Equity Research

ICC International Cannabis Corp.

SPECULATIVE BUY

ICC-TSXV

Last:	**C$0.97**
Target:	**C$2.50**

Research Report – December 4, 2017

Q3 immaterial, ICC acquires high-CBD hemp strain

ICC announced Q3/17 results which are largely immaterial given they include only the first quarter of recreational product sales in Uruguay, and no CBD-extract sales. Revenues of $147k were below our $292k forecast due to lower volumes (estimated 180kg vs. 324kg forecast) as fewer pharmacies participated in the domestic market. Adj. EBITDA of –$686k was better than our –$833k forecast on lower SG&A expense.

ICC acquires two high-CBD hemp strains. As per Q3/17 MD&A, in October ICC acquired 160kg of CW2a-b (CW) hemp seeds, with a CBD content of ~10%, as well as 650kg of Carmanola Selezionata (CS) hemp seeds, a commonly grown outdoor variety used to obtain CBD. ICC reported that studies have shown that CS hemp's CBD:THC ratio can reach up to 10:1. Hence, assuming a THC content of ~1.0% (maximum amount permitted for hemp strains in Uruguay), this would put the CBD content of CS hemp at a maximum of ~10%.

CW2a-b supports ICC's yield advantage. ICC's CW hemp strain carries CBD at roughly 2x the level of strains available to hemp growers in Canada, China and most of Europe. This is due to Uruguay's favourable regulations allowing the cultivation of hemp with higher THC content (and hence higher CBD content), while other jurisdictions are more restrictive on the THC level of permitted hemp strains (max. 0.3%). Hence, CW should generate a strong yield advantage for ICC over competitors, while also supporting our CBD extract production forecasts for ICC.

Yield advantage provides negotiation tool. ICC has already entered into pre-sales agreements for its CBD oil product (BIDIOL) in Mexico and Brazil, totalling 300k bottles and representing ~25% of anticipated FY18 production of 1.2m bottles. We expect contract negotiations to continue in other countries such as Europe and Canada to increase pre-sales for both BIDIOL and ICC's other CBD extract products. In our view, ICC's yield advantage for CBD should provide a strong negotiation tool, and improve the company's ability to penetrate medical and nutraceutical end-markets globally.

Recommendation and valuation

Maintaining $2.50 target and SPEC BUY. ICC shares have underperformed the broader cannabis sector recently, remaining largely range-bound. With valuation relatively low at ~3.5x CY19 EV/EBITDA (~40% discount to junior LP peers), we believe this provides an attractive entry point for investors, while offering downside protection. We view ICC's cost advantage and strategic location as key drivers to capitalize on the rapid global growth of CBD. Our target is based on a DCF using: 1) a discount rate of 18%, 2) two-stage average revenue growth of 28% and EBITDA margin of 40%, and (3) terminal growth of 0%.

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