1.9	-8.9	0.3	-2.4
DPS	0.0	0.0	0.0	0.0

Valuation	
Discounted Cash Flow	
Cost of equity	11.5%
Cost of debt	5.5%
Net Debt/ Net debt + equity	20.0%
WACC	10.0%
Terminal Growth Rate	3.0%
Per Share (AU$)	**$ 1.10**

Source: Company reports, Canaccord Genuity estimates

Investment thesis

Little Green Pharma is a vertically integrated medicinal cannabis company. We initiate coverage of LGP with a SPECULATIVE BUY rating and a $1.10 price target.

We are bullish on the outlook for LGP for the following reasons:

- **Medicinal cannabis is an emerging industry globally that we believe warrants interest given its substantial, huge potential TAM and long-term tailwinds**

  We are bullish on the demand outlook for cannabis globally. The Australian Federal Government enacted legislation to legalise access to medicinal cannabis products in 2016 and countries around the world continue to make similar moves. The total number of patient approvals in Australia has grown to ~116,000 since it was legalised, of which ~74,000 occurred in the last 12 months. Similar dramatic growth rates have been experienced around the world and the potential eventual size of the market continues to increase as patient uptake exceeds expectations and countries gradually make further moves to relax restrictions. As it currently stands, we estimate LGP's existing target markets have a total addressable market worth ~$23b at maturity, although this could grow depending on future recreational or nutraceutical regulations.

Figure 2: Identified target markets of LGP and Canaccord TAM estimates. We believe the list of countries could grow and the potential TAM is likely to shift demanding on future regulations (which to date have generally increased the TAM substantially)

Country	Population (m)	TAM at maturity	Notes
Australia	25	A$1b	CBD over the counter could increase this estimate
France	65	A$6b	Currently illegal
Germany	84	A$8b	Already a large market
United Kingdom	68	A$6b	Restricted by condition, but CBD legal and widely available
Denmark	6	A$1b	
Brazil	213	A$2b	Cultivation illegal, but imported oils are ok
Total	**461**	**A$23b**	

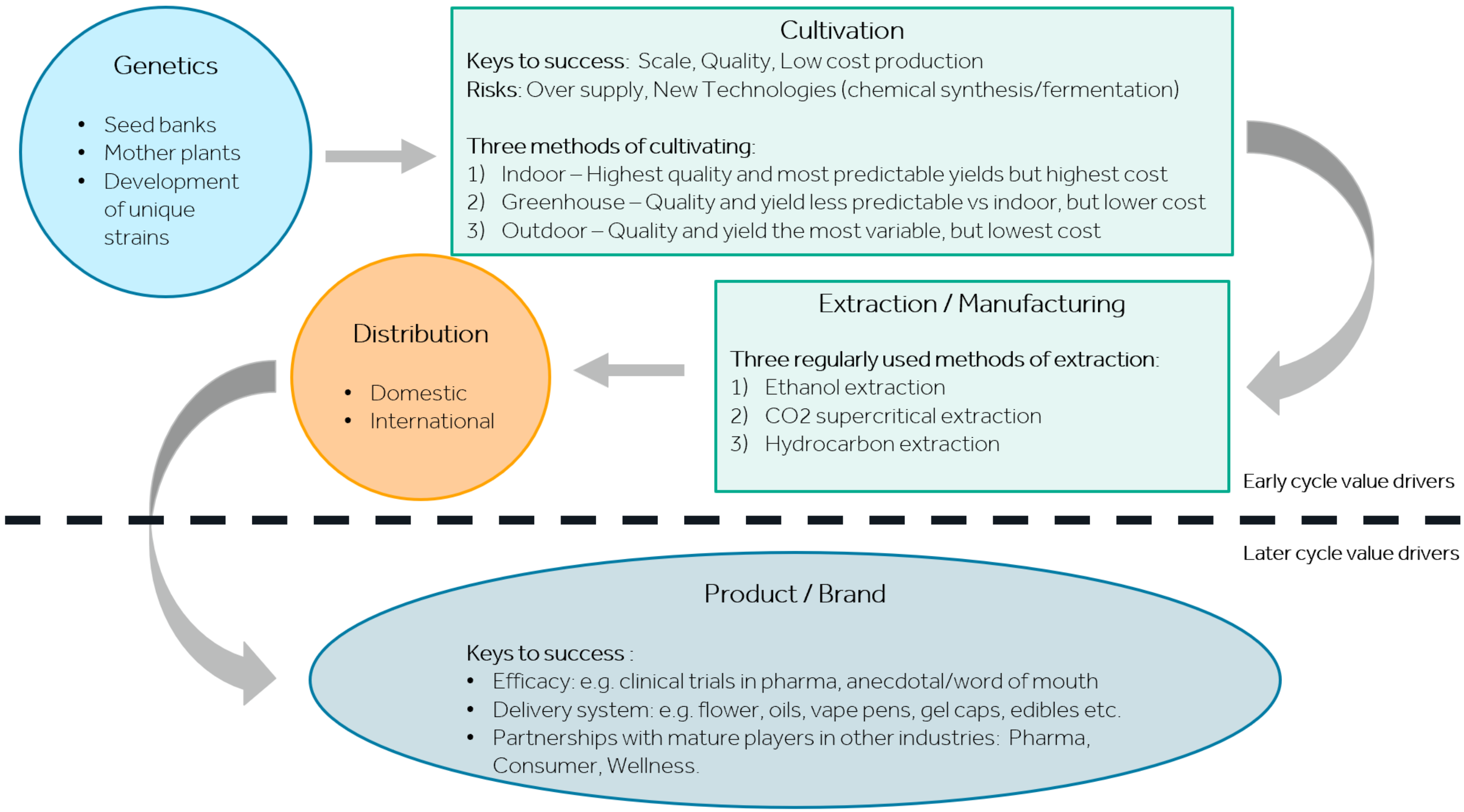
Source: Worldometer, Canaccord Genuity estimates

- **The company has put together one of the strongest business models in Australia and globally, in our view**

  We believe LGP has taken a measured approach to constructing its business model without overexposing itself to any one area of the value chain. The company's vertically integrated structure has meant that it can expand each area of its supply chain as the market requires. In an immature industry that is experiencing massive growth, we view this as crucial to success.

