

# Fundamental Research Corp.

Investment Analysis for Intelligent Investors

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## Eve & Co Inc. (TSXV: EVE / OTC PK: EEVVF) – Q1-2019 Sales Grow Significantly QoQ, Financings Solidify Liquidity Position

Sector/Industry: Cannabis

[www.evecannabis.ca](http://www.evecannabis.ca)

### Market Data (as of June 7, 2019)

|               |                 |
|---------------|-----------------|
| Current Price | C\$0.39         |
| Fair Value    | C\$1.08         |
| Rating*       | BUY             |
| Risk*         | 4               |
| 52 Week Range | \$0.16 - \$0.66 |
| Shares O/S    | 265,917,972     |
| Market Cap    | \$103.71 M      |
| Current Yield | N/A             |
| P/E (forward) | N/A             |
| P/B           | 5.62x           |
| YoY Return    | N/A             |
| YoY TSXV      | -23.04%         |

\*see back of report for rating and risk definitions



### Highlights

- Eve & Co Inc. (“Eve”, “company”) has entered into significant sales generation, and substantially shored up its balance sheet with financings and warrant exercises.
- **QoQ Revenue Growth Outsized, Sales to Grow with Scale:** Eve reported Q1-2019 revenue of \$1.71 million, QoQ growth of 253.79%.
- **Significant Capital Raised:** Subsequent to the quarter, Eve raised \$10.45 million in gross proceeds from a bought deal. In addition, \$5.8 million was received by the company from exercised warrants.
- **Board Appointment:** Eve appointed Alice Murphy to its board of directors on April 22, 2019. Ms. Murphy was previously the CFO of Harry Winston Diamond Corp.
- **We are revising our previous fair value estimate of \$1.13 per share to \$1.08 per share**

| Key Financial Data (FYE - DEC 31)<br>(C\$) | *YE OCT 31st  |               |               |               |
|--|---------------|---------------|---------------|---------------|
|  | 2017*         | 2018          | 2019E         | 2020E         |
| Cash                                       | \$ 91,400     | \$ 1,038,174  | \$ 160,710    | \$ 2,866,184  |
| Working Capital                            | \$ -4,086,754 | \$ 3,901,877  | \$ 2,334,469  | \$ 16,576,943 |
| Assets                                     | \$ 2,067,680  | \$ 23,488,377 | \$ 56,440,186 | \$ 74,220,161 |
| Total Debt                                 | \$ 2,654,423  | \$ 4,322,099  | \$ 19,676,000 | \$ 19,676,000 |
| Revenues                                   | \$ -          | \$ 482,663    | \$ 10,800,000 | \$ 61,900,000 |
| Net Income                                 | \$ -1,241,034 | \$ -7,649,075 | \$ -4,124,681 | \$ 12,694,975 |
| EPS (basic)                                | \$ -0.01      | \$ -0.04      | \$ -0.02      | \$ 0.05       |

## Financials

Q4-2018 marked the company's first quarter of revenue generation, with sales of \$0.48 million, all of which was from December 2018 sales. In Q1-2019, Eve reported dramatic QoQ sales growth of 253.79% for revenue of \$1.71 million, with the growth due to an additional two months of sales as well as increasing sales volumes. Based on the annualized run-rate suggested by the company's Q1-2019 performance, our 2019 revenue forecast of \$15.60 million appears aggressive. **We are revising our 2019, and 2020 revenue forecasts, of \$15.60 million, and \$85.18 million, respectively, to \$10.80 million, and \$61.90 million, respectively.**

