

# Australis Capital

Cocoon, a next-gen self-service platform

Business update

Pharma & biotech

1 November 2019

**Price** **C\$0.62**

**Market cap** **C\$104m**

C\$1.35/US\$

Net cash (\$m) at 30 June 2019 23.17

Shares in issue 167.43m

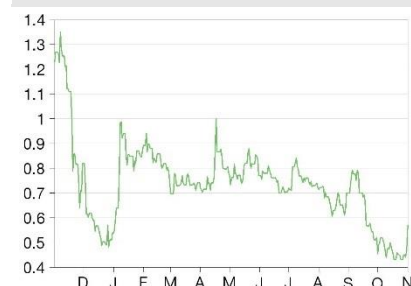
Free float 97.3%

Code AUSA

Primary exchange CSE

Secondary exchange OTCQX

## Share price performance



% 1m 3m 12m

Abs (9.6) (34.9) (62.5)

Rel (local) (11.4) (36.1) (66.5)

52-week high/low C\$1.3 C\$0.4

## 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. The company's goal is to form these assets into a fully operational and integrated US cannabis business.

## Next events

Green Therapeutics deal closes Late 2019

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On 29 October 2019, Australis announced the formation a new subsidiary, Cocoon Technology, which will develop a self-service kiosk (CocoonPod) for the cannabis industry. Each device will handle all aspects of consumer interaction including ID processing, payment and rewards, with integration into dispensary retail platforms for order fulfillment and reporting.

Moreover, Australis will integrate Cocoon with its existing mobile platform to provide a loyalty program and likely other features.

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	0.3	(3.6)	(0.02)	0.0	N/A	N/A
03/21e	0.3	(6.5)	(0.04)	0.0	N/A	N/A

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

## Bringing automation to dispensaries

The goal with Cocoon is to provide the same level of automation in customer interaction in the cannabis industry that we have grown to expect in other retail outlets. The customer completes the ordering and payment process at the kiosk and an employee then delivers the product. The value proposition for automated customer interaction is well established and we believe there is an immediate market for solutions in this industry.

## Integrated marketing and rewards

Part of this planned platform includes integration with the company's Coil cannabis tracking app, rebranded CocoonRewards. The app was developed at the company's rthm subsidiary and provides users with tools to track their favorite strains, find them at partnered dispensaries and earn rewards. CocoonRewards could be integrated with Cocoon inventory systems to direct customers to the closest kiosk with their desired strain, providing immediate marketing and customer retention benefits to partnered dispensaries and producers.

## Cocoon consistent with Australis investment strategy

The formation of Cocoon Technology is consistent with Australis' key investment strategies, which include investing in more durable assets such as technology. There is still a high degree of uncertainty in the cannabis markets in any given state, but investments in technology such as rthm, Wagner Dimas and now Cocoon provide a method of capitalizing on the growth of the industry without being tied to the cannabis supply chain or to a particular geography.

## Valuation: Market pullback leads to slim premium

The pullback in cannabis stocks continues and has brought the Australis market cap much closer to our adjusted nominal value (C\$91.0m). The company trades at only a 14% premium on basic shares (45% on diluted shares). This valuation implies that the premium is justified if the company can produce a 14% annual rate of return, which we believe it will far exceed if it delivers on its investment strategy.

## **Bringing automation to dispensary fulfilment**

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At its core, CocoonPod is a point-of-sale (POS) system aimed at streamlining the cannabis ordering and fulfilment process by providing an interface to select the desired products and pay. In an ideal use scenario, the customer enters a dispensary and approaches a kiosk, where they select their product. The customer is then prompted for payment and receives a receipt, while the order is simultaneously routed to staff to complete. When the order is ready, the customer can collect it from the counter and leave. In geographies where it is appropriate based on regulations, the kiosk can also potentially carry out ID verification or log visits to further streamline the process and reduce staff engagement. Also, in the event that cannabis is decriminalized nationally, or credit and debit card services become more broadly allowed, the kiosk can be updated with this functionality.

Like an ATM at a bank, this product would allow customers with routine requests to fulfil their order quickly and avoid longer queues, while retaining the option of personal assistance. We expect this to be an attractive option in locations where queues have been a problem. For instance, the small number of Massachusetts dispensaries that have been licensed to date have been plagued with long queues that could be at least partially addressed with automation. This product will likely gain the most immediate traction in the small number of very high-volume dispensaries that aim to benefit the most from streamlining fulfilment. There may also be potential in the future for this system to be used in dispensaries with a low footprint to enable an increase in customer throughput that would otherwise be impossible.

