



LHS | CNQ

\$1.36

Rating: Speculative Buy

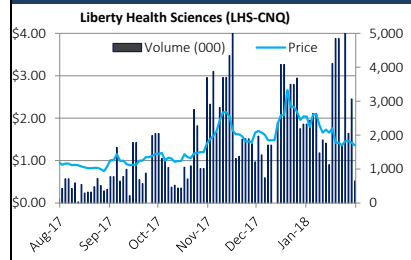
One Year Target: \$2.20

Total Return: 61.7%

Dividend Yield: 0%

February 15, 2018

Financial Metrics (\$)					
Shares O/S (M):	284.0	FD. Mkt. Cap (\$M):	\$418		
FD Shares (M):	307.4	FD. Net Cash (\$M):	\$11		
Price:	\$1.36	Ent. Value (\$M):	\$407		
12-Month Target:	\$2.20	Implied Return:	61.8%		
FY Feb 28	2018E	2019E	2020E	2021E	
Sales (\$M)	686	10,079	34,640	85,919	
Growth (y/y)	N/A	1369%	244%	148%	
Adj. Gross Profit (\$M)	81	4,369	18,592	48,117	
Gross Margin	12%	43%	54%	56%	
Adj. EBITDA (\$M)	-4,236	-1,629	6,974	33,859	
Adj. EBITDA Margin	-617%	-16%	20%	39%	
EV/ Adj. EBITDA	-96.2x	-250.0x	58.4x	12.0x	
	Q2/18A	Q3/18A	Q4/18E	Q1/19E	
Sales (\$M)	0.0	0.1	0.5	1.4	
Adj. Gross Profit (\$M)	0.0	0.0	0.2	0.6	
Adj. EBITDA (\$M)	-1.5	-1.9	-0.8	-0.7	
Target Valuation Parameter 1x DCF 10%					



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## Liberty Health Sciences Inc.

### Solid Volume Potential and Strong Margins Drive EBITDA

**Strong Florida market growth potential:** Florida is home to the third largest state population in the US, with an estimated 21M, including the largest percentage of residents in the 65+ demographic, at 19.9% of the population. It is estimated that 6M people qualify under one of the Florida Department of Health conditions for use of medical marijuana (MMJ). If we were to assume just 10% of them would eventually use MMJ, then we arrive at a potential patient base of 600,000, or 2.9% of the population. Full MMJ usage only became legal in 2017. Today, there are approximately 75,000 registered patients, equating to 0.4% of the population versus 16,760 at the end of June 2017 (shortly after Liberty Health Sciences (LHS) entered the market). To put this into context, Canada went from 24k patients at the end of June 2015 and took 12 months to reach 75k patients.

**Capacity expansions and access to capital to allow for LHS volume growth:** LHS is expanding its facility to 12,000kgpa by November 2018. On the distribution side, its first dispensary is now open, with a further 14-17 locations to open within the next two years. Management expects that in mid-CY2020, it will require a further expansion decision of at least 9,000kgpa for the Florida market, with the expectation that it would be available by mid-CY2021. There are only 13 licenses to date in Florida, and only four are producing, with Liberty being the only one with access to the publicly traded capital markets today. The Company envisions a market share in the high teens over the next several years. Furthermore, if the market allows wholesale volumes within the next few years, LHS estimates they will require additional capacity as they expect to supply other licensed producers, none of which have the access to public capital markets that LHS does. Liberty is also evaluating opportunities in other states that offer similar characteristics to that of Florida, including Connecticut, Maryland, Pennsylvania, Michigan, Ohio and New Jersey, in the expectation of replicating their Florida business model.

**Solid margins:** Given restrictions on dried bud and the allowance for higher margin product sales, this increases the realized average price and dollar margin received relative to Canadian Licensed Producers (LP). We estimate the Company's average realized margin (including depreciation) at 54% at the retail level, which equates to a dollar margin above \$8/g. As well, the limited number of initial licenses creates a significant opportunity for those currently in production, which should initially act to insulate those producers from excessive competitive forces and oversupply of product, and provide those early entrants with a first mover advantage to grow their market share. We estimate EBITDA will be positive by Q1/CY2019 and margins will reach 45% by F2022.

**Risks are elevated:** There is a substantial risk in investing in companies with US cannabis assets as marijuana remains a federally illegal substance to produce, sell or consume. Material losses can occur if the federal government were to prosecute the businesses involved in this sector or enact changes that constrict earnings potential.

**Valuation:** We rate the shares of Liberty Health a Speculative Buy with a target price of \$2.20, based on our discounted cash flow (10%) of \$2.19.

