

Hempco Food and Fiber Inc.

(TSXV:HFF)

International Sales Growth and Retail Launch Pushes Hempco Into a Leading Contender Within the Hemp-Based Foods Industry

Event

A lot has happened to Hempco since the release of our [Initiation Report filed in May 2016](#). To summarize:

- International bulk sales orders from Asia tripled, from \$3.0 to \$9.0 million
- Hempco secured \$2.2 million in financing (August 31, 2016)
- Hempco is increasing capacity at its first manufacturing facility in Manitoba to handle \$15 million, as well as building a second processing facility in Alberta (of similar processing capacity)
- Retail line – PLANETHEMP – has officially launched in the UK and Canada, with an expected network of 1,600 stores coming on by 2017
- Hempco is becoming a serious acquisition target contender

Impact & Analysis

Overall, it's been an incredible four-month period for Hempco. Not only has the Company delivered on its growth promises and issued much higher performance guidance for 2017/2018, but they have also surpassed the growth exhibited by their closely-watched competitors. And the story is just beginning.

Specifically, Hempco strengthened considerably its international product exposure via a new \$9.0 million deal signed with Seoulution Corp. This is significant because it provides the Company with not only cash flow for operations, but also a strong voice of confidence for the quality of Hempco's products. With Hempco now working to increase its production capacity to \$30mm, this gives them enough room to accept additional bulk orders that they will likely receive.

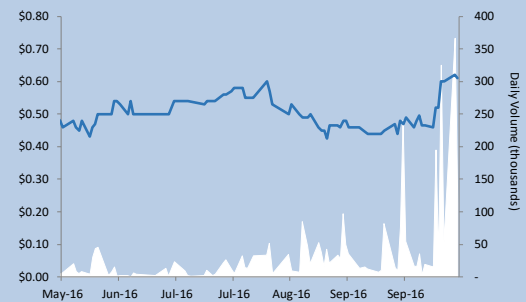
On the retail side, although the waters have yet to be fully tested, we believe that the expansion into roughly 1,600 stores by 2017 fiscal year end will bring in an additional \$2.7mm in revenues for the year. Operational growth, paired with a strong management team and expanding international presence, has turned Hempco into a leading contender for a merger. We would not be surprised to find out that merger talks would become more apparent throughout the following 12 months.

Outlook

We forecast revenues of \$15.7 million in 2017 FYE (August 31st), sporting a blended gross profit margin of 32%. With a market cap of just \$21 million, the Company's valuation seems quite cheap in comparison to some of the exits we've seen in the industry. In fact, the previous six exits have averaged a sales multiple of 3.1x. It's a far cry from the valuation Hempco is receiving today (with much superior growth attributes in relation to the competition).

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Price Performance - since QT on Apr. 20, 2016



Market Data (TSXV:HFF)

Price (October 12, 2016 close)	\$0.61
52 Week Range	\$0.41 - \$0.72
Market Cap (mm)	\$20.8
Shares Outstanding (basic, mm)	34.1
Free Float	38%
Average Daily Volume (3 months)	49,713
Total Debt (mm)	\$0.0
Cash & Short-Term Investments (pro-forma, mm)	\$3.1
Total Assets (pro-forma, mm)	\$6.3

Headquarters

Burnaby, BC, Canada

Top Shareholders

Charles Holmes, CEO	29.3%
Angela Holmes, COO	29.3%
Varshney Capital Corp.	3.0%
Praveen Varshney, CFO	0.4%

All figures in CAD unless otherwise stated.

Source: Thomson Reuters (10/12/2016)

Business Description

Hempco Food and Fiber Inc. ("Hempco") is a Canada-based processor of hemp seeds. The Company sources farmed hemp seeds from local Canadian farmers, and uses its manufacturing facility in Manitoba to process the seeds into nuts, oils, and protein powders. Up until March 2016, Hempco was focused purely on bulk sales of the three product categories. However, recent growth efforts have been put towards launching a retail brand, PLANETHEMP, with plans of distributing consumer packaged goods into Canada, Europe and Asia.

