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Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well informed of changes affecting local business decisions and our investment recommendations.

We believe Knowledge Pays and we want our knowledge to help pay for you.

BRAND NEW HIGH CONSTELLATION BRANDS MAKES MONDO BET ON CANOPY GROWTH

Note: Canadians who own shares of cannabis stocks who attempt to cross the United States border could be banned from the United States indefinitely due to their connection to the cannabis industry, as cannabis remains a Schedule 1 substance in the United States.

We wish to stress the fact that we are not recommending the purchase of Canopy Growth shares. This article is for informational purposes only, chiefly the benefits of cash on hand. Canopy is now trading at a fully diluted valuation of ~\$30 billion (~\$20 billion net of cash) on trailing 12-month revenues of \$88 million and future revenues that may struggle to reach \$1 billion. ***This is an extreme valuation for any industry.***

On August 15, Constellation Brands, better known as the purveyor of Corona beer and Robert Mondavi wine among other alcoholic products, announced its intention to invest ~CAD\$5 billion into Canopy Growth, as well as receive warrants to invest another ~CAD\$4.5 billion at a future date. While this investment does not excuse the cannabis sector of its extreme valuations, it does change the industry's outlook. For perspective, no other cannabis company has more than half a billion in cash available.

In any young industry, if one player has the majority of the capital, that player is likely to capture a considerable amount of market share as it can outspend peers. Canopy's cash reserves will help it maintain its market leadership in the Canadian medical cannabis market and weather the underestimated growing pains of the Canadian consumer cannabis market. Keep in mind that cash does not ensure product success.

We have previously written about the significant overcapacity that exists in the Canadian cannabis market. As many cannabis players attempt to enter the market at the same time, a company's cash reserves will become an important factor in a company's long-term success. Like in any industry, cannabis companies will attempt to undercut each other on price and spend heavily on marketing, product development and R&D in an attempt to get an edge over competition and secure market share.

Cash reserves will also open the door to international expansion. Joint venture agreements will likely be required to enter foreign markets as most states/provinces/nations will demand that cannabis is grown in-country so that the state/province/nation benefits from employment and corporate taxes related to cannabis production, in addition to excise taxes on final products. Partnerships will also be important in the international arena, as cannabis companies currently have no experience in international procurement, sales and marketing.

Like in any young industry, cash is king. Generally, those who have it, thrive, while those who don't, wilt. ***However, we reiterate, Canopy Growth shares are extremely overvalued, and should not be purchased. A high cash balance does not forgive extreme valuation.***

Current Rates & Data

Govt of Canada

| | |
|---------|-------|
| 90 day | 1.53% |
| 1 year | 1.99% |
| 2 year | 2.14% |
| 5 year | 2.28% |
| 10 year | 2.37% |
| 30 year | 2.40% |

U.S. Treasury

| | |
|---------|-------|
| 90 day | 2.17% |
| 1 year | 2.57% |
| 2 year | 2.79% |
| 5 year | 2.93% |
| 10 year | 3.04% |
| 30 year | 3.19% |

Canada Prime Rate

3.70%

U.S. Prime Rate

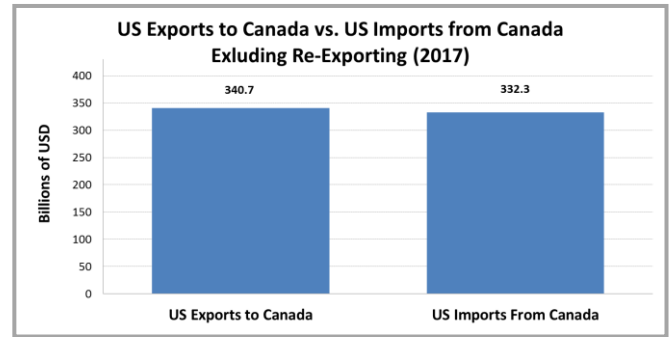
5.00%

Exchange Rates

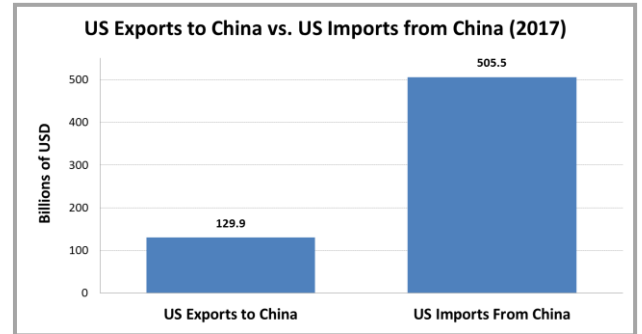
| | |
|---------|-------|
| CAD/USD | 0.771 |
| USD/EUR | 1.166 |
| JPY/USD | 112.3 |

ECONOMIC TIDBITS NEW NAFTA APPEARS TO BE GETTING CLOSE & US-CHINA TRADE WAR RAMPS UP AGAIN

- In late August, the US and Mexico reached a bilateral trade deal as part of NAFTA negotiations. Many of the deal terms are favourable to Canada. The US is using the concessions earned from Mexico as a bargaining chip in negotiations with Canada. Negotiators have until October 1 to submit a trilateral deal to American and Mexican lawmakers or face a new set of negotiators and further delays.



- The US-China consultation period on new tariffs ended on September 6. The markets eagerly await whether the Trump administration will carry out its threat to slap a tariff of 25% on \$200 billion worth of Chinese imports and how China will respond. Trump ordered his staff to ready tariffs on another \$267 billion in Chinese imports, equating to tariffs on effectively all (\$517 billion) Chinese imports.



LE JIT A “JUST-IN-TIME” RUNDOWN OF OUR CURRENT INVESTMENT THEME

Ways to Indirectly Play the Overheated Cannabis Market Without Paying Up Too Much

- Constellation Brands (STZ-US)** and **Scotts Miracle Gro (SMG-US)** are two ideas related to this theme.
- Constellation** is third largest beer company in the world by market share driven by sales of Corona and Modelo and has a vast portfolio of wine and hard liquor brands including Robert Mondavi and Svedka Vodka. Constellation owns 38% of Canopy Growth shares and has warrants that can bring its ownership over 50%. Constellation trades at 16x trailing EV/EBITDA versus diversified global peers Anheuser Busch Inbev and Diageo at 17x. Investors are effectively getting Constellation’s controlling ownership in the world’s largest cannabis company (Canopy Growth) for free. We think Constellation should trade at a significant premium to peers given the above average earnings growth that Canopy should provide Constellation and the hedge that cannabis provides against its alcohol portfolio in the long run.
- Scotts** is a producer of lawn care products, herbicides and pesticides. Next year is likely to be a transition year for Scotts. Scotts owns the right to market Roundup for consumer use. A California jury judged the active ingredient in Roundup (glyphosate) is a potent carcinogen. While Scotts has limited liability associated with Roundup, it may have to temporarily pull the product from shelves and reformulate it. In addition to its core business, Scotts operates hydroponics businesses and is currently looking into specialized fertilizers for cannabis. Scotts could benefit materially if craft and DIY cannabis catches on.

Key risk points: Both securities are cyclical and would come under pressure in a weak economic environment. Both securities would likely be impacted if valuations in the cannabis sector came down.

JEANNINE’S TIP O’ THE MONTH Have You Heard? There May Be a Work Stoppage at Canada Post

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