



GENERATIONETFs - Season 2 Ep. 2: John Zamparo (Part 1)

Mark Noble

Welcome to the second episode of our podcast series: Generation ETFs. I'm Mark Noble, senior vice president of ETF strategy at Horizons ETFs. Today we're going to have a key focus on marijuana investing, which is obviously a specialty of Horizons ETFs. The global marijuana industry - the recreational and medical components - are a real business, globally. I mean, that's one message that our firm tries to get out there, but that doesn't necessarily make them a great investment. Sometimes there can be a disconnect between the idea of a real business occurring and being a great investment business, to have your money in.

Mark Noble

There's an astounding amount of interest in cannabis and marijuana equity investing, particularly in Canada, but it's actually quite a rarity to find people who are looking at marijuana stocks with the same lens as other established sectors and taking an investment rather than a promotional approach to looking at these stocks. I think that's why we're really excited today to have John Zamparo with us. John is one of a select group of dealer affiliated equity research experts who directly covers the cannabis companies. So for those of you who aren't familiar ... I mean he's looking at cannabis firms the same way other equity research groups look at companies like Apple or Netflix with a focus on the investment merits of owning or in some cases not owning some of these firms.

Mark Noble

Today we're going to talk to John about key developments in the cannabis equity space and you know, really talking about the actual investment case for looking to own stocks in this sector. Just a little bit about John before we start. John is the director of equity research, retail consumer products and cannabis at CIBC Capital Markets. John joined CIBC in 2014 as an associate covering Canadian retailers and consumer products business. And more recently, he's developed expertise in the emerging cannabis industry. He was a primary author of the CIBC report titled Cannabis almost showtime, and now provides research coverage for the industry as well as several individual companies in the sector. And it's really one of only a very, very select group of large Canadian bank analysts covering the space. John, thanks so much for being with us today.

John Zamparo

Thanks for having me, Mark. I'm very excited to be here. It's never a dull moment in this industry, right?

Mark Noble

I kind of wanted to get a sense of, how do you end up, at a bank as a bank dealer analyst, cause you are one of a rarefied group of people who have these large household banks, behind the research you're doing in a very emerging sector.

John Zamparo

Sure. For me it started ... I cover the company - I still do - formally called Liquor Stores, with a footprint out west and also in Alaska. And I started asking them a question, probably a couple of years ago just as Alaska was starting to legalize recreational cannabis. And I said, "Hey, you know, you guys, you're experts in selling adult beverages in this market. Why not also sell another adult substance?" It's a great revenue driver. It helps you diversify. And we started talking about that and on occasions publicly, and then our director of research said, when we wanted to pick up the industry, said, "Hey, would you be interested in it?" And I thought, "Hey, it's a growth driver in this industry and there aren't that many growth industries within the banking sector now." Why CIBC covers it? Ultimately, it's what clients want.

John Zamparo:

We started getting more and more questions from clients about it and we want to serve those needs. That's ultimately what we're about: servicing clients. The more they want to know about it, the more we'll cover it. It's been an exciting year or so, that we started picking up companies and we get even more and more questions nowadays. Last week or last month I would say is, you know, 10 times the interest we even had last year. So it's always growing and there's plenty more to do as well.

Mark Noble:

How many of the companies in the sector are you currently covering?

John Zamparo:

We currently cover five in the space, if you count the retail aspect which is Alcanna that's formerly Liquor Stores, but for the traditional LPs, so Canopy growth, Cronos Group, HEXO and Aphria as well as what I call a nontraditional LP Canopy Rivers, which is the venture capital arm of canopy growth. So those are the five in the traditional space that we cover.

Mark Noble

And amongst those names, you pretty much have probably 60 - 70% of the market cap as the business or I would say close to.

John Zamparo

Unless it's challenging, I don't have those numbers in front of me, but we're certainly very involved in them I would say. But you'd be surprised. Any given name - it can vary on any given day.