  We view the cannabis value chain (Figure 3) as split into early cycle valuation drivers and late cycle valuation drivers, and LGP's operations cover the length of the value chain. We believe this leaves the company less exposed to various risk factors including price deflation, becoming a price taker, over capitalising and market share strength.

Figure 3: The cannabis value chain – our view on valuation drivers in the medicinal cannabis industry and why we believe LGP has one of the most robust models in the sector. LGP's vertically integrated operations span the early cycle value drivers as well and the later cycle value driver

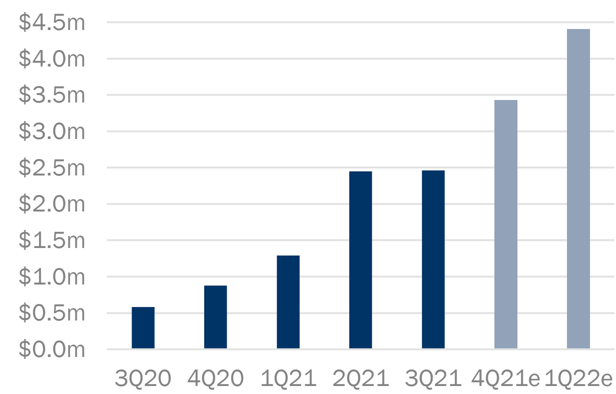


Source: Canaccord Genuity

- **We believe LGP is executing on its goals**

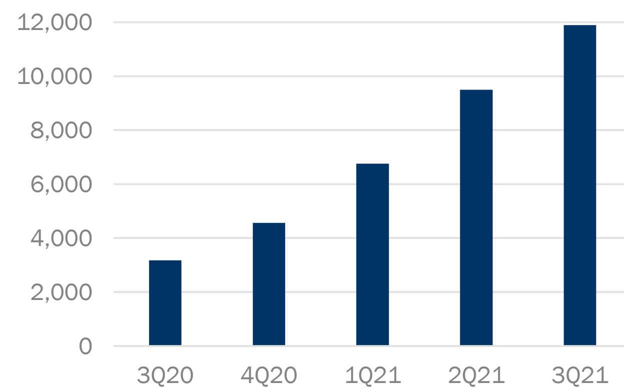
  As supporting evidence of the quality of its business model and its execution, LGP is growing faster than most peers, with high margins and low patient acquisition costs.

Figure 4: Historical and forecast revenue growth



Source: Company reports, Canaccord Genuity estimates

Figure 5: Historical patient number growth



Source: Company reports, Canaccord Genuity

- **Regulatory updates provide ongoing sentiment support and positive potential catalysts, in our view**

  We see ongoing potential for positive catalysts in the form of regulatory advances. For example, in the last few months we have seen several developments that have supported share prices of listed companies in the sector including:

  - The TGA making CBD an over-the-counter drug.
  - The US House of Representatives passing the Marijuana Opportunity, Reinvestment and Expungement (MORE) Act which seeks to de-schedule and remove cannabis from the Controlled Substances Act (CSA), and expunge historical cannabis convictions.
  - The United Nations commission voting to remove cannabis from its list of dangerous narcotics, which will see it removed from Schedule IV of the 1961 Single Convention on Narcotic Drugs.
  - The European Union (via the European Court of Justice) ruled that CBD is not a narcotic, which relaxes marketing restrictions and opens up the potential for companies to register products as novel foods.

  The trend of regulatory relaxation has been a prominent factor in the cannabis sector over the last decade and appears unlikely to slow down anytime soon.

- **Regulatory approvals provide defensibility and a competitive advantage**

  LGP has the full suite of Australian licenses and permits required for cultivation and manufacturing of cannabis products in Australia. The company's operations are also GMP certified which essentially means it can manufacture its own cannabis flower and oil products from its own cultivated flower for delivery into Australian and European markets. LGP has also successfully undertaken the approval process to ensure compliance with the applicable EU, German and Australian regulatory requirements for the import/export of product. There are very few cannabis companies globally that have this level of regulatory approvals, and the process of obtaining them is timely, challenging, and costly, which creates a natural competitive moat around LGP's business.

Company overview

LGP refers to itself as a 'company of firsts' due to its track record of reaching a number of milestones before its competitors in the Australian medical cannabis industry. Specifically, we believe LGP was the first company to produce domestically grown medical cannabis products for patients in Australia and more recently, the first company to export Australian grown and manufactured medical products overseas. The company is headed by Managing Director Fleta Solomon who is aligned with shareholders by her ~11% (20m) shareholding. Alongside Ms Solomon is Executive Director Angus Caithness who also holds over 6m shares as well as 3.5m options and 1m performance rights. In this section, we provide a company overview and discuss LGP's business model in some detail.

