

## **Cronos: The Dark Side of The Cannabis Space**

**Target Price- \$3.50**

Citron has a hot hand in cannabis lately. First Aurora (\$ACB) and then in the last two weeks our trading calls played out to 70% returns. One long and one short (respectively: \$TLRY and \$CVSI).

**Cronos (NASDAQ:CRON) price target of \$3.50.**

### **An Aside to Investors**

Citron would like to inform investors of caution on the ongoing and real green rush. Although the hype is big and the prohibition after 100 years is real, it is critical to understand that in the Canadian landscape, there are over 100 licensed producers and there will ultimately be more losers than winners.

### **Reality Check on Cronos**

While Canadian growers get ready for October 17 and the new age of recreational marijuana usage in Canada, Citron believes that there are a few truths that need to come to light with regards to Cronos.

### **The Great Deception in Process**

Cronos management appears to have been deceiving the investing public by purposely not disclosing the size of its distribution agreements with provinces – unlike every other major cannabis player.

Our sources have informed us that it's because the agreements are so small they could never justify the premium investors are paying for the stock.

Some may argue that US listed cannabis stocks are subject to stricter regulation so companies are much more careful with what they disclose but both Canopy Growth (NYSE:CGC) and Tilray (NASDAQ:TLRY) are much more forthright.

See below for Cronos' latest disclosure on its provincial supply agreements. Cronos refers to the size of the market which is quite irrelevant when considering they now have a supply agreement.

## Cronos Group Inc. Announces Provincial Supply Agreements

**TORONTO, August 21, 2018 /CNW/** – Cronos Group Inc. (NASDAQ: CRON) (TSX: CRON) ("Cronos Group" or the "Company"), a geographically diversified and vertically integrated cannabis group, is proud to announce its initial supply agreements for retail distribution, both government-operated and private, across Canada for the upcoming launch of the recreational market in October 2018.

Cronos Group has secured listings and signed binding master supply agreements with both the Ontario Cannabis Retail Corporation and the BC Liquor Distribution Branch. In combination, these provinces encompass over 50% of the Canadian population and hence the potential customer base which the Company is prepared to serve.

The Company has also secured listings and has accepted supplier terms with the Nova Scotia Liquor Corporation and Prince Edward Island Liquor Corporation. Cronos Group will be offering Dried Flower, Pre-Rolls and its highly rated Oils through both government-operated retail stores and online platforms across its three recreational brands.

<https://thecronosgroup.com/cronos-group-inc-announces-provincial-supply-agreements/>

Now compare the above to Canopy Growth and Tilray's disclosures.

### **CANOPY ENTERS MOU WITH BC LIQUOR DISTRIBUTION BRANCH TO SUPPLY BRITISH COLUMBIAN MARKET**

**July 12, 2018**

**ALDERGROVE & DELTA, BC** - Continuing the theme of securing major supply agreements in every Canadian province and territory with announced supply plans, Canopy Growth Corporation (TSX:WEED)(NYSE:CGC) (the "Company" or "Canopy Growth") is proud to announce that cannabis grown in its Delta and Aldergrove facilities, its other sites across the country, and products from its CraftGrow partners will be sold in fine retailers, both government-operated and private, across the province of British Columbia post-prohibition.

Canopy Growth entered into a supply MOU with the BC Liquor Distribution Branch to make available 5,719 kg of high-quality cannabis products in the first 12-months following October 17, 2018. The quantity referenced is a delivery requirement agreed to in the MOU, not an internal allocation.

<https://www.canopygrowth.com/wp-content/uploads/2018/07/BC-Supply-NR-Final.pdf>

# High Park Company™ Announces Agreement to Supply Société des alcools du Québec (SAQ) with Cannabis

April 11, 2018 at 7:00 AM EDT

TORONTO--(BUSINESS WIRE)--Tilray Canada Ltd. ("Tilray") announced today that the company has signed an agreement with the Société des alcools du Québec (SAQ) to supply the Québec market with high-quality cannabis brands and products in anticipation of adult-use legalization later this year. Tilray will fulfill the agreement through its affiliate High Park Company ("High Park"), which was formed to produce and distribute a broad-based portfolio of adult-use cannabis brands and products.

