Zacks Small-Cap Research

April 15, 2016
John D. Vandermosten, CFA
312-265-9558 / jvandermosten@zacks.com
Brian Marckx, CFA
312-265-9474 / bmarckx@zacks.com

scr.zacks.com
10 S. Riverside Plaza, Suite 1600, Chicago, IL 60606

Ceapro Inc. (V.CZO - TSXV)

Reports record earnings with 20% FY15 sales growth and ~200% earnings growth.

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	10/05/2015
Current Price (2/4/16)	$0.62
Target Price	**$0.85**

OUTLOOK

Ceapro Inc. manufactures two lead products which include avenanthramides and beta glucan, two natural ingredients that are derived from oats and are currently being used in products such as Aveeno, Burts Bees, and Nexxus. The company also received a U.S. patent for its Pressurized Gas eXpanded (PGX) technology.

CZO is expanding its capacity through the construction of a new GMP bio-processing extraction facility which should be on-line by 4Q:16.

Ceapro is a “green” growth-stage biotechnology company that develops and commercializes health and wellness products through its proprietary extraction technology platform and natural, renewable resources.

We maintain our Buy rating and increase our price target to C$0.85 per share based on topline and margin strength.

SUMMARY DATA

52-Week High	**$0.66**
52-Week Low	**$0.17**
One-Year Return (%)	**6.9**
Beta	**2.69**
Average Daily Volume (sh)	**43,098**
Shares Outstanding (mil)	**62**
Market Capitalization ($mil)	**$27.81**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Med-Biomed/Health**

ZACKS ESTIMATES

Revenue

(In millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	$1.7 A	$2.4 A	$3.1 A	$3.4 A	$10.7 A
2016	$2.8 E	$3.2 E	$3.4 E	$3.6 E	$13.0 E
2017					$15.0 E
2018					$17.2 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	-$0.00 A	$0.01 A	$0.02 A	$0.05 A	$0.08 A
2016	$0.01 E	$0.01 E	$0.02 E	$0.02 E	$0.06 E
2017					$0.07 E
2018					$0.08 E

© Copyright 2016, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

Earnings Update

Ceapro Reports Accelerating Growth

On April 14, 2016, Ceapro Inc. (TSXV:CZO) released full year 2015 revenues and earnings. The company achieved 20% revenue growth for the period posting revenues of C$10.7 million and surpassing our estimates of C$10.3 million. Topline strength came from better than expected sales of beta glucan in Asia and more specifically China, and a stronger dollar which helped CAD based revenues. Sales to Germany were also a strong contributor to topline trends, adding C$2.5 million of additional revneues, offset in part by lower sales to the United States.

Gross margins were very strong in 2015, especially in the fourth quarter and rose to 66% in FY15, twelve percentage points above the full year results for 2014. The improvement was due to several factors, some of which were temporary. They include improved production efficiencies and the allocation of fixed costs over a greater level of revenues, the use of feedstock with higher levels of end product content and a stronger US dollar which leverages CAD-sourced feedstock.

General and administrative expense increased by 27% to $2.5 million reflecting higher share based compensation depreciation expense, investor relations and website costs. These amounts were partially offset by lower rent expense year on year, as the head office was moved to less expensive new facilities in Edmonton. Research and development expenses also rose compared to FY14, posting an 8% increase over the prior period. Sales and marketing expense, on the other hand, declined to $8 thousand from the $14 thousand spent last year due to a shift of Ceapro's sales strategy to the near exclusive use of a distribution network. Earnings also benefitted from an income tax recovery of $1.1 million related to recognizing deferred tax assets. Adjusting to the 26% statutory tax rate, 2015 earnings would have been 4.5 cents per diluted share.

The balance sheet is much stronger at year end due to the issuance of convertible debt and shares to bolster cash levels and support the construction of the new manufacturing facility in Edmonton. Additionally, the company signed a financing agreement with Agriculture Financial Services Corporation for a commercial financing of up to $900,000 providing additional financial support.

Cash flow improved in 2015, with operations generating $4.0 million and providing the vast majority of the $4.2 million required for capital investments and the purchase of leasehold improvements related to the new facilities. Financing activities generated a net of $0.9 million and cash increased by $1.4 million for the year.

