

FinCanna Capital Corp.

(CSE: CALI / OTCQB: FNNZF)

Starts Receiving Royalty Revenue

BUY

Current Price: \$0.06

Fair Value: \$0.20

Risk*: 4

Sector/Industry: Cannabis

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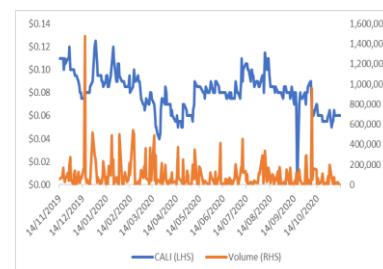
Highlights

- In Q1-FY2021 (quarter ended July 31, 2020), FinCanna Capital Corp. (“CALI”, “FinCanna”) generated \$55k in revenue, of which, \$44k was from royalties, and the remaining was from accrued interest (non-cash) from a loan offered to its portfolio company named CTI. Although we were pleased with the commencement of royalty revenue, they were well below our expectations.
- CALI reported a net loss of \$0.44 million (EPS: -\$0.00) in Q1. As Q1 was the first quarter of royalty revenue, we believe it is not appropriate to compare Q1’s performance with prior quarters.
- CALI’s portfolio currently holds CTI, QVI and GCI; all operational by Q1 – FY2021. However, the company did not report the composition of royalty revenue.
- Revised agreement with QVI wherein FinCanna committed an additional US\$1.5 million in return for a minimum royalty payment of 70% of QVI’s after tax-income. We believe the revised agreement provides more potential upside for CALI, contingent upon QVI’s performance.
- Acquired 100% of GCI from existing shareholders.. Management stated that the core management team came onboard with CALI.
- California remains the largest market in the U.S. for cannabis. Also, there is growing optimism regarding the federal legalization of cannabis. Five states — Arizona, Mississippi, Montana, New Jersey and South Dakota — passed some form of cannabis legalization in the 2020 Election , adding an expected \$9 billion to the cannabis market in the U.S. According to Marijuana Business Daily, the U.S. market will grow to \$30-\$37 billion by 2024.

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Price and Volume (1-year)



| | YTD | 12M |
|--------|------|------|
| Return | -37% | -45% |
| CSE | 43% | 42% |

Company Data (as of 11 May 2020)

| | |
|---------------|-------------------|
| 52-Week Range | \$0.125 - \$0.035 |
| Shares O/S | 100,289,734 |
| Market Cap. | \$5.52 million |
| Current Yield | N/A |
| P/E (forward) | N/A |
| P/B | 0.28x |

| Key Financial Data (FYE - APR 30) | 2018 | 2019 | 2020 | 2021E | 2022E |
|-----------------------------------|----------------|--------------|----------------|---------------|---------------|
| Cash | \$ 2,716,030 | \$ 7,832,298 | \$ 2,646,607 | \$ 380,644 | \$ 73,357 |
| Working Capital | \$ 2,911,104 | \$ 8,011,701 | \$ -1,215,705 | \$ 918,009 | \$ 301,344 |
| Total Assets | \$ 13,132,730 | \$24,409,269 | \$ 13,362,180 | \$19,250,954 | \$ 19,075,721 |
| Revenues | \$ 838,148 | \$ 1,882,687 | \$ 776,650 | \$ 861,387 | \$ 1,779,870 |
| Net Income | \$ -12,695,539 | \$ 210,179 | \$ -11,684,382 | \$ -2,302,402 | \$ -1,494,604 |
| EPS (basic) | \$ -0.31 | \$ 0.00 | \$ -0.12 | \$ -0.02 | \$ -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:

| Portfolio Company | Total Funding | Funding to Date | Status |
|-------------------|---------------|-----------------|-------------------------------|
| CTI* | US\$2.7M | US\$2.7M | Commercially Operational |
| QVI | US\$4.5M | US\$4.11M | Commercially Operational |
| GCI** | US\$3M | US\$1.75M | Commercially Operational |
| RRT | US\$3M | US\$3M | Ceased Operations Permanently |

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

**FinCanna acquired the company and now holds 100% ownership of GCI

Source: Company filings, FRC

Since our last report, the companies had the following notable developments:

Cultivation Technologies, Inc. (“CTI”) – a cannabis extraction company

CTI started paying a royalty

We believe the royalty revenue reported in Q1 was primarily from CTI. We were expecting all the portfolio companies to contribute to royalty revenue in Q1.