## Summary Financial and Operating Statistics C\$ (Fiscal Year End February 28)

Assumptions	2018E	2019E	2020E	2021E	Balance Sheet (\$000)	2018E	2019E	2020E	2021E
<b>Dried KG Equivalents</b>					Working Capital	36,975	18,303	22,045	40,100
Kilograms Sold	44	672	2,309	6,120	PP&E	13,233	32,213	32,206	37,435
Revenue Per Gram (\$)	\$ 15.00	\$ 15.00	\$ 15.00	\$ 14.04	Other	25,755	43,850	42,019	40,234
<b>Cannabis Revenue (000)</b>	<b>660</b>	<b>10,078</b>	<b>34,639</b>	<b>85,919</b>	Total Assets	75,963	94,365	96,271	117,770
					Long-term Debt	8,459	8,459	0	0
					Other Liabilities	4,315	626	-4,647	14
					Shareholders' Equity	63,189	85,280	100,918	117,756
					Total Liabilities + Equity	75,963	94,365	96,271	117,770
					<b>Net Debt (Cash)</b>	<b>(20,745)</b>	<b>(1,313)</b>	<b>(18,209)</b>	<b>(36,005)</b>
					Net Debt/EBITDA	N/A	0.8x	N/A	N/A
Income Statement (\$000)	2018E	2019E	2020E	2021E	Cash Flow (\$000)	2018E	2019E	2020E	2021E
<b>Revenue</b>	<b>686</b>	<b>10,079</b>	<b>34,640</b>	<b>85,919</b>	Net Income	(25,147)	(4,509)	168	14,838
Cost of Production	575	5,709	16,047	37,802	<b>Operating Cash Flow</b>	<b>(8,112)</b>	<b>(4,052)</b>	<b>5,426</b>	<b>26,121</b>
<b>Adj. Gross Profit (excluding bio. gains)</b>	<b>81</b>	<b>4,369</b>	<b>18,592</b>	<b>48,117</b>	Capex	(11,145)	(20,380)	(2,400)	(8,325)
Margin (%)	12%	43%	54%	56%	<b>Investing Cash Flow</b>	<b>(30,842)</b>	<b>(20,380)</b>	<b>(2,400)</b>	<b>(8,325)</b>
Salaries and benefits	1107	4013	8923	10708	Share Issuances	31,797	25,000	-	-
Advertising & Marketing	152	115	228	344	Borrowings (Repayments)	15,386	-	-	-
General & Admin.	329	355	723	940	<b>Financing Cash Flow</b>	<b>47,203</b>	<b>25,000</b>	-	-
DD&A	1,325	1,906	1,830	1,785					
Other	3,737	3,420	3,740	4,275					
<b>Adj. Operating Income</b>	<b>(6,571)</b>	<b>5,440</b>	<b>3,148</b>	<b>30,066</b>					
Interest	487	1,664	832	(1)					
<b>Income Before Taxes</b>	<b>(26,256)</b>	<b>(8,198)</b>	<b>305</b>	<b>26,978</b>					
Income Taxes	1,109	3,689	(137)	(12,140)					
<b>Adj. Net Income att. to Shareholders</b>	<b>(6,016)</b>	<b>(2,609)</b>	<b>2,068</b>	<b>17,153</b>					
Adj. EPS (diluted)	-\$ 0.02	-\$ 0.01	\$ 0.01	\$ 0.05					
<b>Adj. EBITDA</b>	<b>(4,236)</b>	<b>(1,629)</b>	<b>6,974</b>	<b>33,859</b>					
<b>Adj. EBITDA Margin (%)</b>	<b>-617%</b>	<b>-16%</b>	<b>20%</b>	<b>39%</b>					
Shares Outstanding (000)	2018E	2019E	2020E	2021E					
Basic	303,358	313,358	320,858	320,858					
Fully Diluted	307,390	317,390	324,890	324,890					
Growth	2018E	2019E	2020E	2021E					
Dried Gram Equivalent Volumes	N/A	1427%	244%	165%					
Revenues	N/A	1369%	244%	148%					
Adj. EBITDA	N/A	N/A	N/A	385%					
Adj. EPS	N/A	N/A	N/A	717%					
Valuation	2018E	2019E	2020E	2021E					
EV/Sales	593.8x	40.4x	11.8x	4.7x					
EV/EBITDA	N/A	N/A	58.4x	12.0x					
P/E	N/A	N/A	210.6x	25.8x					
DuPont Analysis	2018E	2019E	2020E	2021E					
Profit Margin	-877%	-26%	6%	20%					
Asset Turnover	0.0	0.1	0.4	0.7					
Return on Equity	-10%	-3%	2%	15%					

## Investment Thesis

Liberty Health Sciences is focused on operating in US states where regulations are supportive for the ease of business of medicinal marijuana producers, but supply is limited in the form of available licences, offering the potential for Liberty to pursue its distribution and product strategy. It currently has operations in Florida where the regulations allow LHS to offer a substantially greater suite of products and dollar margins than are currently offered in Canada. There are only 13 production licenses to date in a state that is home to 21M people, including a significant level of elderly inhabitants that suffer from chronic pain. With a strong patient growth rate being realized in Florida, only four producers are serving this market today, and only one of them (Liberty) has access to the publicly traded capital markets today. This should allow LHS to accelerate their growth profile over our forecast period, acquire retail market share and eventually increase sales further through the wholesale market, to companies that do not have the same access to capital. The Company is also evaluating opportunities in other states that offer similar characteristics to that of Florida, including Connecticut, Maryland, Pennsylvania, Michigan, Arizona and New Jersey in the expectation of replicating their Florida business model. LHS also owns 14% of an Arizona-based MMJ producer. Furthermore, given the company was founded with Aphria's management team, Liberty utilizes Aphria's greenhouse expertise, product development and industry knowhow to the Company's benefit.