GENERATIONETFs - Season 2 Ep. 2: John Zamparo (Part 1)

Mark Noble

Let's just jump into the long term case for investing in marijuana equities. I find that you get a lot of outlooks out there. Things that go from outright bearish, like this is a business that won't be around to ... things that suggest that we'll be having marijuana in every facet of our life. What's your view in terms of the long-term case of investing in this space and it, and more importantly than the numbers which can just come out of nowhere, what are the big drivers of growth in this space?

John Zamparo

I certainly ... It's fair to say that I'm a bull on the industry. That said, I think there is some expectations from some people in the industry that are maybe a bit far fetched. But that said, we're just scratching the surface of what this industry does, right? I mean, it's basically the six month anniversary of legalization in Canada. And I know we like to think that we're incredibly important and sure we are trailblazers in this industry. But I mean, at the end of the day, we're one country in the world that has made this move. There's only another one in South America, Uruguay, that's done it as well. So there's so much more for this industry to explore. I think it's obvious to me that the first step in any country is going through the medical route and then through adult use.

John Zamparo

And there's still so many countries that have just barely started on this. So for me, that's the biggest driver is, unlocking the medical side of this industry. And I think that depends on a lot of advancements. A lot of these companies will talk about clinical trials, about how there are engineers, there are doctors who are focusing on this. And to date, it's only been anecdotal evidence so far that there's any medical reason at all to use cannabis but I think there's a reason for that. There just hasn't been any research for the most part, it's been entirely illegal and you can't really research something when it's illegal and you can't grow it. There will come a time I think, when we're able to substantiate some of these claims. So for people who say it cures the cancer, I don't know if I'd go that far, but for people who say, "It treats my pain far better than an opioid would."

John Zamparo

I think there's probably merit to that. And I think there's a reason to explore that. For me, that's the biggest driver of growth in the industry. But that said, it's clear that there's a demand for this product. It's historically been served by the illicit market and we know whatever your estimate is in Canada, \$5 billion, \$6 billion, \$10 billion. It's certainly there. We've published that. We think it's on par with the spirits industry in Canada. I don't think it's all that different in the US and different parts of the world very, but in the US, it is likely the biggest market worldwide. I think the demand is certainly there. It's a fun social and economic experiment that were going down now, but I really do think we've just scratched the surface. And that both on the medical and recreational side, there's so much more to come. But the key to unlocking it all I think is on the medical side and figuring out exactly what this plant is capable of and saying with certainty that it can treat X or Y and here's the evidence to prove it.

Mark Noble

I think that's a great segue because you and I both talked to sometimes the senior management of some of these large LPs and certainly they always talk up the global medical side because I think the global medical side has a little bit more Let's say intellectual property to it. You look that through is more from the pharmaceutical angle where are the beverages and recreational side, you're looking at a consumer product. But how big is the global medical opportunity, especially when we considered relative to the Canadian recreational. Because I think investors get cut off with the recreational idea that people are going to be smoking joints at the grocery store, whereas I think the industry is more focused on the profits and the IP associated with the global medical side.

John Zamparo

For sure. The companies ... The serious ones at least they want to demonstrate first and foremost that they follow a culture of compliance. So for them that means talking about medical 90% of the time. And there still is to some extent a stigma about talking about the recreational side. So I mean, you'll see the odd comment from CEOs about wanting to serve Canadian consumers. But, first and foremost, they really do want to prioritize the medical market. If you think about Canopy Growth, their CEO, Bruce Linton has been on the record multiple times saying they want to be a globally dominant medical cannabis company. And that's not to say they don't want to also dominate among Canadian consumers. You can see that in bars across Toronto. You'll see advertisements for their brands. I shouldn't just say Canopy Growth, there's others of course too. But at the end of the day, that's where most of these companies want to begin. I think the path to that is easier when you're advertising your medical capabilities. If you're having these conversations with heads of state, with pharmacy companies around the world, I think that's the way to do it is to talk about how you can help these countries, on a medical basis. How you can alleviate pain or mood problems or just help people feel better in general. For them, that's the first path. Eventually this becomes a lot more like the tobacco or alcohol industries and becomes multiple times larger. But I think that's the way in for this plant is to help people first and foremost and really to treat it on a medical basis.

