

Fundamental

Research Corp.

Investment Analysis for Intelligent Investors

May 10, 2019

Plus Products Inc. (CSE: PLUS) – New Products Help Solidify Top Ranking, Explosive Revenue Growth Beats Forecast

Sector/Industry: Cannabis

www.plusproducts.com

Market Data (as of May 10, 2019)

Current Price	C\$5.00
Fair Value	C\$7.99
Rating*	BUY
Risk*	4
52 Week Range	N/A
Shares O/S	45,493,813
Market Cap	C\$227.47 M
Current Yield	N/A
P/E (forward)	N/A
P/B	8.86x
YoY Return	N/A
YoY CSE	-7.77%

*see back of report for rating and risk definitions

**\$ denotes US\$ unless otherwise specified.



Highlights

- Plus Products Inc. (“Plus Products”, “company”) has maintained its rank as the top edibles brand in California, solidifying their position with new products and flavors.
- **New Flavors and a New Mint Line:** The company has introduced pink lemonade (a seasonal flavor) and mango (CBD-dominant item replacing their pineapple flavor) flavored candies to their product portfolio, as well as a new line of infused mints.
- **Baked Goods Brand Provides Product Diversification:** The company completed the acquisition of California infused baked goods brand GOOD CO-OP Inc. in December 2018 in a share transaction valued at approximately C\$2.03 million. The acquisition provides the company with an additional edibles line to solidify their leading market position.
- **Revenue Grows Past Our Forecasts:** Plus Products reported 2018 revenue of \$8.36 million, reflecting YoY growth of 681.36%, and beating our forecast of \$7.52 million. We are maintaining our 2019 revenue forecast of \$15.04 million, and introducing our 2020 revenue forecast of \$74.50 million.
- **We are maintaining our BUY rating and fair value estimate of C\$7.99 per share.**

Key Financial Data (FYE- DEC 31)

(US\$)	2017	2018	2019E	2020E
Cash	\$ 150,122	\$ 22,398,587	\$ 32,444,248	\$ 28,355,196
Working Capital	\$ -56,382	\$ 22,414,992	\$ 34,731,982	\$ 29,596,357
Assets	\$ 1,821,500	\$ 27,845,032	\$ 45,754,118	\$ 57,445,441
Total Debt	\$ 600,000	\$ -	\$ 25,000,000	\$ 25,000,000
Revenues	\$ 1,070,256	\$ 8,362,547	\$ 15,036,603	\$ 74,500,000
Net Income	\$ -3,056,206	\$ -6,835,815	\$ -9,028,610	\$ -1,306,038
EPS (basic)	\$ -0.27	\$ -0.48	\$ -0.26	\$ -0.03

Financials

The company reported revenues of \$8.36 million in 2018, versus revenue of \$1.07 million during 2017, reflecting revenue growth of 681.36% YoY. For Q4-2018, revenue was reported at \$3.35 million, YoY growth of 769.98%. The significant increase in sales was due to the legalization of cannabis for full adult use in California, which resulted in a large increase in cannabis sales state-wide. Prior to this, cannabis was legal for medical use, and as such, sales of cannabis goods were made only to registered patients.

The company soundly beat our 2018 revenue forecast of \$7.52 million, with the excess revenue over our forecast shining a bright light on the company's future topline growth. **We are maintaining our 2019 revenue forecast of \$15.04 million, and introducing our 2020 revenue forecast of \$74.50 million.** The large increase in expected revenue between 2019 and 2020 is due to the facility expansion that we expect to come online during 2019, increasing production capacity.

The table below outlines the company's consolidated income statements, as well as our two-year guidance:

