Zacks Small-Cap Research

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Ceapro Inc. (V.CZO - TSXV)

In-line 4Q:17 Revenues; PGX Advancing

Based on our forward looking multiple of earnings model and a 20x 2018 EPS multiple, CZO is valued at approximately C$1.70 per share.

Current Price (6/5/17)	$1.10
Valuation	**$1.70**

OUTLOOK

Ceapro Inc. manufactures two main 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, Coppertone and Neutrogena.

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

CZO has expanded its capacity through the construction of a new 30,000 square foot GMP bio-processing extraction facility which has completed its 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.

SUMMARY DATAt

52-Week High	**$2.47**
52-Week Low	**$0.90**
One-Year Return (%)	**-12.0**
Beta	**4.77**
Average Daily Volume (sh)	**177,671**
Shares Outstanding (mil)	**75.4**
Market Capitalization ($mil)	**$82.9**
Short Interest Ratio (days)	**4.41**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**18.8**
Earnings Per Share (%)	**37.8**
Dividend (%)	**N/A**
P/E using TTM EPS	**26.3**
P/E using 2017 Estimate	**22.7**
P/E using 2018 Estimate	**12.0**
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)
2016	$4.1 A	$4.2 A	$3.0 A	$2.4 A	$13.7 A
2017	$3.2 A	$4.1 E	$3.9 E	$4.1 E	$15.3 E
2018					$19.0 E
2019					$22.8 E

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	$0.02 A	$0.03 A	$0.01 A	$0.00 A	$0.05 A
2017	$0.00 A	$0.02 E	$0.02 E	$0.02 E	$0.05 E
2018					$0.09 E
2019					$0.12 E

*Earnings adjusted for normalized tax rate

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WHAT'S NEW

Earnings Update

Ceapro First Quarter 2017 Results

On May 17, 2017, Ceapro Inc. (TSXV: CZO) posted financial and operational results and filed interim statements for the first quarter of 2017. Revenues during the period were $3.2 million and matched our estimates. Due to lower gross margin and higher operating expenses, earnings of $18 thousand or $0.00 per share fell below our predictions of $0.9 million or $0.01 per share. These results compare to first quarter 2016 revenues of $4.1 million and per share earnings of $0.02.

On a year over year basis, increases in US sales were offset by declines in Germany, China and Other regions, representing an $881 thousand contraction. While overall revenues were down 22%, product sales volumes fell by 15% due to lower unit prices, lower sales of beta glucan and a lower U.S. dollar compared to the Canadian dollar.

Gross margins for 1Q:17 fell to 53.8% compared to 69.7% in 1Q:16 and 66.5% in 4Q:16. Lower gross margins were attributable to a number of factors including greater labor costs to support operating two facilities simultaneously as well as training for new personnel and for operators at the new facility. Higher feedstock costs also increased cost of goods sold as did increased utilities and maintenance spend. Fixed costs of goods sold were spread over a smaller unit base also contributing to a lower margin. Ceapro is navigating a transition from their incubator manufacturing plant to their newly constructed facility and this has led to additional time allocated to commissioning and validation activities, thereby limiting production volumes. Sales mix was also unfavorable, with sales of higher margin beta glucan falling and avenanthramides rising.

General and administrative expense rose 69% to $0.8 million due to higher salaries and stock option grants and an increase in CEO compensation. Other contributors included higher communications costs, higher regulatory fees, partially offset by lower board of director compensation, a decrease in share-based payment expense and lower travel and legal fees.

Research and development totaled $596,000 in the first quarter, representing an 82% increase over levels a year ago. Studies related to the beta glucan and avenanthramides programs contributed to costs as did hiring of more R&D staff over the last year. Government funding offsets were also lower on a year over year basis, increasing recognized salaries and benefits expense. Note that amounts spent for R&D reflect a net value partially offset by investment tax credits.

Finance costs decreased by 20% to $78,000, relating to the absence of a $19,000 accretion charge recognized in the prior year. Other operating loss increased by 3%, predominantly due to expenditures related to continued implementation costs for a quality management system.