Mark Noble

Well, what about the global side too? Because when I look ... When you go through some of the earnings, right? I mean, the margins of profit and in places like Germany are just so much better than what you would see even selling medical here in Canada and certainly better than recreational. Does that drive some of that as well? You're probably getting one bill, \$12 a gram, I think in Germany and maybe \$5 wholesale here.

John Zamparo

Yeah, absolutely. I think that's part of the reason you're seeing a supply shortage at least of products in demand in Canada, is that, I know for a fact some of these companies have what's called an allocation committee and they look to, where can we sell our next gram for the best economics? And you referenced Germany, I think that's a great example. It typically is twice as much on a gram or gram equivalent basis. So that

makes a lot of sense for them. That said, the demand in those countries is there, it's not necessarily going to be supported by Canadian exports for now, just because of issues on the regulatory side, on exporting or importing rules.

John Zamparo

Issues on the regulatory side, on exporting or importing, rules on insurance reimbursement. There are, I would say, roadblocks to unlocking all of those markets, but they certainly are a priority.

John Zamparo

And going back to your earlier question of how big this opportunity you can get, I think I've seen, I think I've seen estimates range from you know, \$5 billion dollars a year to \$200 billion dollars a year, depends how you tweak any number of variables. All I know I can say for certain is that it's multiple times larger than what we're dealing with right now. And I think, I think the next step probably is Europe and then we start moving to to other jurisdictions. But that seems like that's the next big medical opportunity. At least, that's the one that the LPs are most excited in for the near term.

Mark Noble

And how, are they capped though? I mean, their view right now is mainly strategic partnerships. So they're looking to partner up with established local infrastructure. But what kind of opportunity is that if today I'm buying Canadian marijuana companies based on the global growth trajectory, how much am I actually getting exposure to that with a Canadian LP and how much potential is there for that?

John Zamparo

I think it depends who you pick.

Mark Noble

Okay.

John Zamparo

Some of them have been more forthright with saying we are going to target, you know, Germany, Israel, Australia, et cetera. Talk more about their international operations rather than the Canadian consumer. So there's no, there's no simple way of telling other than getting to know these companies a lot better. But for the most part, I think you have to rely on international opportunities, whether it's medical or recreational, just because the valuations of these companies doesn't support just the Canadian consumer, right? I mean we're at, I think probably between \$50 and \$70 billion dollars of EV across the Canadian space.

Mark Noble

Right.

John Zamparo

I mean we've published that the entire cannabis sector, at least on the producer's side, will do EBITDA of about a billion dollars a year. So to justify those valuations, I think you have to go well beyond Canada. I think if you're picking most of these names, you're assuming that they can make some in-roads in other countries. And certainly on the medical side. It likely won't be in the next year to three years on the recreational side, so you're betting on them to make medical advancements and you're betting on them to, to reach other countries in a relatively material way.

Mark Noble

And that's a great movement into valuations because I know I would love to see a conversation when, you know, you've got this job as a trained equity analyst and you have to look at valuing companies, which let's face it, most of them have negative earnings. So, you know, this begs the question, you know, how do you make a recommendation on a company that doesn't really have positive earnings flows and, and kind of defies most of the fundamental analysis that you can do on them?

John Zamparo

It's a great question. It's what we get from a lot of traditional investors who are long only, who are used to looking at price, earnings, multiples, EDD, EBITDA, free cash flow, and like you said, you can't really do that in this industry unless you're willing to walk a few years out, which is you know, what we do and that is the challenge. But I mean in general we do, I'd say a combination of top down and bottom up analysis. We like to look at what the Canadian market is going to generate in terms of sales and then allocate share based on that. But for the most part we're using an EV to sales model, which I know frightens some people because it purely looks at the top line and not at all at profitability. I think you can look at it through the lens of EV to EBITDA to get specific. You're still probably fast forwarding two or three years and this is non-traditional, to be sure. I mean that's, let's be clear about that.