From soil to bottle: The lifecycle of an LGP crop

Based in Western Australia, LGP already had the capacity to cover all stages of the medical cannabis production process at the time of IPO in December 2019. Assisted by a manufacturing partnership with the only Good Manufacturing Practice (GMP) certified medical cannabis manufacturer in Western Australia, LGP was able to cover the entire cannabis lifecycle, from cultivation to manufacture to branded end products. Since then, the company has further in-housed the supply chain by constructing its own manufacturing facility at its southwest WA site and obtaining a GMP licence itself. The company has also materially increased its cultivation capacity by expanding its indoor facility and is likely to increase capacity further in the near term. We believe LGP's strategy of covering the entire production process is superior to focusing on one specific stage, as it gives the business control over its own destiny by allowing the company to react swiftly to customer requests without having to rely on partners. This is particularly important for addressing the needs of specific parties within burgeoning medical cannabis export markets in Europe such as Germany, France and the UK. Below we summarise the key stages in the medical cannabis production process and LGP's current capabilities for each stage.

Cultivation

Due to the strict standards for medical grade cannabis the cultivation process for commercial cannabis operations is sophisticated.

Figure 6: Stages of the cultivation process

Term/stage	Definition
Mother plants and mother rooms	The mother plant is the prototype that is essentially being replicated time and time again with each crop grown. Mother plants are selectively chosen to have the best characteristics (growth speed, durability, yield, potency, etc.) and provide an infinite supply of prototype plants with identical specifications that can be 'cloned'. Cloning is done by taking clippings from mother plants and replanting.
Vegetative rooms	Vegetative rooms are used to grow the clones while the crop is in the 'vegetative stage'. This is when the stems are growing but the plant is not yet flowering. By timing the vegetative phase to align with harvests, yields can be maximised by replacing harvested crops instantaneously.
Flowering rooms	The lengthiest stage of the cultivation process where the plants are left to flower.
Harvest and drying rooms	After harvesting, plants are hung in drying rooms for two weeks. This enables flowers to be removed and bagged for manufacturing more efficiently than if they were removed immediately (while still containing moisture).

Source: Company reports, Canaccord Genuity

Upon listing, LGP utilised two flowering rooms for a cultivation capacity 15,000 bottles per annum however has since substantially increased that. One of the reasons for listing was to raise capital to increase this cultivation capacity. The company has successfully completed its stated capacity expansion to now have a facility with nine flowering rooms, two vegetative and two mother rooms, capable of producing ~3 tonnes of flower (or 300,000 bottles of oil). The company also has room to double cultivation capacity within the fence line of the existing WA site which we estimate would cost ~$7-10m. Following this, the company now has the option to expand into two other properties that were recently secured.

Manufacture

Since its inception, LGP has utilised an exclusive manufacturing partner to manage the final stages of production where cannabis flower is converted into consumable products. The manufacturing partner can produce oils, tablets, suppositories and other consumables at its GMP certified facility in WA. Using the funds raised at IPO, LGP has since constructed its own in-house manufacturing facility to supplement its current partner-based arrangement. This was undertaken in preparation for expected increases in demand and will likely increase gross margins and de-risk any limitations from outsourcing, in our view. We estimate the company previously paid ~$20 per bottle for bottling however going forward, LGP plans to utilise its in-house production alongside its partners to respond efficiently to demand as needed.

Branded products

The company's flagship products are the LGP classic range of cannabinoid oils. We believe there are now six LGP-branded SKUs, in addition to some white labelled products. The SKUs include a range of THC:CBD ratio products (e.g. high THC, high CBD or a blend, etc.), with five of these oils and one flower.

Figure 7: LGP's branded products

Source: Company reports

We believe having a branded product in market (as opposed to just supplying white-label) is an astute strategy that provides an element of differentiation to competitors and will help drive more sustainable demand for LGP's medicinal cannabis directly from the source (patients and practitioners), as well as more sustainable pricing control. We see brand presence as particularly important in LGP's context – the company is entering a novel industry that still carries a level of uncertainty by participants. If patients and practitioners are experiencing uncertainty, they are more likely to gravitate towards a trusted brand, which in our view, LGP is building.

LGP's Australian leadership position provides a platform for growth in larger international markets, in our view

Whilst the Australian cannabis market is likely to grow to a significant size in time, we believe the larger opportunities for LGP are in the export markets. We believe Australia's history of producing restricted pharmaceutical actives from plants and its reputation of having reputable regulatory bodies such as the TGA, helps LGP to address the regulatory requirements of overseas markets that are unlikely to be met as quickly by companies based in nations with less reputable health bodies. Below we discuss LGP's current market position and opportunities within the geographies that it currently operates in.

Australia

As the first company to sell domestically grown medical cannabis products for patients in Australia, LGP has continued to deliver on its strategy, growing market share most quarters. We estimate that LGP will reach ~20% market share in Australia (from its current ~15%) as the market matures, however once CBD OTC accelerates it becomes more challenging to forecast market shares. Key highlights from the company's performance in Australia to date include:

- 11,900+ patients as of the March 2021 quarter, which is ~275% up on pcp.
- $2.3m of revenue in the March 2021 quarter, which is ~300% up on pcp.
- Entered a partnership with HIF, which became the first Australian health insurance company to publicly state a policy to provide rebates for medical cannabis products.
- Exclusively supplying The QUEST Initiative which aims to be one of the largest longitudinal studies investigating the quality of life for patients with chronic disease and who are prescribed medicinal cannabis. We expect the study to accelerate LGP's ability to attract patients while also lowering sales and marketing costs per patient. The study aims to recruit 2,100 patients.

Germany

Germany is the largest targeted medical cannabis export market for LGP and where the company has made the most inroads. At the time of its prospectus in December 2019, LGP had non-binding term sheets/letters of intent with three German distributors: CC Pharma, DEMECAN and Cansativa. These partnerships have progressed since then and are described below.