Cash and equivalents as of March 31, 2017 were $7.8 million, down from $9.8 million at the end of 2016. Cash burn consumed ($1.0) million as receivables balances increased, capital expenditures increased and leasehold improvements continued.

Pressurized Gas Expanded (PGX)

In a June 1st release, Ceapro announced several achievements regarding its Pressurized Gas Expanded (PGX) enabling technology. This follows the recent successes in the combination of beta glucan (BG) with coenzyme Q10 (CoQ10). Employing PGX technology, the two substances were combined into a chemical complex which were tested in a functional drink.

A new program, which is being conducted in conjunction with the University of Alberta with $332,000 of funding provided by the Natural Sciences and Engineering Research Council of Canada, will study the addition of other products combined into bio-delivery systems. This study will explore the potential for a variety of biopolymers and bioactives and may expand into such as avenanthramides, fat soluble vitamins such as D and E and proteins such as monoclonal antibodies. The initial goal of the program will be to determine the bioavailability of the CoQ10 and BG complex. Other goals include testing whether the complex will achieve the anticipated health benefits and

observing cholesterol and other biomarkers for support of BG as cholesterol reducer. This work will take place at the company's new manufacturing facility

The specific objectives for the CoQ10-BG research include:

- Determining the direct *in vivo* intestinal bioavailability of the compound in a rodent model
- Evaluating the plasma pharmacokinetics using a rodent model
- Determine bioactivity effects under high dietary fat conditions
- Assessing plasma pharmacokinetics of different foods in human trials

The company is targeting the completion of the first two animal studies before year end 2017. This will provide data for discussions with global distributors.

Estimates

First quarter revenues were in-line with our expectations, however, due to higher than expected transition expenses gross margins fell below our forecasts. We maintain our revenue forecasts but reduce gross margin rate for 2017. We also raise R&D to reflect higher costs for beta glucan and avenanthramides clinical trials. Despite the year over year revenue decline in recent quarters, we see demand for natural products increasing as concerns over the impact of chemicals in products has motivated quality conscious consumers towards brands that use Ceapro inputs. Additionally, new uses and market expansion into exercise induced inflammation and cholesterol control support additional growth as the benefits of beta glucan and avenanthramides become clear. To satisfy this demand growth, Ceapro opened its new bio-processing facility in September 2016, 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 six months following the completion of validation trials. We believe the trials were completed in April, implying a September or October 2017 exit from the old facility. We forecast higher levels of utilization and more efficient processing in support of improved gross margin levels in future quarters. When the new facilities are operating at normal capacity, we anticipate higher efficiencies, automation and throughput to support a further improvement of gross margin levels over the longer term.

Research and development costs are anticipated to increase in 2017 as clinical trials ramp up for beta glucan (cholesterol reduction) and safety and bioavailability studies are conducted for avenanthramides (inflammation). General and administrative costs are expected to show a modest increase in 2017 and sales and marketing expenses will continue to be close to zero going forward as the company exclusively uses distributors to sell its product.

Recent Material Events

- Holders of $960,000 of convertible debentures converted their instruments into common shares at $0.64 per share at year end 2016. 1.5 million common shares were issued to convertible holders to reflect the conversion as described in a January 4, 2017 press release.
- Completion of two studies related to CoQ10 energy drink and first commercial application of PGX technology for combining beta glucan and CoQ10 for increased bioavailability. Additional detail available in our note from May 8.
- Company holds its Annual General and Special Meeting of Shareholders June 1st and presents updates to its PGX efforts.

Upcoming Milestones

- Provide readout on bioavailability study for avenanthramides inflammation indication
- Complete the development of a prototype for a functional coenzyme Q-10 drink in 2017
- Commence patient recruitment for 18-month pilot clinical study to develop beta glucan as a cholesterol reducer in 2017
- Launch additional PGX studies for CoQ10, beta glucan and other compounds

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 been completed. The study has been submitted for publication.

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 which is expected to provide results in 3Q:17. The study is examining exercise-induced inflammation and is orally administering the active ingredient in this dose finding effort.