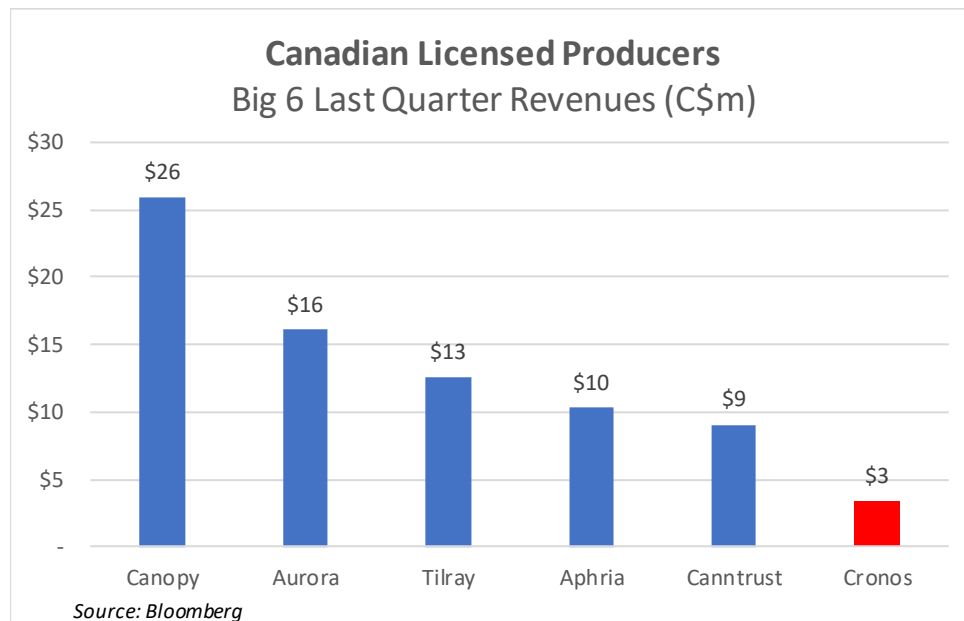
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"We are thrilled High Park will deliver a safe, secure and reliable supply of cannabis to Quebec," said Adine Fabiani-Carter, Chief Marketing Officer at High Park. "Our goal is to deliver on the high expectations that Canadians have of us by cultivating and distributing a portfolio of world-class adult-use products that will lead the market in quality, excellence and craftsmanship."

Under the terms of the agreement, High Park commits to supplying the Quebec market with 5,000 kilograms of cannabis per year across a variety of brands for a three-year period.

<https://ir.tilray.com/news-releases/news-release-details/high-park-companytm-announces-agreement-supply-societe-des>

Cronos is all talk. Last quarter, despite having the first ever license issued by Health Canada in late 2013, Cronos has vastly underperformed every big competitor.



This is a total joke!!

Two days ago there was a [pot bust in Wyoming](#) with an estimated street value of US\$7m. That is more than three times the revenue that Cronos, a \$3B CAD company, generated last quarter. For context: this Wyoming bust is an illegal business that was merely transporting a portion of its load.

## A clear example of hype vs. reality with Cronos

In October 2017, Cronos issued a grandiose [press release](#) noting:

*Cronos Group Inc. (TSX-V: MJN) (OTC – Nasdaq Int’l Designation: PRMCF) (“Cronos” or the “Company”) is pleased to announce that it has entered into a strategic distribution partnership with G. Pohl-Boskamp GmbH & Co. KG (“Pohl-Boskamp”). Founded in 1835, Pohl-Boskamp is an international pharmaceutical manufacturer and supplier, distributing its products to over 12,000 pharmacies in Germany alone.*

*Leveraging Pohl-Boskamp’s extensive distribution network, this partnership provides Cronos with unrivaled access to the German market. Cronos will begin shipping product to Pohl this quarter and will terminate all other existing German supply agreements following this announcement. With over 82 million people and federal insurance coverage for cannabis, Germany is currently the largest legal cannabis market in the world.*

*“We are ecstatic to partner with Pohl-Boskamp, an established and reputable pharmaceutical leader. This partnership allows us to leverage an existing industry leading pharmaceutical distribution channel to immediately create the world’s largest medical cannabis distribution platform,” said Mike Gorenstein, CEO of Cronos.*

Now here’s the reality. There was zero mention of Germany on the Q2’18 earnings call. Cronos last mentioned Germany on the Q1’18 earnings call and noted that “export sales to Germany accounted for **6% of the reported revenue**”, **meaning Germany accounted for \$177k CAD of revenue in Q1’18.**

What are you getting when you buy Cronos? Nothing more than fluff and distribution agreements.

### Just one big Stock Promo : Immaterial R&D Spend

On the [latest earnings call](#), the CEO noted that “**Cronos seeks to build the world most innovative cannabinoid platform using different plant genetic and production methodologies** to develop a portfolio of cannabinoid and terpene recipes that deliver differentiated psychoactive effects and therapeutic benefits.”

