

FinCanna Capital Corp.

(CSE: CALI / OTCQB: FNNZF)

First Quarter of Royalty Revenue

BUY

Current Price: \$0.08
Fair Value: \$0.29
Implied Upside: 262%
Risk*: 4

Sector/Industry: Cannabis

[Click here for more research on the company and to share your views](#)

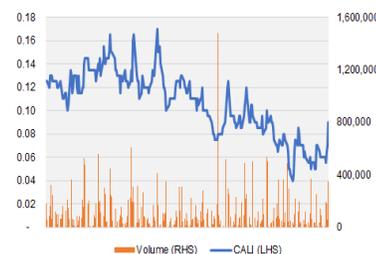
Highlights

- **FinCanna Capital Corp. (“FinCanna”, “company”) withdrew foreclosure proceedings against CTI and negotiated a new royalty agreement.** FinCanna is now entitled to receive 10% (5% in cash and 5% deferred) of CTI’s revenue in perpetuity. As part of the agreement, FinCanna forgave CTI’s outstanding loan amount and its profit-sharing agreement. **CTI commenced commercial operations in March 2020** at its 5,200 sq. ft. facility in Palm Desert, California.
- QVI has the authorization to manufacture, package, and distribute cannabis-infused products from its 8,300 sq. ft. facility in Sonoma County, California. **QVI is expected to commence commercial operations in late May 2020.**
- **GCI commenced early stage commercial operations in April 2020,** and has funding of US\$1.25 million outstanding from FinCanna.
- **RRT is not expected to be operational due to the inability to raise additional capital.** FinCanna has written down their US\$3 million investment in RRT to US\$0.93 million (which primarily reflects the value of RRT’s equipment).
- **Legal spending on cannabis in California is expected to grow at a compound annual growth rate (“CAGR”) of 19% from 2018 to 2024, to reach US\$7.13 billion** (Source: Arcview Market Research and BDS Analytics). This value comprises 23% of the United States’ expected legal cannabis market size by 2024.

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Head of Research

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Equity Analyst

CALI Price and Volume (1-year)



	YTD	12M
Return	-18%	-31%
CSE	-21%	-65%

Company Data (as of May 14, 2020)

52-Week Range	\$0.03 - \$0.17
Shares O/S	100,289,734
Market Cap.	\$8.94 million
Current Yield	N/A
P/E (forward)	N/A
P/B	0.5x

Key Financial Data (FYE - APR 30)

(C\$)

	2018	2019	2020E	2021E
Cash	\$ 2,716,030	\$ 7,832,298	\$ 2,421,430	\$ 127,936
Working Capital	\$ 2,911,104	\$ 7,958,358	\$ 2,013,323	\$ 665,645
Total Assets	\$ 13,132,730	\$24,409,269	\$19,337,379	\$18,537,805
Revenues	\$ 838,148	\$ 1,882,687	\$ 912,702	\$ 2,894,251
Net Income	\$ -12,695,539	\$ 210,179	\$ -5,704,029	\$ -1,261,651
EPS (basic)	\$ -0.31	\$ 0.00	\$ -0.06	\$ -0.01

*See last page for important disclosures, rating, and risk definitions. All figures in C\$ unless otherwise specified.

Operational Update

The following summarizes funding to date in portfolio companies of FinCanna:

Portfolio Company	Total Funding	Funding to Date	Status
CTI*	US\$6,000,000	US\$6,000,000	Commercially Operational
QVI	US\$3,000,000	US\$3,000,000	Commercial Operations Expected Late May 2020
GCI	US\$3,000,000	US\$1,750,000	Early Stage Operations
RRT	US\$3,000,000	US\$3,000,000	Not Operational

*The investment in CTI was originally a loan, which has since been converted to a royalty agreement.

No short-term plans to originate new deals

Management has indicated that their primary focus, at the moment, is generating cash flows from their current portfolio and that they do not have short-term plans to originate new deals. Below, we outline key operational developments to each portfolio company since our last update report (dated November 2019).

