under the radar report
SMALL CAPS

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DON'T INHALE

Medical marijuana stocks are rocketing with the crop of ASX listings delivering multiples on their IPO prices in just a matter of months. The market is excited because deregulation of medical cannabis is gaining pace both here and abroad and there's a palpable untapped need.

In this Report, Tim Boreham looks at the fundamentals of the sector and whether there is still money to be made. Then we look in depth at three companies that we feel are the best positioned to survive.

It's worth pointing out that Under the Radar looks for "sleep easy" Small Caps to invest in. These are stocks that have some risk, but won't keep you awake at night, wondering if they'll be around this time next year.

We target Small Caps that have a **strong balance sheet** with plenty of cash and are not burdened by debt; are producing **positive cash flow**; can pay **dividends** and have a good business with **barriers to entry** and **growth prospects**. The company should also have a **five-year track record**.

Also in this week's Report we cover two agricultural services stocks - Elders and Ruralco - which are about to report their full year results. If there are any stocks that stand in contrast to the much-hyped medical marijuana stocks, these are it. ■

Richard Hemming
Editor

the issue

Small Talk

"Market history shows that what looks and feels like a boom is indeed a bubble. The question for investors is whether the bubble violently pops or subsides like an old balloon."

TIM BOREHAM, UNDER THE RADAR REPORT

99% of all financial news relates to the 40 to 50 biggest companies. So what about the rest? They're Under the Radar.

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SPECIAL REPORT: MEDICAL MARIJUANA

Medical marijuana stocks are rocketing with the crop of ASX listings delivering multiples on their IPO prices in only a matter of months. The market is excited because deregulation of medical cannabis is gaining pace both here and abroad and there's a palpable untapped need. Tim Boreham looks at the fundamentals of the sector and whether there is still money to be made.

SKY HIGH VALUATIONS

The surge in valuations means medical marijuana stocks have gone from a standing start just over 24 months ago, to being valued between $27m and $190m, with the whole sector valuation approaching $1bn despite the lack of a revenue track record. Is this sustainable?

Certainly, it can keep going if you look at the North American stocks in this sector, which are worth US$200m (A$264m), with the US-listed GW Pharma valued at US$2bn despite achieving modest revenue of US$13m last year.

As of December balance date the ASX stocks in the medical marijuana sector had thin cash balances of no more than $5m. But since then, investors have thrown more cash at them via a rash of capital raisings. In the last two weeks, MGC Pharmaceuticals (MXC), Creso Pharma (CPH) and Zelda Therapeutics (ZLD) and Botanix Pharmaceuticals (BOT) have raised a collective $32m. It's all happening.

The question is whether these new investors are wasting their money. Given the companies' limited trading history, it is hard to tell which ones will deliver the revenue (and of course earnings) to justify the elevated valuations. It says a lot when even executives in the sector are sceptical of value. "You have to look hard at what the revenue model for the company ultimately is," Botanix executive director Matt Callahan tells Under the Radar.

WHAT THE FUSS IS ABOUT

With or without its active ingredient tetrahydrocannabinol, or THC, cannabis is broadly accepted in medical circles as not just a pain palliative, but also a treatment for maladies including epilepsy, acne, anxiety, unwanted weight loss, rheumatoid arthritis and insomnia.

The cannabinoids, of which there are hundreds, provide the goodness without the high. Animals don't miss out either, with at least one company (Creso) targeting hemp-based products for both humans and pets.

According to Zelda executive director Dr Stewart Washer, the hard part will be to convince doctors to prescribe cannabis products alongside established medicines. He says most of the companies are targeting purposes that only require low THC cannabis, such as for cosmetics. But pain relief requires THC and that's where more clinical work is needed.

IF IT LOOKS LIKE A BUBBLE …

Market history shows that what looks and feels like a boom is indeed a bubble. The question for investors is whether the bubble violently pops or subsides like an old balloon, rather like what has happened with most of the red-hot lithium and graphite plays. From the tulip boom to the 1960s Poseidon boom, market manias follow an assured pattern with investors copping a harsh reality check as blue sky promises fail to translate into real projects and real revenues.

