

Australis Capital

Australis to reverse merge with Folium

Business update

Pharma & biotech

13 December 2019

Price **C\$0.45**
Market cap **C\$76m**

C\$1.32/US\$

Net cash (C\$m) at September 2019 22.2

Shares in issue 169.9m

Free float 96.02%

Code AUSA

Primary exchange CSE

Secondary exchange OTCQX

Australis Capital announced on 11 December 2019 that it has entered into an agreement with Folium Biosciences to merge into a combined company focused on non-psychoactive cannabinoid products. Existing Australis shareholders will own approximately 11% of the resulting company, but the plan is for Australis management to be involved in running the combined entity. We expect the company to divest its assets based in THC, with the goal of making the company fully federally legal in the US, and to list on a US stock exchange.

Year end	Revenue (C\$m)	PBT* (C\$m)	EPS* (C\$)	DPS (C\$)	P/E (x)	Yield (%)
03/19	0.1	(3.5)	(0.04)	0.0	N/A	N/A
03/20e	0.2	(9.5)	(0.06)	0.0	N/A	N/A
03/21e	0.2	(10.4)	(0.06)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortization of acquired intangibles, exceptional items and share-based payments.

Folium: Aiming to be the biggest US CBD producer

Folium is a producer of full spectrum CBD products based in Colorado. Australis previously invested a small amount (US\$3m) in early 2019. Folium is currently in the process of building what it reports to be the largest cannabinoid processing facility in the US, which is expected to expand its production capacity by tenfold and to be complete in 2020. The CBD produced by the company is for wholesale and is used in a range of third-party products. Following the merger, the combined company will take the Folium name and predominantly focus on Folium operations.

A significant change in direction; divestments needed

Despite all the efforts made by Australis to build itself into a diversified cannabis company, we expect it to divest all of its current assets that are tied to the THC cannabis industry. This includes its stake in Body and Mind, Mr. Natural and Wagner Dimas, and the purchase agreement for Green Therapeutics. Once these assets have been divested, the new company will be able to list on US stock exchanges and potentially have greatly expanded access to capital.

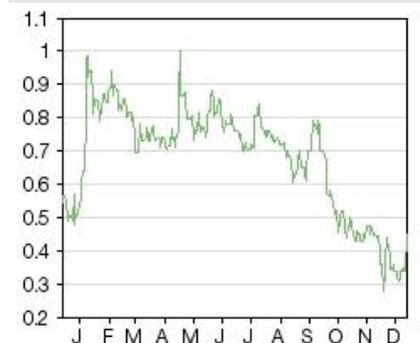
More details forthcoming

We have limited information on the merger at this time, including the details of Folium financials, but expect this to be provided in the short term with the company publication of a management information circular. The stock is halted until the prospectus is published, and the transaction is subject to shareholder approval.

Valuation: Suspended until there are more details

We are currently suspending our valuation analysis until such time as we have further details on the merger and on Folium. Australis most recently traded with a market cap of C\$76m, which would imply a value for the combined company of C\$695m, although this might change once trading resumes.

Share price performance



%	1m	3m	12m
Abs	(23.3)	(51.4)	(42.4)
Rel (local)	(25.1)	(53.9)	(51.8)

52-week high/low C\$1.0 C\$0.3

Business description

Australis Capital is focused on US cannabis assets and is acquiring a range of low-valuation cannabis assets that it believes will have staying power in the rapidly developing cannabis market. However, the company currently has an open reverse merger offer with Folium Biosciences, which would shift it to a CBD-focused company.

Next events

Folium merger materials published Upcoming

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A major change toward THC free

The announcement that Folium would reverse merge with Australis came as somewhat of a surprise, considering that it marks a major pivot from Australis's previous business strategy. Australis has been focused on building through acquisition a diversified but operationally focused THC cannabis company and is currently in the midst of a major brand acquisition and expansion (with Green Therapeutics). Now the stated purpose of the combined company (if the merger is approved) will be squarely focused on non-psychoactive cannabinoids. The goal, as expressed to us by Australis management, is to become fully compliant with US federal law and attempt to up-list the company to a major US exchange. This would provide substantially greater access to capital for Folium, but would necessitate the divestment of all of the THC-related Australis assets at a minimum. These include Body and Mind, Mr. Natural and Wagner Dimas, which are directly involved in the THC cannabis industry. Quality Green would be exempt because it is a Canadian operation. The asset purchase agreement with Green Therapeutics was still pending as of the last report from the company (guidance towards it closing in Q419), and it is unclear at this time if the deal will be completed and what the ramifications will be if it is not. The company also previously had a development plan for a 400,000 square foot production facility in North Las Vegas, which we assume will not go forward at this point. Cocoon can be retained, and although it would be a small part of the combined business, the company has been enthusiastic regarding its potential. Cocoon signed its first client in early December 2019 with Thrive, which currently operates four dispensaries in Nevada and has announced plans to open at least three more.

Folium: A CBD player with big goals

The primary purpose for the reverse merger and the potential up-listing to a US exchange is to improve the access to capital for Folium. The company's current business is the production of wholesale CBD products for other brands. These include both pure extracts as well as formulated products such as ointments and water-soluble CBD. The company currently has 242 employees and is reported to be profitable.

However, the company has major expansion plans. It is currently building what it reports is the largest US cannabinoid extraction facility at 100,000 square feet, which will increase its production capacity tenfold and employ 150 to 200 people. Additionally, it has broken ground on a Canadian production facility reported to be 170,000 square feet. In October, the company took a major step toward entering the pharmaceutical cannabinoid market and acquired an active pharmaceutical ingredient (API) license, which will allow the company to supply CBD for inclusion in drugs such as Epidiolex. Finally, the company announced in April 2019 that it would be launching Folium Finance, which would provide its CBD customers with a range of financial services ranging from merchant services to banking and insurance. Folium has undoubtedly committed a large amount of capital to these development programs already, but listing on a US exchange would substantially increase its access to capital.