2016 Estimates

Our forecasts for 2016 reflect a continuation of fourth quarter 2015 sales trends on the revenue line. During 2016, Ceapro anticipates bringing new production facilities on-line with initial validation trials in the June to August timeframe and eventual production by 4Q:16. The company is required by its agreements with customers to run both the old and new facilities simultaneously for the first six months; however, it will try to shorten this period to leverage the higher level of efficiency anticipated with the new manufacturing plant. We forecast some of the temporary drivers of gross margin in 2015 to subside in 2016 and forecast a decline to levels more in line with 2014's mid-50% range; however, the company should see an improvement as we move into 2016. The new facilities are expected to generate higher levels of end product with the same levels of feedstock, which should be evident in gross margin after a few quarters of production. This improvement will be reflected in 2017 margins. The new plant is also highly automated, which will also reduce costs.

Research and development costs are anticipated to rise in 2016 as clinical trials are launched for beta glucan (cholesterol reduction) and safety and bioavailability studies are conducted. We have conservatively forecasted $1.2 million of expenses here. General and administrative costs should remain relatively constant with 2015 levels despite the anticipated continued growth of the company due to lower expected options expenses and the absence of other one-time expenses that were carried in this line item in previous years. Sales and marketing expenses are considered to be essentially zero in 2016 as the company exclusively uses distributors for selling its product.

Ceapro believes that operating cash flows combined with cash from financing will be sufficient to fund operating expenses, ongoing capital investment and current debt repayment. The company currently estimates it will need to

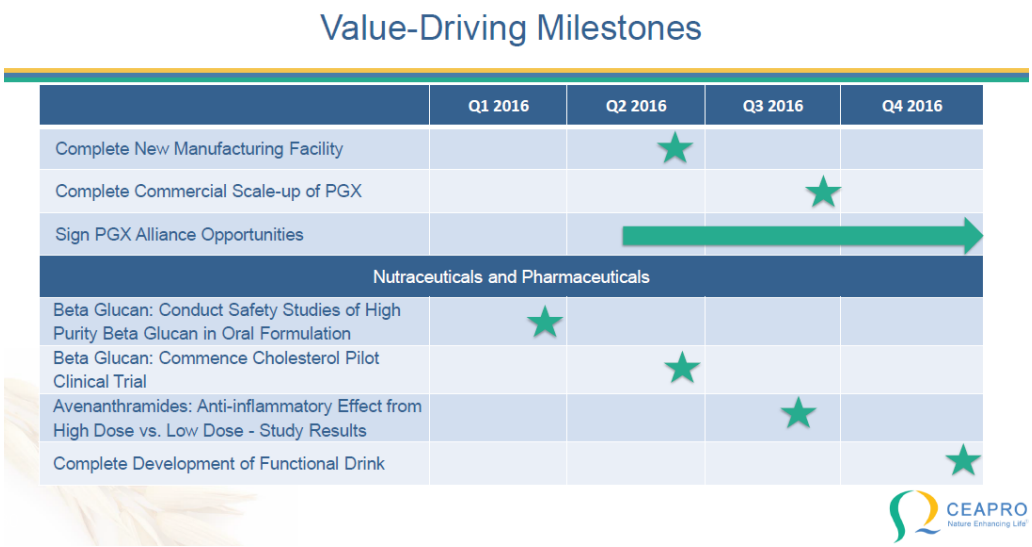
generate $3 million from operations and other sources to complete the new facility and we anticipate that the majority of this cash requirement will be able to be generated internally through operating activities.

Recent Material Events

Ceapro announced a continuation of its relationship with the German-based Symrise on April 6, which, along with Ross Organic in California, comprise near 90% of corporate sales. This is an agreement for the distribution and commercialization of Ceapro's active ingredients in the cosmetic markets. Additionally, the company has an outstanding loan agreement with Symrise for Euro 1 million.

On February 3, 2016, Ceapro announced that it received issuance from the U.S. Patent and Trademark Office (USPTO) for U.S. Patent No. 13/638,254 titled, "Supercritical Fluid Treatment of High Molecular Weight Biopolymers." The patent covers proprietary methods related to the production, impregnation and microencapsulation of micro- and nano-particles, agglomerates and fibers from high molecular weight water-soluble biopolymers generated by applying Pressurized Gas eXpanded (PGX) supercritical fluid technology. Not only does this strengthen Ceapro's intellectual property portfolio, but also helps expand the company's reach into the pharmaceutical and nutraceutical arenas in addition to advancing strategic alliance collaborations in various industrial applications.

