



ASX Announcement

27 July 2017

Creso Pharma gains Canadian footprint, in world's largest legal medicinal cannabis market, with acquisition of Mernova Medicinal Inc

Highlights:

- **Acquisition of Mernova Medicinal Inc (Mernova) for C\$10.1 million (A\$10.2 million) in cash and equity**
- **Creso Pharma becomes the only Australian cannabis company with direct exposure to the world's largest legal medical cannabis market**
- **Delivers on Creso's strategy of establishing a Canadian presence and the pursuit of opportunities in the medicinal cannabis space, with added exposure to the huge recreational cannabis market anticipated to open up in 2018**
- **Enables Creso to vertically integrate its supply and production chain by building its own Good Manufacturing Process growing and extraction facilities**

Creso Pharma Limited (ASX:CPH, the "Company" or "Creso") is pleased to announce that it has successfully expanded into the Canadian market with the proposed acquisition of emerging Nova Scotia-based medicinal cannabis producer, Mernova Medicinal Inc (Mernova) for a total C\$10.1 million (A\$10.2 million) in cash and equity.

As a result of the deal, Creso will become the only Australian cannabis company with direct exposure to the world's largest legal medicinal cannabis market. The fully-funded acquisition also delivers on Creso's strategy of establishing a Canadian presence and to pursue opportunities in the medicinal and soon to be legalised recreational cannabis space. Moreover, it gives Creso the ability to rationalise and vertically integrate its supply and production chain by building its own Good Manufacturing Process (GMP) cultivation facility.

About Mernova

Mernova is a privately held company, based in Nova Scotia, that has applied for a medical cannabis cultivation licence under Health Canada's Access to Cannabis for Medical Purposes Regulation (ACMPR) program.

Mernova has acquired a strategic parcel of land that is highly suited for development of a medical cannabis growing facility, with construction of a 20,000 square foot facility due to commence in the coming months. Creso also intends to build a state-of-the-art CO2 extraction facility that is fully GMP compliant at the

Mernova site. This is an important strategic step for Mernova to ensure that it is fully able to capitalise on the Canadian market opportunity.



Completion of Mernova's initial 20,000 square foot production facility is being targeted to coincide with the legalisation of recreational cannabis in Canada on 1 July 2018.

Thereafter, the Company has plans to expand the facility on the available adjoining land parcel to up to 200,000 square feet. Mernova is in the process of engaging a team of experts to design and construct the facility to a GMP standard, with the most modern growing and production capabilities.

Mernova applied for its licence under the ACMPR in 2014.

Effective 25 May 2017, the application process for becoming a licensed producer of cannabis for medical purposes under the ACMPR is as follows:

1. Intake and Initial Screening
2. Detailed Review and Initiation of Security Clearance Process
3. Issuance of Licence to Produce (cultivation)
4. Introductory Inspection (as cultivation begins)
5. Pre-Sales Inspection
6. Issuance of Licence to Sell

Mernova is currently in the final stages of the Detailed Review (having already passed the security clearance process) and expects to receive its licence to produce (cultivation) in the coming months. At this time, Mernova will be in a position to immediately commence construction of the facility because it anticipates completing the final aspects of the facility design and engineering in the intervening period.

Upon completion of the facility, Mernova will access the market as a large-scale, high-quality producer of medicinal cannabis and will be well placed to expand into the recreational market once Canadian legislation is implemented.

Strategic rationale

The acquisition delivers on Creso's strategy of establishing a Canadian presence and to pursue opportunities in the medicinal and, when legalised, the recreational cannabis space as outlined in its Prospectus for its ASX listing in October 2016.

The acquisition also gives Creso:

- A presence in the growing and well-regulated Canadian market for its innovative animal and human health nutraceutical products;
- The ability to vertically integrate its product line and control its production chain by building its own GMP cultivation facility and the ability to conduct its own extraction;
- Cost-effective entry into the Canadian market where licences are expected to become more expensive as quality standards increase;
- The ability to greater integrate its supply chain, allowing it to produce its own medicinal cannabis as well as supply its existing planned products to the Canadian market;
- The ability to bring its significant pharmaceutical expertise and rigour to medicinal cannabis production and cultivation in Canada; and
- Diversification into the Canadian recreational use market from 1 July 2018 when this market is expected to be legalised.



In addition, the granting of a licence under the ACMPR to Mernova will give the Company a significant competitive advantage as Creso will be one of the few companies globally and the only medicinal cannabis company listed on the ASX with the capacity to commercially cultivate medicinal-grade cannabis in the Canadian federally regulated environment. Similar licences, once granted, are valued at between C\$50-C\$250 million (A\$50.4-A\$252.2 million).