STATEMENTS OF OPERATIONS				
(in US\$) - YE Dec 31st	2017	2018	2019E	2020E
Revenue	1,070,256	8,362,547	15,036,603	74,500,000
COGS	1,556,185	7,251,392	12,781,113	61,462,500
Gross Profit	(485,929)	1,111,155	2,255,490	13,037,500
EXPENSES				
SG&A Expense	2,408,832	6,384,643	8,938,500	11,173,125
Share-based Compensation	56,520	1,225,714	751,830	827,013
EBITDA	(2,951,281)	(6,499,202)	(7,434,840)	1,037,362
Depreciation & Amortization	434	1,956	93,770	343,399
EBIT	(2,951,715)	(6,501,158)	(7,528,610)	693,962
Financing Costs	58,417	33,219	1,500,000	2,000,000
EBT	(3,010,132)	(6,534,377)	(9,028,610)	(1,306,038)
Non-Recurring Expenses	46,074	145,724		
Taxes		155,714		
Net Profit (Loss)	(3,056,206)	(6,835,815)	(9,028,610)	(1,306,038)
Net Profit (Loss) to Shareholders	(3,056,206)	(6,835,815)	(9,028,610)	(1,306,038)
Shares outstanding	11,532,228	14,296,098	34,120,360	45,493,813
EPS	\$ -0.27	\$ -0.48	\$ -0.26	\$ -0.03

Source: FRC, Financial Statements

Gross margin was positive in 2018 at 13.29%, as a result of increased sales volume and production efficiency at the company's facility. In 2017, gross margin was -45.40%.

Margins	2017	2018
Gross	-45.40%	13.29%
EBITDA	-275.75%	-77.72%
EBIT	-275.80%	-77.74%
Net	-285.56%	-81.74%
Expenses	2017	2018
SG&A	225.07%	76.35%
Stock-Based Compensation	5.28%	14.66%

Source: FRC, Financial Statements

Selling, General and Administrative (“SG&A”) expenses grew significantly YoY to \$6.38 million in 2018, versus \$2.41 million in 2017. As a result, EBITDA deteriorated to -\$6.50 in 2018, versus -\$2.95 million in 2017.

The company reported a net loss of \$6.84 million (EPS: -\$0.48) in 2018. This compares to a net loss of \$3.06 million in 2017 (EPS: -\$0.27). The company’s net loss was higher than our forecast of \$6.13 million (EPS: -\$0.43). **We are revising our 2019 net loss forecast of \$7.47 million (EPS: -\$0.22) to \$9.03 million (EPS: -\$0.26) and introducing our 2020 net loss forecast of \$1.31 million (EPS: -\$0.03).** The drop in our two-year earnings guidance is due to the incurrence of debt (convertible notes), and the addition of expected interest expenses to our models.

Free cash flows (“FCF”) deteriorated on a YoY basis due to a larger net loss and increased investment cashflows related to facility expansion and a small acquisition.

Summary of Cash Flows (\$, mm)	2017	2018
Operating	-\$2.65	-\$5.34
Investing	-\$0.82	-\$1.50
Financing	\$3.35	\$29.08
Effects of Exchange Rate	\$0.00	\$0.00
Net	-\$0.12	\$22.25
Free Cash Flows to Firm (FCF)	-\$3.47	-\$6.84

Source: FRC, Financial Statements

At the end of 2018, the company had a cash position of \$22.40 million and working capital of \$22.41 million, as well as a current ratio of 11.35x. Subsequent to the quarter, the company raised gross proceeds of \$25 million through the issue of 25,000 units at \$1,000 face value. Each unit comprises a convertible note bearing 8% p.a, convertible at \$6.50 per share, and 77 warrants exercisable at \$8 per share.

Valuation

(in US\$) - YE Dec 31st			
Liquidity & Capital Structure		2017	2018
Cash	\$	150,122	\$ 22,398,587
Working Capital	\$	-56,382	\$ 22,414,992
Current Ratio		0.95	11.35
LT Debt	\$	-	\$ -
Total Debt	\$	600,000	\$ -
LT Debt / Capital		-	-
Total Debt / Capital		0.43	-
Total Invested Capital	\$	1,230,528	\$ 3,281,319

Source: FRC, Financial Statements

Stock Options and Warrants: We estimate that the company has 1.75 million stock options (weighted average exercise price of \$2.06) and 6.02 million warrants (weighted average exercise price of \$3.74) outstanding. All the options and 4.09 million warrants are currently in the money. We estimate that the company will be able to raise up to \$10.73 million if all these in the money options and warrants are exercised.

Discounted Cash Flow Valuation

Our updated DCF valuation on Plus Product's shares is \$4.72 per share, versus our previous estimate of \$4.94 per share. The minor drop is due to a higher diluted share count, and slightly lower operating profit forecasts.

