

# Marijuana Industry Update: History Suggests Pullback May Be About Done

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## Update Since Our January 8, 2018, Industry Report

- In our January 8, 2018, industry report, we cautioned that “given the extraordinary increases in the past few weeks, we see a heightened risk of a healthy pullback”. The sector (using the Horizons Marijuana Life Sciences Index ETF (HMMJ-T, not covered) as a gauge) peaked the next day. **The average North American cannabis stock is down 35% since that date.**
- From a stock picking perspective, we expressed our view in that report that “regardless of what the broader sector does, we recommend investors focus on names with foreseeable company-specific imminent catalysts”. In particular, **we highlighted The Hydrothecary Corp. (THCX-V)** given our view that a contract with the SAQ was imminent, **and we named it our top pick in the sector.** While it may not feel like it, **down 20% since the January 9 peak, Hydrothecary is the best performer in Canada.**
- The other stocks we highlighted for imminent catalysts were **Village Farms International Inc. (VFF-T) for the receipt of a cultivation license (down 23%, the third-best Canadian cannabis stock)** and **CannTrust Holdings Inc. (TRST-C, not covered) for an uplisting to the TSX (down 29%, the sixth-best Canadian cannabis stock).** We also highlighted Canaccord Genuity Group Inc. (CF-T, not covered) as a cannabis derivative (up 2% during this period). The two U.S. operators we cover – iAnthus Capital Holdings Inc. (IAN-C) and CannaRoyalty Corp. (CRZ-C) – have been the best performers within that group. In total, **the seven cannabis companies we cover are outperforming the sector (down 27% vs. down 35%).**

## So Now What?

- **Short-Term:** While no two corrections are the same, given the limited history of the cannabis sector, in this report, we compare the current experience to the April to June 2017 correction. In particular, we note that **last year the average stock was down 30% (median down 37%) during the 57 days** between the peak and the sector trough. While there are other factors at play (there are more companies and money ‘in the system’ now, recreational sales are now only six months away with several supply agreements announced vs more than a year still remaining), **the fact that the average stock is down 35% (median down 36%) in the 49 days since the sector peaked suggests to us that we are likely much closer to the end of this pullback than the beginning.** Accordingly, we recommend investors consider becoming more constructive in the sector. In particular, **we highlight Village Farms, where we believe a major catalyst (licensing) is imminent.**
- **Medium-Term:** We continue to expect a broad based run up in the stocks during the few months in the lead up to the start of recreational sales in Canada (now expected around August/September 2018). In that context, **we highlight Hydrothecary and Sunniva Inc. (SNN-C, not covered).** As these stocks are **each down over 10% since announcing the two largest supply agreements in cannabis history,** we believe they are well positioned to outperform as the sector comes back. Should we see another bull market, **we highlight the sector’s torquiest name, Cronos Group Inc. (MJN-V, CRON-US).** Cronos tends to meaningfully outperform in hot markets (such as since Christmas Eve 2017). The fact that it is now trading on the Nasdaq should help expand its potential investor base. Particularly now that we have regulatory clarity, we continue to believe that **more investor attention will gradually shift towards U.S. operators, making them the next big wave of returns for investors – especially as more U.S. operators with meaningful revenue go public,** making it ‘more of a sector’.
- **Longer-Term:** Particularly given the plethora of recent greenhouse announcements, **we are becoming increasingly concerned about the quantity of planned supply.** While not all of these plans may ever be fully realized, and they will not affect supply initially, there is the potential for pricing to come under pressure a few years down the road. In such an environment, **we believe firms will have to pick a niche and excel at it to be successful,** while companies ‘in the middle’ may be disproportionately squeezed. On the **low cost end of the spectrum, we highlight Village Farms, Sunniva and Aphria Inc. (APH-T, not covered).** On the other end (premium pricing, distribution and global reach), we highlight **The Supreme Cannabis Company Inc. (FIRE-V), MedReleaf Corp. (LEAF-T, not covered), Canopy Growth Inc. (WEED-T), Cronos and CannTrust.** Hydrothecary is in the rare position of successfully straddling both the ‘low cost’ and ‘premium product’ niches.