QVI, Inc. (“QVI”) – an edible manufacturing company

Revised agreement with QVI

In Q4-FY2020, CALI revised its agreement with QVI. **According to the new terms, CALI will receive a minimum of 70% of QVI’s annual after-tax net income, paid in cash every year.** CALI will also receive 70% of sales proceeds (previously ranging from 25% - 35%) if QVI gets bought out by a third-party. We think the amendment will result in higher payments for CALI – however, the potential upside is contingent upon QVI’s performance going forward. According to management, QVI has been operational for a few months, and **FinCanna is actively involved in the management of QVI.**

Green Compliance Inc. (“GCI”) – a compliance software company

Acquired 100% of GCI

Failure to restructure the royalty agreement caused FinCanna to acquire GCI. Management is currently in discussions with several parties that can potentially use GCI’s solutions. Note that GCI only started commercial operations earlier this year.

Financials

In Q1-FY2021, CALI generated \$55k in revenue, of which, \$44k was royalty revenue, and the rest was interest from a loan to CTI. Most of the company’s previous revenue till the end of FY2020 (ended April 30, 2020), came from accrued interest (non-cash) on loans to CTI.

| STATEMENTS OF OPERATIONS | | | |
|--------------------------------------|----------------------|----------------------|---------------------|
| (in C\$) - YE April 30th | FY2019 | FY2020 | Q1 FY2021 |
| Revenue | \$1,882,687 | \$776,650 | \$54,563 |
| Gross Profit | \$1,882,687 | \$776,650 | \$54,563 |
| SG&A Expense | \$2,593,154 | \$2,072,974 | \$355,677 |
| EBITDA | -\$1,344,716 | -\$1,461,313 | -\$301,114 |
| EBITDA (without SBC) | -\$710,467 | -\$1,296,324 | -\$301,114 |
| Net Profit (Loss) | \$210,179 | -\$11,684,382 | -\$442,806 |
| EPS | \$0.00 | -\$0.12 | \$0.00 |
| Summary of Cash Flows | | | |
| | FY2019 | FY2020 | Q1 FY2021 |
| Cash flows from operations | -\$3,112,000 | -\$1,832,233 | -\$277,370 |
| Cash flows from investing | -\$7,323,708 | -\$3,053,399 | -\$1,555,787 |
| Cash flows from financing | \$15,498,633 | -\$603,338 | \$2,187,942 |
| Net | \$5,062,925 | -\$5,488,970 | \$354,785 |
| Free Cash Flows to Firm (FCF) | -\$10,435,708 | -\$4,885,632 | -\$1,833,157 |

Source: Company, FRC

Since royalty companies do not have any costs other than overhead, the company's gross margin is 100%. **SG&A expense is on a declining trend, primarily due to lower marketing and investor relations activities.**

At the end of Q1-FY2021, **the company had a cash balance of \$3 million, and working capital of \$2.6 million.** CALI had \$6.2 million in convertible debentures outstanding (12% p.a., conversion price of \$0.15, maturing in 2023).

| Liquidity & Capital Structure | FY2019 | FY2020 | Q1 FY2021 |
|--|---------------------|---------------------|---------------------|
| Cash | \$7,832,298 | \$2,646,607 | \$3,001,392 |
| Working Capital | \$8,011,701 | -\$1,215,705 | \$2,615,038 |
| Current Ratio | 9.99 | 0.74 | 3.43 |
| LT Debt | \$3,746,701 | \$0 | \$5,442,398 |
| Total Debt | \$4,273,274 | \$4,227,236 | \$6,208,696 |
| LT Debt / Capital | 0.16 | 0.00 | 0.37 |
| Total Debt / Capital | 0.18 | 0.33 | 0.42 |
| EBIT Interest Coverage | 0.00 | 0.00 | 0.00 |
| Total Invested Capital | \$16,212,434 | \$10,129,748 | \$11,698,034 |

Source: Company, FRC

Shares and warrants: We estimate the company has 6.85 million options (weighted average exercise price of \$0.39) and 36.43 million warrants (weighted average exercise price of \$0.30) outstanding. None of the options or warrants are in the money.