Withdrawn foreclosure proceedings against CT

Cultivation Technologies, Inc. (“CTI”)

In February 2020, **FinCanna withdrew foreclosure proceedings against CTI and negotiated a new royalty agreement.** Effective January 1, 2020, **FinCanna will earn 10% of CTI’s revenue in perpetuity** – 5% is to be paid in cash monthly and 5% is deferred and paid upon certain events, such as a change of control (defined as a material change in ownership of CTI) or an initial public offering. FinCanna is additionally entitled to 25% to 50% (the final percentage is based on predetermined parameters – we do not have information on what these parameters are) of sale proceeds of any change of control. As part of the agreement, **FinCanna extended a US\$0.25 million bridge loan** (6 months maturity, 12% interest per annum) to CTI and forgave CTI’s outstanding loan amount and its profit-sharing agreement (total amount forgiven of \$8.44 million).

Negotiated a new royalty agreement

We are unable to comment on whether this new royalty agreement is a better alternative to foreclosing on CTI and selling its assets, as we are not privy to the value of CTI’s assets. **With that said, the present value of expected royalty revenue from this agreement (we estimate to be US\$23 million using a discount rate of 15%), without accounting for any sale proceeds, is significantly greater than the total amount forgiven.**

CTI commenced operations in March 2020

According to FinCanna, **CTI commenced commercial operations at its new 5,200 sq. ft. facility in March 2020.** Images of the facility are presented below.

CTI Facility



Facility tour: <https://www.youtube.com/watch?v=q-tGNdb-vrg&t=290s>

Source: Company

Management at CTI has stated that the COVID-19 pandemic has not negatively impacted their business. According to Headset, **adult-use cannabis sales in California in the month of April 2020 were 17% higher year-over-year (“YoY”)**. This provides an indication that cannabis sales in California are resilient to an economic downturn.

QVI, Inc. (“QVI”)

In April 2020, QVI received a California Cannabis Manufacturing License Type N and a Distribution Type 11 License. **QVI is now authorized to manufacture, package, and distribute cannabis-infused products** from its 8,300 sq. ft. facility in Sonoma County, California. FinCanna expects QVI to **commence commercial operations in late May 2020**.

FinCanna expects QVI to generate first 12-month revenue of at least US\$10 million. We are not privy to information that would support this claim. We are currently forecasting first 12-month revenue to be US\$7.38 million.

Green Compliance Inc. (“GCI”)

According to management, **GCI has commenced early stage commercial operations in April 2020**. In our discussions with management, it was indicated that revenue generation has been limited due to the lack of capital required to expand operations. GCI has funding of US\$1.25 million outstanding from FinCanna, which the company plans to extend once GCI acquires more customers. We have directly contacted GCI to inquire about the scale of their operations and customer base but were unable to connect to a representative. To remind readers, GCI has developed an enterprise compliance point-of-sale (“POS”) software solution for licensed cannabis dispensaries and cultivators.

Refined Resin LLC (“RRT”)

FinCanna indicated that **RRT will not become operational** due to being unable to raise additional capital. The company has written down their US\$3 million investment in RRT to US\$0.93 million (which primarily reflects the value of RRT’s equipment). RRT is currently looking to liquidate the equipment, and FinCanna is in the process of maximizing the amount recoverable.

A discussion on the California cannabis market, where both CTI and QVI operate in, is provided on the next page.

QVI expected to commence operations in May 2020

GCI has commenced early stage operations

RRT will not become operational

California expected to become the largest legal cannabis market in the U.S.

California’s Legal Cannabis Market

According to U.S. research firms Arcview Market Research and BDS Analytics, **California is expected to become the largest legal cannabis market in the U.S.** A rationale for this is the fact that California has the largest population among other U.S. states.