**Exhibit 1. Share Price Performance: 2017 Peak To Trough (left); 2018 Peak To Current (right)**

Ticker	10-Apr-17	6-Jun-17	% Change	Ticker	9-Jan-18	27-Feb-18	% Change
<b>Canadian</b>				<b>Canadian</b>			
CBW-V	\$1.33	\$1.13	-15%	THCX-V	\$4.21	\$3.38	-20%
FIRE-V	\$1.85	\$1.32	-29%	ABCN-V	\$2.23	\$1.74	-22%
N-C	\$0.29	\$0.20	-33%	VFF-T	\$8.92	\$6.88	-23%
THC-C	\$0.77	\$0.50	-35%	ACB-T	\$13.63	\$9.89	-27%
CMED-T	\$12.98	\$8.20	-37%	MARI-C	\$3.45	\$2.49	-28%
WEED-T	\$10.87	\$6.82	-37%	TRST-C	\$11.20	\$8.00	-29%
THCX-V	\$2.71	\$1.67	-38%	LEAF-T	\$26.28	\$18.74	-29%
ACB-T	\$3.29	\$2.02	-39%	MJN-V	\$13.68	\$9.67	-29%
OGI-V	\$3.50	\$2.11	-40%	NINE-V	\$2.75	\$1.92	-30%
BE-C	\$2.52	\$1.40	-44%	OGI-V	\$5.40	\$3.76	-30%
APH-T	\$8.39	\$4.71	-44%	EMH-V	\$6.70	\$4.53	-32%
EMC-V	\$3.06	\$1.62	-47%	WMD-V	\$2.99	\$1.91	-36%
EMH-V	\$2.10	\$1.09	-48%	THC-C	\$1.99	\$1.26	-37%
MJN-V	\$3.41	\$1.69	-50%	WEED-T	\$42.07	\$26.45	-37%
<b>U.S.</b>				<b>U.S.</b>			
LDS-C	\$0.52	\$0.65	25%	HIKU-C	\$3.50	\$2.14	-39%
IAN-C	\$2.70	\$2.63	-3%	EMC-V	\$2.47	\$1.43	-42%
MDM-C	\$1.13	\$1.07	-5%	BE-C	\$3.33	\$1.91	-43%
GLH-C	\$0.35	\$0.31	-10%	FIRE-V	\$3.07	\$1.76	-43%
TNY-C	\$0.34	\$0.30	-13%	CBW-V	\$2.52	\$1.40	-44%
MPX-C	\$0.58	\$0.43	-27%	HVT-V	\$1.81	\$0.99	-45%
EAT-C	\$0.15	\$0.10	-34%	APH-T	\$22.89	\$12.50	-45%
CRZ-C	\$2.88	\$1.79	-38%	N-C	\$3.25	\$1.60	-51%
MGW-V	\$0.72	\$0.40	-44%	HIP-V	\$2.95	\$0.76	-74%
<b>Beacon Coverage</b>			<b>-33%</b>	<b>U.S.</b>			
<b>All Avg</b>			<b>-30%</b>	IAN-C	\$3.35	\$3.08	-8%
<b>Median</b>			<b>-37%</b>	CRZ-C	\$4.68	\$3.47	-26%
<b>Canadian Avg</b>			<b>-38%</b>	MDM-C	\$0.93	\$0.69	-26%
<b>U.S. Avg</b>			<b>-17%</b>	MPX-C	\$0.99	\$0.67	-32%
				EAT-C	\$0.68	\$0.46	-32%
				MGW-V	\$1.25	\$0.81	-35%
				TGIF-C	\$0.88	\$0.56	-36%
				TNY-C	\$1.67	\$1.04	-38%
				LDS-C	\$1.08	\$0.67	-38%
				LHS-C	\$2.15	\$1.25	-42%
				GLH-C	\$0.53	\$0.31	-42%
				<b>Beacon Coverage</b>			
				<b>-27%</b>			
				<b>Beacon Catalysts</b>			
				<b>-24%</b>			
				<b>All Avg</b>			
				<b>-35%</b>			
				<b>Median</b>			
				<b>-36%</b>			
				<b>Canadian Avg</b>			
				<b>-36%</b>			
				<b>U.S. Avg</b>			
				<b>-32%</b>			

Source: ThomsonReuters, Beacon Securities.

- During the April to June 2017 pullback, the average North American cannabis stock declined 30%, with a median return of -37%. The average cannabis stock has now declined 35% since the January 9, 2018 peak, with a median of a 36% decline.
- While each pullback is different, this one indicator suggests that we have likely seen the worst of this correction.

- The three companies with seemingly imminent catalysts we highlighted in our January 8, 2018, industry report have significantly outperformed the market (down 24% vs. down 35%).