| <b>STATEMENTS OF OPERATIONS</b>        |                    |                    |                  |
|--|--------------------|--------------------|------------------|
| <b>(in C\$) - YE Dec 31st</b>          | <b>2018</b>        | <b>Q1-2018</b>     | <b>Q1-2019</b>   |
| Revenue                                | 482,663            |                    | 1,707,626        |
| COGS                                   | 1,204,878          |                    | 899,959          |
| <b>Gross Profit</b>                    | <b>(722,215)</b>   | <b>-</b>           | <b>807,667</b>   |
| Fair Value Adj. on Biological Assets   | -3,130,649         |                    | 342,787          |
| <b>Adj. Gross Profit</b>               | <b>2,408,434</b>   | <b>-</b>           | <b>464,880</b>   |
| <b>EXPENSES</b>                        |                    |                    |                  |
| SG&A Expense                           | 5,217,911          | 862,630            | 517,511          |
| Share-based Compensation               | 1,576,553          |                    | 151,230          |
| <b>EBITDA</b>                          | <b>(4,386,030)</b> | <b>(862,630)</b>   | <b>(203,861)</b> |
| Depreciation & Amortization            | 123,013            | 38,972             | 20,483           |
| <b>EBIT</b>                            | <b>(4,509,043)</b> | <b>(901,602)</b>   | <b>(224,344)</b> |
| Financing Costs                        | 1,495,685          | 90,257             | 609,782          |
| <b>EBT</b>                             | <b>(6,004,728)</b> | <b>(991,859)</b>   | <b>(834,126)</b> |
| Non-Recurring Expenses                 | 1,817,347          | 111,405            | -9,811           |
| Taxes                                  | -173,000           |                    | 173,000          |
| <b>Net Profit (Loss)</b>               | <b>(7,649,075)</b> | <b>(1,103,264)</b> | <b>(997,315)</b> |
| FOREX Translation Adj.                 |                    |                    |                  |
| <b>Comprehensive Net Profit (Loss)</b> | <b>(7,649,075)</b> | <b>(1,103,264)</b> | <b>(997,315)</b> |
| Shares outstanding                     | 177,719,449        | 140,976,000        | 234,575,158      |
| EPS                                    | \$ -0.04           | \$ -0.01           | \$ -0.00         |

Source: FRC, Financial Statements

The company's normalized gross profit in Q1-2019 (before adjusting for the change in fair value of biological assets) was \$0.81 million, reflecting a gross margin of 47.30%. After fair value adjustments, the Q1-2019 gross margin of the company is 27.22%. We have forecasted an adjusted gross margin of 61.54% for 2019, and management has suggested that the deviation in the quarter was due to delays in the production ramp up in one of their flowering rooms, which in turn, was due to delays in Health Canada approval. As management have suggested that production costs are expected to ramp up through to Q2-2020, we are lowering our gross margin forecast to 52.78% for 2019 and 52.42% for 2020.

Eve reported Q1-2019 SG&A expense of \$0.52 million. As we had forecasted 2019 SG&A expenses of \$6.54 million, the company's Q1-2019 expenses appear to be far below our

estimate on an annualized basis. However, we note that the company has yet to operate at full capacity, and SG&A could increase significantly in subsequent quarters to facilitate increased sales volume. We will maintain our SG&A forecast until financials for the coming quarters are released. Q1-2019 EBITDA was -\$0.20 million (compared to Q1-2018's EBITDA of -\$0.86 million) and EBITDA was -\$4.39 million in 2018. **After adjusting for share-based compensation and biological asset fair value changes, adjusted EBITDA was \$0.29 million in Q1-2019.**

Eve reported a net loss of \$1 million (EPS: -\$0.00) compared to Q1-2018's net loss of \$1.10 million (EPS: -\$0.01). 2018's net loss was \$7.65 million (EPS: -\$0.04). **We are revising our earnings forecasts from -\$0.22 million (EPS: -0.00) to -\$4.12 million (EPS: -\$0.02) for 2019, and \$24.54 million (EPS: 0.09) to \$12.69 million (EPS: \$0.05) for 2020.**

The following table provides a summary of Eve's cashflows. Despite a lower net loss in Q1-2019, operating cashflows deteriorated YoY, largely to significantly higher working capital investment. Investing cashflows decreased YoY, however, and as a result, the net effect was a YoY improvement in free cash flows. Investors should note that this may change as the year progresses as the company may need to deploy additional cash to complete their facility expansion.

