Zacks Small-Cap Research

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Ceapro Inc. (V.CZO - TSXV)

New Facility Opens, Topline Takes a Break.

Based on our forward looking multiple of earnings model and a 20x 2017 EPS multiple, CZO is valued at approximately C$1.75 per share.

Current Price (11/29/16)	$1.32
Valuation	**$1.75**

OUTLOOK

Ceapro Inc. manufactures two lead products which include beta glucan and avenanthramides, both natural ingredients that are derived from oats and are currently being used in products such as Aveeno, Burts Bees, and Nexxus.

The company also heralds its Pressurized Gas eXpanded (PGX) technology which allows for advanced conversion of liquids to powder, fiber or other solid.

CZO is expanding its capacity through the construction of a new 30,000 square foot GMP bio-processing extraction facility which is currently conducting validation trials.

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 reduce our price target from C$2.20 to C$1.75 per share maintaining our 20x target multiple on 2017 EPS.

SUMMARY DATA

52-Week High	**$2.47**
52-Week Low	**$0.34**
One-Year Return (%)	**189**
Beta	**4.62**
Average Daily Volume (sh)	**186,303**
Shares Outstanding (mil)	**73.2**
Market Capitalization ($mil)	**$96.6**
Short Interest Ratio (days)	**1.12**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**20.6**
Earnings Per Share (%)	**43.6**
Dividend (%)	**N/A**
P/E using TTM EPS	**15.3**
P/E using 2016 Estimate	**19.1**
P/E using 2017 Estimate	**15.1**
Zacks Rank	**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	$4.1 A	$4.2 A	$3.0 A	$3.5 E	$14.7 E
2017					$16.5 E
2018					$20.1 E

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	-$0.00 A	$0.01 A	$0.01 A	$0.03 A	$0.05 A
2016	$0.02 A	$0.02 A	$0.01 A	$0.01 E	$0.07 E
2017					$0.09 E
2018					$0.11 E

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WHAT'S NEW

Earnings Update

Ceapro Third Quarter Results

On November 23, 2016, Ceapro Inc. (TSXV: CZO) released third quarter 2016 revenues and earnings. On a year over year basis, sales fell by 2%, settling at $3.0 million (note that all currency herein is denominated in Canadian dollars). This was below our estimates of $4.3 million and lower than 2Q:16 sales of $4.2 million.

By geography, on a year over year basis, sales increases in the US and Canada were offset by declines in Germany, and other regions. Sequentially, substantial declines in Germany, China, Canada and other geographies, and a slight decline in the US led to a 28% sales contraction overall. Veterinary sales to China were $0 in the quarter, matching the prior year. The China segment comprises one buyer who is expected to fill their normal order in the fourth quarter. We note that Ceapro's distribution partner, Symrise, has sales attributed to Europe but also distributes Ceapro products beyond Europe's borders. The volatile movement in the topline overall was attributed to timing and unpredictable ordering patters for new customers.

Gross margins increased year over year but fell sequentially to 62.7%. This compares to 3Q:15 levels of 61.2% and 2Q:16 levels of 72.3%. The increase in year over year gross margin was attributable to favorable product mix.

General and administrative expense rose 1% year over year to $528 thousand, as increases in public company costs, travel and insurance were mostly offset by a decline in salary, benefits and board of director compensation. In the prior year, there was a large non-cash share-based payment granted to employees and officers, contributing to higher compensation costs.

Research and development totaled $265 thousand in the quarter up from $142 thousand in the same period during 2015. Higher salaries and other expenses attributable to the avenanthramides and beta glucan clinical programs were behind the increase. Work was also performed on Ceapro's PGX project, but was offset by grant funding. Expenses related to CeaProve were zero in 3Q:16 compared to $20,000 in 3Q:15 which was related to a patent renewal. In 2016, these expenses will be incurred in the fourth quarter.

Finance costs declined by 4% to $49 thousand due to lower interest expense on long term debt, partially offset by higher accretion expense related to the convertible bonds outstanding. Other operating loss was also lower on a year over year basis by 3% on foreign exchange movements, partially offset by higher plant relocation costs.

Cash levels increased over the prior quarter due to a private equity placement during the period. Cash and equivalents increased by $7.6 million as Ceapro issued equity shares of gross $10 million in the quarter. As of September 30, 2016 cash was $9.2 million. For the first nine months of 2016, Cash generated from operating activities was $4.1 million with the recognition of deferred revenue and an increase in receivables explaining the majority of the difference between this and the $5.1 million in net income earned during the period. Capital expenditures and leasehold improvements were ($4.3) million for the first nine months of 2016 compared to ($2.6) million in the prior year period with the increase attributable to expenditures related to the new bio-processing facility located in Edmonton. Share issuance costs and repayment of long-term debt reduced cash levels year to date by approximately ($1.6) million. Total debt carried on the balance sheet, including convertible debentures, fell sequentially from $4.0 million to $3.8 million.