DCF Model	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	Terminal
EBIT(1-tax)	\$ -7,528,610	\$ 548,230	\$ 1,606,620	\$ 8,179,405	\$ 15,329,594	\$ 28,494,497	\$ 34,379,021	\$ 42,011,059	
Non-Cash Expenses	\$ 845,600	\$ 1,170,412	\$ 1,485,944	\$ 1,573,104	\$ 1,894,551	\$ 1,989,937	\$ 2,097,065	\$ 2,216,998	
Investment in WC	\$ -2,271,329	\$ 1,046,573	\$ -1,103,125	\$ -3,734,375	\$ -3,140,625	\$ -3,750,000	\$ -1,875,000	\$ -1,875,000	
CFO	\$ -8,954,339	\$ 2,765,216	\$ 1,989,439	\$ 6,018,133	\$ 14,083,520	\$ 26,734,434	\$ 34,601,086	\$ 42,353,057	
CAPEX	\$ -4,500,000	\$ -5,000,000	\$ -500,000	\$ -5,000,000	\$ -500,000	\$ -500,000	\$ -500,000	\$ -500,000	
FCF	\$ -13,454,339	\$ -2,234,784	\$ 1,489,439	\$ 1,018,133	\$ 13,583,520	\$ 26,234,434	\$ 34,101,086	\$ 41,853,057	\$ 43,108,649
PV	\$ -12,464,887	\$ -1,832,243	\$ 1,080,667	\$ 653,725	\$ 7,718,351	\$ 13,191,842	\$ 15,174,819	\$ 16,481,778	\$ 169,762,310
Discount Rate	13%								
Terminal Growth Rate	3%								
Total PV	\$ 209,766,363								
Cash - Debt	\$ 22,398,587								
Equity Value	\$ 232,164,950								
Shares O/S (dil)	49,188,687								
Fair Value (US\$)	\$ 4.72								

Source: FRC

Comparables Valuation

Our updated comparables valuation model is outlined below:

Comparables Valuation			
2026 Forecast (Gross Revenues)	\$ 450,000,000	2026 Forecast (EBITDA)	\$ 53,930,449
Average EV/ Revenue	1.88	Average EV/ EBITDA	13.74
Expected EV (US\$)	\$ 846,000,000	Expected EV (US\$)	\$ 741,004,372
Discounted EV (US\$)	\$333,155,687	Discounted EV (US\$)	\$291,808,299
Expected Market Cap (US\$)	\$344,298,258	Expected Market Cap (US\$)	\$302,950,870
Value per Share (US\$)	\$ 7.00	Value per Share (US\$)	\$ 6.16

Source: FRC

Risks

Our updated comparables valuations are \$7 per share on an EV/R basis and \$6.16 on an EV/EBITDA basis. This is compared to our previous valuations of \$7.24 on an EV/R basis and \$6.25 on an EV/EBITDA basis. The drop was due to the increase in diluted share count, which was slightly offset by an increase in the valuation multiples used which have been updated with the most recent industry data.

Based on our updated valuation models, we are maintaining our BUY rating and fair value estimate of C\$7.99 per share. This is the average of all three of our valuations, \$5.96 per share, converted at a USD/CAD exchange rate of C\$1.34.

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.
- Cannabis is illegal at the federal level in the U.S. This makes cannabis businesses in California potentially vulnerable to federal prosecution, though current conventions allow for U.S. state governments to enforce their own state cannabis laws.
- We believe there is an inherent discount required to account for risks related to the legal status of cannabis in the U.S. This may cause a basket of operationally identical U.S. cannabis stocks to trade at a lower valuation relative to Canadian cannabis stocks.
- Equity and debt financing may be difficult to raise due to existing risks for U.S. cannabis businesses. Equity raises may call for significant discounts to market price (dilution) and debt raises may be done at a high interest-rates relative to market rates, impacting profitability and resulting returns for investors.
- No guarantee that the company will be able to sell the entirety of their production capacity, which would impact our valuation.
- Contamination risk and other risks associated with cannabinoid production.
- Access to capital and share dilution.
- Liquidity risk.
- Exchange rate risk.
- Difference in investor's time horizon.