| Summary of Cash Flows<br>(\$, mm)    | 2018 (3M)      | 2019 (3M)      |
|--------------------------------------|----------------|----------------|
| Operating                            | -\$0.53        | -\$1.12        |
| Investing                            | -\$1.37        | -\$0.12        |
| Financing                            | \$0.01         | \$5.59         |
| Effects of Exchange Rate             | \$0.00         | \$0.00         |
| <b>Net</b>                           | <b>-\$1.89</b> | <b>\$4.35</b>  |
| <b>Free Cash Flows to Firm (FCF)</b> | <b>-\$1.90</b> | <b>-\$1.24</b> |

*Source: FRC, Financial Statements*

At the end of Q1-2019, the company had a cash position of \$5.39 million and working capital of \$1.54 million, as well as a current ratio of 1.15x. The company also maintains a debt position of \$6.31 million, the majority of which is from a non-revolving term facility with Royal Bank of Canada (TSX: RY). As the borrowings are due December 2019, the debt is considered current. Based on management's commentary, they expect the full \$18.70 million of their RBC term facility to be drawn down by Q3-2019. Note that the company completed a financing subsequent to the quarter, which improved the company's liquidity position relative to the table below.

| (in C\$) - YE Dec 31st        |    |            |
|-------------------------------|----|------------|
| Liquidity & Capital Structure |    | Q1-2019    |
| Cash                          | \$ | 5,388,371  |
| Working Capital               | \$ | 1,541,389  |
| Current Ratio                 |    | 1.15       |
| LT Debt                       | \$ | -          |
| Total Debt                    | \$ | 6,305,266  |
| LT Debt / Capital             |    | -          |
| Total Debt / Capital          |    | 0.25       |
| Total Invested Capital        | \$ | 19,368,563 |

Source: FRC, Financial Statements

**Financings:** On May 10, 2019, the company completed a bought deal financing, raising gross proceeds of \$10.45 million via the issue of 20.90 million special warrants at a price of \$0.50 per special warrant. Each special warrant can be converted into a unit at no cost, with each unit comprising a common share of the company and a warrant exercisable at \$0.60 per share.

In addition to the bought deal financing, the company announced on April 18, 2019, that 16.67 million warrants had been exercised for proceeds of approximately \$5.8 million.

**Stock Options and Warrants:** We estimate that the company has 18.40 million stock options (weighted average exercise price of \$0.34) and 37.57 million warrants (weighted average exercise price of \$0.49) outstanding. 8.30 million options and 16.67 million warrants are currently in the money. **The company will be able to raise up to \$8 million if all these in the money options and warrants are exercised.**

## Valuation

### DCF Valuation

Our updated DCF valuation on Eve's shares is \$1.08 per share, versus our previous valuation of \$1.13 per share. The drop was due to the near-term deterioration in our revenue forecasts and a lowering of our forecasted gross margin. This was offset by a reduction in our diluted share count, as the company has raised forecasted cash needs with lower than expected dilution. Our models are summarized below:

| DCF Model            | 2019E          | 2020E          | 2021E         | 2022E         | 2023E         | Terminal       |
|----------------------|----------------|----------------|---------------|---------------|---------------|----------------|
| EBIT(1-tax)          | \$ -2,683,626  | \$ 11,721,803  | \$ 23,021,610 | \$ 32,537,925 | \$ 39,078,410 |                |
| Non-Cash Expenses    | \$ 1,231,800   | \$ 4,012,736   | \$ 5,556,298  | \$ 6,741,394  | \$ 7,555,900  |                |
| Investment in WC     | \$ 1,651,526   | \$ -11,537,000 | \$ -8,884,800 | \$ -7,584,610 | \$ -5,212,840 |                |
| CFO                  | \$ 199,700     | \$ 4,197,539   | \$ 19,693,108 | \$ 31,694,709 | \$ 41,421,470 |                |
| CAPEX                | \$ -34,879,144 | \$ -2,465,236  | \$ -2,465,236 | \$ -2,465,236 | \$ -2,465,236 |                |
| FCF                  | \$ -34,679,445 | \$ 1,732,303   | \$ 17,227,872 | \$ 29,229,473 | \$ 38,956,234 | \$ 40,124,921  |
| PV                   | \$ -32,768,995 | \$ 1,461,493   | \$ 12,977,367 | \$ 19,658,841 | \$ 23,393,536 | \$ 267,726,020 |
| Discount Rate        | 12%            |                |               |               |               |                |
| Terminal Growth Rate | 3%             |                |               |               |               |                |
| Total PV             | \$ 292,448,262 |                |               |               |               |                |
| Cash - Debt          | \$ 15,607,894  |                |               |               |               |                |
| Equity Value         | \$ 308,056,156 |                |               |               |               |                |
| Shares O/S (dil)     | 286,442,972    |                |               |               |               |                |
| <b>Fair Value</b>    | <b>\$ 1.08</b> |                |               |               |               |                |

Source: FRC

## Risks

**After updating our valuation models, we are updating our fair value estimate of \$1.13 per share to \$1.08 and maintaining our BUY rating.**

We believe the company is exposed to the following risks (list is non-exhaustive):

- The company operates in an industry that is highly regulated and subject to material change from governmental intervention.
- There is no guarantee that the company will be granted an immediate amendment to their Health Canada licensing at their production facility for the expansion phase. Any delay could materially impact our valuation.
- No guarantee that the company will be able to sell the cannabis produced at their facilities, nor successfully secure further long-term supply contracts.
- Contamination risk and other risks associated with biological/ agricultural production.
- Access to capital and share dilution.
- Liquidity risk.

**We are maintaining our risk rating of 4 (Speculative).**

## Appendix

| <b>STATEMENTS OF OPERATIONS</b><br><b>(in C\$) - YE Dec 31st</b> | <b>*YE OCT 31st</b><br><b>2017*</b> | <b>2018</b>        | <b>2019E</b>       | <b>2020E</b>      |
|--|-------------------------------------|--------------------|--------------------|-------------------|
| Revenue  |                                     | 482,663            | 10,800,000         | 61,900,000        |
| COGS   | 433,533                             | 1,204,878          | 5,100,000          | 29,450,000        |
| <b>Gross Profit</b>  | <b>(433,533)</b>                    | <b>(722,215)</b>   | <b>5,700,000</b>   | <b>32,450,000</b> |
| Fair Value Adj. on Biological Assets                             |                                     | -3,130,649         |                    |                   |
| <b>Adj. Gross Profit</b>   | <b>(433,533)</b>                    | <b>2,408,434</b>   | <b>5,700,000</b>   | <b>32,450,000</b> |
| <b>EXPENSES</b>  |                                     |                    |                    |                   |
| SG&A Expense   | 568,221                             | 5,217,911          | 6,539,963          | 12,380,000        |
| Share-based Compensation   |                                     | 1,576,553          | 1,512,470          | 1,547,500         |
| <b>EBITDA</b>  | <b>(1,001,754)</b>                  | <b>(4,386,030)</b> | <b>(2,352,433)</b> | <b>18,522,500</b> |
| Depreciation & Amortization                                      | 147,452                             | 123,013            | 555,537            | 2,465,236         |
| <b>EBIT</b>  | <b>(1,149,206)</b>                  | <b>(4,509,043)</b> | <b>(2,907,970)</b> | <b>16,057,264</b> |
| Financing Costs  | 91,828                              | 1,495,685          | 1,216,711          | 1,122,000         |
| <b>EBT</b>   | <b>(1,241,034)</b>                  | <b>(6,004,728)</b> | <b>(4,124,681)</b> | <b>14,935,264</b> |
| Non-Recurring Expenses   |                                     | 1,817,347          |                    |                   |
| Taxes  |                                     | -173,000           |                    | 2,240,290         |
| <b>Net Profit (Loss)</b>   | <b>(1,241,034)</b>                  | <b>(7,649,075)</b> | <b>(4,124,681)</b> | <b>12,694,975</b> |
| FOREX Translation Adj.   |                                     |                    |                    |                   |
| <b>Comprehensive Net Profit (Loss)</b>                           | <b>(1,241,034)</b>                  | <b>(7,649,075)</b> | <b>(4,124,681)</b> | <b>12,694,975</b> |
| Shares outstanding   | 140,976,000                         | 177,719,449        | 265,917,972        | 265,917,972       |
| EPS  | \$ -0.01                            | \$ -0.04           | \$ -0.02           | \$ 0.05           |