FRC Projections

Even with all the portfolio companies currently operational, we are lowering our short and long-term revenue projections, as we believe our previous estimates were overly optimistic.

| | Old FY2021 | New FY2021 | Old FY2022 | New FY2022 |
|-----------------|----------------|----------------|----------------|----------------|
| Revenue | \$2.89 million | \$0.86 million | \$4.70 million | \$1.78 million |
| Net Loss | \$1.26 million | \$2.30 million | \$0.69 million | \$1.49 million |
| EPS | -\$0.01 | -\$0.02 | -\$0.00 | -\$0.01 |

Source: FRC

Valuation

Based on the above mentioned revisions, our Discounted Cash Flow (DCF) model gave a fair value of \$0.14 per share vs our previous estimate of \$0.21.

| DCF Model | 2021E | 2022E | Terminal |
|----------------------|----------------|-------------|---------------|
| EBIT(1-tax) | \$ -1,508,783 | \$ -708,809 | |
| Non-Cash Expenses | \$ 37,547 | \$ -108,775 | |
| Investment in WC | \$ -215,956 | \$ 313,152 | |
| CFO | \$ -1,687,192 | \$ -504,432 | |
| CAPEX | \$ - | \$ - | |
| FCF | \$ -1,687,192 | \$ -504,432 | \$ 3,319,371 |
| PV | \$ -1,467,123 | \$ -381,423 | \$ 15,815,512 |
| Discount Rate | 15% | | |
| Terminal Growth Rate | 3% | | |
| Total PV | \$ 17,361,108 | | |
| Cash - Debt | \$ -3,207,304 | | |
| Equity Value | \$ 14,153,804 | | |
| Shares O/S (dil) | 100,289,734 | | |
| Fair Value | \$ 0.14 | | |

Source: FRC

We are continuing to use a P/B ratio of 2.3x (historical average of mining royalty companies), which gave a fair value of \$0.19 vs our previous estimate of \$0.36 per share. The valuation dropped due to lower book value.

Our updated valuation on FinCanna is \$0.17 per share. This is the average of our models above, and compares to our previous valuation of \$0.29 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 investees.
- Access to capital and share dilution.
- Exchange rate risk.
- The company has \$6.2M in debentures outstanding.
-

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

Appendix

| STATEMENTS OF OPERATIONS | | | |
|--|---------------------|--------------------|--------------------|
| (in C\$) - YE April 30th | | | |
| | 2020 | 2021E | 2022E |
| Revenue | 776,650 | 861,387 | 1,779,870 |
| COGS | | | |
| Gross Profit | 776,650 | 861,387 | 1,779,870 |
| EXPENSES | | | |
| SG&A Expense | 2,072,974 | 2,176,623 | 2,285,454 |
| Share-based Compensation | 164,989 | 173,238 | 181,900 |
| EBITDA | (1,461,313) | (1,488,474) | (687,484) |
| Depreciation & Amortization | 40,618 | 20,309 | 21,324 |
| EBIT | (1,501,931) | (1,508,783) | (708,809) |
| Financing Costs | 844,520 | 860,095 | 860,095 |
| EBT | (2,346,451) | (2,368,878) | (1,568,904) |
| Non-Recurring Expenses (Gains) | 9,337,931 | -66,476 | -74,300 |
| Taxes | | | |
| Net Profit (Loss) | (11,684,382) | (2,302,402) | (1,494,604) |
| FOREX Translation Adj. | | | |
| Comprehensive Net Profit (Loss) | (11,684,382) | (2,302,402) | (1,494,604) |
| Shares outstanding | 100,289,734 | 100,289,734 | 118,471,552 |

| BALANCE SHEET | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| (in C\$) - YE April 30th | 2019 | 2020 | 2021E | 2022E |
| ASSETS | | | | |
| CURRENT | | | | |
| Cash and cash equiv. | 7,832,298 | 2,646,607 | 380,644 | 73,357 |
| A/R | 418,260 | 32,031 | 172,277 | 355,974 |
| Inventory | | | | |
| GST | | | | |
| Prepays | 598,910 | 401,140 | 86,139 | 177,987 |
| Subscriptions receivable | | | | |
| Lease receivable | | 44,080 | 46,226 | 50,000 |
| Loans receivable | 53,343 | 356,622 | 405,000 | - |
| Advance to suppliers | | | | |
| Related parties | | | | |
| Total Current Assets | 8,902,811 | 3,480,480 | 1,090,286 | 657,318 |
| PPE | 61,674 | 30,234 | 38,935 | 34,670 |
| Deposits | | 29,915 | | |
| Lease receivable | | 116,877 | 104,319 | 54,319 |
| Other receivable | | 15,000 | | |
| ROU assets | | | | - |
| Profit sharing agreement | 758,478 | | - | - |
| Loan | 6,359,934 | | - | - |
| Royalty investments | 8,326,372 | 9,689,674 | 17,861,414 | 17,861,414 |
| CTI revenue agreement | | | 156,000 | 468,000 |
| Total Assets | 24,409,269 | 13,362,180 | 19,250,954 | 19,075,721 |
| LIABILITIES | | | | |
| CURRENT | | | | |
| A/P | 364,537 | 424,869 | 172,277 | 355,974 |
| Convertible debt | 526,573 | 4,227,236 | | - |
| Deferred revenue | | | | |
| Lease liabilities | | 44,080 | - | - |
| Total Current Liabilities | 891,110 | 4,696,185 | 172,277 | 355,974 |
| Convertible debt | 3,746,701 | | 6,461,215 | 6,461,215 |
| Lease liabilities | | 116,876 | - | - |
| Total Liabilities | 4,637,811 | 4,813,061 | 6,633,492 | 6,817,189 |
| SHAREHOLDERS EQUITY | | | | |
| Share capital | 29,135,454 | 29,595,780 | 29,285,999 | 30,239,773 |
| Reserves | 3,646,688 | 3,648,405 | 4,067,410 | 4,249,310 |
| Convertible debt (Equity) | | | | |
| Deficit | (13,010,684) | (24,695,066) | (20,735,948) | (22,230,551) |
| Total Shareholders' Equity (deficiency) | 19,771,458 | 8,549,119 | 12,617,461 | 12,258,532 |
| Total Liabilities and Shareholders Equity | 24,409,269 | 13,362,180 | 19,250,954 | 19,075,721 |