### Summary Forecast of Volumes, Revenue and Adj. EBITDA

#### Estimated Volumes, Revenues and Adj. EBITDA

Year	F2019	F2020	F2021	F2022	F2023
Kg equivalent sold	672	2,309	6,120	11,627	15,115
Avg. Price per dried gram equivalent (\$CAD)	\$ 15.00	\$ 15.00	\$ 14.04	\$ 13.33	\$ 12.87
Forecasted sales (\$CAD 000)	10,079	34,640	85,919	155,037	194,535
Forecasted EBITDA (\$CAD 000)	(1,629)	6,974	33,859	70,135	90,631

Figure 1: Liberty Health Sciences Forecasted Sales Volumes, Revenues and EBITDA

Source: ACC Estimates

## Company History

Liberty Health Sciences was formed in 2017 with Aphria Inc. as its primary sponsor and largest single shareholder. Liberty's mandate was to acquire and operate US-based medicinal marijuana businesses across various states. In May 2017, Liberty acquired Chestnut Hill Tree Farm, a Medical Marijuana Treatment Center (MMTC) license holder with a productive facility near Gainesville, FL that began selling MMJ in January 2017. Liberty recently announced the acquisition of 242 Cannabis, LLC, which owns a 387 acre parcel of land in Gainesville, FL, which includes a state of the art greenhouse property that will be retrofitted for cannabis usage, allowing the company to advance its expansion plans within the state. In early February, LHS acquired Aphria's 14% stake in Copperstate LLC, an Arizona-based MMJ producer.

## Business Strategy

The Company intends to emulate its strategy in Florida by entering other MMJ markets where a similar ease of conducting business but with limited licenses can offer Liberty the potential to realize strong volume growth and solid margins. An integral part of the strategy is having continuous access to Aphria's know-how and intellectual property (IP) to enable Liberty to become a low cost producer of medical quality cannabis in each state it operates. With know-how and IP agreements firmly in place between Liberty and Aphria, the recently announced divestiture by Aphria of their stake in Liberty will have no impact on the go-forward strategy.



## **The Florida Market**

### **History of Legalization**

Prior to July 2017, the state of Florida allowed CBD-only products, with a maximum level of 0.3mg of THC. The full legalization of medical marijuana was voted into law by Florida residents in 2016 with the passage of Amendment 2, which received a 71% approval from voters in 2017. Since then, the state has continued to build and develop the regulatory framework and advanced the licensing process, granting a limited number of license holders, known officially in the legislation as Medical Marijuana Treatment Centers to commence cultivation and sale of marijuana for registered patients. Thus far, licensing has been relatively limited, with 13 being issued, and with only four (including Liberty) of the MMTCs being in production at this time. The state has said they will issue an additional four licenses for every 100,000 new patients registered in the state. There are no imminent plans to legalize recreational marijuana in Florida.

### **Product regulations and distribution System**

Florida prohibits the sale of dried bud, and currently only allow for oils, and other oil-based derivatives including topical ointments, vape pens and capsules. Edibles are expected to be legalized by mid-2018.

Another important feature of the regulatory regime is the requirement for MMTCs to control the product at each step in the value chain. They must grow, refine, package and retail the products themselves. In rare cases, such as when a crop is destroyed, a producer may be allowed to purchase cannabis from another MMTC. Regular wholesale sales are being discussed at the state level, and we expect them to be approved over the next few years.

Distribution regulations require the MMTCs to sell directly to patients through direct home delivery or via a retail dispensary. The regulations allow each MMTC to operate up to 25 retail dispensaries in the state. While local jurisdictions cannot prohibit marijuana cultivation or restrict the location of marijuana retail operations, some municipalities have done so with respect to retail locations.

### **Patient Access**

Patients will require a doctor's 'recommendation' to obtain a patient identification card issued by the Florida Department of Health. A qualified physician may prescribe marijuana for any of the listed allowable 'debilitating medical conditions', or other similar conditions where they feel the potential benefits of marijuana outweighs the risks to the patient. The list of conditions is fairly broad, and includes cancer, epilepsy, glaucoma, HIV, AIDS, PTSD, ALS, Crohn's, Parkinson's, MS, a terminal condition and chronic non-malignant pain.

### **Population and Usage**

Florida is home to the third largest state population in the US, with an estimated 21M residents as of 2017. It also has the largest percentage of residents in the 65+ demographic, at 19.9% of the population. It's estimated that 6M people qualify under one of the conditions above – if we were to assume just 10% of them would eventually use MMJ, then we have a potential patient base of 600,000, or 2.9% of the population. This upper 2% range is higher than the low 2% of the population we typically estimate as a patient usage rate in a mature medical market. However, given the substantially higher percentage of elderly residents, the inclusion of snowbirds, the higher rate of occurrence for chronic conditions, and the higher offering of available products, we assume the ultimate patient penetration level will exceed the typical low 2% average over the long-term.