| <b>BALANCE SHEET</b><br><b>(in C\$) - YE Dec 31st</b> | <b>*YE OCT 31st</b><br><b>2017*</b> | <b>2018</b>       | <b>2019E</b>      | <b>2020E</b>      |
|---|-------------------------------------|-------------------|-------------------|-------------------|
| <b>ASSETS</b>   |                                     |                   |                   |                   |
| <b>CURRENT</b>  |                                     |                   |                   |                   |
| Cash and Cash Equiv.                                  | 91,400                              | 1,038,174         | 160,710           | 2,866,184         |
| A/R   |                                     | 545,409           | 1,620,000         | 6,190,000         |
| Inventory   |                                     | 2,075,368         | 1,080,000         | 9,285,000         |
| Biological Assets                                     |                                     | 2,912,369         | 3,788,759         | 3,788,759         |
| Prepays   |                                     | 167,234           | 270,000           | 1,547,500         |
| HST Receivable  | 76,767                              | 1,889,568         | 216,000           | 1,238,000         |
| <b>Total Current Assets</b>                           | <b>168,167</b>                      | <b>8,628,122</b>  | <b>7,135,469</b>  | <b>24,915,443</b> |
| PPE   | 1,899,513                           | 14,860,255        | 49,304,718        | 49,304,718        |
| Deposits  |                                     |                   | -                 | -                 |
| <b>Total Assets</b>                                   | <b>2,067,680</b>                    | <b>23,488,377</b> | <b>56,440,186</b> | <b>74,220,161</b> |
| <b>LIABILITIES</b>                                    |                                     |                   |                   |                   |
| <b>CURRENT</b>  |                                     |                   |                   |                   |
| A/P   | 624,498                             | 3,750,245         | 3,825,000         | 7,362,500         |
| ST Debt   | 25,142                              |                   |                   |                   |
| Related Parties                                       | 430,562                             | 976,000           | 976,000           | 976,000           |
| Current Portion of LT Debt                            | 2,198,719                           |                   |                   |                   |
| Other   | 976,000                             |                   |                   |                   |
| <b>Total Current Liabilities</b>                      | <b>4,254,921</b>                    | <b>4,726,245</b>  | <b>4,801,000</b>  | <b>8,338,500</b>  |
| LT Debt   |                                     | 3,346,099         | 18,700,000        | 18,700,000        |
| <b>Total Liabilities</b>                              | <b>4,254,921</b>                    | <b>8,072,344</b>  | <b>23,501,000</b> | <b>27,038,500</b> |
| <b>SHAREHOLDERS EQUITY</b>                            |                                     |                   |                   |                   |
| Share Capital   | 900,128                             | 23,447,576        | 43,582,940        | 43,582,940        |
| Contributed Surplus                                   |                                     | 2,704,901         | 4,217,371         | 5,764,871         |
| Deficit   | (3,087,369)                         | (10,736,444)      | (14,861,125)      | (2,166,150)       |
| <b>Total shareholders' equity (deficiency)</b>        | <b>(2,187,241)</b>                  | <b>15,416,033</b> | <b>32,939,186</b> | <b>47,181,661</b> |
| <b>Total Liabilities and Shareholders Equity</b>      | <b>2,067,680</b>                    | <b>23,488,377</b> | <b>56,440,186</b> | <b>74,220,161</b> |