- **CC Pharma –** CC Pharma was the first German medical cannabis distributor to receive product shipments from LGP when LGP shipped 2,400 units of cannabis oil in November 2020. This initial shipment was valued at over A$600,000. CC Pharma has since been acquired by Aphria which is a Canadian competitor of LGP, so ongoing demand is uncertain.
- **DEMECAN –** On February 27, 2020, LGP announced the signing of a three-year purchase agreement with Berlin-based DEMECAN to supply up to 1,000kg of dried flower or 48,000 bottles of oil, or any combination thereof, per year. There are no minimum purchase requirements in the deal. The first commercial shipment was made on 5 February 2021, officially commencing the three-year arrangement. Although the first shipment was immaterial (500 units), the partnership has rapidly accelerated recently, with LGP expecting 9,000 units of flower (15g per unit) to be sold in 4Q21E and 17,000 in 1Q22E. We estimate the 1Q22E revenue will be worth $2.1m from DEMECAN alone, which translates to ~$8.3m annualised.

Each supply deal faced a stringent approval process that was undertaken by all parties involved to ensure compliance with applicable EU, German and Australian regulatory requirements. The CC Pharma process took almost two years, while DEMECAN took ~12 months. These laborious red-tape processes will be a deterrent to LGP's competitors and illustrates the benefits of LGP's first-mover advantage within a nation with globally recognised health care standards, in our view.

United Kingdom

LGP announced it has an established partnership with UK pharmaceutical distributor, Astral Health, which received its first shipments from LGP in April 2020. Unfortunately, there was no commentary provided about the outlook for volumes or revenues for LGP within the announcement.

France

On the 27 January 2021, LGP announced it had been successful in winning a French Government tender in a partnership with French pharmaceutical distributor, Instel Chimos, to supply medical cannabis for use in a two-year national trial that provides the only form of legal access to products in the country. We believe the outcome of the trial will likely determine the legalisation decision for the sector going forward. Key highlights:

- The focus of the trial is on the use of medicinal cannabis products in the treatment of clinical conditions that are resistant to conventional treatments.
- Plans to recruit over 3,000 patients during its lifetime.
- LGP received primary supplier status for two CBD-dominant oils.
- LGP received back-up supplier status for one balanced THC:CBD oil.
- Other global medical cannabis producers appointed as primary suppliers include large peers Tilray, Panaxia and Aurora.

We believe success among only three other global suppliers positions LGP extremely well to take significant market share of a newly established medical cannabis market in France if legalisation goes ahead in time. We believe it is likely that many of the patients recruited for trials will choose to continue using the brand that they first tried if it brings them symptom relief. We also believe a similar dynamic should play out within the doctor community, where early adopters who use one of the four brands supplying the trial will likely continue to use/recommend that brand if they find it to be efficacious. The products are provided by LGP free of charge, so the near-term financial impact is negative, however we are encouraged to see management making investments for the long term.

R&D programs and education initiatives to drive awareness

A key pillar of LGP's growth strategy is to increase the general awareness of the medical cannabis industry. Because the industry is new, one of the headwinds the company is facing is the lack of awareness, within doctor and patient communities, that medical cannabis is available as a viable treatment option. Strategies being undertaken include education initiatives and clinical trials.

Major R&D currently progressing includes its ARISE (Atomic Rapid Injection for Solvent Extraction) project which intends to facilitate improved targeting for release in the body. LGP is the global medicinal cannabis licenses holder for ARISE and is pursuing products that utilise the technology to optimise the delivery of cannabinoid medicines.

The company is progressing a liposomal delivery technology, with formulation optimisation expected to be completed by July 2021. LGP also recently completed a clinical investigation into the treatment of chronic refractory pain and the quality of life outcome measures associated with LGP's Classic 10:10 medicine.

Brief industry summary

Overview

Due to its therapeutic benefits and safety profile, countries around the world have been moving to amend legislative and regulatory frameworks to allow patients access to medicinal cannabis products. This has accelerated over the last decade to the point that the global cannabis industry is gaining widespread awareness and the accompanying financial returns. Led by the relaxation of medical cannabis laws in Canada in 2014 (which was extended to legalisation of recreational use in October 2018), the Australian government enacted legislation to allow the cultivation, production and manufacture of cannabis for medical use in November 2016.

Key medical properties of cannabis

Cannabis contains many active compounds, termed cannabinoids, but the two that garner the most attention are tetrahydrocannabinol (THC) and cannabidiol (CBD). THC, CBD and other cannabinoids work by acting on the cannabinoid receptor cells within the human brain and nervous system, which is referred to as the endocannabinoid system. These receptor cells control the release of neurotransmitters that regulate physiological processes such as mood, appetite, and pain. Studies have found that cannabinoids are efficacious in treatment for improving symptoms in many health disorders while also serving a protective function. Specific illnesses that have been found to be responsive to cannabinoids include but are not limited to multiple sclerosis (MS), pain, anxiety, insomnia, epilepsy and chemotherapy-induced nausea and vomiting (CINV). In Australia there are already over 100 conditions approved for treatment using medical cannabis.

Administration of medical cannabis is usually via oral ingestion, but it can also be smoked or vapourised. The final product usually takes the form of oils, drops, sprays or capsules which can be ingested by patients directly or added to food products. Smoking or vaporisation is less frequently recommended by health professionals as it increases the difficulty of dose control while carrying added health risks associated with the inhalation of smoke. However, in some extreme cases it is recommended due to its more rapid effects relative to oral digestion.