At the end of January, 2018, there were over 70,000 registered patients, equating to 0.3% of the population. As older patients who may have never used cannabis are introduced to the product, and doctors become increasingly educated on prescribing cannabis to their patients, this figure is expected to grow steadily. In June 2017, there were 16,760 registered patients. To put this into context, Canada went from 24,000 registered patients at the end of June 2015 and took 12 months to reach 75,000 patients. Given that Florida realized a gain of 7,000 in January, we estimate the state to surpass 75,000 partway through February, which highlights that it took Florida nine months to add 58,000 patients, while Canada took 12 months to add 51,000. As of January 2018, 1,053 (1.7%) physicians had provided prescriptions to patients within the state.

### Medicinal Marijuana Replacing Other Prescriptions

Medicinal marijuana is often prescribed to patients as a replacement for other prescription medications and over-the-counter products, and a majority of those that do have found (in a recent study) that MMJ is preferred over the products that were previously used to treat their various ailments (Figure 1). Furthermore, given the well-known data on the dangers of opioid prescriptions, MMJ has the potential to grow usage through the replacement of a substantial percentage of opioids. These products are expensive compared to cannabis, are highly addictive and can be quite hazardous to one's health. The ongoing validation of cannabinoids provides a readily available product that is proven to provide relief for many of the same ailments that opioids offer but at a lower cost and safer outcome. According to the National Center for Health Statistics (U.S.), almost 29,000 people died in 2014 alone from an accidental opioid-related death. Researchers at Johns Hopkins University found that when comparing U.S. states that have legalized medicinal cannabis versus those that have not, there is a 25% decrease in opioid fatalities versus those states that do not allow medicinal cannabis.

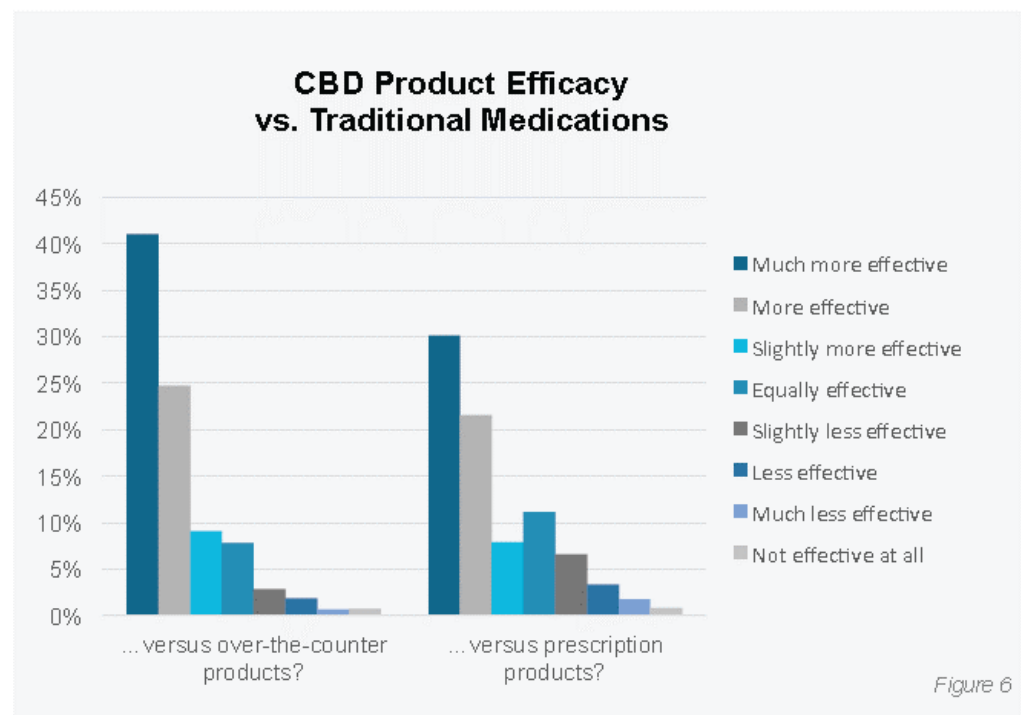


Figure 2: Patient Survey Regarding Efficacy of CBD vs Traditional Pharma Drugs  
Source: HelloMD, Brightfield Group

## Market Size

Arcview, a leading cannabis industry research firm, estimates total 2017 Florida MMJ sales at US\$151M. This figure is expected to grow rapidly in the coming years, as production and distribution capabilities, as well as patient and physician education, are at a relative nascent stage today. MMJ sales are estimated to reach US\$1.4B in 2021, a CAGR of 75%.