Legal Cannabis Spending by U.S. State

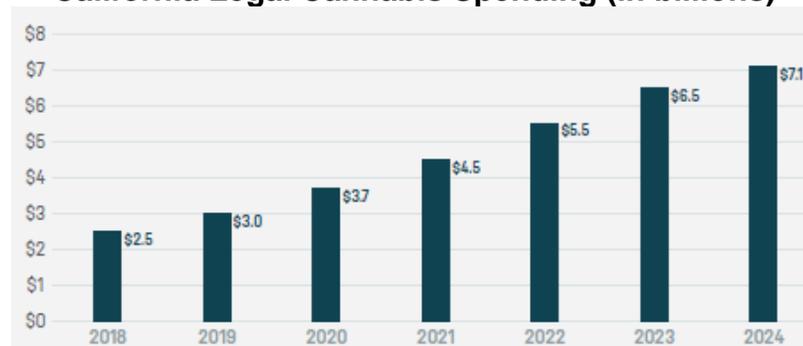
	TOTAL SPENDING		2018–2024
	2019	2024	CAGR
California	\$ 2,961.6	\$ 7,130.1	18.9%
Florida	\$ 659.6	\$ 2,547.3	48.1%
Colorado	\$ 1,616.0	\$ 2,049.2	4.8%
New York	\$ 143.9	\$ 1,656.1	87.2%
Arizona	\$ 705.4	\$ 1,471.6	16.8%
Massachusetts	\$ 672.2	\$ 1,463.5	37.5%
Nevada	\$ 750.2	\$ 1,407.6	16.4%
Illinois	\$ 232.9	\$ 1,402.9	47.5%
Washington	\$ 1,078.8	\$ 1,270.6	3.9%
Michigan	\$ 639.5	\$ 1,250.2	12.0%
Maryland	\$ 254.8	\$ 1,099.2	46.5%
New Jersey	\$ 107.1	\$ 1,066.1	64.7%
Oregon	\$ 752.3	\$ 1,020.0	8.0%
Oklahoma	\$ 346.2	\$ 814.5	205.7%
New Mexico	\$ 124.4	\$ 570.4	32.3%
Pennsylvania	\$ 310.2	\$ 525.5	27.8%
Ohio	\$ 62.4	\$ 521.3	n/a
Texas	\$ —	\$ 489.1	n/a
Georgia	\$ —	\$ 338.0	n/a
Connecticut	\$ 100.2	\$ 336.4	26.3%
Alaska	\$ 147.2	\$ 285.5	19.7%
Missouri	\$ —	\$ 268.6	n/a
Maine	\$ 50.0	\$ 219.5	26.1%

Source: Arcview Market Research, BDS Analytics

Legal spending on cannabis in California to grow at a CAGR of 19%

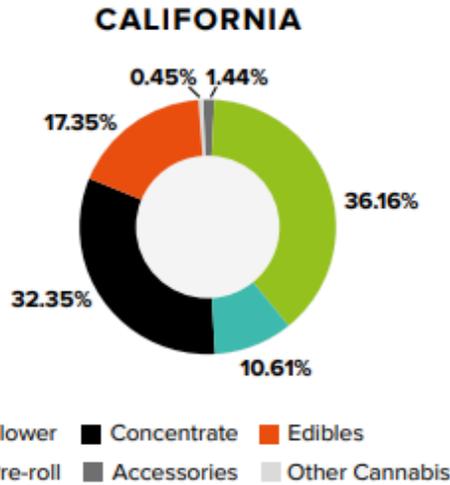
Legal spending on cannabis in California is expected to grow at a compound annual growth rate (“CAGR”) of 19% from 2018 to 2024, to reach US\$7.13 billion. This value comprises 23% of the United States’ expected legal cannabis market size by 2024.

California Legal Cannabis Spending (in billions)



Source: Arcview Market Research, BDS Analytics

The following shows the current composition of California’s cannabis market.



