

Target Change

August 23, 2016

APH - TSX	\$2.39
TARGET: (from \$2.25)	\$3.75
PROJ. RETURN:	57%
VALUATION:	EV/EBITDA
Share Data	
Basic Shares O/S (mm)	87.5
Fully Diluted (mm)	110.1
Market Cap (\$mm)	209.1
Enterprise Value (\$mm)	161.2
Cash (\$mm)	50.9
Debt (\$mm)	3.0
Dividend (\$)	0.00
Yield (%)	0.0%
Next Reporting Date	TBD

Thomson Chart – 1 Year



Corporate Profile

Aphria is a Leamington, Ontario based licensed producer of medical marijuana under the MMPR. The company is licensed to sell up to 2,500 kg annually from its greenhouse production facility. Aphria is expanding its facility to 6,000 kg annually by the Spring of 2017.

Upcoming Events

- Q1 results in October 2016

APHRIA INC. – SPECULATIVE BUY

Equity Financing Drives Capacity Expansion

ACTION – Reiterate SPECULATIVE BUY

We reiterate our **SPECULATIVE BUY** recommendation and are increasing our target price to \$3.75 from \$2.25 per share. We believe that Aphria is an excellent play on the growing medical marijuana market and upcoming legalization for recreational use.

DETAILS – Equity Financing Complete Sets Stage for Significant Expansion

Raised Gross Proceeds of \$34.5M: Last week Aphria closed its equity financing that raised the company net proceeds of approximately \$32.5M at a price of \$2.00 per share. The principal use of proceeds will be to fund the company's Part III expansion of its facility and bring eventual capacity to about 52,000 kg annually. We review the details and approach later in this note and expect more detailed information from the company after it evaluates various options over the next few months.

Received Oil Sales License from Health Canada: Aphria announced on August 17th that it had received its oil sales license with product available for shipment immediately. The company announced that it had 3 products available in 60mL bottles for a price of \$99. Aphria stated that each bottle has an equivalent of 10 grams of dried marijuana sourced from bud.

Cannabis Supply Deal With Medlab: Yesterday morning Aphria announced that it had signed a significant cannabis supply agreement with Australian company Medlab. The two companies have established an extraction process for CBD and THC. The agreement calls for Aphria to grow and prepare the extract that Medlab will combine with its patented medicine delivery system NanoCelle. Medlab will conduct a human trial for the management of intractable pain with oncology patients.

Acquires 11 Acres of Additional Property: Last Friday Aphria announced that it has entered into a purchase and sale agreement with DiNiro Farms to acquire an additional 11 acres of property adjacent to its existing facility for a cost of \$2.1 million. DiNiro will continue to operate its existing greenhouse operations until December 31, 2017.

IMPACT – Positive

Aphria is in an excellent position to benefit in this growing market and is now well positioned to execute on its growth strategy. With better clarity on its expansion plans and the funding to support that growth, we have revised our estimates and are publishing out F2019 forecast. In addition, we are rolling forward our valuation basis to capture and reflect some of the earnings potential. We note however that the full realization of the company's earnings potential is not likely until F2020-2021.

FYE May 31		2015A	Q1/16A	Q2/16A	Q3/16A	Q4/16A	2016A	Q1/17E	Q2/17E	Q3/17E	Q4/17E	2017E	2018E	2019E
Sales	\$ million	0.6	1.0	2.0	2.7	2.8	8.4	4.2	4.9	5.6	6.2	21.0	56.0	115.2
EBITDA	\$ million	(2.1)	(0.4)	0.0	0.4	0.2	0.6	0.9	1.3	1.5	1.8	5.5	17.1	42.9
EPS	\$ million	(0.09)	(0.01)	(0.01)	0.00	0.02	0.01	0.00	0.00	0.01	0.01	0.02	0.10	0.27
EV/Sales	multiple	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	7.7x	2.9x	1.4x
EV/EBITDA	multiple	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	29.3x	9.5x	3.8x
P/E	multiple	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	23.8x	8.7x

RECEIVES OIL SALES LICENSE

Last week, Aphria received its license to produce and sell medical cannabis from Health Canada. The company has developed three oil extract formulas that were immediately available for sale. The product is available in 60 mL bottles and contains the equivalent of 10 grams of dried marijuana sourced from bud. The company will sell the bottles for \$99 each representing a per gram equivalency of \$9.90. Aphria's three initial products include a high THC, high CBD and a balanced THC/CBD product. As we have commented previously, we expect demand for oil products to drive overall adoption and market expansion given its attractive delivery method versus smoking/vaping. We believe that it is positive that Aphria has now secured this license and expect it to have an impact on patient adoption in future quarters (minimal impact in the current quarter ending August).

Figure 1: Aphria's Oil Product



Source: Company website

DETAILS OF EXPANSION PLANS REVEALED FOLLOWING FINANCING

Last week, Aphria completed its recent equity financing that raised gross proceeds of \$34.5M at a price of \$2.00. The company laid out its expansion plans (Part III Expansion) in the prospectus that was filed as the primary use of proceeds from the financing. As a reminder, Aphria is currently in the midst of its Part II expansion that will see its production capacity more than double. The Part II expansion is expected to add an additional 57,000 square feet of greenhouse capacity along with other upgrades that will bring capacity to 6,000 kg annually. The company expects completion and Health Canada approval to be complete by May 2017 with the first harvest by the summer of 2017.