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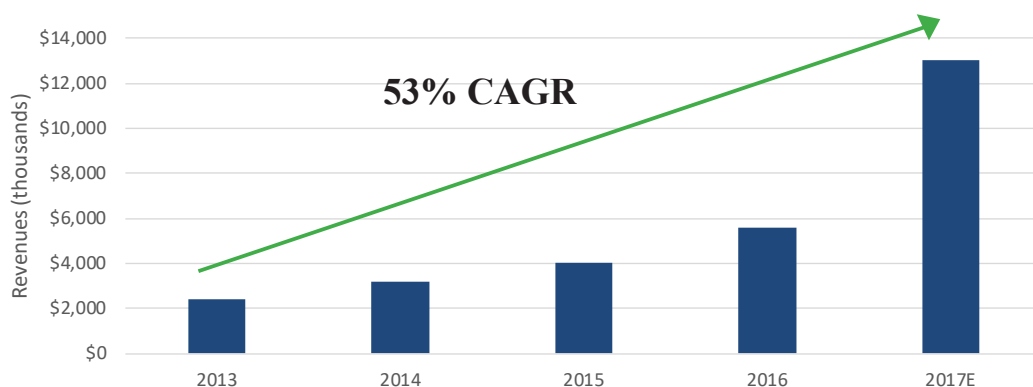
Investment Highlights

Sales Are Racking Up Much Faster Than Originally Expected, And Much Faster Than Any Of Its Competitors

Bulk Sales

Bulk sales have shown a three-year CAGR of 33% over the 2013 – 2016 fiscal-year periods (ending August), and a 53% CAGR if including 2017 forecasted revenues of \$15.7 million. And the figures are about to get a serious boost from product demand coming out of the Asian market.

Figure 1: Bulk Sales Revenue Growth



Source: Company Financials, Ubika Research

Seoulution Corp. is a government-approved international trading company in South Korea. The Company is diligently focused on sourcing the best suppliers throughout the world, with a goal of providing a superior product to its 4,000+ retail distribution points in Korea. Seoulution initially contacted Hempco to sign a preliminary product purchase agreement with them in the amount of \$3.0 million.

Hempco’s products passed the initial sale agreement (a contract originally scheduled to be filled in 12 months, but delivered in 7), with a follow-on agreement recently signed for \$9.0 million. We expect this new order to be filled without any hiccups, and expect Seoulution to grant another, higher-grossing contract to Hempco by 2017 FYE (August 2017).

Accounting for only the Seoulution contract, the growth in bulk sales for 2017 would equal 61%. However, a little over \$3.0 million in sales (for 2016) have come from other international partners, which we forecast will also experience product growth. Overall, a bulk sales revenue target of \$13.0 million for 2017 FY seems highly attainable.

Retail Sales

Aiding the Company’s bulk sales success, is its newly-launched retail line of PLANETHEMP branded food products. Hempco has successfully launched its line of consumables (including packaged hemp seeds, hemp snacks, packaged oils, packaged protein powder, and more) to the UK and Canada. Although it experienced some initial delays, the Company has finally granted vision into sales figures for the first month (that being September 2016).

With retail, store count is a very important measure of success. The more outlets carrying PLANETHEMP products, the more awareness and sales the brand is capable of generating. Therefore, having a solid distribution pipeline is important to Hempco.

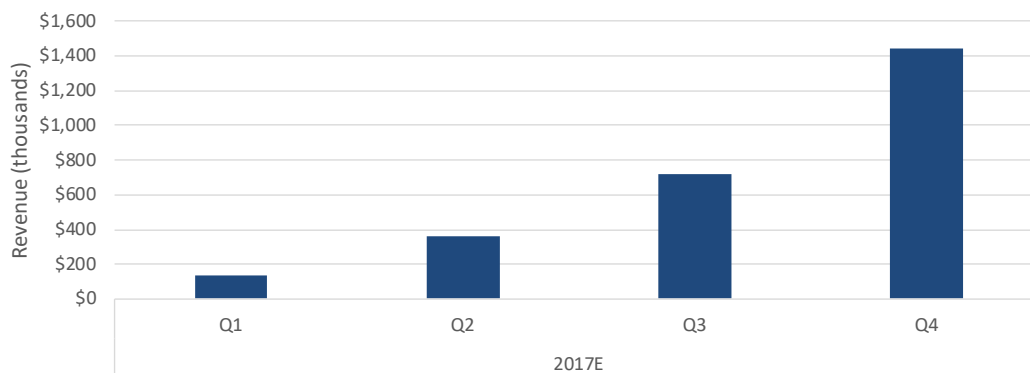
Figure 2: Distribution Pipeline - Number of Stores

