

### GTEC Holdings Ltd. (GTEC:TSXV)

RECOMMENDATION: Buy

1 YR-TARGET PRICE: \$2.00

RISK RATING: HIGH

## Incremental Capacity Secured at Attractive Price

#### SHARE DATA

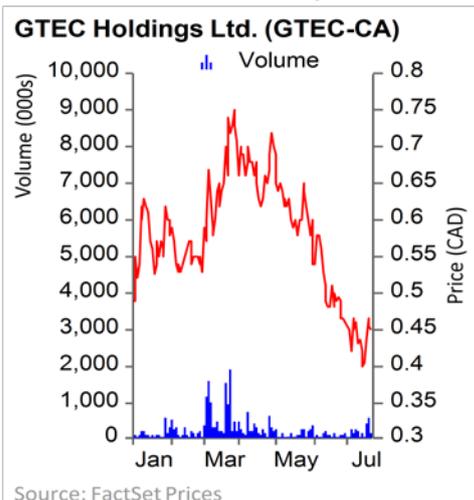
Price (7/21/19)	\$0.45
Shares outstanding (basic)	159M
Shares outstanding (diuted)	203M
Market cap (basic)	\$71M
Market cap (diluted)	\$91M
Net Cash (debt) 2019E	\$5M
Enterprise Value (Diluted)	\$96M

FINANCIALS	2018A	2019E	2020E
Revenue (\$M)	\$0.1	\$13.1	\$73.5
EBITDA (\$M)	-\$10.4	-\$3.0	\$36.2
EPS (FD) (\$)	\$ (0.10)	\$ (0.02)	\$ 0.11

RATIOS	2018A	2019E	2020E
EV/Sales	1665x	7.4x	1.3x
EV/EBITDA	n/a	n/a	2.7x
P/E	n/a	n/a	3.9x

#### VALUATION:

Recommendation:	Buy
One Year Price Target:	\$2.00
Valuation:	12.5x 2020E
	EV/EBITDA



#### New Facility Adds Significant Capacity to GTEC's Existing Footprint

GTEC announced it has acquired a cultivation facility in Kelowna from Canopy in a transaction we believe is positive for the company and moves it closer to larger cap peers (Flowr, Harvest One, ect.) from both a financial outlook and capacity standpoint. We have updated our estimates to account for the incremental 4,000 kg of capacity along with the ~\$15M in funding needed to acquire the location and finish construction. While our target price is unchanged post the announcement, we believe the market will accord GTEC a higher multiple to the shares given the increased scale of operations.

#### We see the main takeaways from the announcement as follows:

- **The facility would add an incremental 4,000 kg of high end indoor capacity.** With the purchase, GTEC's potential annual output would climb to ~14,000 kg (adjusted for % ownership of F20), which we believe will drive consolidated cultivation revenues of \$67.5M in 2020 and \$78.7M in 2021. Assuming the new facility operates similarly to GTEC's other facilities, we expect the new location to account for \$22.5M of GTEC's total revenues and \$12.3M of EBITDA in 2021.
- **Operations at the facility could commence as early as Q1/2020.** Assuming the purchase closes by the October 15<sup>th</sup> date set out in GTEC's press release, we would expect the final construction and licensing to take 4 to 6 months to complete. This would infer that the new site could be licensed by as early as Q1/2020. Conservatively, we have only included a half year of production from the location in 2020 and thus there could be upside to our current forecast if either the buildout or regulatory process occurs quicker than expected.
- **Price tag represents an attractive multiple of ~1.2x 2021E EBITDA.** In total, the Kelowna location will require funding of \$15M to complete - \$13M to acquire and \$2M to complete construction. Based on our expectations from above, the consideration paid represents a very attractive purchase price of ~1.2x our 2021E EBITDA from the facility. We believe the price represents the investment made to date by the seller and ultimately provides GTEC with a faster path to developing additional capacity than building from scratch. At this price, assuming margins in line with GTEC's other operations, we expect the acquisition of the facility to be accretive to earnings immediately following licensing.

