

the cannin report

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SAMPLE REPORT

fundamental analysis

Nov

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Risks Disclosures

If you are considering investing in a company that is connected to the marijuana industry, be aware that marijuana-related companies may be at risk of federal, and perhaps state, criminal prosecution. The Department of Treasury recently issued guidance noting: “[T]he Controlled Substances Act (“CSA”) makes it illegal under federal law to manufacture, distribute, or dispense marijuana. Many states impose and enforce similar prohibitions. Notwithstanding the federal ban, as of the date of this guidance, 20 states and the District of Columbia have legalized certain marijuana-related activity.”

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CV Sciences

Fundamentals



Profile:

HQ: Las Vegas, NV

Founded: 2010

Facilities: San Diego, CA

Symbol: CVSI (OTC QB)

Focus: **Neutral**

CV Sciences, Inc. operates two distinct business segments: Consumer Products, a division that manufactures, and sells plant-based CBD products to a range of market sectors, and Specialty Pharmaceuticals, a division focused on developing and commercializing novel therapeutics using synthetic CBD (cannabidiol).

Its PlusCBD Oil brand consumer products is a leading CBD brand sold nationally, in several market sectors including nutraceutical, beauty care, specialty foods, and vape. Its initial pharmaceutical candidate, CVSI-007, combines CBD and nicotine for the treatment of smokeless tobacco use and addiction.

Size: **Strong**

Market Cap: US \$455 mil

Enterprise value: \$462 mil

of employees: 52

Markets: **Strong**

Primary: US states. Its consumer products are derived from hemp-based CBD, which is federally legal.

There are three types of CBD: hemp-derived, marijuana-derived, and pharmaceutical. The total US CBD market may have exceeded \$500 million in 2018, \$260 million of which was hemp derived. The recent federal legalization of hemp in the US is expected to drive hemp-derived CBD sales growth. Analysts estimate it could grow over 30% per year until 2022 to \$650 million. Marijuana-derived CBD and pharmaceutical CBD markets may also grow. CVSI management believes that the FDA will eventually favor CBD from hemp, although the market now gets it from all sources.

They also believe the market for treating smokeless tobacco use and addiction will be a multi-billion-dollar opportunity—a market that is currently unmet.

Operations: **Strong**

Cultivation:

CV Sciences does not report much information about its operations, so we do not know if they grow or buy their industrial hemp. We know that they control their supply

chain carefully, because it is monitored from “seed to shelf”, and recently received certification from the US Hemp Authority Certified program.

Distribution:

Direct sales: Yes, online at its [pluscbd.com website](https://pluscbd.com) and other online stores
Store networks: Yes, sold nationwide in 2,200+ natural product stores (+45% vs YAG).

Supply agreements: It also sells its hemp-based CBD to wholesale and bulk accounts.

Their CV products are distributed nationally to health food stores, health care provider’s offices and online. According to SPINS, Plus CBD is the #1 brand sold in the natural food store channel. They believe “distribution is on the verge of broadening to more traditional food, drug, mass merchandise and convenience (FDMC) store retailers.”

CVSI management thinks the total addressable market could be huge. They currently have 2,200 stores. They believe the total could be 4,000 or 5,000. Doctor offices could grow to a “significantly higher number” from their current estimate of 1,000. The FDMC market could become 50,000 stores (they currently have none).

In the US, natural food stores currently have 29% of the hemp sales market share, online sales 24%, and smoke shops 24%. By 2022, analysts predict chained retailers will have 64%, natural foods stores 15%, and online platforms 12%.

Integration/Diversification:

Vertically integrated: Yes, manufacturing product and selling retail.

Horizontally diversified: No. It sells CBD supplements and is researching patented CBD drugs that address specific maladies.

Financials: Strong

Previous Quarter Income after Taxes: \$3.3 mil

Outstanding shares (diluted): 97 mil

Cash: \$12.7 mil

EPS: \$0.09

Revenue Growth (QoQ): 10%

Management: Medium

CEO: Joseph D. Dowling (CFO)

COO: Michael J. Mona III (Son of ousted founder)

Chief Medical Officer: Dr. Joseph Maroon

Founder: Michael Mona Jr. (Resigned in Jan 2019 due to SEC settlement)

Mr. Dowling was appointed CEO in May 2018 after being CFO since 2014. From 2005 to 2013, he was President and CFO of MediVas, LLC, a biotech focused on drug formulation and delivery, where he led day-to-day operations, drug research and development, product

development and commercialization including license agreements with Pfizer, Merck, Wyeth, DSM, Guidant and Boston Scientific.

Previously, he was Managing Director at Citigroup, a global financial services firm, and before that held various operating, finance and accounting roles in both public accounting and in the banking industry.

Mr. Mona III, (son of the founder) cofounded CV Sciences and has been developing the worldwide supply chain for hemp products. He has expertise in hemp farming, processing, testing and product development which helped develop the company's consumer products division.