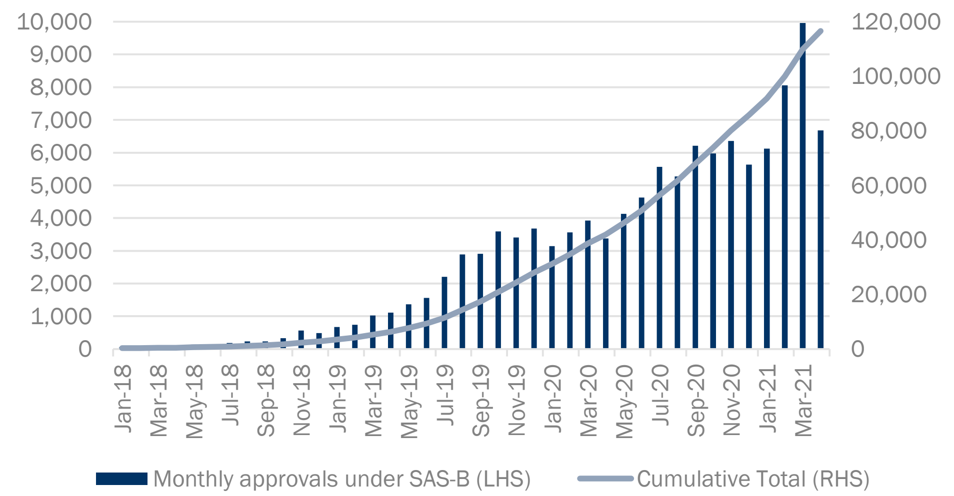
The Australian market

There is only two approved cannabis products in Australia (Sativex, which treats muscle stiffness in multiple sclerosis, and Epidiolex for seizures associated with two rare forms of drug resistant epilepsy), for all other products there are three key pathways for patients to access:

1. **Clinical trials.**
2. **Authorised prescribers:** These are doctors who have obtained regulatory approval to prescribe a specific product for a specific medical condition. As of 30 April 2021 there were 279 Authorised Prescribers, and this number has increased dramatically over the last 12-18 months.
3. **Special Access Scheme - B:** This has been the primary legal access path for patients in Australia. Patients and doctors make an application to the TGA for an unapproved product. The TGA has approved SAS-B applications for the following indications:
   - chemotherapy-induced nausea and vomiting;
   - refractory paediatric epilepsy;
   - palliative care indications;
   - cancer pain;
   - neuropathic pain;
   - spasticity from neurological conditions; and
   - anorexia and wasting associated with chronic illness (such as cancer).

Of the three channels described above, SAS is the main channel for patients to access medical cannabis in Australia. SAS numbers have been growing steadily since the industry was legalised in 2016 with 116,000, of which 74,000 have joined in the last 12 months.

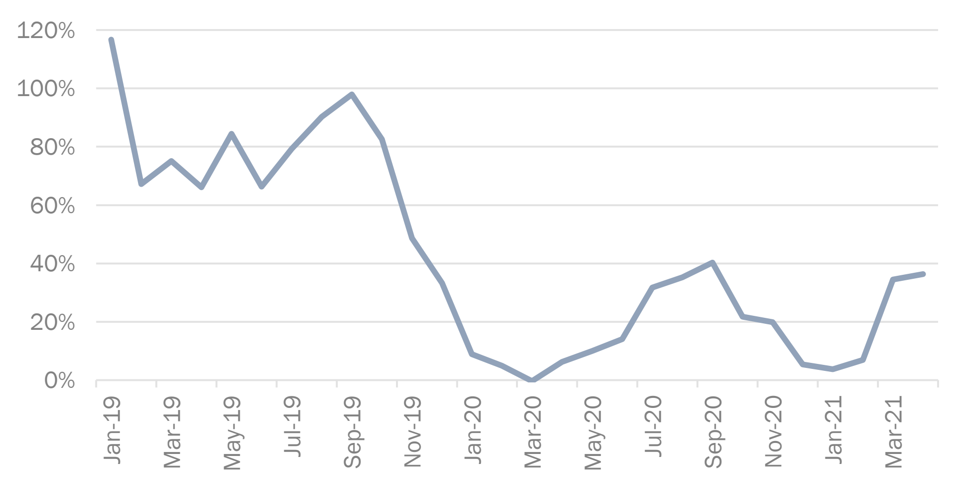
Figure 8: Number of SAS-B approvals for medical cannabis access



Source: Therapeutic Goods Association, Canaccord Genuity

Monthly fluctuations occur frequently due to various factors; however, the March numbers appear to have been partially driven by a flower shortage in Queensland that saw several products out of stock so authorised prescribers had to prescribe other products, which meant going through the SAS-B channel. For a smoother measure, the rolling quarter-on-quarter growth remains very high at 36%.

Figure 9: Rolling quarter-on-quarter growth of SAS-B approvals is ~36%



Source: Therapeutic Goods Association, Canaccord Genuity

We estimate the Australian market is currently run-rating ~$160m value at present, with ~43,000 active patients. There have been 74,000 applications in the last 12 months from patients wanting to access medicinal products under Special Access Scheme-B.

The scope of the market in each jurisdiction also has the potential to expand, and regulations are eased further, and product offerings increase in range.

Figure 10: Key subsets of products and the markets that may gradually open in Australia (which we believe may also be indicative of markets in other countries)

Current opportunity in Australia	Future potential opportunities in Australia	
Medical	**Wellness/Consumer**	**Recreational**
Primary legal pathway in Australia. Almost all cannabis-based medications are unapproved, so access is via Authorised Subscribers, Clinical Trials or Special Access Schemes. Requires high quality, consistent product. Hence higher cost to produce. Cost to patient is high - Average monthly cost to Australian patients in 1Q21 was $359. Currently not covered by insurance. Exports permitted (with licence/permit) for medical use only.	CBD is legalised as an over-the-counter product but there are no products registered yet. Many applications: supplements, food, beverages, skincare, cosmetics, animal health, etc. Can be extracted from low cost outdoor hemp crops. Large potential market.	Currently no legal pathway in Australia. Legal in Canada, some US states, Uruguay and parts of Europe. Many applications: joints, edibles, confectionary, vapes. Large potential market, could cannibalise part of the medical market if consumers self-prescribe.