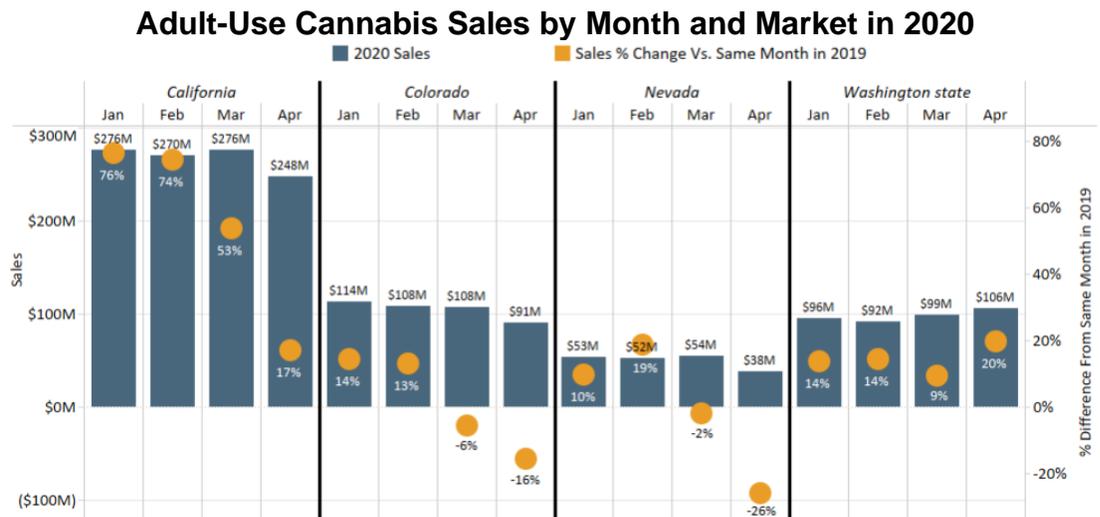
Taken from: Indiva ; Source: BDS Analytics, Deloitte, PBO, Headset

FinCanna, through portfolio companies, is targeting over 60% of California’s cannabis market

Given that CTI is a cannabis concentrate manufacturer and QVI is a cannabis edibles and pre-rolls manufacturer, **FinCanna is effectively targeting over 60% of California’s cannabis market.**

Impact of COVID-19 on California’s Cannabis Market

As provided by Marijuana Business Daily, the following chart shows adult-use cannabis sales in select states.



Taken From: Marijuana Business Daily, Source: Headset

Cannabis sales in California resilient to an economic downturn

As shown above, sales of cannabis in California have shown resilience to the COVID-19 pandemic compared to other states such as Colorado/Nevada (these states generate a material amount of cannabis sales from tourists). **We speculate that cannabis sales in California are resilient to an economic downturn.**

Revenue decreased
40% YoY

Financials

For the nine months (“9M”) of FY2020, FinCanna generated revenue of \$0.82 million (\$0.80 million of which is non-cash) – a YoY decrease of 40%. **Readers should not place a strong emphasis on the YoY decline as revenue generated in the 9M of 2019 were entirely non-cash.**

	2019 (9M)	2020 (9M)	Change
Interest income from loan*	\$986,213	\$767,778	-22%
Profit-sharing income*	\$374,542	\$-	NM
Royalty revenue	\$-	\$54,924	NM
Total revenue	\$1,360,755	\$822,702	-40%

*interest income from loan and profit-sharing income relates entirely to CTI. The accrued amounts have been forgiven, as outlined on page two.

Source: Company, FRC

First quarter of
royalty revenue

Fiscal Q3-2020 revenue was \$0.24 million (\$0.19 million of which is non-cash and \$27k is deferred). Fiscal Q3-2020 marked the company’s first quarter of royalty revenue, which was entirely generated from CTI. CTI has been selling products previously produced at its old facility during the downtime from transitioning to its new facility.

	Q3-2019	Q3-2020	Change
Interest income from Loan	\$307,685	\$189,801	-38%
Profit sharing income	\$183,578	\$-	NM
Royalty revenue	\$-	\$54,924	NM
Total revenue	\$491,263	\$244,725	-50%

Source: Company, FRC

Due to the new royalty agreement with CTI, FinCanna is expected to exceed our FY2020 revenue forecast of \$0.86 million. However, writing off RRT in our valuation of the company will decrease our FY2021 revenue forecast (which was partly offset from CTI). We are revising our FY2020, and FY2021, revenue forecast to \$0.91 million and \$2.89 million (previously \$4.21 million), respectively.