At the current time, Aphria has not determined the exact course of action for Part III. However, the company has identified 3 phases of that expansion and expects to determine the approach sometime in the fall of 2016. The following summarizes the expansion plan of Part III and use of proceeds as outlined in the prospectus.

- Phase 1: Replace existing greenhouses acquired from CF and construct state of the art greenhouses across 3.5 acres as well as build 36,000 sq. ft. of additional infrastructure (additional vault capacity, processing and state of the art extraction). Estimated cost \$18.5M
- Phase 2: Construction of new state-of-the-art Leamington standard greenhouses across 6 acres of vacant land. Estimated cost \$13M
- Phase 3: Building out a further 6 acres of state-of-the-art greenhouses with an estimated cost of \$18M

As noted, the company has not made a decision on which of Phase 1 or 2 will be executed first. Aphria is currently in the process of evaluating its various options with a decision expected in the next few months. Overall, the company anticipates the Part III expansion to be complete within 3 years and add 46,000 kg of annual capacity.

With a decision expected this fall on which approach will be Aphria's first phase, we expect construction to commence in H1/17 with completion of its first phase by the end of 2017. At a minimum the company will be

adding 3.5 acres or about 150,000 square feet that will increase capacity by 2-3x the 6,000kg capacity level from Part 2.

CANNABIS SUPPLY DEAL WITH MEDLAB

Yesterday morning Aphria announced that it had signed a significant cannabis supply agreement with Australian company Medlab. The two companies have established an extraction process for CBD and THC. The agreement calls for Aphria to grow and prepare the extract that Medlab will combine with its patented medicine delivery system NanoCelle. Medlab's NanoCelle delivery technology enables sub-micron sized particles to be taken by mouth spray that allows for a more direct absorption into the bloodstream.

Medlab will conduct a human trial for the management of intractable pain with oncology patients. The start of the trial is subject to approval by regulatory authorities in Australia as well as Aphria receiving approval from Health Canada for the export of its product formulation.

REVISING ESTIMATES AND PUBLISHING F2019 FORECAST

We estimate that Aphria has about \$50M in cash following its recent financing. With the balance sheet well positioned to execute on its expansion plans and some visibility to the nature and timing of the capacity increases, we are introducing our F2019 estimates to reflect and capture some of the earnings potential. Many uncertainties remain with respect to the regulatory framework for both medical and recreational going forward. We expect at some point pharmacies will be include in the medical distribution of cannabis (in oil or capsule/pill form) and the potential for more of a wholesale model under the recreational framework yet to be introduced.

We expect APH to receive approval towards 6,000kg in the spring of next year and the next stage of approval more than doubling once again in early 2018, positioning APH for material growth for Fiscal 2019. We have accounted for a higher portion of wholesale product pricing and a more significant ramp in oil sales. As a result our F2018 sales estimates have increased however we have lowered our margins for both wholesale sales and a lower oil extract price than we had previously modeled.

Figure 2: Estimate Revisions

	F2017			F2018			F2019		
	New	Old	Change	New	Old	Change	New	Old	Change
Revenue	\$21.0	\$22.1	-5%	\$56.0	\$42.2	33%	\$115.2	N/A	N/A
Adjusted Gross Profit	\$15.4	\$16.3	-6%	\$37.7	\$32.1	17%	\$77.2	N/A	N/A
Adj. Gross Margin (%)	73.4%	73.8%	-42 bp	67.4%	76.1%	-870 bp	67.0%	N/A	N/A
Adjusted EBITDA	\$5.5	\$6.1	-9%	\$17.1	\$17.5	-3%	\$42.9	N/A	N/A
Adj. EBITDA Margin (%)	26.2%	27.3%	-111 bp	30.5%	41.5%	-1102 bp	37.2%	N/A	N/A
Adjusted Net Income	\$2.6	\$2.9	-10.2%	\$11.1	\$11.3	-2.2%	\$30.2	N/A	N/A
Adjusted EPS	\$0.02	\$0.04	-41.8%	\$0.10	\$0.16	-36.6%	\$0.27	N/A	N/A

Source: MRCC

INCREASING TARGET PRICE ON CHANGE IN VALUATION BASIS

We are increasing our target price on Aphria as we roll our valuation basis forward. We had previously set our target using a 12x multiple to our Fiscal 2018 estimates (ending May 31, 2018). With the broad approach of the expansion plans disclosed and the capital to execute, we believe it's appropriate to reflect some of the future earnings capability in our valuation basis. As a result our new target price of \$3.75 is based on a 12x multiple on the average of our Fiscal 2018/19 EBITDA estimate of \$30M.

We note however that APH is capable of generating much higher sales and earnings with its planned expansion. As we commented when it announced the agreement to acquire the land from CF Greenhouses that APH is likely able to generate \$200-250 million in sales once fully constructed. At the low end of the range and using an EBITDA margin of 37% that we model for F2019 would imply approximately \$75M in EBITDA annually and about \$95M on the high end. We expect that the timing of recreational legalization, medical regulation evolution and Aphria's ability to scale production once the capital expenditures are complete will all factor into when Aphria will reach that earning capability.

RISKS TO TARGET

While this is not an exhaustive list, we view the following risks as being noteworthy to investors in Aphria: regulatory, limited operational history, changes to the marijuana framework, dispensaries, demand/supply estimates. Please see our initiating coverage report for additional details.

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