Little Green Pharma Limited (ASX: LGP): New Product Development Could Unlock Huge Potential Value

BY ACE INVESTORS / 06 SEPTEMBER 2021

Reading Time: 5 Mins

By Team Ace Investors

Stock Code	ASX: LGP
Shares O/S	235.94 million
Closing Price	AUD 0.740
Market Cap	175.77 million
52 W H/L	1.018/0.245
One Year Stock Performance	158.62%
Avg. Volume(TTM)	0.46 million
EPS(TTM)	-0.027
P/E	-
Annual Dividend Yield	0.00%
Franking	-
Last Dividend Ex-Date	-
Last Dividend Pay Date	-
DPS (AUD)	-
ROE (%)	-75.10%

(Source: ASX)

Company Overview

Little Green Pharma Limited ("LGP" or the "Company") is a vertically integrated medical-grade cannabis producer with an established manufacturing and distribution network. It has an indoor cultivation facility in Western Australia (WA). The company has exclusive partnerships with the GMP-licensed pharmaceutical manufacturer for the production of its own-branded range of medicinal cannabis products. Its cannabis-based products are complying with the required Therapeutic Goods Administration (TGA) regulations and testing requirements. The company has a strong focus on patient access in the emerging global medicinal cannabis markets and clinical investigations and research projects to develop new delivery systems as well as dissemination of awareness through outreach programs.

Investment Rationale

New product development could unlock huge potential value

LGP has strong research & product development capability. The Company has recently completed a clinical investigation of LGP Classic 10:10 for the treatment of chronic refractory pain in over 150 patients. This longitudinal observational phase-2 clinical investigation investigated the efficacy, adverse event profile, and quality of life outcome measures in connection with LGP's Classic 10:10 medicine. The company is undergoing product development using its proprietary patented small particle formulation technology. A small particle formulation product may represent a significant improvement over currently available cannabis oil delivery systems and could enable a three-to-six-fold reduction in the cannabinoid dosage required to achieve an equivalent therapeutic effect compared to LGP's existing medicinal cannabis oil products. Reduced dosages may help alleviate many of the dose-dependent adverse effects and reduce the cost-per-dosage administered. The company has also tied up with Curtin University for the usage of its patented atomized rapid injection for solvent extraction (ARISE) technology that generates particles of active pharmaceuticals ingredients that are more readily absorbed by the body. It is expected that the ARISE technology will form the basis of LGP's prescription medication registration pipeline.

An expanded manufacturing facility will likely increase volumes by tenfold

The company has an exclusive 5-years agreement with TGA-GMP certified manufacturer in Australia and permission to sell into the EU. The exclusive manufacturing license is valid up to 22nd Nov 2023 and can be terminated with prior notice. The manufacturing Partner is licensed to produce oil, gel cap, suppository, and emulsion and spray products on behalf of the company. The company has received medical cannabis cultivation and production permit from the Office of Drug Control (ODC) for the expanded cultivation and manufacturing facility on 20 July 2020. The manufacturing permit will allow it to supply cannabis extracts produced in-house to manufacture finished medicinal cannabis products through its TGA-GMP certified manufacturing partner. The expanded cultivation and manufacturing capacity will likely increase the production volume by 10 x to 110,000 bottles of medicinal cannabis oil per annum. In March 2021, the Company announced its entry into a binding term sheet for the purchase of the freehold titles underlying its cultivation and manufacturing facilities, as well as two adjacent freehold properties, together representing a combined total area of approximately 16,000 sqm. To date, the Company has spent over $7 million constructing its cultivation and manufacturing facilities.

Distribution agreement with Balancial Danmark ApS will further solidify its position in the EU

On 20 April 2021, the Company has entered into a distribution agreement with Denmark-based Balancial Danmark ApS for the sale and distribution of LGP branded cannabis oil and flower medicines in Denmark. The agreement is a non-exclusive agreement for the supply and distribution of LGP Products in Denmark for five years commencing on the delivery of the first shipment of Products. The agreement represents another milestone in LGP's global sales strategy of growing its market share in key European medicinal cannabis markets, with Denmark joining the UK, Germany, and France as jurisdictions into which the Company currently ships products or has binding agreements with distributors. The Company also signed an exclusive distribution agreement for Poland with a subsidiary of Pelion SA, the largest operator in the Polish and Lithuanian healthcare sector to expand its distribution capability.