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

Appendix

STATEMENTS OF OPERATIONS				
(in US\$) - YE Dec 31st	2017	2018	2019E	2020E
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EBT	(3,010,132)	(6,534,377)	(9,028,610)	(1,306,038)
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Shares outstanding	11,532,228	14,296,098	34,120,360	45,493,813
EPS	\$ -0.27	\$ -0.48	\$ -0.26	\$ -0.03

BALANCE SHEET				
(in US\$) - YE Dec 31st	2017	2018	2019E	2020E
ASSETS				
CURRENT				
Cash and Cash Equiv.	150,122	22,398,587	32,444,248	28,355,196
A/R	329,696	1,379,066	3,007,321	7,450,000
Inventory	307,941	630,337	2,255,490	7,450,000
Prepays	81,000	172,128	375,915	1,862,500
Related Parties	115,709			
Total Current Assets	984,468	24,580,118	38,082,974	45,117,696
Deposits	20,649	586,354		
Intangibles		741,863	741,863	741,863
Goodwill		61,296	61,296	61,296
PPE	816,383	1,875,401	6,867,985	11,524,586
Total Assets	1,821,500	27,845,032	45,754,118	57,445,441
LIABILITIES				
CURRENT				
A/P	440,850	2,009,412	3,195,278	15,365,625
Income Taxes Payable		155,714	155,714	155,714
Notes Payable	600,000		-	-
Total Current Liabilities	1,040,850	2,165,126	3,350,992	15,521,339
Convertible Debt			25,000,000	25,000,000
Total Liabilities	1,040,850	2,165,126	28,350,992	40,521,339
SHAREHOLDERS EQUITY				
Share Capital	4,073,099	34,065,191	36,456,246	36,456,246
Shares to be Issued	648,076	2,391,055		
Reserves			751,830	1,578,843
Deficit	(3,940,525)	(10,776,340)	(19,804,950)	(21,110,988)
Total shareholders' equity (deficiency)	780,650	25,679,906	17,403,126	16,924,102
Total Liabilities and Shareholders Equity	1,821,500	27,845,032	45,754,118	57,445,441

STATEMENTS OF CASH FLOWS				
(in US\$) - YE Dec 31st	2017	2018	2019E	2020E
OPERATING ACTIVITIES				
Net Profit for the Year	(3,056,206)	(6,835,815)	(9,028,610)	(1,306,038)
Adjusted for items not involving cash:				
Amortization	23,927	447,195	93,770	343,399
Share-based Compensation	56,520	1,225,714	751,830	827,013
Bad Debt	46,074			
Consulting Fees	648,076			
Loss on Asset Disposal				
Interest Expense	58,417			
Funds From Operations	(2,223,192)	(5,162,906)	(8,183,010)	(135,625)
Change in working capital				
A/R	(359,122)	(1,049,370)	(1,628,255)	(4,442,679)
Prepays	(58,609)	(617,380)	(203,787)	(1,486,585)
Inventory	(272,901)	(322,396)	(1,625,153)	(5,194,510)
A/P	357,074	1,543,679	1,185,866	12,170,347
Income Tax Payable		155,714	-	-
Related Parties	(88,872)	115,709	-	-
NET CASH USED IN OPERATING ACTIVITIES	(2,645,622)	(5,336,950)	(10,454,339)	910,948
INVESTING ACTIVITIES				
PPE	(820,561)	(1,414,794)	(4,500,000)	(5,000,000)
Acquisitions		(83,591)		
NET CASH USED IN INVESTING ACTIVITIES	(820,561)	(1,498,385)	(4,500,000)	(5,000,000)
FINANCING ACTIVITIES				
Proceeds from Loans	200,000			
Repayment of Loans	(91,600)	(600,000)		
Convertible Debt			25,000,000	
Share Buyback	(12,000)	(1,200)		
Equity Issue	3,251,479	29,685,000		
NET CASH FROM FINANCING ACTIVITIES	3,347,879	29,083,800	25,000,000	-
Foreign Exchange / Others				
INCREASE IN CASH FOR THE YEAR	(118,304)	22,248,465	10,045,661	(4,089,052)
CASH, BEGINNING OF THE YEAR	268,426	150,122	22,398,587	32,444,248
CASH, END OF THE YEAR	150,122	22,398,587	32,444,248	28,355,196

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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