Valuation

We are currently suspending our valuation analysis of Australis until we have more information regarding the merger. We can say that the current market valuation of Australis at C\$76m would imply a valuation of the combined company of C\$695m (based on Australis shareholders retaining 11% of the combined entity), but we should note that at this time, Australis has been halted since

before the announcement and may trade differently once trading resumes. For comparison, the major US CBD producer Charlotte's Web (TSX:CWEB) currently has a market valuation of C\$1.11bn, albeit with consumer CBD products.

It is also worth noting that if the company executes its plan to become fully federally legal in the US, this will trigger the provisions of the Aurora back-in warrants. These include warrants for 22.6m shares exercisable at C\$0.20 (which would be substantially diluted by the agreement) and a warrant for 20% of outstanding shares exercisable at the market.

Financials

We are providing updated financials following the company's FQ220 report for the period ending 30 September 2019, but they should be viewed as for illustrative purposes only, as we do not expect them to be representative of the business going forward if the company executes the Folium merger.

Exhibit 1: Financial summary

	C\$'000s	2019	2020e	2021e
Year end 31 March		IFRS	IFRS	IFRS
INCOME STATEMENT				
Revenue		129.8	226.4	226.4
Cost of Sales		0.0	0.0	0.0
Gross Profit		129.8	226.4	226.4
EBITDA		(3,606.8)	(10,112.7)	(10,112.7)
Normalised operating profit		(3,616.8)	(10,323.1)	(10,323.1)
Amortization of acquired intangibles		0.0	0.0	0.0
Exceptionals		0.0	0.0	0.0
Share-based payments		(677.5)	(4,336.0)	(4,336.0)
Reported operating profit		(4,294.4)	(14,659.1)	(14,659.1)
Net Interest and financial income		284.9	801.5	(45.1)
Joint ventures & associates (post tax)		0.0	0.0	0.0
Exceptionals		(161.7)	0.0	0.0
Profit Before Tax (norm)		(3,493.7)	(9,521.6)	(10,368.2)
Profit Before Tax (reported)		(4,171.2)	(13,857.6)	(14,704.2)
Reported tax		0.0	0.0	0.0
Profit After Tax (norm)		(3,493.7)	(9,521.6)	(10,368.2)
Profit After Tax (reported)		(4,171.2)	(13,857.6)	(14,704.2)
Minority interests		0.0	0.0	0.0
Discontinued operations		0.0	0.0	0.0
Net income (normalised)		(3,493.7)	(9,521.6)	(10,368.2)
Net income (reported)		(4,171.2)	(13,857.6)	(14,704.2)
Basic average number of shares outstanding (m)		94	170	178
EPS - basic normalised (\$)		(0.04)	(0.06)	(0.06)
EPS - diluted normalised (\$)		(0.04)	(0.06)	(0.06)
EPS - basic reported (\$)		(0.04)	(0.08)	(0.08)
Dividend (\$)		0.00	0.00	0.00
BALANCE SHEET				
Fixed Assets		36,939.9	51,619.3	50,897.0
Intangible Assets		4,048.0	3,536.5	3,024.6
Tangible Assets		120.5	4,528.2	4,317.8
Investments & other		32,771.4	43,554.6	43,554.6
Current Assets		28,111.5	20,667.6	11,021.6
Stocks		0.0	0.0	0.0
Debtors		273.7	331.1	331.1
Cash & cash equivalents		24,515.5	16,783.3	7,137.4
Other		3,322.3	3,553.2	3,553.2
Current Liabilities		(1,864.5)	(2,640.9)	(2,640.9)
Creditors		(1,864.5)	(2,514.5)	(2,514.5)
Tax and social security		0.0	0.0	0.0
Short term borrowings		0.0	0.0	0.0
Other		0.0	(126.4)	(126.4)
Long Term Liabilities		(2,512.6)	(3,463.4)	(3,463.4)
Long term borrowings		0.0	0.0	0.0
Other long term liabilities		(2,512.6)	(3,463.4)	(3,463.4)
Net Assets		60,674.3	66,182.5	55,814.3
Minority interests		0.0	0.0	0.0
Shareholders' equity		60,674.3	66,182.5	55,814.3
CASH FLOW				
Op Cash Flow before WC and tax		(3,606.8)	(10,112.7)	(10,112.7)
Working capital		833.9	3,964.4	0.0
Exceptional & other		(33.1)	1,313.3	466.8
Tax		0.0	0.0	0.0
Net operating cash flow		(2,806.0)	(4,835.0)	(9,646.0)
Capex		(130.6)	(382.5)	0.0
Acquisitions/disposals		(15,789.3)	(24,489.8)	0.0
Net interest		0.0	0.0	0.0
Equity financing		52,386.7	12,822.8	0.0
Dividends		0.0	0.0	0.0
Other		(9,438.5)	5,340.0	0.0
Net Cash Flow		24,222.3	(11,544.5)	(9,646.0)
Opening net debt/(cash)		0.0	(24,515.5)	(16,783.5)
FX		293.2	(143.5)	0.0
Other non-cash movements		0.0	3,956.0	0.0
Closing net debt/(cash)		(24,515.5)	(16,783.5)	(7,137.6)

Source: Australis Capital reports, Edison Investment Research

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