Newly acquired Denmark Facility to position LGP as a leading global pure-play medicinal cannabis producer

In late June 2021, the Company has acquired a world-class GACP/GMP licensed medicinal cannabis cultivation and manufacturing facility in Denmark (EU) ("Denmark Facility") with over 20 tonnes biomass per annum capacity, including 12.5 tonnes per annum of dried cannabis flower for C$20 million payable in two installments. The acquisition represents a step-change for LGP and positions it as a leading global pure-play medicinal cannabis producer. The Denmark Facility provides LGP with a key strategic platform and production capacity to capitalize on its early mover status and brand recognition in Europe and Australia. With a 21,500 m2 cultivation site and 4,000 m2 post-harvest GMP manufacturing facility, the formerly Canopy Growth Corporation-owned Denmark Facility provides access to one of the largest production assets in Europe. Under the terms of the acquisition, LGP paid C$10 million at Completion with the remaining C$10 million payable in 12 months at an imputed interest rate of 12.5%.In conjunction with the acquisition, LGP completed a successful $27.2 million Placement which received strong support from existing institutional and sophisticated investors, including Hancock Prospecting, who committed $15 million to hold over 11% of the Company post-settlement. Proceeds from the placement will be used to partly fund the acquisition, build out a European sales team, and fund capital expenditure works and working capital purposes. The key strategic rationale of the acquisition is as follows:

- Accelerates planned capacity expansion and market penetration: LGP proposes to embark on a rapid, market-share acquisition strategy by placing Denmark-produced strategically-priced new LGP brands/strains and white-label products into EU and global markets
- Significantly increases capacity: Acquisition immediately increases LGP's cultivation capacity to >23 tonnes per annum of cannabis biomass (up from ~3 tonnes) –a ~8x increase
- Increased economies of scale: Denmark Facility expected to produce GMP medicinal cannabis flower at superior economics (cost per gram) to West Australian Facility
- Superior cost of incremental capacity expansion and avoidance of over-capitalization: Significantly lower cost of incremental capacity expansion through acquisition, with an acquisition cost of ~A$1.0 million per ton approximately one-third of the ~A$2.7 million per ton cost of building equivalent capacity in Australia

16,000 m2 land acquired in WA is expected to reduce its CAPEX requirement onwards

The Company executed a purchase agreement for the acquisition of the 16,000 m2 of land underlying its WA cultivation and manufacturing facilities as well as the two adjoining properties. Following shareholder approval of the scrip issue, settlement of the $6 million purchase price ($4.2 million cash and the remainder in scrip) is settled in the first week of Aug 2021. The transaction will ensure LGP can protect its significant capital expenditure to date (~$8 million), eliminates LGP's rental expenses of $170,000 per annum, and provides rental income from the currently tenanted premises on the adjoining properties.

During FY21, the Company has experienced strong growth in underlying demand in Australia, with the number of patients increased from 4,550 on 30 June 2020 to over 15,000 at the end of the reporting period. During the reporting period, LGP Group generated over $7.01 million in revenue with a profit after tax of $24.60 million (compared to the previous year's loss of $9.31 million), predominately reflecting the impact of the bargain purchase of the Denmark Facility for accounting purposes. The company has recognized $24.97 million on the FY21 Profit & Loss account related to gain on the bargain purchase of the Denmark Facility. Progress was also made in overseas markets, with products being delivered to Germany, the United Kingdom, France, New Zealand, and Brazil. The gross margin continued to improve as a result of the increasing scale and operating efficiencies, with the gross margin increasing from 51% to 61% (when excluding changes to the fair value of biological assets) and increasing from 52% to 82% (when including changes to the fair value of biological assets). The company finished the financial year with a strong cash position of $40.2 million.

ACE's Recommendation:

Little Green Pharma Limited (ASX: LGP) is a vertically integrated medical-grade cannabis producer with strong research & product development capability. The company is now in an expansion mode and expanded its WA manufacturing capacity tenfold to support its growth strategy. In late June 2021, the Company has acquired a world-class GACP/GMP licensed medicinal cannabis cultivation and manufacturing facility in Denmark (EU) with over 20 tonnes biomass per annum capacity, including 12.5 tonnes per annum of dried cannabis flower for C$20 million payable in two installments. The Denmark Facility provides LGP with a key strategic platform and production capacity to capitalize on its early mover status and brand recognition in Europe and Australia. The acquisition immediately increases its cultivation capacity to >23 tonnes per annum of cannabis biomass (up from ~3 tonnes) –a ~8x increase. Moreover, the recently concluded acquisition of the 16,000 m2 of land underlying its WA cultivation and manufacturing facilities will reduce CAPEX requirement onwards. We believe that the expanded manufacturing facility and recently executed distribution agreement in Denmark will solidify the company's position in the European Union (EU). The stock has advanced +30.97% YTD to A$0.740/share and offers significant potential upside. So, we would like to recommend a **SPECULATIVE BUY** rating on the stock.