## Why We Like GTEC

- I. Top quality management team with a track record of producing ultra-premium flower at scale
- II. Value of near term production increase is not reflected in current valuation. GTEC continues to trade at a deep discount to peers at 2.7x 2020E EBITDA versus the group at 9.2x 2020E.
- III. Retail assets could provide upside to our forecast
- IV. Ultimately, we see GTEC as a takeout candidate

## Model Revisions

We have updated our model to account for the additional earnings produced from the new Kelowna facility, which we expect to become operational in 2H/2020. We have assumed that GTEC will fund the purchase of the facility along with the required capital to complete construction through the issuance of \$15M in equity. We note that while we have modelled an equity raise, there is capacity on GTEC's balance sheet for the company to address some of its funding needs through debt. Details of the changes to our estimates and our revised forecast can be found in the exhibit below.

### Exhibit 1. Model Revisions

Model Revisions (\$M)	Old		Revised		Old		Revised		Old		Revised	
	2019E	Variance	2019E	2020E	Variance	2020E	2021E	Variance	2021E	Variance	2021E	
Cultivation Revenue	13,084	-	13,084	56,252	11,262	67,514	56,252	22,524	78,776			
Retail Revenue	-	-	-	5,940	-	5,940	5,940	-	5,940			
<b>Revenue</b>	<b>13,084</b>	<b>-</b>	<b>13,084</b>	<b>62,192</b>	<b>11,262</b>	<b>73,454</b>	<b>62,192</b>	<b>22,524</b>	<b>84,716</b>			
Cost of sales	4,110	-	4,110	21,658	3,504	25,162	21,658	7,008	28,666			
<b>Gross margin</b>	<b>8,974</b>	<b>-</b>	<b>8,974</b>	<b>40,533</b>	<b>7,758</b>	<b>48,291</b>	<b>40,533</b>	<b>15,517</b>	<b>56,050</b>			
<b>Operating expenses</b>												
Amortization	848	-	848	1,174	100	1,274	1,165	95	1,260			
SG&A	12,301	-	12,301	11,194	925	12,120	11,194	3,207	14,402			
	13,149	-	13,149	12,368	1,025	13,393	12,359	3,302	15,662			
<b>Net loss from operations</b>	<b>(3,654)</b>	<b>-</b>	<b>(3,654)</b>	<b>28,165</b>	<b>6,733</b>	<b>34,898</b>	<b>28,174</b>	<b>12,215</b>	<b>40,388</b>			
<b>Adjusted EBITDA</b>	<b>(3,014)</b>	<b>-</b>	<b>(3,014)</b>	<b>29,339</b>	<b>6,833</b>	<b>36,172</b>	<b>29,339</b>	<b>12,310</b>	<b>41,648</b>			
EBITDA Margin %	-23%	-	-23%	47%	0	49%	47%	0	49%			
<b>Net loss and comprehensive loss</b>	<b>(3,585)</b>	<b>-</b>	<b>(3,585)</b>	<b>20,561</b>	<b>4,915</b>	<b>25,476</b>	<b>20,567</b>	<b>8,917</b>	<b>29,484</b>			
Earnings (loss) per share (Basic)	\$ (0.03)	\$ 0.00	\$ (0.03)	\$ 0.15	\$ (0.00)	\$ 0.14	\$ 0.15	\$ 0.02	\$ 0.17			
Earnings (loss) per share (Diluted)	\$ (0.02)	\$ 0.00	\$ (0.02)	\$ 0.11	\$ 0.00	\$ 0.11	\$ 0.11	\$ 0.02	\$ 0.13			

Source: SCP research

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**TENDER:** The analyst recommends tendering shares to a formal tender offering

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9	The analyst has been reimbursed for travel expenses for a site visit by the issuer	NO

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HOLD:	1
SELL:	0
UNDER REVIEW:	1
NOT RATED:	1
TOTAL	100%