| STATEMENTS OF CASH FLOWS<br>(in C\$) - YE Dec 31st | *YE OCT 31st<br>2017* | 2018                | 2019E               | 2020E              |
|--|-----------------------|---------------------|---------------------|--------------------|
| <b>OPERATING ACTIVITIES</b>                        |                       |                     |                     |                    |
| Net Profit for the Year                            | (1,241,034)           | (7,649,075)         | (4,124,681)         | 12,694,975         |
| <b>Adjusted for items not involving cash:</b>      |                       |                     |                     |                    |
| Amortization                                       | 147,452               | 200,934             | 555,537             | 2,465,236          |
| SBC  |                       | 1,576,553           | 1,512,470           | 1,547,500          |
| Shares for Services                                |                       | 403,979             |                     |                    |
| Finance Expense                                    |                       | 340,297             |                     |                    |
| Biological Assets                                  |                       | (3,130,649)         |                     |                    |
| Deferred Tax                                       |                       | (173,000)           |                     |                    |
| Transaction Costs                                  |                       | 1,751,000           |                     |                    |
| <b>Funds From Operations</b>                       | <b>(1,093,582)</b>    | <b>(6,679,961)</b>  | <b>(2,056,673)</b>  | <b>16,707,710</b>  |
| <b>Change in working capital</b>                   |                       |                     |                     |                    |
| A/R  |                       |                     | (1,074,591)         | (4,570,000)        |
| HST  | (74,008)              | (2,358,210)         | 1,673,568           | (1,022,000)        |
| Prepays  |                       | (167,234)           | (102,766)           | (1,277,500)        |
| Inventory  |                       | (1,857,089)         | 995,368             | (8,205,000)        |
| A/P  | 572,827               | 642,318             | 74,755              | 3,537,500          |
| Biological Assets                                  |                       |                     | (876,390)           | -                  |
| Related Parties                                    |                       |                     | -                   | -                  |
| <b>NET CASH USED IN OPERATING ACTIVITIES</b>       | <b>(594,763)</b>      | <b>(10,420,176)</b> | <b>(1,366,729)</b>  | <b>5,170,710</b>   |
| <b>INVESTING ACTIVITIES</b>                        |                       |                     |                     |                    |
| PPE  | (447,290)             | (10,678,247)        | (35,000,000)        | (2,465,236)        |
| Deposits   |                       |                     |                     |                    |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>       | <b>(447,290)</b>      | <b>(10,678,247)</b> | <b>(35,000,000)</b> | <b>(2,465,236)</b> |
| <b>FINANCING ACTIVITIES</b>                        |                       |                     |                     |                    |
| Equity Issue                                       |                       | 15,251,458          | 16,789,265          |                    |
| Issue Costs  |                       | (1,665,713)         |                     |                    |
| Debt   | 1,018,967             | (1,523,861)         | 18,700,000          |                    |
| Convertible Debt                                   |                       | 10,000,000          |                     |                    |
| Related Parties                                    | 107,540               | (16,687)            |                     |                    |
| <b>NET CASH FROM FINANCING ACTIVITIES</b>          | <b>1,126,507</b>      | <b>22,045,197</b>   | <b>35,489,265</b>   | <b>-</b>           |
| Foreign Exchange / Others                          |                       |                     |                     |                    |
| <b>INCREASE IN CASH FOR THE YEAR</b>               | <b>84,454</b>         | <b>946,774</b>      | <b>(877,464)</b>    | <b>2,705,475</b>   |
| CASH, BEGINNING OF THE YEAR                        | 6,946                 | 91,400              | 1,038,174           | 160,710            |
| <b>CASH, END OF THE YEAR</b>                       | <b>91,400</b>         | <b>1,038,174</b>    | <b>160,710</b>      | <b>2,866,184</b>   |



#### Fundamental Research Corp. Equity Rating Scale:

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

#### Fundamental Research Corp. Risk Rating Scale:

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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