	Q1 / 2017	Q2 / 2017	Q3 / 2017	Q4 / 2017	Total (2017 FYE)
Tree of Life (UK)	100	200	300	600	1,200
Raw Elements (Canada)	50	50	100	200	400

Source: Ubika Research

We are forecasting revenues of \$2.7 million to be delivered via the retail channel over the next year, as calculated using the Distribution Pipeline data above, and assuming a \$300/store/month in sales. We believe that the \$300 figure is highly attainable and conservative (giving more potential upside for investors), and the figure is benchmarked down from the rough \$900/store/month figure attained by Manitoba Harvest.

Figure 3: Retail Sales Revenue Growth



Source: Ubika Research

Processing Capacity Will Quadruple From \$7.5 million to \$30 million By August 2017

Hempco was established as a Company when Charles Holmes and Co. developed their own processing technology to be able to process harvested industrial hemp plants for their nutrient rich food byproducts. The engineering resulted in the Company's first (and currently only) manufacturing facility in MacGregor, Manitoba.

Figure 4: Alberta Manufacturing Facility (top 2 images), Manitoba Manufacturing Facility (bottom image)



Source: Company Presentation

Since then, the Manitoba facility has been in construction to double capacity (to handle 250k lb. of hulled hemp seed production – or roughly \$15mm in sales), while also scheduling plans to construct another facility in Leduc, Alberta (with a similar capacity of 250k lb. hemp / \$15mm sales).

The upgrade of the Manitoba facility is nearing completion, whereas the financing has already been secured for the manufacturing expansion in Manitoba, and an additional \$2.0mm is budgeted for the Alberta facility (which is expected to be internally generated via positive cash flows).

Hempco is Becoming a Potential Acquisition Target

Targeting to hit \$15.7 million in sales over the next 12 months, and only trading at a market cap of \$21 million, the Company’s valuation seems very cheap in comparison to some of the exits we’ve seen in the industry. In fact, the previous six exits we’ve seen have been sold at an average sales multiple of 3.1x.

Figure 5: Precedent Transactions

Target	Acquirer	Sales Multiple
Manitoba Harvest	Compass	4.1x
Hemp Oil Canada	Compass	2.3x
Gardein	Pinnacle	2.7x
Annie's	General Mills	2.5x
So Delicious	White Wave	1.7x
Vega	White Wave	5.5x
		3.1x

Source: Ubika Research

Manitoba Harvest (“MH”), which is the largest hemp-based foods company in the world and is now owned by Compass Diversified Holdings (NYSE:CODI), is Hempco’s closest competitor. The maker of well-recognized and popular “Hemp Hearts” generated US\$28.4 million in revenues over H1/2016 calendar year, sporting a gross profit margin of 40% over the last reported quarter. However, other costs brought the Company to a net loss of US\$3.6 million over the first half of the year.

On a growth note, the US\$28.4 million in revenues recorded by MH, experienced growth of 26% over the same period last year. Although impressive, Hempco’s 38% growth year over year (and 160% growth forecasted for next year) are much more vivid to memory.

For a multi-billion dollar diversified investment company such as Compass, a bolt-on acquisition such as Hempco is a no-brainer. Hempco adds three key elements to the business:

1. Superior manufacturing aptitude, built by management with over 15 years of industry experience
2. Expansion into a vast international market, with high growth coming from Asia
3. Retail presence in the UK

Apart from MH, other potential acquirers may include companies within the natural and organic foods industry, as well as marijuana companies looking to expand into a closely-comparable industry.

Increased Interest in the Marijuana Industry is a Catalyst for the Hemp Industry as Well

Hemp is most often associated with its close counterpart, marijuana. The two come from the same plant, Cannabis Sativa, yet the two are very different, as apparent by their use. Although the association between hemp and marijuana is false in nature, the increased interest given to the marijuana industry (due to the potential for recreational marijuana use legalization in North America) is a real catalyst for the hemp industry as well.

