

# APHRIA

## Everything Has Changed: The Big 5 Canadian Cannabis Companies Have Achieved “Platform Status”

While Mulvaney is a move towards Federal Legalization, Canada Remains the Only Game in Town

The Bidding for Aphria is officially ON.

### **Citron Expects to see \$8 US before the end of 2018.**

In a dramatic change, Trump announced on Friday that marijuana reform ally Mick Mulvaney will replace marijuana opponent John Kelly as his acting White House chief of staff ([source](#)).

Governor Andrew Cuomo outlined a plan last week to legalize marijuana in New York (a \$3.1B market). The current “political atmosphere” is “unlike anything we’ve ever seen before” ([source](#)). With federal legalization faintly visible at the end of the tunnel, every large CPG player is now required to explain its cannabis strategy to investors.

However, the key news for Aphria shareholders came in one-line last week in the NYT:

**“Big companies are unlikely to make major moves in the American market until recreational use of THC products is legal at a federal level”** ([source](#))

Despite the increasing number of States moving towards legalization, marijuana remains a Schedule I drug at the U.S. federal level (which is why only Canadian cannabis companies are listed on the NYSE/Nasdaq).

Constellation’s investment in Canopy earlier this year was initially met with broad investor criticism that it was a one-time deal. Then, two weeks ago, Altria/Cronos announced a deal which proved that these types of partnerships have become the new standard.

The main takeaway from Cronos take-out is both i) CPG interest in cannabis is here to stay, and ii) the only way to play is through the Canadian LPs. Fact: no US companies have secured big CPG.

Even though federal legalization is around the corner, it will still take at least 18-24 months for the law to change which makes the Canadian Cannabis LPs the only game in town in the near-

term. In this environment, traditional metrics can no longer be used to value the businesses of the big five Canadian Cannabis companies.

First Constellation, then Altria...this list exploring partnerships is growing by the day.

Exhibit 6: Familiar names have expressed an interest in or are involved in cannabis (shaded)

Alcohol	Food + Non-Alcoholic Beverage	Tobacco	Pharma	Cosmetics
DIAGEO	Nestlé	PHILIP MORRIS INTERNATIONAL	Pfizer	L'ORÉAL
ABInBev	Coca-Cola	Altria	Roche	Unilever
ambev	pepsi	BRITISH AMERICAN TOBACCO	Johnson-Johnson	ESTÉE LAUDER COSMETICS
Constellation Brands	DR PEPPER SNAPPLE™	IMPERIAL BRANDS	SANOFI	P&G
MOLSON-Coors	Red Bull	ALLIANCE One	NOVARTIS	COTY

Source: Company reports

### Next Up – Aphria

Shareholders of Aphria were torpedoed by a short report that questioned the corporate governance and quality of acquisitions. Although the report was well researched, the eulogy that the short sellers were writing on Aphria had to get put on hold as the dynamics of the whole industry have just changed.

Tilray, Aurora, and Aphria are the only remaining US listed Canadian LP's that have yet to announce a major CPG partnership. Tilray's valuation is still in the stratosphere, with Aurora's not too far behind.

It is reasonable to assume that Cronos beat out its competitors to securing Altria because it was 'cheaper'. Shifting gears ever so slightly, with Aphria's recent share price decline, it is the clear winner in the 'don't overspend' game. This is a look at valuations in the new landscape.



In millions of grams per year, except as noted

Company	Capacity	Expansion Details	Target Capacity
Canopy Growth (WEED)*	19	5,675,000 sq. ft. planned.	347
Aurora Cannabis (ACB)	16	Mid-2018 - Adding 100 metric tons (LEAF capacity separately classified)	453
Aphria (APH)	30	Part III - April 2018 to 30 metric tons Part IV+ - December 2018 to 240 metric tons	240
MedReleaf (LEAF)**	9.5	Phase 2 - October 2017 to April 2018 Phase 3 - April 2018 to June 2018	185
Cronos Group (CRON)	6.7	Stayner: Peace Naturals, Armstrong: OGBC	40
CannTrust (TRST)	25	Phase 1 - December 2017 adding 25 Phase 2 - Mid-2018 adding 25	100
Tilray (TLRY)	6.5	Expansion to 1,000,000 sq. ft. planned	60
HEXO Corp (HEXO)	3.6	Quebec Acquisition - December 2018 Quebec Expansion - July 2018	133
<b>Group Total</b>	<b>116</b>		<b>1,558</b>
<b>Industry capacity</b>	<b>Assumes other legal producers represent 30% of capacity</b>		<b>2,226</b>

\* Canopy Growth and Tilray disclose only square footage instead of production capacity. Our estimates appear above.