In reality, Cronos has only spent \$1 million in R&D of all the capital it has raised from its bought deals over the last year. They are not even in the universe of any medicinal research anywhere.

#### Use of Proceeds

Below is a reconciliation of the manner in which the net proceeds from the April 2018 Bought Deal were used by the Company compared to the disclosure in the Company's final short form prospectus dated March 29, 2018 (the "**March 2018 Final Prospectus**").

Disclosure in the March 2018 Final Prospectus	Use of Proceeds
\$10,000,000 for its proportionate share of capital expenditures relating to construction and operating expenses of Cronos Australia in connection with Phase I of Cronos Australia.	The Company has advanced \$0.4 million of the proceeds in connection with the construction or operating expenses of Cronos Australia and expects to apply such remaining proceeds in 2018.
\$5,000,000 to purchase equipment for use in Cronos Israel's greenhouse and manufacturing facility for Phase I of Cronos Israel.	The Company has not yet applied any of the proceeds in connection with the equipment purchase for use in Cronos Israel. The \$5.0 million has been set aside for future equipment purchases for Phase I of Cronos Israel.
The remaining net proceeds for general working capital purposes, including working capital for the Company's international operations, and as capital on hand for potential new investment opportunities.	The Company has not applied any remaining net proceeds to date.

Below is a reconciliation of the manner in which the net proceeds from the January 2018 Bought Deal were used by the Company compared to the disclosure in the Company's final short form prospectus dated January 18, 2018 (the "**January 2018 Final Prospectus**").

Disclosure in the January 2018 Final Prospectus	Use of Proceeds
\$5,000,000 for research and development (" <b>R&amp;D</b> ") initiatives, including cannabinoid production research and clinical trials.	<u>The Company applied approximately \$0.5 million of the net proceeds of the January 2018 Bought Deal to R&amp;D initiatives, including cannabinoid production research.</u>  The remaining approximately \$4.5 million allocated for R&D initiatives in the January 2018 Final Prospectus has been set aside for ongoing research in product formulation, clinical trials, and cannabinoid production research and are expected to be applied in 2018.

Below is a reconciliation of the manner in which the net proceeds from the bought deal offering of common shares in November 2017 ("**November 2017 Bought Deal**") were used by the Company compared to the disclosure in the Company's final short form prospectus dated November 3, 2017 (the "**November 2017 Final Prospectus**").

Disclosure in the November 2017 Final Prospectus	Use of Proceeds
\$7,000,000 for expanding production at Peace Naturals. This includes general construction costs, the contractor's management fees, labor costs, material (e.g. structural steel, roofing material, and paneling) and equipment (e.g. irrigation, generators) for the continued construction of Building 4 and Peace Naturals' greenhouse.	The Company applied approximately \$10.1 million of the net proceeds of the November 2017 Bought Deal plus an additional \$0.6 million from operations, for a total of \$10.7 million to general construction costs and deposits on equipment for the continued construction of Building 4 and Peace Naturals' greenhouse.  Such amount represents the \$7.0 million allocated for such use in the November 2017 Final Prospectus, plus an additional amount equal to approximately \$3.1 million from the net proceeds allocated to general working capital purposes in the November 2017 Final Prospectus (including approximately \$2.1 million of the net proceeds from the exercise of the November 2017 Bought Deal over-allotment option) and an additional \$0.6 million from operations.
\$3,000,000 for <b>R&amp;D</b> initiatives, including product formulation and the purchase of associated production equipment.	<u>The Company applied approximately \$0.5 million for R&amp;D initiatives associated with plant and process productivity.</u>  The remaining approximately \$2.5 million allocated for R&D initiatives in the November 2017 Final Prospectus has been set aside for ongoing research in product formulation, clinical trials, and plant process productivity and are expected to be applied in 2018.

## It Only Gets Better

On what little revenues that Cronos has, the cant even get that right

## Cronos has a history of product recalls

In [Feb 2015](#), Cronos (its wholly owned subsidiary Peace Naturals) had its first known recall for wrongful labelling if not worse, wrongful testing.

In [May 2017](#), Cronos once again had a recall, but this time for using what appeared to be pesticides that they ought not to have.



And this is the worst. While Cronos was raising money and touting an international strategy, surprisingly Germany was missing from their Q2 conference call.

What happened?