| STATEMENTS OF CASH FLOWS | | | | |
|---|--------------------|--------------------|--------------------|--------------------|
| (in C\$) - YE April 30th | 2019 | 2020 | 2021E | 2022E |
| OPERATING ACTIVITIES | | | | |
| Net Profit for the Year | 210,179 | (11,684,382) | (2,302,402) | (1,494,604) |
| Adjusted for items not involving cash: | | | | |
| Amortization | 15,419 | 40,618 | 20,309 | 21,324 |
| Interest income on loan | (1,245,015) | (776,650) | | |
| Impairment loss | | 9,480,961 | | |
| Gain on disposal of equipment | | (30,000) | | |
| Gain on sublease | | (8,271) | | |
| Restructuring fee | (1,619,006) | | | |
| Penalties | (263,130) | | | |
| Profit sharing income | (374,542) | | | |
| FOREX | (359,194) | 203,761 | | |
| Deferred revenue | | | (156,000) | (312,000) |
| Finance expense on Loan | 36,500 | 833,864 | | |
| Accretion on lease liability / convertible debentures | | | | |
| Listing expense | | | | |
| SBC | 634,249 | 164,989 | 173,238 | 181,900 |
| Shares for services | | | | |
| Shares for finders fees | | | | |
| Funds From Operations | (2,964,540) | (1,775,110) | (2,264,854) | (1,603,379) |
| Change in working capital | | | | |
| A/R | 24,716 | 17,969 | (80,254) | (183,697) |
| GST | | | - | - |
| Prepays | (81,018) | 197,770 | 247,519 | (91,848) |
| A/P | (37,815) | 60,332 | (315,721) | 183,697 |
| Deposits | | (29,915) | | |
| Deferred Charges | | | | |
| Loans Receivable | (53,343) | (303,279) | (67,500) | 405,000 |
| NET CASH USED IN OPERATING ACTIVITIES | (3,112,000) | (1,832,233) | (2,480,811) | (1,290,227) |
| INVESTING ACTIVITIES | | | | |
| PPE | (77,093) | 27,082 | | |
| Cash on RTO | | | | |
| Loans | (53,343) | (609,090) | | |
| Royalties | (7,193,272) | (2,471,391) | (2,012,836) | |
| ROUA | | | | |
| NET CASH USED IN INVESTING ACTIVITIES | (7,323,708) | (3,053,399) | (2,012,836) | - |
| FINANCING ACTIVITIES | | | | |
| Equity Issue | 6,350,087 | | | 1,000,000 |
| Subscription | 11,100 | | | |
| Subscriptions received in advance | | | | |
| Issue Costs | (863,661) | | | |
| Lease payments | | (36,990) | (16,247) | (17,060) |
| Convertible debt | 4,785,000 | (566,348) | 2,187,941 | |
| 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 | (603,338) | 2,171,694 | 982,940 |
| Foreign exchange / Others | | | | |
| INCREASE IN CASH FOR THE YEAR | 5,062,925 | (5,488,970) | (2,321,953) | (307,287) |
| CASH, BEGINNING OF THE YEAR | 2,716,030 | 7,832,298 | 2,702,597 | 380,644 |
| CASH, END OF THE YEAR | 7,778,955 | 2,343,328 | 380,644 | 73,357 |

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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The distribution of FRC's ratings are as follows: BUY (68%), HOLD (7%), SELL / SUSPEND (25%).

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