The company has not yet published the exact pricing model for the product, but has suggested in the news release that it will include both the cost of capital equipment and a fraction of revenue generated by the machine. We would expect the revenue share to be small (low single digits) given the margin pressure on the business and the fact that the system must be more cost-efficient than human workers. We would expect the capital equipment costs to be in the range of \$10,000 to \$15,000, which is closer in price point to a bank ATM than other POS kiosks, given that it will be designed with higher controls in place and the capacity to handle large amounts of cash.

## **Mobile connectivity and marketing**

The company has described its plans to integrate Cocoon with its existing cannabis tracking app, Coil. Coil already allows customers to track different strains and find these strains at participating dispensaries. The combination of this functionality with a POS system could potentially enable payment via mobile to 'pre-order' the desired product before entering the store, and even further reduce waiting times. Moreover, the combined product provides a wide range of marketing opportunities. Because Cocoon will be fulfilling orders, it can communicate details such as pricing changes and sales to carriers of the app, without any additional steps. We believe the loyalty program has a much higher probability of success when paired with Cocoon. Right now it is a standalone product, and we expect better uptake and utilization when bundled with an integrated product.

## **Partnership with a seasoned developer from the casino industry**

Cocoon is the product of a development partnership with Passport Technology. Passport is primarily a developer of self-service cash access devices and kiosks for use in the casino industry, and this partnership reflects Australis management's existing expertise in that space. The casino market is similar to cannabis in terms of its high degree of regulation and oversight, which gives us confidence that Passport will be able to maintain compliance with the various regulations that may affect device function and reporting. Although they present a hurdle, these regulations may also

prove to be protective against future competition. The precise details of the agreement have not been made public.

## Market hurdles and competition

There are very few other companies developing products that are directly analogous to Cocoon. There have been multiple previous attempts to streamline the cannabis fulfilment process, but by and large these systems have focused on automated vending. A 2018 [article](#) in Marijuana Business Daily describes feedback from dispensary operators: vending machines plagued with 'technical glitches, such as jams or returning incorrect change'. The article also highlights issues with maintenance and oversight that absorbed staff time, limiting the benefits of the products. Cocoon avoids many of these issues by not tackling vending, and we are confident that the expertise of Passport will help avoid some of the maintenance and support through thoughtful development.

The closest comparator of which we are aware is Grasshopper, which has developed a kiosk (as well as other cannabis-centric fulfilment products) that it markets as the 'only compliant automated retail system in the cannabis industry' (although we cannot verify this claim). The kiosk integrates with the company's other platform components, including integration with the Grasshopper app, which allows individuals to search for locations and pay through the app.

## Valuation

Valuations in the cannabis industry have been brought down significantly by the market. The Cannabis ETF HMMJ is the lowest it has been since 2017. Australis has been similarly affected, as has Body and Mind (BaM, in which Australis owns 38m shares), which has reduced our adjusted nominal value of the Australis portfolio to C\$91.0m. Australis is currently trading at just a 14% premium to this value (based on basic shares). It is worth noting that in our adjusted nominal value, only BaM is marked to market and the remainder of the portfolio is valued at cost. The current premium on the fully diluted market cap (C\$132m, 45%) implies just a 14% annual growth rate will justify this valuation. Compare this to our estimates of 24% annual growth in the cannabis market as a whole. We have significant confidence in the company's ability to produce better returns than the current market valuation implies.

We should note that our valuation does not include Cocoon at this time due to the lack of detail on the terms of the deal with Passport. However, as we value the assets at cost for our analysis, if the company paid cash, this would have no net impact on our analysis.

Exhibit 1: Australis portfolio		
Asset	Nominal value (C\$m)	Adjusted nominal value (C\$m)
rthm	3.86	
Body & Mind	17.03	37.03
Wagner Dimas	3.00	
Quality Green	2.00	
Folium Biosciences	3.99	
Mr. Natural	1.21	
Green Therapeutics *	12.50	
Core portfolio value	43.59	63.59
Legacy portfolio (Australis holdings & SubTerra)	4.23	4.23
Cash for investing	12.36	12.36
Other Cash	10.80	10.80
Total value	70.99	90.99
Source: Australis Capital reports, Edison Investment Research. Note: *Definitive agreement signed.		

**Exhibit 2: Australis market valuation**

Shares outstanding (m)	167.43
Share price (C\$)	0.62
Market cap (C\$m)	103.81
Dilutive warrants and options (m)	44.64
Weighted average exercise price (C\$)	0.43
Diluted shares (m)	212.07
Diluted market cap (C\$m)	131.49

Source: Australis Capital reports, Edison Investment Research.