A licence under the ACMPR would also be a significant strategic asset with current production levels from existing licensees forecast to only be able to meet approximately 5% of the future demand from the medicinal and recreational sectors.

Financial consideration

Creso is acquiring Mernova for three milestone cash payments of C\$1.8 million (A\$1.82 million) and three milestone issues of Creso shares to the value of C\$8.3 million (A\$8.38 million). These staged payments can be summarised as follows:

- Upon settlement of the acquisition, Creso will make an initial cash payment of C\$600,000 and issue C\$8,300,000 of fully paid exchangeable preferred shares (Exchangeable Shares) in the capital of Canadian subsidiary of Creso (Creso Sub) at an issue price equal to the 10-day volume weighted average trading price (VWAP) of the ordinary shares of Creso (Creso Shares) as traded on ASX over the 10 trading days immediately prior to settlement (the Consideration Shares);
- Upon Creso announcing to the market of the planting by Mernova of its first crop following completion of construction of the production facility (Milestone 1), Creso will make a further cash payment C\$600,000 and C\$2,400,000 of the Consideration Shares will become convertible into Creso Shares at an issue price equal to the 10-day VWAP of the Creso Shares at the date the relevant Mernova shareholder elects to convert the Consideration Shares; and
- Upon Creso announcing to the market of the granting of sales licence to Mernova under the ACMPR (Milestone 2), Creso will make a further cash payment C\$600,000 and C\$3,500,000 of the Consideration Shares will become convertible into Creso Shares at an issue price equal to the 10-day VWAP of the Creso Shares at the date the relevant Mernova shareholder elects to convert the Consideration Shares.

To satisfy the arrangement, Milestone 1 must be achieved within 24 months of settlement, and Milestone 2 must be achieved within 12 months of Milestone 1 being satisfied, otherwise the Mernova shareholders' entitlement to the Consideration automatically lapses. These dates may be extended if agreed force majeure events occur.

The transaction has been structured so that the Mernova shareholders receive "Exchangeable Shares" in the Creso Sub to enable them to secure tax deferral in Canada on the disposal of their shares in Mernova (in much the same way that CGT roll over relief applies under Australian tax laws).

In addition, the Consideration Shares for Milestone 1 and Milestone 2 will be convertible into Creso Shares based on a VWAP after these milestones are achieved. Importantly, this will result in less dilution for existing Creso shareholders if the trading price of Creso's shares on ASX appreciates in the intervening period.

The agreement with Mernova remains subject to completion of due diligence by Creso, and receipt of any required regulatory approvals.



Benefits of entry into the Canadian market

Canada is a well-regulated and growing market. There are currently 52 licensed producers operating under the ACMPR program and Health Canada forecasts that there will be 450,000 medicinal marijuana patients by 2024, representing C\$1.3 billion (A\$1.3 billion) in sales.

In addition, the legalisation of the recreational market would immediately create significant opportunity for medicinal producers to expand into recreational production. The base retail market value is estimated at between C\$4.9 billion (A\$4.9 billion) to C\$8.7 billion (A\$8.7 billion), with significant industry growth expected following legalisation.

“With this acquisition, we have delivered on one of the key pillars of our corporate strategy: establishing a Canadian presence and the pursuit of opportunities in the medicinal and the recreational cannabis space. It also allows us to rationalise and vertically integrate our supply and production chain through establishing our own GMP-quality cultivation and extraction facility,” said Creso Pharma CEO and Co-Founder Dr Miri Halperin Wernli.

“This gives us a key strategic benefit in allowing us to cultivate and manufacture our own innovative medicinal cannabis products. These will be standardised in dose and formulation, in innovative and proprietary delivery technologies and will provide patients with new therapeutic choices beyond smoking or vaping. We’re also looking forward to pursuing further opportunities in the Canadian market, when it comes to both local distribution and exporting to other countries such as Australia that already accept medicinal cannabis imports.”

“Importantly, Creso remains well funded with A\$9.23 million cash on hand as at 30 June 2017 and this will enable the Company to execute its medium-term objectives without any obligation to return to the market for additional funding,” she said.

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About Creso Pharma

Creso Pharma brings pharmaceutical expertise and methodological rigour to the world of medicinal cannabis and strives for the highest quality in its products. It is the leader in cannabidiol (CBD) innovation and develops cannabis- and hemp-derived therapeutic-grade nutraceuticals and medicinal cannabis products with wide patient and consumer reach for human and animal health. Creso uses GMP development and manufacturing standards for its products as a reference of quality excellence with initial product registrations in Switzerland. It has worldwide rights for a number of unique and proprietary innovative delivery technologies which enhance the bioavailability and absorption of cannabinoids.