MEDICAL MARIJUANA FLYING HIGH

THE FINANCIAL METRICS OF AUSTRALIAN LISTED MEDICAL MARIJUANA STOCKS

COMPANY NAME	ASX CODE	DATE LISTED	IPO PRICE $	CURRENT PRICE $	% GAIN	MARKET CAP $M	EST CASH $M	EST CUR QTR CASH BURN $M
AusCann Group	AC8	Feb-17	0.20	0.80	400%	173	4.8	1.3
Medlab Clinical	MDC	Jul-15	0.20	0.90	451%	161	4.3	2.2
MMJ Phytotech	MMJ	Feb-15	0.20	0.69	343%	138	3.2	2.1
MGC Pharmaceuticals	MXC	Feb-16	0.04	0.08	184%	82	4.6	1.7
Botanix Pharmaceuticals	BOT	Jul-16	0.02	0.07	325%	27	2.4*	0.5
Creso Pharma	CPH	Oct-16	0.20	0.73	365%	42	3.0	1.2
Zelda Therapeutics	ZLD	Nov-16	0.03	0.11	448%	75	3.8	0.9

* BEFORE CURRENT $7.4M EQUITY CAPITAL RAISING

> **A DICHOTOMY IS EMERGING BETWEEN COMPANIES TAKING THE LOW-THC, REGULATORY LIGHT APPROACH FOR PRODUCTS SUCH AS SKINCARE; AND THOSE PONDERING CLINICAL TRIALS FOR APPLICATIONS SUCH AS CANCER, PAIN AND EPILEPSY.**

It's hard to dispute that cannabis demand will soar, both for medical use and with legalised recreational dope replacing the shady dealer down the alley. But cannabis is reasonably easy to grow – the 'weed' descriptor is a dead giveaway – and the stocks targeting supply only risk operating in a commoditised market.

A dichotomy is emerging between companies taking the low-THC, regulatory light approach for products such as skincare; and those pondering clinical trials for applications such as cancer, pain and epilepsy.

JUST SAY NO?

Under the Radar believes there is a strong argument for investors holding off until the sector settles down and develops a track record. In other words, Just Say No. Insofar as we believe that there will be companies that survive any cannabis crash, it's worth putting a few on your watch list. Given the prevalence of claim and counter-claim as to which company has the winning strategy, we highlight the three companies below that we believe have the biggest potential.

BOTANIX PHARMACEUTICALS

Acne treatment developer

Botanix is focussed on skin disease and acne treatments using a synthetic cannabidoil. The regulators usually prefer synthetic variants of botanic products because their quality is more consistent.

The company appears well placed with its focus on skin conditions and a breakthrough acne treatment would be a hit with millions of teenagers. The short-term value driver is news of clinical trials of its synthetic cannabidoil BTX1503 later this year. The company says while acne is a US$4.5bn market, there has been no new treatment for at least two decades. The key to Botanix's success is its compliance with the regulatory processes, which will allow any products to be marketed as prescription products and reimbursed through public or private health insurers.

Just yesterday Botanix announced that it has received commitments to raise up to $7.4m via a placement. It says that the "compelling use of funds" will accelerate its various clinical trial programs. In its slide presentation it says that it has "multiple near term potential revenue streams to complement medium term development upside". We're not holding our breath. ■

RADAR RATING: If its capital raising is successful it will have enough cash possibly for four years. It never lasts too long at a current burn rate of over $500,000 a quarter. We think it has a future because of its focussed approach to skin care, but this week's raising certainly won't be the last. WATCH.

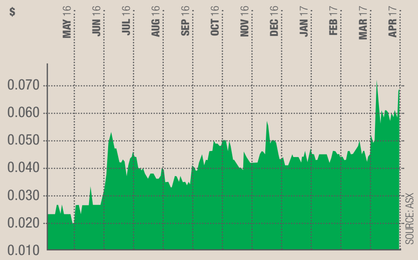
RADAR RATING WATCH

ASX CODE BOT

CASH $2.4M*

CASH BURN $525,000**

BOT - Share Price



* Before current capital raising
** Current quarter estimate

CRESO PHARMA

Food additives developer

Given Creso has a range of approved food additives for animal and human use; the focus is on the pending launch of these products. Without being specific, management says revenues are not too far off but it's hard to know whether they will be big enough to get excited about.

Creso is due to launch its first two animal nutraceutical products – covering pain, inflammation and behavioural disorders, in July. The company's European offshoot Hemp Industries is generating modest revenues. ■

RADAR RATING: It's got enough cash for just under two years, but revenues are around the corner, unlike the others. The big advantage with Creso is its two pronged strategy targeting humans and animals. WATCH.

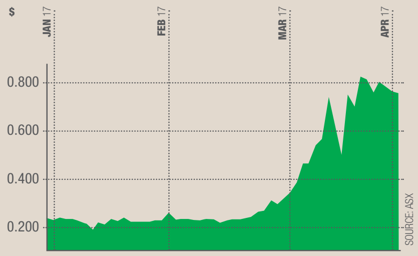
RADAR RATING WATCH

ASX CODE CPH

CASH (POST RAISING) $8.3M

CASH BURN $1.16M*

CPH - Share Price



* Current quarter estimate