\$3.08 million
impairment loss on
RRT

The company does not record cost of goods sold (“COGS”), which is in-line with their royalty investment business model. FinCanna’s EBITDA, EBIT and net margins continue to be negative due to high selling, general and administrative (“SG&A”) expenses. **The net margin deteriorated significantly due to the \$3.08 million impairment loss on portfolio company RRT.**

	Q3-2019	Q3-2020	2019 (9M)	2020 (9M)
Gross	100%	100%	100%	100%
EBITDA	-46%	-125%	-86%	-143%
EBIT	-46%	-135%	-87%	-151%
Net	-45%	-1468%	30%	-589%

Source: Company, FRC

The following table outlines the EBITDA, net income, and EPS for FinCanna:

	Q3-2019	Q3-2020	2019 (9M)	2020 (9M)
EBITDA	-\$223,978	-\$306,774	-\$1,176,363	-\$1,173,289
Net Income	-\$221,117	-\$3,592,221	\$412,474	-\$4,846,414
EPS	\$0.00	-\$0.04	\$0.00	-\$0.05

Source: Company, FRC

Our revised net loss forecast for FY2020 and FY2021 is presented below.

	Old 2020 Forecast	New 2020 Forecast	Old 2021 Forecast	New 2021 Forecast
Net Income	-\$2,254,651	-\$5,704,029	158,749	-\$1,261,651
EPS	-\$0.02	-\$0.06	\$0.00	-\$0.01

Source: FRC

Free cash flows improved YoY due to lower cash outlays to portfolio companies.

Summary of Cash Flows	2019 (9M)	2020 (9M)
Cash Flows from Operations	(730,044)	(1,521,961)
Cash Flows from Investing	(7,365,970)	(2,663,933)
Cash Flows from Financing	8,139,594	(80,162)
Exchange Rate	-	-
Net Change	43,580	(4,266,056)
Free Cash Flows ("FCF")	(8,096,014)	(4,185,894)

Source: Company, FRC

At the end of fiscal Q3-2020, FinCanna reported a cash position of \$3.56 million, working capital of \$0.63 million, a current ratio of 1.19x and a total debt position of \$4.34 million (due in calendar Q1-2021). In regard to this debt position, management has stated that they will look to restructure the debt or raise additional capital. The entire debt position is also convertible into common shares at \$0.20 per share.

Cash position of \$3.56 million and working capital of \$0.63 million

Material amount of debt due in calendar Q1-2021

Liquidity and Capital Structure	Q3-2020
Cash	3,566,242
Working Capital	629,513
Current Ratio	1.19
LT Debt	1,612,536
Total Debt	4,338,170
Total Debt / Capital	0.22
LT Debt / Capital	0.08

Source: Company, FRC

Shares and warrants: We estimate that the company has 6.85 million options (weighted average exercise price of \$0.39) and 51.07 million warrants (weighted average exercise price of \$0.41) outstanding. None of the options or warrants are in the money.

Valuation

DCF Valuation

Our updated discounted cash flow (“DCF”) valuation on FinCanna’s shares is \$0.21 per share, versus our previous DCF valuation of \$0.27 per share. The deterioration in our DCF valuation is due to (1) writing off revenue from RRT and (2) assuming a slower ramp up to operational capacity by portfolio companies.