## Financials

The company reported an operational loss of C\$2.8m for Q120, which was largely offset by non-operational items, including a C\$2.0m recognition of a deferred gain (reported net loss of C\$259k). The largest change to operational expenses for the most recent quarter was share-based payments of C\$1.2m, up from C\$677k for the whole of FY19. We have carried the new rate of share-based payments forward in our projections. We have adjusted some of our accounting, which has taken C\$20m capex associated with the grow facility build-out in North Las Vegas, and moved that value to investment activity as we expect it to be deployed through subsidiaries. These amounts are provisional.

We expect to update our forecasts with the launch and traction of the various brands and services that Australis is offering, including the new Cocoon partnership. We expect some time will be needed to develop and prototype the CocoonPod, but that first sales may be possible in CY20.

**Exhibit 3: Financial summary**

	C\$000s	2019	2020e	2021e
Year end 31 March		IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>				
Revenue		129.8	270.6	270.6
Cost of Sales		0.0	0.0	0.0
Gross Profit		129.8	270.6	270.6
EBITDA		(3,606.8)	(6,238.1)	(6,238.1)
Normalised operating profit		(3,616.8)	(6,448.3)	(6,448.3)
Amortization of acquired intangibles		0.0	0.0	0.0
Exceptionals		0.0	0.0	0.0
Share-based payments		(677.5)	(3,753.1)	(3,753.1)
Reported operating profit		(4,294.4)	(10,201.3)	(10,201.3)
Net Interest and financial income		284.9	2,819.4	(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)	(3,628.9)	(6,493.4)
Profit Before Tax (reported)		(4,171.2)	(7,382.0)	(10,246.4)
Reported tax		0.0	0.0	0.0
Profit After Tax (norm)		(3,493.7)	(3,628.9)	(6,493.4)
Profit After Tax (reported)		(4,171.2)	(7,382.0)	(10,246.4)
Minority interests		0.0	0.0	0.0
Discontinued operations		0.0	0.0	0.0
Net income (normalised)		(3,493.7)	(3,628.9)	(6,493.4)
Net income (reported)		(4,171.2)	(7,382.0)	(10,246.4)
Basic average number of shares outstanding (m)		94	167	176
EPS - basic normalised (C\$)		(0.04)	(0.02)	(0.04)
EPS - diluted normalised (C\$)		(0.04)	(0.02)	(0.04)
EPS - basic reported (C\$)		(0.04)	(0.04)	(0.06)
Dividend (C\$)		0.00	0.00	0.00
<b>BALANCE SHEET</b>				
Fixed Assets		36,939.9	55,547.7	55,337.5
Intangible Assets		4,048.0	3,086.6	3,086.6
Tangible Assets		120.5	7,249.8	7,039.7
Investments & other		32,771.4	45,211.2	45,211.2
Current Assets		28,111.5	18,608.1	12,324.9
Stocks		0.0	0.0	0.0
Debtors		273.7	273.7	273.7
Cash & cash equivalents		24,515.5	15,286.8	9,003.6
Other		3,322.3	3,047.7	3,047.7
Current Liabilities		(1,864.5)	(3,119.1)	(3,119.1)
Creditors		(1,864.5)	(3,119.1)	(3,119.1)
Tax and social security		0.0	0.0	0.0
Short term borrowings		0.0	0.0	0.0
Other		0.0	0.0	0.0
Long Term Liabilities		(2,512.6)	(1,305.0)	(1,305.0)
Long term borrowings		0.0	0.0	0.0
Other long-term liabilities		(2,512.6)	(1,305.0)	(1,305.0)
Net Assets		60,674.3	69,731.8	63,238.4
Minority interests		0.0	0.0	0.0
Shareholders' equity		60,674.3	69,731.8	63,238.4
<b>CASH FLOW</b>				
Op Cash Flow before WC and tax		(3,606.8)	(6,238.1)	(6,238.1)
Working capital		833.9	(417.8)	0.0
Exceptional & other		(33.1)	3,780.8	(45.1)
Tax		0.0	0.0	0.0
Net operating cash flow		(2,806.0)	(2,875.2)	(6,283.2)
Capex		(130.6)	(17.3)	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)	5,330.8	0.0
Net Cash Flow		24,222.3	(9,228.7)	(6,283.2)
Opening net debt/(cash)		0.0	(24,515.5)	(15,286.8)
FX		293.2	0.0	0.0
Other non-cash movements		0.0	0.0	0.0
Closing net debt/(cash)		(24,515.5)	(15,286.8)	(9,003.6)

Source: Australis Capital reports, Edison Investment Research

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