### Estimated Legal Sales of Medical Marijuana in Florida

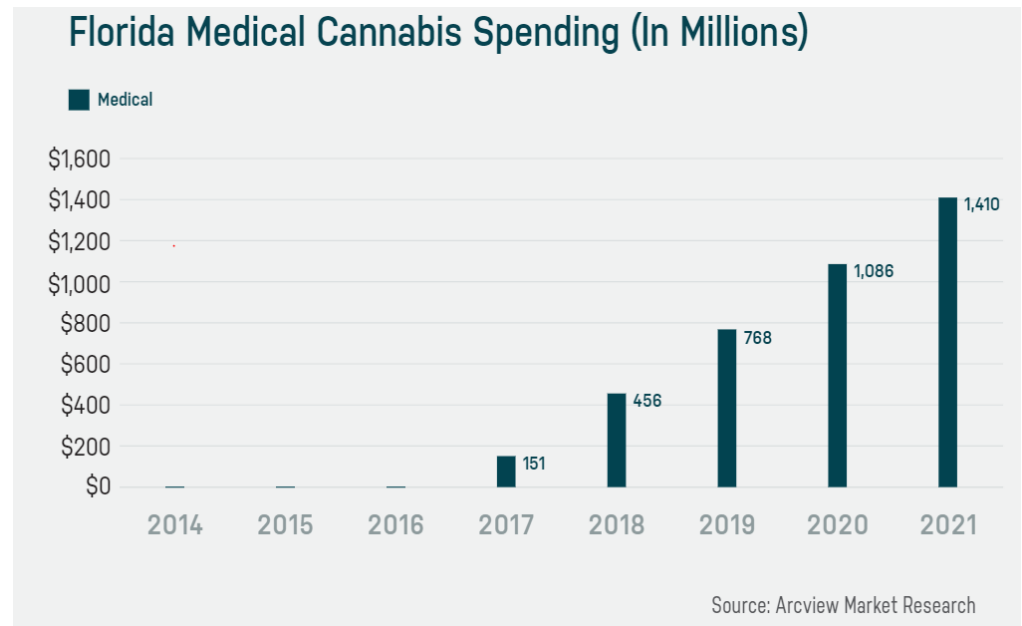


Figure 3: Estimated Legal Sales of Medical Marijuana in Florida

Source: State of the Legal Marijuana Market, 5th Edition, Arcview Market Research

Over the long term, applying an average daily usage assumption of 0.5g equivalent per patient (this is lower than typical in Canada due to Florida being an oil or oil derivative market), and using a patient base of 600,000, the potential volume demand for the Florida market is 110,000kg per annum of dried equivalent. Also noteworthy is that out of state patients, including 'snowbirds' can receive a prescription if they've been in the state for more than 31 consecutive days.

## Risks of Investing in Cannabis Companies with US Assets

There is a substantial risk in investing in companies with US cannabis assets as marijuana remains a federally illegal substance to produce, sell or consume. Material losses to these investments can occur if the federal government were to pursue and prosecute the businesses involved in this sector.

### A Schedule I substance

Marijuana is categorized by the United States federal government as a Schedule I substance. It is federally illegal to produce, sell, or consume marijuana, and it is illegal to cross US state lines with it or to import/export it to or from the US. However, to date, over 30 individual US states have passed legislation to permit the production, sale and consumption of either medicinal and/or recreational marijuana. In addition, based on recent polls, over 60% of Americans approve of marijuana for medicinal purposes.





### **Rohrabacher-Blumenauer Amendment**

Medical cannabis sales have been allowed to occur without federal interference due to a purposeful lack of oversight by the US Department of Justice through the past several US administrations, and more recently, by the passing in the US Congress of the Rohrabacher-Blumenauer amendment in 2014, which states that the US Department of Justice cannot use federal funding to prosecute medicinal marijuana companies that are complying with state law. Enacted as a budget amendment, it requires re-approval each time a new budget is submitted. The legislation, which essentially protects people and businesses engaged in medical marijuana from legal or criminal action taken against them at the federal level. The legislation received a favourable ruling in the US Court of Appeals in 2016. The language of the amendment does not cover the recreational market. As the amendment requires approval within each budget, the legislation remains without a permanent resolution. There is no guarantee that the US Congress will continue to vote in its favour. At the current time, Congress continues to support the Amendment.

### **The Cole Memorandum versus the current US Attorney General**

For historical context, we highlight the Cole Memorandum, issued under the Obama Administration in 2013 by then Deputy Attorney General James M. Cole. The memorandum provided US Attorneys with guidance regarding federal prosecution with respect to marijuana enforcement. The memo laid out principles that business should follow, which would essentially protect them from federal prosecution. Amongst these were: follow the laws of the state regarding marijuana; do not ship or sell product out of state; keep product out of the hands of minors; and do not launder money.

Attitudes toward marijuana legalization have changed within the current administration. US Attorney General Jeff Sessions has been quite vocal regarding his anti-marijuana views. To that point, in January 2018, he rescinded the Cole Memorandum, which essentially leaves the option to prosecute up to the various state US Attorneys. AG Sessions withheld from providing explicit commentary on whether or not US Attorneys should actively prosecute people and businesses who followed the marijuana laws of their respective states. Since that time, many of the state Attorney Generals where it is legalized have stated they will continue to support the spirit of the Cole Memo and desires of the voters of their respective states.

### **Comments from the President**

While President Trump has been largely silent on the issue of legalized marijuana in recent months, but he had previously come out and supported medicinal usage. In an interview in February 2016, he made comments suggesting he was more skeptical of legalization of recreational marijuana use but supported medicinal consumption, stating he was “in favour of it a hundred percent”. He has made several other such comments in support of legalized medical usage, touting its ability to help patients, stating, “I know people that are very, very sick and for whatever reason the marijuana really helps them”.