*DCF valuation of
\$0.21 per share*

DCF Model	Q4-2020E	2021E	2022E	2023E	2024E	Terminal
EBIT(1-tax)	\$-640,834	\$-421,806	\$ 766,546	\$ 2,970,190	\$ 4,666,374	
Non-Cash Expenses	\$-321,889	\$ -30,401	\$-100,727	\$ -212,308	\$ -379,679	
Investment in WC	\$ 29,241	\$-419,243	\$ 224,800	\$ -296,963	\$ -391,494	
CFO	\$-933,482	\$-871,450	\$ 890,620	\$ 2,460,919	\$ 3,895,201	
CAPEX	\$ -	\$ -	\$ -24,487	\$ -24,487	\$ -24,487	
FCF	\$-933,482	\$-871,450	\$ 866,133	\$ 2,436,432	\$ 3,870,714	\$ 3,986,835
PV	\$-933,482	\$-757,783	\$ 654,921	\$ 1,601,994	\$ 2,213,093	\$ 18,995,715
Discount Rate	15%					
Terminal Growth Rate	3%					
Total PV	\$ 21,774,458					
Cash - Debt	\$ -771,928					
Equity Value	\$ 21,002,530					
Shares O/S (dil)	100,289,734					
Fair Value	\$ 0.21					

Source: FRC

Comparables Valuation

Our updated comparables valuation is outlined below. To reiterate from our initiating report, we believe that a comparable business model is the mining royalty investment business model. The updated price-to-book (“P/B”) multiple of comparables is 2.31x

Company	P/B
Franco-Nevada Corp.	5.60
Wheaton Precious Metals Corp.	3.70
Osisko Gold Royalties Ltd.	1.40
Labrador Iron Ore Royalty Corp.	2.30
Sandstorm Gold Ltd.	2.90
Altius Minerals Corp.	1.15
Cobalt 27 Capital Corp.	0.73
Maverix Metals Inc.	2.43
Average (excluding outliers)	2.31

Source: S&P Capital IQ, FRC

*Comparables
valuation of \$0.36
per share*

Based on a P/B of 2.31x, we value FinCanna at \$0.36 (previously \$0.42). Note that the company's book value used in the computation has been adjusted to include remaining funding. Although the P/B multiple improved, our valuation on the company's shares are lower due to a lower book value.

*Valuation of \$0.29
per share*

Our updated valuation on FinCanna is \$0.29 per share. This is the average of our models above and compares to our previous valuation of \$0.34 per share. We are maintaining a BUY rating.

Risks

We believe the company is exposed to the following risks (list is non-exhaustive):

- Cannabis is illegal at the federal level in the U.S. Though it is legal at the state level in some capacity, in most U.S. states, the illegality of cannabis federally still poses significant risk to cannabis businesses and the operations of the company's investee.
- There is no guarantee that QVI will commence operations by the date stated by management.
- Access to capital and share dilution.
- Exchange rate risk.
- The company has a large outstanding debenture payment due in calendar Q1-2021.

*Maintaining our risk
rating of 4*

We are maintaining our risk rating of 4 (Speculative).

Appendix

STATEMENTS OF OPERATIONS			
(in C\$) - YE April 30th	2019	2020E	2021E
Revenue	1,882,687	912,702	2,894,251
COGS			
Gross Profit	1,882,687	912,702	2,894,251
EXPENSES			
SG&A Expense	2,593,154	2,457,790	2,826,458
Share-based Compensation	634,249	247,484	371,225
EBITDA	(1,344,716)	(1,792,571)	(303,433)
Depreciation & Amortization	15,419	93,388	118,373
EBIT	(1,360,135)	(1,885,960)	(421,806)
Financing Costs	128,054	860,095	860,095
EBT	(1,488,189)	(2,746,055)	(1,281,901)
Non-Recurring Expenses (Gains)	-1,698,368	2,957,974	-20,250
Taxes			
Net Profit (Loss)	210,179	(5,704,029)	(1,261,651)
FOREX Translation Adj.			
Comprehensive Net Profit (Loss)	210,179	(5,704,029)	(1,261,651)
Shares outstanding	94,369,899	100,289,734	100,289,734
EPS	\$ 0.00	\$ -0.06	\$ -0.01