Below, we share some of the key milestones expected in 2016 with regard to the manufacturing facility and some of the research the company is conducting on the health benefits from its key products.



PGX Research Programs Update

On November 12, 2015, Ceapro announced that the National Research Council of Canada (NRC) through its Industrial Research Assistance Program (IRAP) made a contribution of up to $350,000 for the development, demonstration and testing of Ceapro's PGX technology, which will support salaries of researchers dedicated to the building of a fully functional skid in Alberta for processing a wide range of feedstock using PGX equipment. Ceapro's researchers will focus efforts on completing the design of process equipment, fabricating and commissioning the demonstration skid, testing of biopolymer samples, assessing and determining the biopolymers with the best value proposition for further development and commercialization. In addition to in-house applications that have been developed with beta glucan using PGX technology, the other expected deliverable will be a system that will allow assessment of various materials originating from different companies or organizations on a worldwide basis.

Review of PGX Technology

On May 20, 2014, Ceapro signed a Development and Licensing Agreement with the University of Alberta for the use of its **P**ressurized **G**as e**X**panded (PGX) technology. Ceapro intends to utilize PGX technology to develop dry powder formulations of active ingredients in order to enable the transition to other sectors that mostly require the production of dry formulations in the form of tablets and capsules, such as cosmeceuticals, functional food, nutraceutical and pharmaceutical industries. Subsequently, on February 11, 2015, Ceapro announced an expansion to the license agreement with the University of Alberta, granting worldwide rights to the company to develop and commercialize PGX Technology in all industrial fields.

In May 2015, Ceapro announced that it would embark on a scale-up of its PGX technology to commercial and demonstration levels. The scale-up is estimated to cost around $2 million, and the company has received additional funding from Al Bio, this time in the amount of an $800K funding contribution, in order to help support the project. Similarly, as mentioned above, Ceapro was also awarded a research contribution from the National Research Council of Canada (NRC) through its Industrial Research Assistance Program (IRAP) of up to $350k for the project. Management believes that the implementation of PGX at a commercial scale has the potential to generate many novel bio-based products with improved functionality and purity.

Update on Avenanthramides Program

Ceapro's flagship product, avenanthramides, has applications in the cosmetics and personal care industries, and when taken orally, AVA could be beneficial in inflammatory conditions. These findings supported the research and development of AVA as an active pharmaceutical ingredient (API). Ceapro has initiated a bioavailability study with a U.S.-based university, comparing low-dose vs. high-dose AVA. Ceapro expects to commence its clinical program following a positive readout of study results in 3Q:16. Management believes that this bioavailability study will pave the way for future clinical study protocols, and should provide efficacy information as an anti-inflammatory compound. We hope to have a better sense of the market opportunity here and the value of avenanthramides after the bioavailability study is completed, and once we see the IND filing down the road.

Update on Oat Beta Glucan Program

Beta glucan is known for its cholesterol lowering properties (Othman, *et al.,* 2011), and Ceapro aims to develop beta glucan as a cholesterol reducer. It will conduct safety studies to assess high purity beta glucan when taken orally and a pilot clinical trial program on cholesterol reduction beginning in the second quarter. We believe the safety study will take about 10 months to complete. Furthermore, the beta glucan pilot study will enroll approximately 300 patients and will take approximately 16-18 months to complete. Both studies will be conducted in parallel.

Bio-Processing Extraction Facility on Track for Second Half 2016 Completion

In 2011, Ceapro originally planned to construct a new 21,000 square foot GMP bio-processing extraction facility in Edmonton, Alberta. The scope of the original planned manufacturing facility was redefined in later years to take advantage of new manufacturing process design opportunities with an expanded production area specifically designed to house a commercial and demonstration scale PGX skid and ethanol recycling system, and as a result, Ceapro is adding an additional 10,000 square feet to the facility. The goal is to be able to host all of Ceapro's enabling technologies under one roof, and management believes the facility is on track for a second half 2016 completion.