### **Banking regulations**

One of the primary issues faced by cannabis businesses as a result of the federally illegal status of the drug is the inability for these companies to access banking services. Major US banks have shied away from the sector as a result of the onerous regulatory and compliance burden that would be required to accept funds, make loans and provide financial services to marijuana businesses. This void has been filled by a combination of smaller community banks and credit unions. By the end of 2017, approximately 400 US banks and credit unions provided services to cannabis businesses, compared to 301 in 2016 and 51 in 2015. Furthermore, in 2014, the US



Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a series of guidelines which, if followed, would allow financial institutions to work with cannabis companies. Since AG Sessions decision to rescind the Cole Memo, many have been left wondering if the Treasury Department will rescind the FinCEN guidelines on dealing with state legalized cannabis companies. However, last week, the US Treasury Secretary stated that perhaps the process will change but that "we want to make sure that we can collect our necessary taxes and other things" and that "I assure you we don't want bags of cash", which was taken as financial institutions will still be able to conduct business with cannabis companies.

### **Taxes**

In 1982, the IRS implemented Internal Revenue Code Section 280E, which prohibits businesses deemed to be selling illegal products from deducting operating expenses related to the sale of those illegal goods, thereby increasing their tax burden. Since the sale of marijuana is federally illegal in the US, Section 280E holds for cannabis companies, regardless of state approval. While members of Congress have voiced support for repealing this law's applicability to cannabis companies, the recent US tax overhaul passed in December 2017, known as the Tax Cuts and Jobs Act, did not repeal 280E for cannabis businesses. Marijuana companies are able to separate out some costs that are not directly related to the trafficking of illegal goods, but remain with a higher than normal tax burden.

## **Company Overview**

### **Operations - Florida**

The Company owns an 800kg greenhouse production facility in Alachua County, FL, approximately 15 miles northwest of Gainesville. LHS is currently expanding the facility to a capacity of 1,600kg by March 2018. In January 2018, Liberty announced it had entered into a binding term sheet to acquire 242 Cannabis Canada, owners of a 387 acre parcel of land in Gainesville, which includes over 200,000 square feet of state of the art greenhouses and supporting facilities. Liberty intends to retrofit the facilities in order to increase its capacity to 12k kg per annum by November 2018.

### **Retail Dispensaries**

Under Florida regulations, each license holder is allowed to operate up to 25 dispensaries across the state. In early January, Liberty announced the opening of its first retail outlet (under the banner the Cannabis Education Center), located in The Villages, which is the largest retirement community within the state. The Company is planning to open another four locations in H1/2018, including Port St. Lucie in March, St. Petersburg immediately thereafter, then Fort Myers and Fort Lauderdale by May. Ultimately, the Company believes they will operate 15-18 retail outlets within the next two years, including Orlando, Tallahassee, Jacksonville, Miami, Boca Raton, Sarasota and Tampa to name a few. At the moment, there are 27 dispensaries operating across the state (Trulieve operates 13 locations, Knox at six, Surterra four, Curaleaf three and Liberty one).



### Liberty Health Sciences Cannabis Education Center in Florida



Figure 4: Liberty Health Sciences Cannabis Education Center in Florida

Source: Liberty Health Sciences

### Products and Pricing

Dried bud is not permitted for sale in Florida but numerous oil derivative products are, including the following, which are sold by Liberty. Consumption/duration of purchased product will depend on active ingredient strength and severity of condition.

#### Vapes

These products are sold for US\$35-40 per 250mg cartridge. They account for approximately 60% of sales today.

#### Capsules

Liberty produces seven capsule varieties, ranging from US\$35-US\$200 for 30 capsules, depending on the dosage within each capsule. These account for approximately 20% of sales.

#### Oral Solution

The Company sells six varieties of oral solution (30ml bottle) at US\$35-US\$110 per bottle, which account for approximately 20% of sales.

### Exclusive Agreements

Liberty signed a marketing agreement with MM Technology Holdings, LLC, to be the exclusive producer and provider of Mary's Medicinals products to the Florida market. Under the three year agreement, Liberty will be able to market various Mary's products, including transdermal patches, gels and capsules, tinctures, vape pens and distillates, among others. In January, Liberty announced an agreement with Colorado-based Incredibles brands whereby Liberty will be the exclusive producer and provider of Incredibles products in Florida over a three-year period, including cannabis edibles, wellness products and extracts. It is expected that Florida will allow edibles for sale by mid-2018.

### Branding

Florida regulations allow medicinal marijuana companies to market their products, whether it be television ads, billboards, etc. Going forward, the Company does anticipate a budget for this type of marketing in order to support its Cannabis Education Centers. Liberty utilizes Aphria

branded products across its offerings, except for the Mary's and Incredibles products which will carry their own branding.