2016 Estimates

We reduce our forecasts for 4Q:16 due to the slowdown in revenue growth in the third quarter and increased uncertainty in ordering patterns. Ceapro had seen substantial uptake of product sales in China in the first half, but sales to this geography slowed in the third quarter. Year to date, demand for natural products has been increasing as concerns over the impact of chemicals in products has pushed quality conscious consumers towards brands that use Ceapro inputs. Additionally, the increasingly consumer-oriented Asian markets, especially China, are using more health and beauty products, where quality commands a premium. To satisfy this demand growth, Ceapro opened its new bio-processing facility on September 28, and has processed the first commercial batches of oat extracts at the new facility.

The company is required by its agreements with customers to run both the old and new facilities simultaneously for the first six months and we currently expect validation trials to be completed by the end of 1Q:17. We forecast higher levels of utilization and more efficient processing to support year over year improvement in gross margin levels in 2016. When the new facilities are operating at normal capacity, we anticipate higher efficiencies, automation and throughput to support higher gross margin levels over the longer term.

Research and development costs are anticipated to increase slightly in 4Q:16 as clinical trials are launched for beta glucan (cholesterol reduction) and safety and bioavailability studies are conducted. We have forecasted $350,000 of expenses here for the last quarter of the year. General and administrative costs should decline slightly from 4Q:15 levels as the prior year saw relatively large non-cash share based compensation which is not expected to continue into 2016. Sales and marketing expenses are considered to be close to zero in 2016 as the company exclusively uses distributors for selling its product.

Recent Material Events

On September 28, 2016 Ceapro announced the grand opening of its new bio-processing extraction facility in Edmonton, Alberta which will use an ethanol recycling system, further enhancing the company's "Green" credentials. The new facility will also include a commercial and demonstration area for its PGX technology which was developed at the University of Alberta.

Ceapro was awarded the 2016 BioAlberta Achievement Award for Company of the Year which has provided additional visibility in the Canadian Biotechnology industry.

The company announced that it was awarded a research grant from the German-Canadian Centre for Innovation and Research of $250,000 to commercialize and advance Ceapro's PGX technology. A. Junghans GmbH and Fraunhofer will research and develop membranes to be used in the PGX process, and further commercialize them beyond their use with Ceapro. PGX also received allowance from the Canadian Patent Office for Canadian Patent Application Serial Number 2,794,960 which enables the technology. The patent title is "Supercritical Fluid Treatment of High Molecular Weight Biopolymers."

On July 14, 2016 Ceapro's appointed agent, Echelon Wealth Partners, closed the final tranche of a private placement of $10 million. A total of 9.4 million shares were issued at $1.06 and 4.7 million warrants were also issued with an exercise price of $1.50. 660,000 broker warrants were granted to Echelon at an exercise price of $1.06. Broker warrants also include another half warrant which total 330,000 shares at a strike price of $1.50. Given the sharp rise in the shares, all warrants are in the money and total dilution from this transaction is expected to be 15.1 million shares. Ceapro also paid Echelon 7% on gross proceeds yielding a $700,000 commission.

In early May, Ceapro's senior research scientist Bernard Seifried, Ph.D. presented the PGX Technology at the 15th European Meeting on Supercritical Fluids. His presentation, entitled "PGX Technology: An Enabling Technology for Generating Biopolymer Fibrils, Particles Aerogels and Nano-Composites," discussed the detail behind the Pressurized Gas eXpanded Liquid Technology describing the key advantages over conventional drying and purification technologies that can be used to process biopolymers into high-value, nano-sized polymer structures and novel bio-nanocomposites.

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 micro-encapsulation 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 upcoming milestones expected.

- Commence bio-efficacy study with avenanthramides as an anti-inflammatory compound in exercise induced inflammation Q4 2016;
- Complete the development of a prototype for a functional coenzyme Q-10 drink in Q4 2016; and
- Commence patient recruitment for pilot clinical study to develop beta glucan as a cholesterol reducer in Q1 2017.

PGX Research Programs Update

On May 20, 2014, Ceapro signed a Development and Licensing Agreement with the University of Alberta for the use of PGX. Ceapro intends to use PGX 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.

In November 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.

On September 21, 2016, Ceapro announced a $250,000 grant from the German-Canadian Center for Innovation and Research to advance the commercialization of PGX. The goal of the funding is to advance the sustainability of PGX by integrating an ethanol recycling system with the use of retention membranes developed by A. Junghans GmbH and Fraunhaufer IAP and Fraunhaufer IKTS.

Update on Avenanthramides Program

Ceapro's flagship product, avenanthramides (AVA), 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 the University of Minnesota, comparing low-dose vs. high-dose AVA which has now completed. Ceapro expects the study results to be published in a journal, the name of which is yet to be announced. Management believes that this bioavailability study will pave the way for future clinical study protocols, and is currently conducting a bioefficiency study also at the University of Minnesota. The study is examining exercise-induced inflammation and is orally administering the active ingredient in this dose finding effort.

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 studies to assess high purity beta glucan when taken orally and will conduct a pilot clinical trial program on cholesterol reduction beginning 4Q:16. Expenditures in the third quarter related to this program were to develop the protocol and prepare the material for the pharmaceutical development stage. The 200 enrollee, year-long study is expected to begin in 1Q:17 and should provide a topline readout by

mid-2018. There is currently a library of research that supports the health beneifts of beta glucan and many regulatory agencies in Canada, the US, Australia, the EU and New Zealand already recognize the benefits of the soluble fiber, which should provide for a low-risk approval following the studies.