\*\* MedReleaf has been acquired by Aurora.

Sources: Company disclosures, Veritas estimates

It is important to note that Aphria checks all the boxes to be a platform. It has growing operations, distribution, international, and R&D. To any of the critics who think this is any different than Cronos (if you exclude management issues -- which can be easily rectified) - you are ill informed.

Aside from deals like we saw last week in Paraguay, Aphria has formed partnerships globally that are now being coveted by the larger CPG companies.

**Strategic Innovation Partners**

**3** TODAY AND TOMORROW'S INNOVATIONS

Our Innovation Team & Strategic Expert Partners are committed to to bring **breakthrough innovations** to the global cannabis market. Focusing on untapped opportunities and backed by the latest **technologies, patents and IP**, tomorrow's cannabis products will revolutionize the way our patients and consumers integrate cannabis into their lives.

360 <sup>+</sup> Innovation Hub	IN FINAL STAGE NEGOTIATIONS	ARA	GreenTank Technologies	Clinical Research & University Partners
<b>IN-HOUSE</b>	<b>PARTNERSHIP DETAILS</b>	<b>100% FULLY OWNED SUBSIDIARY</b>	<b>EQUITY INVESTMENT &amp; SUPPLY AGREEMENT</b>	<b>PARTNERS IN R&amp;D AND ANALYSIS</b>
<ul style="list-style-type: none"> <li>Specifically designed to allow our in-house R&amp;D team and strategic partners a place to conceptualize, design and test new and innovative derivative products.</li> </ul>	<ul style="list-style-type: none"> <li>Industrial extraction and refining capabilities</li> <li>New and innovative technologies</li> <li>Mass scale isolation and purification capabilities</li> <li>Micro-encapsulation &amp; water soluble technology</li> <li>Terpene and cannabinoid fractionation</li> </ul>	<ul style="list-style-type: none"> <li>Establishment &amp; Dealer license</li> <li>GMP Certified</li> <li>Analytical testing</li> <li>Product Development</li> <li>Extraction &amp; Purification</li> <li>Formulation</li> </ul>	<ul style="list-style-type: none"> <li>True Taste Ceramic Core Technology for superior user experience</li> <li>Continuous R&amp;D on improved vape technologies</li> <li>Wide range of custom vape devices designed exclusively for Aphria</li> </ul>	<ul style="list-style-type: none"> <li>Tetralbio Pharma (Canada), Med.4 (Australia), Hospital Garrahan (Argentina)</li> <li>University of British Columbia</li> <li>Simon Fraser University</li> <li>University of Alberta</li> <li>University of Saskatchewan</li> <li>University of Western Ontario</li> <li>University of Guelph</li> <li>McMaster University</li> <li>University of Windsor</li> <li>British Columbia Institute of Technology</li> <li>McGill University</li> <li>University of New Brunswick</li> </ul>

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• **Altria’s Investment in Cronos Highlights Aphria’s Valuation Disconnect**

Scarcity value will likely push the valuations of the remaining large Canadian LP’s higher.

Altria’s investment in Cronos further underpins valuation. With the Constellation and Altria’s investments, we’ve now seen two multi-billion-dollar investments at premiums of greater than 40% in each case.

Aphria generated 4x the revenue of Cronos in the last twelve months, Altria bought a 45% stake in Cronos for US\$1.8 billion, and the EV of Aphria today is US\$1.2 billion.

**Aphria has generated US\$35 million revenue in the LTM, which is in-line with what MedReleaf generated prior to being acquired by Aurora for US\$2.5 billion. MedReleaf’s takeout multiple would imply a value of US\$11 per share for Aphria.**

<https://www.reuters.com/article/us-medreleaf-m-a-aurora-cannabis/aurora-to-buy-medreleaf-for-2-5-billion-in-biggest-ever-pot-deal-idUSKCN11F16U>

• **Southern Glazer’s relationship is best in industry to learn the platform**

Aphria has an exclusive distribution agreement with Southern Glazer's (formerly Southern Wine and Spirits), the largest spirit distributor in North America. If one of the larger beverage companies wants to see how Cannabis might play out on a global recreational level, this one particular partnership might be worth the value of the whole company.