### Expansion Plans

Management expects that in mid-2020, it will require a further expansion decision of at least 9,000kgpa for the Florida market, with the expectation that it would be available by mid-2021 (for a total capacity of 21,000kgpa). The Company envisions a market share in the high teens over the next several years. Furthermore, if the market allows wholesale volumes within the next few years, LHS estimates they will require additional capacity to the 9,000kgpa listed above as they expect to supply other licensed producers, none of which has the access to the public capital markets that LHS has today. We have assumed a growth capex spend of \$48M over the next several years as they add 26,000kg of capacity to the 1,600kg that will be in place next month.

### Ownership in Copperstate LLC

In Early February 2018, Liberty announced that it had entered into a definitive agreement with Aphria, whereby Liberty would acquire Aphria's 14% ownership in an Arizona-based and Arizona focused medicinal marijuana producer Copperstate LLC for US\$16.3M in cash (C\$20M). Copperstate operates an 18kg per annum facility (that is currently ramping production), located in Snowflake, AZ. The transaction is expected to close in Q2/18. It is Liberty's expectation, through its discussions with Copperstate that it would be able to own between 20-40% of the company in the future, otherwise, it is expected to receive dividends in the future if its ownership remains at 14%. The Copperstate business is currently profitable, having benefitted from Aphria's know-how and IP.

### Future markets

Liberty management intends to look at entering additional medicinal markets, where population density combined with a relative ease of doing business while operating in a market that has limited licenses today. This should help the Company with a first mover advantage upon entering those markets. These states would include Connecticut, Maryland, Pennsylvania, Michigan, Ohio and New Jersey.

## Financial Overview

### Sales

We estimate the Company will realize revenues of \$10.1M in F2019 and \$34.6M in F2020 from volumes of 672kg and 2,309kg, respectively, at an average dried equivalent price of \$15/g in both years.

#### Estimated Volumes, Revenues and Adj. EBITDA

Year	F2019	F2020	F2021	F2022	F2023
Kg equivalent sold	672	2,309	6,120	11,627	15,115
Avg. Price per dried gram equivalent (\$CAD)	\$ 15.00	\$ 15.00	\$ 14.04	\$ 13.33	\$ 12.87
Forecasted sales (\$CAD 000)	10,079	34,640	85,919	155,037	194,535
Forecasted EBITDA (\$CAD 000)	(1,629)	6,974	33,859	70,135	90,631

Figure 5: Liberty Health Sciences Forecasted Sales Volumes, Revenues and EBITDA

Source: ACC Estimates



## Costs

### Sales and Marketing

We estimate these costs at \$285k and \$689k in F2019 and F2020, respectively, equal to a percentage of sales of 2.8% and 2.0% in F2019 and F2020, respectively.

### Salaries and Benefits

We estimate salaries and benefits costs of \$4M and \$8.9M in F2019 and F2020, respectively, equal to a percentage of sales of 40% and 26% in F2019 and F2020, respectively.

### General and Administrative, and other Operating Costs

We estimate G&A and other operating costs of \$2.8M and \$4.1M in F2019 and F2020, respectively, equal to a percentage of sales of 27.7% and 11.9% in F2019 and F2020, respectively.

### Production Costs

We estimate the average cash cost per dried gram equivalent of US\$1.56 and US\$1.28 in F2019 and F2020, respectively. Given the benefit of the Aphria relationship and given that Aphria is the lowest cost producer in the Canadian market, we would expect that as Liberty builds out its greenhouse capacity within Florida, it will become an efficiently run, low cost producer. However, Florida offers lower costs in energy (less lighting), security and labour costs (no requirement for a Qualified Person to always be present in every cannabis area). Management expects an eventual cash cost per gram at US\$1 over the long term.

### Taxes

Management estimates their corporate tax rate at 45%, which includes section 280E of the IRS code, but separates out some costs from the trafficking portion of that code. For instance, the cultivation portion is not expected to be taxed under 280E, nor is the consultation costs within the retail outlets.

### Capital Expenditures

We estimate the Company's growth capex at \$48M in total over the next five years, allowing for an additional 26ktpa of capacity. Sustaining capex is estimated at \$0.5M per annum, increasing to \$1M per annum in F2023. Liberty management estimates they will have approximately \$33M in cash upon the closing of the Alico greenhouse purchase, expected in mid-February 2018.

### Margin expectations

Given restrictions on dried bud and the allowance for higher margin product sales, this increases the realized average price and dollar margin received relative to Canadian LPs. We estimate the Company's average realized margin (including depreciation) at 54% at the retail level, which equates to a dollar margin above \$8/g. As well, the limited number of initial licenses creates a significant opportunity for those currently in production, which should initially act to insulate MMTCs from excessive competitive forces and oversupply of product, and provide those early entrants with a first mover advantage to grow their market share.

### EBITDA

We estimate the Company will realize adjusted EBITDA of (\$1.6M) in F2019, \$7.0M in F2020 and \$33.9M in F2021, equating to EBITDA margins of (16.2%), 20.1% and 39.4%, respectively.



### Notable Shareholders

Aphria is Liberty's largest shareholder (they were at 37.6%). However, Aphria has announced that it will be divesting its ownership completely by mid-2020 (subject to vesting) as it complies with Toronto Stock Exchange listing requirements. 80% of the Aphria holding in Liberty is being purchased by the Serruya family. The remaining 20% is being purchased by Delavaco Capital. Management and the Board own approximately 3%.