John Zamparo

But I think that's how you have to value these industries that are, you know, not making it today but are in it for three to ten years. There's multitudes of ways, and one of the ways we looked at in one of our launch reports was to examine the industries that are going to get disrupted. Now that can mean any number of industries. Let's pick pain treatment, mood therapy, sleep aid, pet health worldwide. Those are anywhere between, you know, \$40 billion to \$150 billion dollars a year. And just to keep things simple, let's say, you know, one of them is \$100 billion dollars a year. And then if you think, okay, what if they can, what if they can disrupt 10% of that market, and now we're at a 10 billion dollar number. And what if they can get, you know, a 10% share of that, now you're at a billion dollars, and you kind of assess it through different

categories and what you can disrupt and what share you can get. And then, ultimately, what's your profitability in that industry.

John Zamparo

So this whole exercise is a huge thought process and it requires a lot of imagination and a lot of inputs that I think are subject to very different interpretations and reasonable people can differ on them. That said, what I find interesting about the entire space is that valuation, historically, has not at all been the key driver in picking winners. So I mean for those coming from traditional industries, whether it is alcohol, tobacco, to a lesser extent, pharmaceuticals, because there's more an element of predicting the future in that industry. It is different. It does require looking at things a different way. And we've had to tell clients and investors that, you know, you don't just pay zero attention to valuation but it's maybe less relevant for these companies in this industry than in others.

John Zamparo

And really our guidance to investors has been to look to the companies with the strongest balance sheets, the strongest strategy, the best management teams. And then, you know, start a position when the industry is having a rough month. And typically, you know, we forget about the good times during the bad and we forget about the bad times during the good, but there might be three good months in a row in this industry and then one terrible one and we say, you know, this is the time to get started. If you feel comfortable with that management team and their strategy, that's the name for you.

Mark Noble

Right.

John Zamparo

But it is a challenge for sure. And most clients kind of just roll their eyes when we have the conversation about valuations. But I think we do eventually get there. We do have to fast forward probably three or four years, but we've seen this in US jurisdictions that it takes three or four years for a cannabis market to really hit a steady state. As I said, we're just six months in here. So lots and lots left to see.

Mark Noble

So I'm gonna leave it at that today, we will have 4/20 coming up shortly in the next little while, and this is our 4/20 edition of this podcast. But really wanted, again, think about this from an investment lens, there's a lot of noise in the industry and so hopefully today we've been able to do is really clarify if you're looking at this as an investor, where are those opportunities, and certainly they exist, but they come with some of the caveats we talked to.



Horizons ETFs is a Member of Mirae Asset Global Investments. Commissions, management fees and expenses all may be associated with an investment in exchange traded products managed by Horizons ETFs Management (Canada) Inc. (the "Horizons Exchange Traded Products"). The Horizons Exchange Traded Products are not guaranteed, their values change frequently and past performance may not be repeated. Certain Horizons Exchange Traded Products use leveraged investment techniques that can magnify gains and losses and may result in greater volatility of returns. These Horizons Exchange Traded Products are subject to leverage risk and may be subject to aggressive investment risk and price volatility risk. The prospectus contains important detailed information about the Horizons Exchange Traded Products. **Please read the relevant prospectus before investing.**

The views/opinions expressed herein may not necessarily be the views of Horizons ETFs Management (Canada) Inc. All comments, opinions and views expressed are of a general nature and should not be considered as investment advice to purchase or to sell mentioned securities. Before making any investment decision, please consult your investment advisor or advisors.

Certain statements may constitute a forward-looking statement, including those identified by the expression "expect" and similar expressions (including grammatical variations thereof). The forward-looking statements are not historical facts but reflect the speaker's current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. These and other factors should be considered carefully and listeners should not place undue reliance on such forward-looking statements. These forward-looking statements are made as of the date hereof and the speakers do not undertake to update any forward-looking statement that is contained herein, whether as a result of new information, future events or otherwise, unless required by applicable law.