The original facility was estimated to cost around $12 million, but with the expansion, we believe the project will now require an outlay of almost $14 million to complete. Ceapro has completed and recorded $10.8 million of expense as of December 31, 2015. The new facility will hold a Natural Health Products license from Health Canada, and will allow Ceapro to leverage its bio-processing technique and generate additional revenue from custom bio-processing for third party customers that have their own products and extraction processes. The company will need to raise close to $3.0 million to complete the project, and Ceapro will fund the outstanding balance through internally generated cash and potentially equity or debt financing, licensing agreements, and/or government funding programs. Currently, Ceapro has the ability to manufacture 3-4 tonnes of product per week (approximately 100-200 tonnes per year) using batch mode processes. Ceapro's plan is to implement a more efficient process at the new facility, with semi-continuous and continuous manufacturing processes which will allow for the simultaneous production of multiple products, and the production of five to six times more material than the current setup. The

first validation batch trials are expected to be conducted in the June to August timeframe, and the facility should be producing by the fourth quarter. As per customer requirements, Ceapro is required to operate both the old and new facility for six months to ensure steady flow of product.

Summary

Ceapro utilizes a proprietary plant extraction based manufacturing process to supply ingredients that are currently used in multiple household products in the personal care and cosmetics industries. We can find Ceapro ingredients inside well-known branded products like Aveeno, Burts Bees, and Nexxus. Ceapro's active ingredients are manufactured from proprietary oat varieties and various natural sources grown in many regions around the globe, with extra focus being placed on Canadian crops. The company's flagship product, avenanthramides (AVA), in addition to its value driver, beta glucan, are two oat-derived compounds that make up the core of Ceapro's product base. Ceapro is the only worldwide commercial manufacturer of natural AVA.

Over the last ten years, the main priority of the company has been to provide novel, natural, environmentally friendly ingredients to cosmetic and personal care product manufacturers and developers of human and animal therapeutics. Ceapro extracts are currently used in the cosmeceutical (cosmetics that have medicinal or drug-like effects) market, with the hope for entry into the pharmaceutical and nutraceutical (derived from food sources that purport health benefits such as vitamins, minerals, herbals, and functional foods and beverages) sectors in the relative near term. The company has plans to involve a steady pipeline of innovative products for both the human and animal healthcare industries.

We continue to view the Ceapro strategy as promising, and believe there is potential to expand into the functional food/nutraceutical, and possibly the pharmaceutical markets. The PGX technology may be able to crossover into other industries and provide upside potential from licensing revenues. The U.S. patent for PGX technology that was issued on February 3, 2016 further strengthens Ceapro's patent portfolio. We think that Ceapro may have the opportunity to sub-license PGX technology to third parties and/or serve as a contract manufacturer. As per management, several multinational organizations in a variety of different industries have already executed confidentially agreements with Ceapro to assess their material with the proprietary PGX technology.

For the fiscal year 2015, Ceapro reported very strong revenue and earnings growth due to strong international demand for their products and improvements in feedstock yields that improved gross margins and leveraged fixed costs. The balance sheet is very strong due to debt and convertible issuances during the year and strong cash generation from operating activities. While the company may need to raise additional capital to complete the new manufacturing facility, it is also possible that internally generated funds alone may support the project. Although the company does have significant customer concentration, we believe its partnership with Symrise in particular, will assist them in selling the additional manufacturing capacity once the project is completed. We have not assumed any new sales in our model from the completion of the additional manufacturing capacity, and so this represents potential upside to the model.

Neither does our valuation model account for the commercialization of Ceapro's avenanthramides and/or beta glucan as pharmaceutical products. In the near future, we expect to see results from the studies and trials that are being conducted that support efficacy for treating high cholesterol and inflammation. If these potential candidates are eventually approved, we anticipate material upside to our Ceapro valuation.

Our target price is derived using a multiple of earnings ratio of 15x applied to 2016 earnings per share. Based on our revisions to the model, we increase our target price from C$0.65 to C$0.85 per share, and maintain our Buy rating.