Without disclosing to investors or to the SEC, their product got recalled in Germany for Microbial contamination

<https://www.leafly.com/news/industry/canada-lp-german-partner-pulls-cannabis-batch-as-precaution>

Cronos raised \$100m just a few days later on [Mar 21, 2018](#), In our opinion that is securities fraud;

Retail investors have piled into Cronos on the hope that Diageo will announce an investment or alliance relating to cannabis-infused beverages.

As a result, Cronos is now trading almost in-line with Canopy Growth based on market cap relative, which implies that the market is already pricing in that Cronos gets the coveted “beverage deal”.

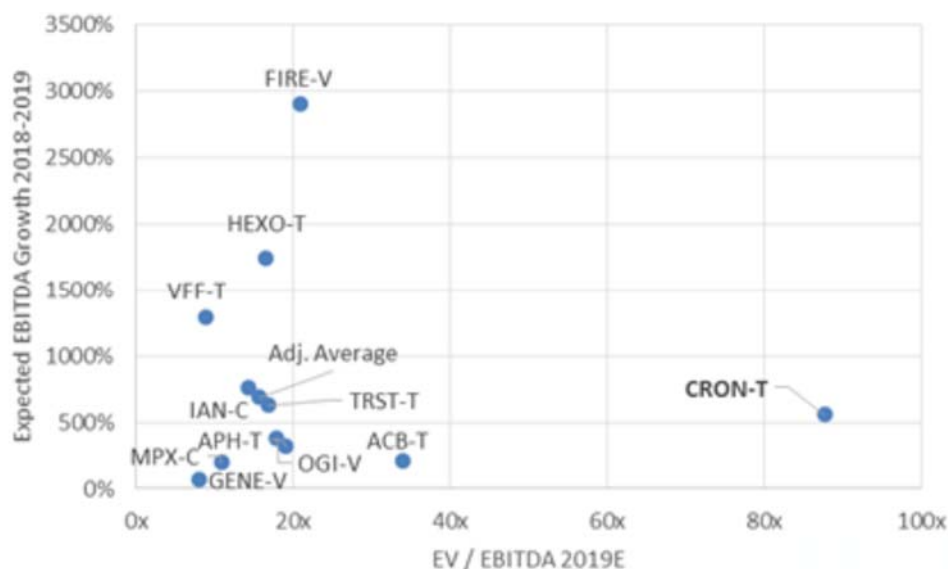
Cronos vs Canopy		
	CRON	WEED
Enterprise Value	\$2,591	\$12,712
Last Quarter Sales Annualized	\$14	\$104
2019 Sales	\$132	\$881
2020 Sales	\$288	\$1,283
EV / LQ Annualized Sales	190.5x	122.7x
EV / 2019 Sales	19.6x	14.4x

*C\$m unless otherwise noted*

Yeah right, Diageo would ever do a deal with a company who has a history of contamination and has proven that they cannot even produce a small amount of commercial product. This is a NON EVENT. Citron feels stupid even discussing this, but it had to get mentioned.

**So how can we value Cronos?**

When looking at Cronos relative to other cannabis stocks that have yet to receive a “beverage deal”, Cronos’ sky high valuation looks completely out of whack with fundamentals.



Despite Cronos claiming they are the leader, that is all talk. So we compare them to a public company with most similar financials and we will disregard the history of product recalls.

## It's Real Comp

### Cronos vs Organigram (\$m unless otherwise noted)

	Cronos (\$CRON)	Organigram (\$OGI)
	Qtr Ended 06/30/2018	Qtr Ended 05/31/2018

#### PNL

Revenue	\$3.4	\$3.7
Net Income	\$0.8	\$2.8

#### Balance Sheet Info

Cash	\$90	\$156
Inventory on Balance Sheet	\$12	\$18
Biological Assets	\$7	\$9

Citron compare Cronos to Organigram despite OGI having

- More revenues in the last quarter (10% higher),
- More profit (>3x)
- Better balance sheet with 50% more cash and inventory that Cronos

- Better management. With Greg Engel who formerly ran Tilray, they have a winner from a institutional way of thinking.

With all that in consideration we will give Cronos at market valuation of \$3.5 a direct comp to Organigram....

## **Conclusion: Lets take Stock**

- Cronos does not have material International sales
  - Worse: Cronos has worst in class sales of the big Canadian Licensed Producers
- Cronos trades more expensive than Canopy, the only company in the space to have a beverage deal
- Cronos has a history of product recalls
- Cronos is hiding bad information
- It has no US operations and has limited potential internationally
- It does not spend money on R&D despite purporting to being a leader

Cronos is a reminder to all investors that what is not released is what you need to pay attention to.

## **Cautious Investing to All**