BALANCE SHEET (in C\$) - YE April 30th	2019	2020E	2021E
ASSETS			
CURRENT			
Cash and cash equiv.	7,832,298	2,421,430	127,936
A/R	418,260	92,023	578,850
Inventory			
GST			
Prepays	598,910	333,657	289,425
Subscriptions receivable			
Loans receivable		337,500	405,000
Advance to suppliers			
Related parties			
Total Current Assets	8,849,468	3,184,611	1,401,212
PPE	61,674	42,996	19,322
ROU assets		261,194	261,194
Profit sharing agreement	758,478	-	-
Loan	6,359,934	-	-
Royalty investments	8,379,715	15,848,578	16,336,078
CTI revenue agreement		-	520,000
Total Assets	24,409,269	19,337,379	18,537,805
LIABILITIES			
CURRENT			
A/P	364,537	487,998	578,850
Convertible debt	526,573	526,573	
Deferred revenue		-	
Lease liabilities		156,716	156,716
Total Current Liabilities	891,110	1,171,287	735,567
Convertible debt	3,746,701	3,746,701	4,273,274
Lease liabilities		104,478	104,478
Total Liabilities	4,637,811	5,022,466	5,113,318
SHAREHOLDERS EQUITY			
Share capital	29,135,454	29,135,454	29,135,454
Reserves	3,646,688	3,894,172	4,265,397
Convertible debt (Equity)			
Deficit	(13,010,684)	(18,714,713)	(19,976,364)
Total Shareholders' Equity (deficiency)	19,771,458	14,314,913	13,424,487
Total Liabilities and Shareholders Equity	24,409,269	19,337,379	18,537,805

STATEMENTS OF CASH FLOWS			
(in C\$) - YE April 30th	2019	2020E	2021E
OPERATING ACTIVITIES			
Net Profit for the Year	210,179	(5,704,029)	(1,261,651)
Adjusted for items not involving cash:			
Amortization	15,419	93,388	118,373
Interest income on loan	(1,245,015)	(767,778)	
Impairment loss		3,081,260	
Restructuring fee	(1,619,006)		
Penalties	(263,130)		
Profit sharing income	(374,542)		
FOREX	(359,194)		
Deferred revenue			(520,000)
Finance expense on Loan	36,500		
Accretion on lease liability			
Listing expense			
SBC	634,249	247,484	371,225
Shares for services			
Shares for finders fees			
Funds From Operations	(2,964,540)	(3,049,675)	(1,292,053)
Change in working capital			
A/R	24,716	326,237	(486,827)
GST			-
Prepays	(81,018)	265,253	44,232
A/P	(37,815)	123,461	90,852
Deferred Charges			
Loans Receivable	-	(337,500)	(67,500)
NET CASH USED IN OPERATING ACTIVITIES	(3,058,657)	(2,672,224)	(1,711,295)
INVESTING ACTIVITIES			
PPE	(77,093)		
Cash on RTO			
Loans	(53,343)		
Royalties	(7,193,272)	(2,663,933)	(487,500)
ROUA			
NET CASH USED IN INVESTING ACTIVITIES	(7,323,708)	(2,663,933)	(487,500)
FINANCING ACTIVITIES			
Equity Issue	6,350,087		
Subscription	11,100		
Subscriptions received in advance			
Issue Costs	(863,661)		
Lease payments		(74,711)	(94,699)
Convertible debt	4,785,000		
Proceeds from loan repayment	5,174,107		
Exercise of options			
Exercise of warrants	42,000		
Exercise of agent's options			
NET CASH FROM FINANCING ACTIVITIES	15,498,633	(74,711)	(94,699)
Foreign exchange / Others			
INCREASE IN CASH FOR THE YEAR	5,116,268	(5,410,868)	(2,293,494)
CASH, BEGINNING OF THE YEAR	2,716,030	7,832,298	2,421,430
CASH, END OF THE YEAR	7,832,298	2,421,430	127,936

For details on FinCanna's disclaimer and Forward-Looking Statements please visit: <https://www.fincannacapital.com/corporate/forward-looking-statement/>

Fundamental Research Corp. Equity Rating Scale:

Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

Hold – Annual expected rate of return is between 5% and 12%

Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:

1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues and may rely on external funding. These stocks are considered highly speculative.

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