Source: Canaccord Genuity

Key international markets

Canada: Canada is the most developed medical cannabis industry globally, having passed medicinal legislation in 2014 and then legalising recreational use in October 2018. Based on Statistics Canada retail sales data up to February 2021, on a trailing three-month basis, Canada is currently operating at an annualised revenue run-rate of C$3.4b.

United States: The market in the United States is inconsistent, with medical cannabis still technically deemed illegal at the federal level, while at the state level it is legal for medical purposes in 33 states and for recreational purposes in 10 states.

Germany: The German market is slightly more advanced than the Australian market but still small in its adoption rate compared to Canada and the US at ~0.1% of the population having used medicinal cannabis. Medicinal cannabis has been legal in Germany since 2001; however, the market underwent a step-change in its speed of adoption in 2017 when the regulations were relaxed and reimbursement by health insurers was allowed. The acceleration in adoption as health insurers began reimbursement could prove illustrative for the Australian market that does not currently have many reimbursement options available, in our view. The domestic cultivation and manufacturing markets in Germany are relatively underdeveloped, with most of their medicinal cannabis products being imported. Large international suppliers to the German market include Aurora, Canopy Growth, Cronos Group and Tilray/Aphria.

United Kingdom: The UK market is even earlier in its infancy than the Australian market with legalisation only enacted in October 2018 through the Misuse of Drugs Regulations. The number of patients is not meaningful at this stage, but CBD is common in consumer goods products.

Financials and forecasts

Income statement

LGP is a relatively young company operating in a rapidly changing industry, that is likely to experience strong growth in the coming years. We split our estimates up by geography (Australia and Export) as well as product (Oil and Flower).

Figure 11: Assumptions by product and geography

(A$m)	FY20	FY21E	FY22E	FY23E	FY24E	FY25E
Flower						
Domestic kg	0.0	30.0	94.2	169.1	303.7	545.3
Export kg	0.0	165.0	1,122.0	1,402.5	1,753.1	2,191.4
Domestic Units (15g per unit)	0	2,000	6,277	11,272	20,243	36,354
Export Units (15g per unit)	0	10,000	74,800	93,500	116,875	146,094
Implied domestic patients	0	913	2,866	5,147	9,244	16,600
Implied export patients	0	4,566	34,155	42,694	53,368	66,709
Domestic price $/unit	$0.00	$150.00	$142.50	$135.38	$128.61	$126.03
Export price $/unit	€ 0.00	€ 75.00	€ 73.50	€ 72.03	€ 70.59	€ 69.18
Domestic price $/g	$0.00	$10.00	$9.50	$9.03	$8.57	$8.40
Export price $/g	€ 0.00	€ 5.00	€ 4.90	€ 4.80	€ 4.71	€ 4.61
Oils						
Domestic (bottles: 50ml = 12g)	15,000	40,589	64,942	81,177	101,471	106,545
Export (bottles: 50ml = 12g)	0	7,000	10,500	31,500	63,000	126,000
Implied domestic patients	0	14,827	23,723	29,654	37,067	38,921
Implied export patients	0	3,196	4,795	14,384	28,767	57,534
Domestic price per bottle (50ml)	$146.93	$145.00	$137.75	$130.86	$124.32	$118.10
Export price per bottle (50ml)	€ 0.00	€ 145.00	€ 145.00	€ 145.00	€ 145.00	€ 145.00
Revenue (A$m)						
Flower - Domestic	0.0	0.3	0.9	1.5	2.6	4.6
Flower - Export	0.0	1.2	8.5	10.4	12.7	15.6
Oils - Domestic	2.2	5.9	8.9	10.6	12.6	12.6
Oils - Export	0.0	1.6	2.3	7.0	14.1	28.1
Subtotal (A$m)	**2.2**	**8.9**	**20.7**	**29.6**	**42.0**	**60.9**

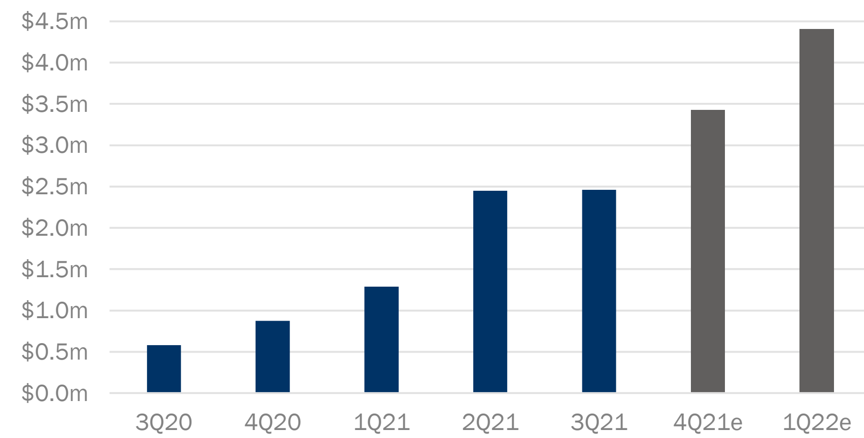
Source: Company reports, Canaccord Genuity estimates

The company is guiding to 17,000 units selling to DEMECAN in Germany in 1Q22E, which sets the basis for our FY22E forecasts. We have assumed slightly higher sales than this for all of flower export, while we have also assumed price deflation across domestic and export flower, as well as domestic oil sales.