### Valuation

We rate the shares of Liberty Health a Speculative Buy with a target price of \$2.20, based on our discounted cash flow (10%) of \$2.19. We have utilized a discount rate of 10% (which is higher than the 8% we use for companies under our coverage operating with Canadian assets) as the risk is higher due to cannabis being illegal at the federal level. However, with this added risk comes opportunity in that it shields the Florida market from further, stronger competitors who would have access to capital markets under normal circumstances.



## Appendix A - Management Team Bios

### **George Scorsis - Chief Executive Officer**

George Scorsis brings over 15 years of leadership experience to the Liberty team having led companies to rapid growth within highly regulated areas such as alcohol, energy drinks and, most recently, medical cannabis. Scorsis served as the President of Red Bull Canada and was instrumental in restructuring the organization from a geographical and operational perspective, growing the business to \$150 MM in revenue. In that role, he also worked closely with Health Canada on guidelines regulating the energy drink category. Most recently, Scorsis was with Mettrum Health Corp as President and was fundamental in shaping MettrumTM & Mettrum OriginalsTM. Under his leadership, the company was acquired for \$430 M. Scorsis is a proven leader dedicated to providing results in business growth and development and brings a wealth of CPG experience to this exciting, burgeoning industry.

### **Rene Gulliver - Chief Financial Officer**

Experienced C-Suite leader Rene Gulliver brings over 30 years of experience in finance, business development, and operations to Liberty Health Sciences. Before joining the team, Rene worked with Dream Global REIT as their CFO where the business grew from \$1.4 billion in assets to just over \$2.8 billion through acquisitions. Working with the capital markets in Canada and Europe, he was responsible for raising the funds to support this growth while maintaining acceptable capital ratios. Before his tenure at Dream Global REIT, Rene was CFO of the Americas at Cushman & Wakefield where he was responsible for financial oversight in the United States, Canada, South America and Mexico. Prior to these roles, he held senior positions at a First Service company as well as Royal LePage, where he was responsible for restructuring those organizations. His financial career started at PwC as part of their Mergers and Acquisitions group, focusing on international transactions. As the Chief Financial Officer of Liberty Health Sciences, Mr. Gulliver is responsible for acquisitions and divestitures, financial reporting and budgeting as well operational oversight. Rene earned his Chartered Professional Accountant, Chartered Accountant (CPA, CA) designation while working at PwC and has his Honors Business Degree from the University of Western Ontario.

*Source: Company website*



## Primary Risk Factors

**Regulation:** As we highlighted in the risks above, regulatory changes could have a material impact to the Company's earnings potential.

**Research on Phytocannabinoids:** While a number of scientific studies have demonstrated the efficacy of medicinal cannabis for a vast array of indications, few clinical trials to assess the impacts on humans have been completed (due to the prohibition.) It is possible that further research could prove the benefits of medical cannabis to be less than what the industry currently believes. This could potentially adversely impact consumer perception regarding the safety and efficacy of cannabis and cannabis based products.

**Litigation and Recall:** We believe that all pharmaceutical and related companies face elevated levels of litigation risk. Any adverse event that leads to litigation against LHS by customers, including class action, could have a material impact on the Company.

**Competition:** There are currently 13 MMTCs licensed to sell cannabis in the Florida. As more participants enter the industry, the Company's profitability could be threatened.

**Operational:** LHS's business of growing cannabis exposes the Company to all the inherent risks of agriculture. As an example, the Company's crop may be damaged by an insect or disease which could prevent it from meeting demand for its product and therefore missing our forecasts. The climate in Florida exposes the Company's assets to risks associate with damage from weather events.

**Early-Stage of the Medicinal Marijuana Industry:** We have yet to see how conventional pharmaceutical companies will respond to the potential threat faced from medicinal cannabis taking market share from opioids. In addition, there is also considerable uncertainty regarding the medical community's acceptance of medical cannabis as an alternative to other drugs in the marketplace.

**Growth Profile may differ from Expectations:** Given the nascent level of the industry and the sizeable expectations put forth by the market, there is a risk that industry and company growth may not materialize be as expected, to the detriment of the company's earnings potential and valuation.



## Liberty Health Sciences Inc.

**LHS** **C\$1.36**  
**Rating:** **Speculative Buy**  
**12 Month Target:** **C\$2.20**

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An **Outperform (Buy)** rating represents a security expected to provide a return greater than the peer group average.

A **Sector Perform (Hold)** rating represents a security expected to provide a return in line with the peer group average.

An **Underperform (Sell)** rating represents a security expected to provide a return less than the peer group average.

A **Speculative Buy** rating represents a security where the return potential is high, but the risk of a significant loss is material.

Rating and Price Target History for: Liberty Health Sciences Inc. (LHS@CN) as of 13-02-2018



	Ranking Distribution	% IB Clients
Outperform	29%	14%
Sector Perform	17%	12%
Underperform	1%	0%
Speculative Buy	3%	20%
Restricted	2%	100%
Not Rated	48%	3%
Tender	1%	0%
Total	100%	10%

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