Mr. Mona Jr. (retired in Jan 2019) was the founder of CV Sciences and had 30 years of management experience in various industries. He and CVSI finally settled with the SEC regarding malfeasance in 2013, but this forced him to retire. He was an industry leader in hemp farming operations and chemical extraction and has established a global supply chain of hemp-derived products. His continued holding of the majority of CVSI shares may be a major sticking point in NASDAQ's long delayed response to uplisting application.

Branding: Strong

Currently they have about 50 SKUs, with more in development. It's Plus CBD Oil™ is one of the top-selling brands of hemp-derived CBD on the market, according to SPINS, a provider of data for the natural, organic and specialty products industry. (CV Sciences [website](#))

This brand is traceable from seed to sale, is non-GMO, gluten-free, and tested to ensure the quality. It comes in sprays, gummies, drops, balms, capsules, and softgels. CV uses CO2 extraction and a chemical-free extraction process that is environmentally friendly.

Success of its recently introduced line of gummies in Q3 2018 is leading them to introduce more types of gummies. However, they think that new FDMC (food, drug, mass retailers and convenience) retailers may favor topicals over edibles in the short term, as they introduce CBD products.

Its initial drug candidate (CVSI-007) is a chewing gum containing nicotine and synthetic CBD to support cessation of smokeless tobacco use and addiction. It claims to have achieved promising preclinical results in developing this and other CBD medicines for a range of medical conditions.

Valuation: Strong

Current share price: US \$4.70

Price to Sales: 11 (Biopharma industry Avg. =7.5)

52 week low/high: US \$0.40 to \$9.20

EV/Revenue: 11.2

Risks: Medium

The risks of investing in any cannabis or hemp company are currently high given the newness of the market. This company has a leading product for sale nationally, increasing revenue and profit, so it is ahead of many companies in the new cannabis market. However, given the rapid changes affecting the CBD and cannabis industry, no company can guarantee to maintain a competitive advantage for long.

Recommendation: Strong

CV Sciences has a leading line of branded, hemp-derived CBD wellness products for sale nationally, revenue that is increasing each quarter, a good gross margin of 72%, and bottomline profit. Based on this alone, barring any mistakes, their bottom line should grow strongly in the coming years as the category expands by as much as 30% per year, which it is predicted to do.

Their founder, Michael Mona Jr, had to resign in Jan 2019 after he and CVSI finally settled an issue with the SEC from 2013, which charged him/it of financial misreporting (defrauding investors) regarding when CVSI bought Phytosphere Systems in 2013. The company denied charges but settled to move on. In settling, CVSI paid a \$150,000 penalty. Mona agreed to (1) a prohibition from serving as an officer or director of a publicly held company for five years, and (2) paying a penalty of \$50,000. His continuing to help a majority of company shares may be a big issue in NASDAQ's long delay in uplisting request.

With this behind them (and we think the company is fully clean now), we hope they may be approved to uplist to the NASDAQ. They now have a financial person as CEO, and a product developer/supply chain director as COO. These are strong skills to have at the top. As competition continues to heat up in this industry in the coming years, it will be increasingly hard to differentiate themselves in the eyes of consumers from aggressive competitors. Branding brilliance may be a key. They are currently pushing their organic certification and seed to shelf stories as a way to build their brand advantage on the "purity" idea. This is currently a smart direction for winning consumers of this kind of product.

In 2018 they received two third party awards that help validate their efforts. They were one of the first companies to receive the U.S. Hemp Authority Certified Manufacturers seal. And their PlusCBD Oil Gold Softgels were named a Top Pick by ConsumerLab.com.

So, we are both optimistic in their ability to ride the wave of growth, yet circumspect in any company's ability to stay ahead in a very competitive field.

We like that they are reporting profit, because it shows financial prudence and concern for investors. But in this fast-growing space, it's possible that they should be spending more on aggressively building out of their production capacity, and introducing more products, in order to dominate shelf space. This is hard to know, and we suspect they are weighing both approaches wisely.

In a conference call on March 12, 2019 they addressed this positively, saying:

“We are also well into the planning phase for an expansion of our manufacturing and fulfillment capabilities to support our growth needs beyond 2019. Negotiations are underway for additional real estate and other infrastructure to support these efforts. We have also worked diligently to secure the hemp-based CBD raw material needed to support all of our planned growth in 2019 and even into 2020.

In this effort to invest more in growth, they do have \$10 million in cash, some steady bottom line profit to spend, and the ability and experience to go to the capital markets if they want.

In general, we are very positive about this company. So, the big question is, how is their stock valuation? Are they overvalued or undervalued? As Cannin readers will know, that is the whole ball game to the fundamentalist analysts among us.

Fortunately, their price to sales is 11, only slightly higher than the biopharma average of 7, so they are not very overvalued relative to their current revenue. While they are currently on a pace of generating about \$50-60 million per year in revenue, we think they are priced to bring in slightly more than that, at about \$70-80 million.

We think with the widely predicted rapid CBD market growth pushing them ahead like a tail wind, they should achieve this revenue in the coming year, and keep growing beyond that level. While their stock price could move up and down before then, when they pass the \$70 million annual revenue rate, we think their revenue will solidly justify the current stock price and drive it higher. For this reason, we think CV Sciences is a good buy today at or near its current price of \$4.92.