We estimate the DEMECAN order saw ~1,000 units sold in 3Q21E and the company has guided to 9,000 being sold in 4Q21E followed by 17,000 in 1Q22E. This is more than the initial announcement indicated and reflects the level of demand coming out of Germany as well as LGP’s quality product and market positioning.

Our domestic patient forecasts imply a mid-teens market share of the Australian medicinal cannabis sector which assumes ~80,000 SAS-B approvals in FY21E while also noting the recent increase in Authorised Prescriber patients.

Figure 12: LGP's quarterly performance and upcoming quarters if we assume no growth outside of the already secured DEMECAN orders. The 1Q22E implied revenue suggests a run rate of ~$17.5m, which we view as the base case scenario for the year. In saying that, market feedback suggests that most Australian providers will be adjusting their distribution plans in the near term given feedback from the regulators around the use of wholesale partners



Source: Company reports, Canaccord Genuity estimates

We estimate the current revenue capacity is ~$25m, and when the company gets close to this level it has the option of doubling capacity which we estimate would cost ~$7-10m capex. In addition, the company also recently purchased additional land that provides it far greater capacity potential, but this would require some additional regulatory approvals.

Figure 13: LGP's current revenue capacity at its current facility. The company can also purchase active pharmaceutical ingredient (API) from anywhere it likes, which means oil capacity is essentially unlimited. The company has 3t capacity of biomass flower, which results in ~1.5t of finished flower, while the remainder can be used in oil

	Capacity	Midpoint	Price	Revenue	Revenue
Flower	1.2-1.5t	1,350,000	€5	€6.75m	A$10.5m
Oil	100000 bottles		$150	A$15m	A$15m
Total					**A$25.5m**

Source: Company reports, Canaccord Genuity estimates

We expect LGP to be approaching this level of revenue soon, and therefore anticipate a capacity expansion and the accompanying capex of ~$7-10m.

In forecasting for LGP below the revenue line, we believe that a base case of 50-60% gross margins is reasonable, and corporate overheads of ~$9-10m. Based on the cost to produce a bottle/unit, we believe the gross margin could be higher and the recent trading suggests the overheads could be lower too. However, in the near term we have gross margins slightly below this, partially due to scale achieving some gains in the long run but also as the cost of products provided into France are currently being borne by the supplier and patients pay nothing, which means costs are incurred but no revenue.

Figure 14: Income statement

(A$m)	FY20	FY21E	FY22E	FY23E	FY24E	FY25E
Revenue						
Flower - Domestic	0.0	0.3	0.9	1.5	2.6	4.6
Flower - Export	0.0	1.2	8.5	10.4	12.7	15.6
Oils - Domestic	2.2	5.9	8.9	10.6	12.6	12.6
Oils – Export	0.0	1.6	2.3	7.0	14.1	28.1
Subtotal	2.2	8.9	20.7	29.6	42.0	60.9
Total revenue (inc. rebates, etc.)	**3.1**	**11.0**	**22.1**	**31.0**	**43.5**	**62.4**
COGS	1.1	4.8	10.3	14.3	19.7	29.2
GP	1.1	4.4	10.3	15.2	22.3	31.6
GP%	51%	48.0%	50.0%	51.5%	53.0%	52.0%
Sales & Marketing	1.5	1.9	2.3	2.7	3.3	3.4
Licenses, permits, compliance	1.2	1.6	1.8	2.0	2.2	2.3
Admin and corporate	4.0	3.4	4.1	4.5	4.6	4.7
Other expenses	0.7	1.2	1.4	1.5	1.5	1.6
R&D	1.0	1.2	1.4	1.5	1.5	1.6
Total operating expenses	8.3	9.3	11.0	12.1	13.1	13.5
Total costs	**9.4**	**14.0**	**21.3**	**26.4**	**32.8**	**42.7**
EBITDA	-6.3	-3.0	0.8	4.6	10.7	19.6
EBIT	-6.5	-3.3	0.2	3.8	9.8	18.7
NPBT	-6.8	-3.3	0.2	3.7	9.8	18.6
NPAT (Normalised)	-6.8	-3.3	0.1	2.6	6.8	13.0

Source: Company reports, Canaccord Genuity estimates

From a cash perspective, we expect a persistent working capital drag that will be especially strong over the coming quarters as the DEMECAN order ramps up. Despite this and some upcoming capex, we forecast LGP to remain in a net cash position.

The company recently raised ~$27m in fresh equity via a ~$22m institutional placement and a $5m SPP. The equity raising was priced at $0.65 per share. The proceeds will be used to fund the company's next phase of growth, with specific investment in cultivation, sales and marketing, R&D and working capital. The company's February 2020 IPO raised $10m at an issue price of $0.45.

Figure 15: Balance sheet and cash flow metrics

	FY20	FY21E	FY22E	FY23E	FY24E	FY25E
Cash balance	4	20	8	9	12	19
Current assets	6	25	19	21	29	44
PP&E	14	21	22	23	25	28
Total assets	16	42	42	46	55	72
Total liabilities	4	5	8	8	11	14
Net assets	12	36	35	37	44	57
Net debt	-4.3	-19.5	-8.3	-8.9	-11.9	-19.0
Net debt/equity	-34.8%	-54.0%	-24.0%	-23.8%	-27.0%	-33.3%
Net debt/EBITDA	0.7	6.5	-10.0	-1.9	-1.1	-1.0
OCF	-6	-5	-2	2	5	10
Capex	-6	-8	-9	-2	-2	-3
FCF	-13	-13	-11	1	3	7

Source: Company reports, Canaccord Genuity estimates

Valuation

We value LGP at $1.10 per share, and we initiate coverage with a SPECULATIVE BUY rating. Our $1.10 price target is based on a DCF model, which assumes a 1.5 equity beta, 10.0% WACC and a terminal growth rate of 3%.