Specifically, capital market activity for the marijuana industry has picked up great steam in 2016. Canadian licensed producers continue to aggressively raise capital, with some recent transactions including:

- Aphria (TSXV:APH) raising \$25mm in July 2016
- Canopy Growth Corporation (TSX:CGC) raising \$25mm in August 2016
- Supreme Pharmaceuticals Inc. (CSE:SL) raising \$15mm in August 2016

The reason why this is important is because when consumers become more acceptant to the growth and use of marijuana, the better the sentiment will be for hemp as well. We believe that consumer demand for hemp-based foods will jointly be affected by the positive consumer/investor demand being present in the marijuana industry.

A major catalyst for both industries would be the legalization of recreational marijuana use in Canada (and some parts of the U.S.). Canadian federal marijuana legislation is expected to be introduced in the Spring of 2017. Justin Trudeau and the Liberal Party have voiced their opinions on opening the industry up for recreational use ever since running for office. Time will tell whether the decision swings to a “yes,” but so far, investor sentiment has been largely positive.

Final Thoughts

To say the least, Hempco has grossly under-promised and over-delivered over the last four-month period. The company has successfully resigned a follow-on order with Seoulution Corp. for \$9.0 million, triple the size of the first contract. Additionally, the company's retail line – PLANETHEMP – has finally generated sales figures, with expected 1,600 stores coming online over the following year. This is a business line which will not only drive additional sales, but will also build a superior brand image for the entire company.

We forecast the company to generate \$15.7 million in revenue in 2017 fiscal year (ending August). This implies a forward sales multiple of just 1.3x, almost one third of that exhibited by industry transaction comparable average of 3.1x. Future catalyst include additional data provided on retail sales traction, indirect positive effect from the growth within the marijuana industry, and potential merger interest from larger players within the industry for hemp / natural and organic foods.

Appendix A: Recent News

October 11, 2016 **Hempco Launches PLANETHEMP Brand Retail Products - UK and Canada**

Hempco announced that September 2016 was the official launch of PLANETHEMP brand retail product distribution throughout Canada and the United Kingdom. Hempco has signed an agreement with Tree of Life UK - natural, health and wellness products distributors in Europe serving hundreds of retailers. PLANETHEMP product line is being presented to well-known companies such as: Whole Foods (12 UK stores), Marks and Spencer (914 UK stores), Sainsbury (1,374 UK stores), Waitrose (350 UK stores) and Tesco (3,243 UK stores).

Hempco has signed an agreement with Raw Elements –a natural, health and wellness products distributors in Canada with approximately 800 stores nationally.

October 6, 2016 **Comparative Monthly Sales Report**

Hempco reported that sales of the Company's products have been growing. The summer period saw a traditional modest decline in sales but bounced back up significantly with September 2016 being a strong month – setting a Company record of over \$1,000,000 in sales. The Company's pipeline includes supplying hulled hemp seed nut/hearts to Seoulution Corp., as well as the launched retail line of products. September 2016 was the official launch of PLANETHEMP brand retail products in the UK and Canada.

October 4, 2016 **New Agreement with Seoulution Corp. and Update On Hempco Food and Fiber Inc. Corporate Developments**

Seoulution Corp., is again experiencing even higher demand for its hemp products. Hempco's previously announced exclusive distribution one-year contract with Seoulution Corp. valued at C\$3.0 million has been filled and completed in 7 months. A new contract has been signed whereby Seoulution Corp. will purchase a minimum of an additional C\$9.0 million of hulled hemp seed nut/hearts from Hempco over the next year.

Hempco is in the process of installing new hemp seed processing equipment and is increasing production to meet all of its customer needs. The processing facility expansion in MacGregor, Manitoba, is near completion, with the fully operational processing capacity anticipated to be 250,000 lbs. of hulled hemp seeds per month.

August 31, 2016 **Hempco Food and Fiber Announces Closing of its Private Placement**

Hempco has completed a non-brokered private placement consisting of the issuance of an aggregate of 4,370,000 units at a price of \$0.50 per unit for aggregate gross proceeds of \$2,185,000. Each unit consists of one common share and one-half of one common share purchase warrant, with each warrant entitling the holder to purchase a common share at \$0.65, for a period of 15 months. Hempco will be using the proceeds to expand its processing facility, and for general working capital purposes.

May 31, 2016 **Hempco Doubling Processing Capacity**

Hempco is doubling its processing capacity of its hulled hemp seed nut processing facility from \$7.5M to \$15M per year due to new international customer demand.

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