PROJECTED FINANCIALS

Ceapro Inc. - Income Statement

Ceapro Inc.	2015 A	Q1 E	Q2 E	Q3 E	Q4 E	2016 E	2017 E	2018 E
Total Revenues	**$10.7**	**$2.8**	**$3.2**	**$3.4**	**$3.6**	**$13.0**	**$15.0**	**$17.2**
YOY Growth	*20%*	*63%*	*31%*	*10%*	*5%*	*22%*	*15%*	*15%*
Cost of goods sold	$3.6	$1.3	$1.4	$1.5	$1.6	$5.9	$6.6	$7.6
Product Gross Margin	*66%*	*55%*	*55%*	*55%*	*55%*	*55%*	*56%*	*56%*
R&D	$0.6	$0.3	$0.3	$0.3	$0.3	$1.2	$1.4	$1.8
G&A	$2.5	$0.7	$0.7	$0.7	$0.7	$2.6	$2.7	$2.8
S&M	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Finance costs	$0.2	$0.1	$0.1	$0.1	$0.1	$0.3	$0.3	$0.3
Income from operations	$3.6	$0.5	$0.7	$0.9	$1.0	$3.1	$4.0	$4.8
Operating Margin	*34%*	*19%*	*23%*	*25%*	*27%*	*24%*	*27%*	*28%*
Other operating loss	$0.2	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	$3.8	$0.5	$0.7	$0.9	$1.0	$3.1	$4.0	$4.8
Income Taxes Paid	($1.1)	($0.1)	($0.2)	($0.2)	($0.3)	($0.8)	($1.0)	($1.2)
Tax Rate	*-28%*	*26%*	*26%*	*26%*	*26%*	*26%*	*26%*	*26%*
Net Income	**$4.9**	**$0.7**	**$0.9**	**$1.1**	**$1.2**	**$3.9**	**$5.1**	**$6.0**
Net Margin	*46%*	*24%*	*29%*	*32%*	*34%*	*30%*	*34%*	*35%*
Reported EPS	**$0.08**	**$0.01**	**$0.01**	**$0.02**	**$0.02**	**$0.06**	**$0.07**	**$0.08**
YOY Growth	*196%*	*-410%*	*27%*	*19%*	*-66%*	*122%*	*27%*	*16%*
Basic Shares Outstanding	62.7	63.5	64.3	65.1	65.9	64.7	66.7	68.7
Diluted Shares Outstanding	65.2	67.6	68.4	69.2	70.0	68.8	70.8	72.8

Source: Company Filing // Zacks Investment Research, Inc. Estimates

DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, John Vandermosten, CFA, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESMENT BANKING, REFERRALS, AND FEES FOR SERVICE

Zacks SCR does not provide nor has received compensation for investment banking services on the securities covered in this report. Zacks SCR does not expect to receive compensation for investment banking services on the Small-Cap Universe. Zacks SCR may seek to provide referrals for a fee to investment banks. Zacks & Co., a separate legal entity from ZIR, is, among others, one of these investment banks. Referrals may include securities and issuers noted in this report. Zacks & Co. may have paid referral fees to Zacks SCR related to some of the securities and issuers noted in this report. From time to time, Zacks SCR pays investment banks, including Zacks & Co., a referral fee for research coverage.

Zacks SCR has received compensation for non-investment banking services on the Small-Cap Universe, and expects to receive additional compensation for non-investment banking services on the Small-Cap Universe, paid by issuers of securities covered by Zacks SCR Analysts. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, equity research, investment management, non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per client basis and are subject to the number of services contracted. Fees typically range between ten thousand and fifty thousand USD per annum.

POLICY DISCLOSURES

Zacks SCR Analysts are restricted from holding or trading securities placed on the ZIR, SCR, or Zacks & Co. restricted list, which may include issuers in the Small-Cap Universe. ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Each Zacks SCR Analyst has full discretion on the rating and price target based on his or her own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for services described above. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but are not guaranteed as to be accurate nor do we purport to be complete. Because of individual objectives, this report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.

ZACKS RATING & RECOMMENDATION

ZIR uses the following rating system for the 1251 companies whose securities it covers, including securities covered by Zacks SCR:
Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters.
Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 27.0%, Hold/Neutral- 51.0%, Sell/Underperform – 15.1%. Data is as of midnight on the business day immediately prior to this publication.