**Exhibit 2. Share Price Performance: December 24, 2017, To Current**

Ticker	24-Dec-17	27-Feb-18	% Change
<b>Canadian</b>			
MJN-V	\$5.82	\$9.67	66%
THC-C	\$0.78	\$1.26	62%
HIP-V	\$0.50	\$0.76	52%
ACB-T	\$7.21	\$9.89	37%
MARI-C	\$2.09	\$2.49	19%
ABCN-V	\$1.51	\$1.74	15%
LEAF-T	\$16.34	\$18.74	15%
WEED-T	\$23.12	\$26.45	14%
VFF-T	\$6.10	\$6.88	13%
OGI-V	\$3.75	\$3.76	0%
CBW-V	\$1.42	\$1.40	-1%
FIRE-V	\$1.80	\$1.76	-2%
TRST-C	\$8.35	\$8.00	-4%
HIKU-C	\$2.26	\$2.14	-5%
EMH-V	\$5.00	\$4.53	-9%
THCX-V	\$3.76	\$3.38	-10%
WMD-V	\$2.20	\$1.91	-13%
BE-C	\$2.25	\$1.91	-15%
HVT-V	\$1.18	\$0.99	-16%
APH-T	\$15.28	\$12.50	-18%
EMC-V	\$1.77	\$1.43	-19%
NINE-V	\$2.65	\$1.92	-28%
N-C	\$2.66	\$1.60	-40%
<b>U.S.</b>			
EAT-C	\$0.25	\$0.46	84%
IAN-C	\$1.97	\$3.08	56%
MPX-C	\$0.44	\$0.67	52%
MGW-V	\$0.56	\$0.81	45%
CRZ-C	\$3.05	\$3.47	14%
GLH-C	\$0.29	\$0.31	7%
LDS-C	\$0.78	\$0.67	-14%
LHS-C	\$1.48	\$1.25	-16%
MDM-C	\$0.87	\$0.69	-21%
TNY-C	\$1.32	\$1.04	-21%
TGIF-C	\$1.20	\$0.56	-53%
<b>Beacon Coverage</b>			<b>22%</b>
<b>All Avg</b>			<b>7%</b>
<b>Median</b>			<b>-2%</b>
<b>Canadian Avg</b>			<b>5%</b>
<b>U.S. Avg</b>			<b>12%</b>

Source: ThomsonReuters, Beacon Securities.

- Measuring the decline from the peak is one data point we believe can be useful. However, especially as returns in the sector started to

really accelerate after the launch of ETFMG Alternative Harvest ETF (MJX-US, not covered) on December 26, 2017, and the start of legal recreational sales in California on January 1, 2018, in Exhibit 2 we show share price returns since December 24, 2017 (i.e., the net of much of the run up as well as the subsequent correction).

- The average return during this period was a more 'reasonable' 7%, and the median return was -2%. The seven companies we cover were up 22% during this period – led by Cronos, up 66%.

**Exhibit 3. Difference By Company: 2017 Correction Vs 2018 Correction**

Ticker	Previous Change 10Apr17-06Jun17	Previous Change 09Jan18-26Feb18	Difference
<b>Canadian</b>			
THCX-V	-38%	-20%	19%
MJN-V	-48%	-29%	19%
EMH-V	-50%	-36%	14%
ACB-T	-39%	-27%	11%
OGI-V	-40%	-30%	9%
EMC-V	-47%	-42%	5%
BE-C	-44%	-43%	2%
WEED-T	-37%	-37%	0%
THC-C	-37%	-37%	0%
APH-T	-44%	-45%	-1%
FIRE-V	-29%	-43%	-14%
N-C	-33%	-51%	-18%
CBW-V	-15%	-44%	-29%
<b>U.S.</b>			
CRZ-C	-38%	-26%	12%
GLH-C	-34%	-24%	11%
IAN-C	-3%	-8%	-5%
EAT-C	-13%	-26%	-13%
MPX-C	-10%	-26%	-16%
MDM-C	-10%	-32%	-22%
TNY-C	-5%	-35%	-30%
LDS-C	-5%	-42%	-37%
<b>Beacon Coverage</b>			<b>5%</b>
<b>All Avg</b>			<b>-4%</b>
<b>Median</b>			<b>0%</b>
<b>Canadian Avg</b>			<b>1%</b>
<b>U.S. Avg</b>			<b>-13%</b>

Source: ThomsonReuters, Beacon Securities.

- In Exhibit 3, we analyze each stock's performance during the pullback since January 9, 2018, versus its experience in the 2017 correction (for stocks included in both time periods).
- The average cannabis company is down 400 bps more this time around than during the April to June 2017 correction, while the median stock has had the exact same experience (i.e., Canopy down 37% from its respective peaks). The top two exceptions to this are Hydrothecary and Cronos, which, backed by significant announcements, are down significantly less since January 9, 2018, than they were during last year's correction.

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As at January 31, 2018	#Stocks	Distribution		
BUY	68	68.0%	Buy	Total 12-month return expected to be > 15%
Speculative Buy	19	19.0%	Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
Hold	12	12.0%	Hold	Total 12-month return is expected to be between 0% and 15%
Sell	0	0.0%	Sell	Total 12-month return is expected to be negative
Under Review	1	1.0%		
Tender	0	0.0%	Tender	Clients are advised to tender their shares to a takeover bid or similar offer
Total	100	100.0%		

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