

Cannabis

| Consumer, Brands & Retail

Q3 results could trigger further share price weakness

Harmonizing valuations downward

The cannabis sector have had a difficult couple of months and we believe that could well continue for another two/three months. Indeed the slow roll out of cannabis stores in Canada (mainly in Ontario), growing concerns on the safety of vapes and hence doubt about the legalisation of vapes in December 2019 and the continued high level of operating losses at some of the larger cannabis companies, are causing short term headwinds for the sector. We use this opportunity to harmonise valuations across the cannabis space and specifically allocate a higher risk factor to the sector, increasing Required return on equity to 15% (with an unleveraged beta of 1.6). We did that previously for Aurora Cannabis and leave its fair value untouched at CAD7.0 per share. We lower the fair value of Aphria to CAD12.4 per share from CAD18.3, for Hexo to CAD7.3 from CAD11, for Khiron to CAD3.6 from CAD4.0, for Canopy Growth to CAD30 from CAD60, for iAnthus to CAD4.7 from CAD7.1 and for MedMen to CAD1.2 from CAD3.0. After the reset, the stock with the largest upside is Khiron (+188%), iAnthus (+139%) and Aphria (+80%).

Concern no 1: Persistent losses at larger operators

One of the chief concerns of investors is the low margin/losses at some of the larger US and Canadian operators. In the current fiscal year, Canopy Growth is expected to come with an operating loss of CAD575m, Aurora with a CAD135m loss and MedMen with USD139m. Nevertheless there are a whole series of cannabis operators that are already making money or are about to including Organigram, Aphria, Aleafia, Trulieve, Valens, MediPharm Labs and many more.

Concern no 2: Weak Q3 CY19 due to inventory build-up

Furthermore in the quarter ending 30 September, we expect revenue figures at the larger Canadian operators to disappoint as the province of Ontario has been sitting on significant inventories as the number of stores remained limited at 21. However, Ontario is expected to open 50 additional dispensaries in October, Alberta has removed its moratorium on new dispensary licences.

Concern no 3: Vaping health issues to impact US MSO and potentially delay Canadian introduction

Although there has not been any communication from Health Canada, we believe there is a growing risk that at the start of Cannabis 2.0 (16 December 2019), the introduction of vapes will be delayed as long as the authorities do not know what has been causing in the US 810 people with cases of vaping-related lung illnesses of which at least 12 have died. That should also weight on the performance of the US MSO's as some states have been taking measures to limit or even to ban sales of certain vape products.

BG Coverage

APHRIA | BUY | CAD12.4 vs. CAD18

HEXO | BUY | CAD7.3 vs. CAD11

IANTHUS | BUY | CAD4.7 vs. CAD7.1

KHIRON LIFE SCIENCES | BUY | CAD3.6 vs. CAD4

AURORA CANNABIS | NEUTRAL | CAD7

CANOPY GROWTH | NEUTRAL | C\$30 vs. C\$60

MEDMEN ENTERPRISES | NEUTRAL | CAD1.2 vs. CAD3

Last rating Change:

AURORA CANNABIS - 13/09/19
Q4 and outlook disappoints

MEDMEN ENTERPRISES - 19/07/19
Model maintenance and downgrade

KHIRON LIFE SCIENCES - 12/07/19
Bold Ambition

CANOPY GROWTH - 04/07/19
CEO on his departure

Last FV Change:

AURORA CANNABIS - 13/09/19
Q4 and outlook disappoints

APHRIA - 05/08/19
Twenty-four little hours - model maintenance

MEDMEN ENTERPRISES - 19/07/19
Model maintenance and downgrade

KHIRON LIFE SCIENCES - 12/07/19
Bold Ambition

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