Bio-Processing Extraction Facility Currently in Commissioning

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. As a result, Ceapro is added 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 the facility was opened in September 2016. Management anticipates product that meets all specifications to be available by year end.

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. In the legacy facility, 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 government-owned bio-incubator currently used. The first validation batch trials are in process, and the facility is expected to produce 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 and we expect this requirement to be met by then end of 1Q:17.

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. The company's flagship product, avenanthramides, and its value driver, beta glucan, are two oat-derived compounds that make up the core of Ceapro's product line. 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.

Ceapro has been able to generate strong earnings growth through a combination of accelerating topline and improving margins. We believe there is potential to expand into the functional food/nutraceutical, and possibly the pharmaceutical markets, augmenting the current organic growth the company has achieved through its distributors over the last few years. The PGX technology may be able to cross over into other industries and provide upside potential from licensing revenues. The U.S. patent for PGX technology that was issued earlier this year 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.

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 assumed only modest growth in 2017 and 2018 compared to levels achieved over the last several years despite the completion of the additional manufacturing capacity.

Our valuation model does not include revenues for the commercialization of Ceapro's avenanthramides or beta glucan as pharmaceutical products; however, we employ a 20x forward multiple to recognize the strong earnings growth from current sales channels and to anticipate continued growth beyond the forecast period from the several programs currently incubated. 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 an increase to our sales and earnings estimates.

Our target price is derived using a 20x multiple of earnings ratio applied to 2017 earnings per share of $0.09. Our selection of the 20x multiple was discussed in depth in our 2Q:16 report. Based on our revisions to the model and multiple, we modify our target price to $1.75 per share.

PROJECTED FINANCIALS

Ceapro Inc. - Income Statement

Ceapro Inc.	2012 A	2015 A	Q1 A	Q2 A	Q3 A	Q4 E	2016 E	2017 E	2018 E
Total Revenues	**$5.2**	**$10.7**	**$4.1**	**$4.2**	**$3.0**	**$3.5**	**$14.7**	**$16.5**	**$20.1**
YOY Growth	*-11%*	*20%*	*137%*	*71%*	*-2%*	*2%*	*38%*	*12%*	*22%*
Cost of goods sold	$2.7	$3.6	$1.2	$1.2	$1.1	$1.4	$4.9	$5.0	$6.0
Product Gross Margin	*47%*	*65.9%*	*69.7%*	*72.3%*	*62.7%*	*60.0%*	*66.7%*	*70.0%*	*70.0%*
R&D	$0.9	$0.6	$0.3	($0.1)	$0.3	$0.4	$0.9	$1.3	$1.4
G&A	$1.8	$2.5	$0.5	$0.5	$0.5	$0.5	$2.1	$2.2	$2.2
S&M	$0.2	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Finance costs	$0.1	$0.2	$0.1	$0.0	$0.0	$0.1	$0.3	$0.3	$0.3
Income from operations	($0.5)	$3.6	$1.9	$2.5	$1.1	$1.1	$6.6	$7.8	$10.2
Operating Margin	*-10%*	*34%*	*47%*	*60%*	*35%*	*33%*	*45%*	*47%*	*51%*
Other operating loss	($0.0)	$0.2	($0.2)	($0.1)	($0.2)	$0.0	($0.5)	$0.0	$0.0
Pre-Tax Income	($0.5)	$3.8	$1.7	$2.4	$0.9	$1.1	$6.1	$7.8	$10.2
Income Taxes Paid	$0.0	($1.1)	$0.5	$0.7	$0.2	$0.2	$1.7	$1.6	$2.0
Tax Rate	*0%*	*-28%*	*30%*	*31%*	*20%*	*20%*	*28%*	*20%*	*20%*
Net Income	**($0.5)**	**$4.9**	**$1.2**	**$1.6**	**$0.6**	**$0.9**	**$4.4**	**$6.3**	**$8.1**
Net Margin	*-10%*	*46%*	*30%*	*39%*	*21%*	*26%*	*30%*	*38%*	*40%*
Reported EPS	**($0.01)**	**$0.08**	**$0.02**	**$0.02**	**$0.01**	**$0.01**	**$0.06**	**$0.09**	**$0.11**
YOY Growth	*-187%*	*196%*	*-687%*	*128%*	*-46%*	*-76%*	*143%*	*41%*	*30%*
Adjusted EPS		**$0.05**	**$0.02**	**$0.03**	**$0.01**	**$0.01**	**$0.07**	**$0.09**	**$0.11**
YOY Growth	*#DIV/0!*	*85%*	*-806%*	*229%*	*-25%*	*-56%*	*171%*	*27%*	*30%*
Basic Shares Outstanding	60.28	62.7	62.6	62.9	71.8	72.6	67.4	68.4	68.4
Diluted Shares Outstanding		65.2	65.7	66.5	76.6	75.7	71.1	71.5	71.5

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

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HISTORICAL STOCK PRICE

Ceapro Inc. - (TSXV: CZO)



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