**Southern Glazer's named exclusive strategic distribution partner**

**ABOUT SOUTHERN GLAZER'S**  
 North America's largest wine and spirits distributor

- Operations in every province across Canada, the U.S. (44 states plus the District of Columbia), and the Caribbean
- Represents 1,700 wine, spirits, beer and beverage suppliers

**AN INDUSTRY-LEADING STRATEGIC PARTNERSHIP**

- **100% retail coverage** of all cannabis retailers from Day 1 - from the most populated cities to the most remote locations
- **Expertise and relationships with liquor boards** in every province
- **Proven track record** of delivering listings and driving sales across all provinces
- **A dedicated team** for the cannabis industry
- **Accountable** to Aphria sales targets and KPIs
- **Exclusive partner to Aphria** among large-scale suppliers

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## Could the deal be Diageo?

With a market cap of more than 2x Constellation, Chairman Javier Ferran publicly stated several months ago that he is watching the cannabis business “very closely”.

<https://www.bloomberg.com/news/articles/2018-11-13/cannabis-industry-is-facing-a-shakeout-aphria-president-says>

Last week, Constellation received analyst praise for its investment in Canopy. Diageo must be feeling the pressure to make a strategic move in the cannabis space.

<https://www.cnbc.com/2018/12/10/pot-analyst-says-brewer-constellation-is-a-top-stock-idea-in-2019.html>

\*\*\*Citron comments that the only metric now is scarcity. If a deal were to be struck with let's say Canntrust by a US Co, that would only make APHA more valuable as that would take one more player out of contention.

## **The Wildcard... Aphria gets acquired by either: Canopy, Tilray, or Aurora.**

In what would be the most Machiavellian move in the cannabis space to date, a total acquisition of Aphria by its competitors would serve everyone's needs. **It's all about the platform.**

Tilray would gain a real business to justify its overvalued stock price, replace current Aphria management immediately, and remove a major competitor from the market.

Aurora has a history of buying revenue/growth and Aphria would offer that at a severe discount.

A deal for either Tilray or Aurora would increase their chances of attaining the next platform investment from a major CPG/strategic.

Canopy would get the extra capacity and the expertise in farming that is well needed, especially with one crop failure after another.

## **The Elephant in The Room – The Short Report**

By no means is Citron discounting the quality of research done by Hindenburg Research and Quintessential, as both of those firms know we have great respect for their work.

However, instead of issuing a quick response dismissing the shorts (which, in Citron's experience, is what the typical stock promoters do), the company is conducting an investigation led by John M. Herhalt, an independent director to Aphria who was the Global Chair of the Government & Infrastructure Practice at KPMG LLP. Seems to Citron like someone is advising Aphria and the steps taken are those that a serious industry player would take.

While we look forward to the results of the investigation, we find them irrelevant now to the greater story. Moreover, despite the questions surrounding the behavior of the Company's CEO, Aphria has a strong and experienced management team with CPG industry background and none of them have resigned amidst the current controversy. Think about this:

Jakob Ripshtein, the President of Aphria, was previously President of Diageo Canada and CFO of Diageo North America, the company's largest geographic region. In addition, Tom Looney joined Aphria's board last month after retiring as President of Diageo's US and Canadian spirits business.

Neither of these gentlemen has resigned.

Based on our estimates, we believe the strike price of Mr. Ripshtein's options are more than 80% higher than current stock price levels. His decision to stay with the company speaks volumes.

<https://www.linkedin.com/in/jakob-ripshtein-ca-51704a11/?originalSubdomain=ca>

<https://www.newswire.ca/news-releases/aphria-shareholders-elect-four-new-directors-699630481.html>

Joel Toguri is the VP of sales of Aphria. His previous role was VP of Sales at Southern Glazer's. He remains at Aphria despite the controversy.

<https://markets.businessinsider.com/news/stocks/aphria-appoints-former-southern-glazer-s-executive-joel-toguri-as-vice-president-of-sales-1027095530>

## **Conclusion**

Despite Aphria's strong growing operations, its association with nefarious characters has put a discount on the stock that is now too great to ignore. Citron believes that the next two weeks are the most important in Aphria's short history and that its board will do all that it can to regain investor confidence.

In the end, Aphria has a shot at increased value through becoming the next platform company or being taken out entirely (and solving others' problems). The stock can easily rise 40% from here by the end of the year.

Investors must acknowledge when things change. Citron admits we did not see the Cronos deal coming, but now there is only one obvious question left: Who is next?

## **Cautious Investing to All**