We have opted to not include a peer group assessment as the listed comps provide limited insights into the valuation of LGP. Multiples, margins and growth rates vary dramatically in the sector and most companies have shifted goals/strategy repeatedly, while the sector itself is still quite immature. We view fundamental cash flow assessment as the most suitable valuation method.

Board and management

Fleta Solomon - Managing Director: Fleta has run LGP since very early in its life. Her background is in corporate and consumer health markets, she is a graduate of the Australian Institute of Company Directors (GAICD), and holds a Bachelor of Science degree and an MBA from the University of Western Australia.

Michael Lynch-Bell - Non-Executive Chair: Michael has a corporate finance and consulting background, having led Ernst & Young's UK IPO and Global Natural Resources transaction teams.

Dr Neale Fong - Non-Executive Director: Neale is a medical practitioner with over 35 years in senior roles in private hospitals, public health systems and management consulting.

Angus Caithness – Executive Director: Angus has a background in corporate finance and consulting. He has previously been CFO of private and publicly listed companies and was an Executive Director at Ernst & Young in London.

Risks

LGP remains a relatively young company that is operating in a new industry so there are some inherent risks. We view the most likely risks for LGP as:

- **Regulatory risk:** The regulatory landscape is rapidly changing in the medicinal cannabis industry globally. Although most changes to date have made access for patients/customers easier, there is a risk the new rules could negatively impact operations of all companies at various times.
- **Crop risk:** As is the case with agricultural products, infection or infestation can result in some crops having to be destroyed rather than turned into finished goods.
- **Customer concentration:** Near-term revenue growth is largely dependent on one large German customer. Any issues with this particular contract could negatively impact LGP.
- **Competition:** Competition is tough in the sector as various groups fight for market share. The loss of market share in any jurisdiction would be negative for LGP.
- **Pricing:** The increase in supply of goods is likely to put downward pressure on commoditised products. Having a strong brand protects from this, and LGP could also benefit from some of its inputs costs falling.
- **Market cannibalisation:** CBD products becoming easier to access in Australia could negatively impact prescription sales, similar to the experience seen with recreational legalisation in parts of North America.

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Investment Recommendation

Date and time of first dissemination: May 11, 2021, 17:31 ET

Date and time of production: May 11, 2021, 17:31 ET

Target Price / Valuation Methodology:

Little Green Pharma Ltd - LGP

Our $1.10 price target is based on a DCF model, which assumes a 1.5 equity beta, 10.0% WACC and a terminal growth rate of 3%.

Risks to achieving Target Price / Valuation:

Little Green Pharma Ltd - LGP

Regulatory risk: The regulatory landscape is rapidly changing in the medicinal cannabis industry globally. Although most changes to date have made access for patients/customers easier, there is a risk the new rules could negatively impact operations of all companies at various times.

Crop risk: As is the case with agricultural products, infection or infestation can result in some crops having to be destroyed rather than turned into finished goods.

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Market cannibalisation: CBD products becoming easier to access in Australia could negatively impact prescription sales, similar to the experience seen with recreational legalisation in parts of North America.

Distribution of Ratings:

Colts Stock Ratings (as of 05/11/21)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	0	0.00%	0.00%
Hold	0	0.00%	0.00%
Sell	0	0.00%	0.00%
Speculative Buy	3	100.00%	66.67%
	3*	100.0%	

*Total includes stocks that are Under Review

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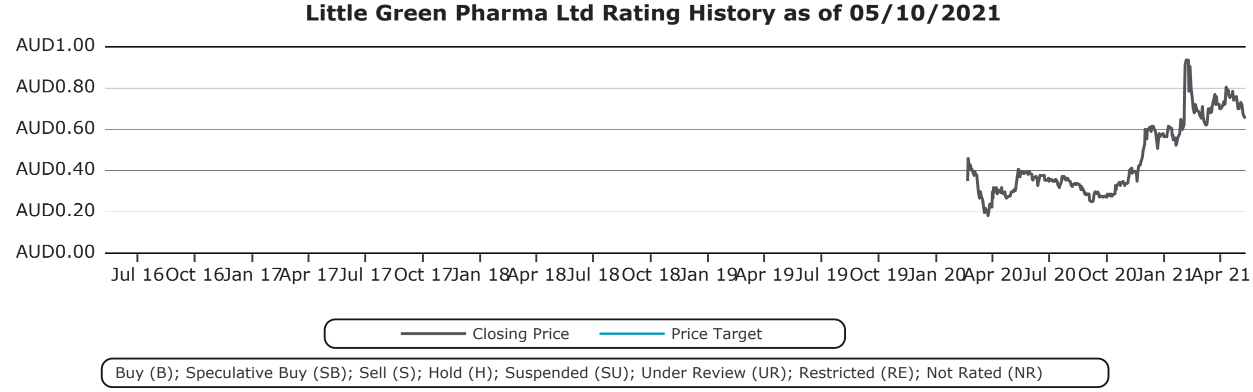
An analyst has visited the material operations of Little Green Pharma Ltd. No payment was received for the related travel costs.

Canaccord Genuity (Australia) Limited has received a fee as Lead Manager to the Little Green Pharma Ltd Capital Raising announced 8 February 2021.

Little Green Pharma Ltd Rating History as of 05/10/2021



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