This program could potentially provide a food additive product with sales in 2018 and a concentrated pill form in 2022, following a registrational trial and regulatory approval. Inflammation is a wide-ranging condition, and a clinically proven solution for it could attract substantial demand.

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. The company is also working on using its PGX technology along with beta glucan as a carrier for CoQ10 to improve bioavailability in a functional drink.

Ceapro developed the protocol and prepared the material for the pharmaceutical development stage in the second half of 2016 for its cholesterol reducing product. An 18 to 24-month study is expected to begin in early 3Q:17 and should provide a topline readout in 2019. 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.

If clinical trials are able to show a substantial reduction in cholesterol levels, Ceapro will be able to carve out a piece of the US$6+ billion statin market for itself. Even access to a small fraction of this market would provide a revenue stream many multiples of current sales levels.

As mentioned above, the company has already successfully conducted two studies combining beta glucan with CoQ10 and testing for consumer appeal. The next step for this program is to test for bioavailability in humans then partner with a multinational company for commercialization.

Bio-Processing Extraction Facility in Final Stages of Validation

Ceapro's new manufacturing facility, which will host all of Ceapro's enabling technologies under one roof, was opened in September 2016. The facility has passed the commissioning stage and was expected to complete the final validation stages in 2Q:17. Management anticipates that following validation, its product will meet all specifications in this GMP-certified plant.

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 previous plant. 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 near the end of 3Q:17.

Summary

Our model does not include an explicit valuation component for the commercialization of Ceapro's PGX technology, CoQ-10 functional drink, avenanthramides or beta glucan as pharmaceutical products; however, we employ a 20x forward multiple on 2018 EPS to recognize the strong earnings growth from current sales channels and to anticipate continued growth beyond the forecast period from the currently incubated programs. 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 applied to 2018 EPS of $0.085. Our selection of the 20x multiple was discussed in depth in our 2Q:16 report. Our target price remains $1.70 per share.

PROJECTED FINANCIALS

Ceapro Inc. - Income Statement

Ceapro Inc.	2016 A	Q1 A	Q2 E	Q3 E	Q4 E	2017 E	2018 E	2019 E
Total Revenues	**$13.7**	**$3.2**	**$4.1**	**$3.9**	**$4.1**	**$15.3**	**$19.0**	**$22.8**
YOY Growth	*28%*	*-22%*	*-2%*	*29%*	*69%*	*12%*	*24%*	*20%*
Cost of goods sold	$4.3	$1.5	$1.8	$1.5	$1.5	$6.2	$5.9	$6.8
Product Gross Margin	*68.4%*	*53.8%*	*57.0%*	*62.0%*	*64.0%*	*59.5%*	*69.0%*	*70.0%*
R&D	$0.9	$0.6	$0.3	$0.3	$0.3	$1.5	$1.4	$1.4
G&A	$2.2	$0.8	$0.5	$0.6	$0.6	$2.5	$2.6	$2.7
S&M	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Finance costs	$0.2	$0.1	$0.0	$0.0	$0.0	$0.2	$0.2	$0.2
Income from operations	$6.0	$0.2	$1.5	$1.5	$1.7	$4.9	$8.9	$11.7
Operating Margin	*44%*	*6%*	*35%*	*39%*	*42%*	*32%*	*47%*	*51%*
Other operating loss	($0.6)	($0.2)	$0.0	$0.0	$0.0	($0.2)	$0.0	$0.0
Pre-Tax Income	$5.4	$0.0	$1.5	$1.5	$1.7	$4.7	$8.9	$11.7
Income Taxes	$1.7	($0.0)	$0.4	$0.4	$0.5	$1.3	$2.4	$3.1
Tax Rate	*33%*	*27%*	*27%*	*27%*	*27%*	*27%*	*27%*	*27%*
Net Income	**$3.6**	**$0.0**	**$1.1**	**$1.1**	**$1.2**	**$3.4**	**$6.5**	**$8.5**
Net Margin	*26%*	*1%*	*26%*	*28%*	*30%*	*22%*	*34%*	*37%*
Reported EPS	**$0.05**	**$0.00**	**$0.01**	**$0.01**	**$0.02**	**$0.04**	**$0.08**	**$0.11**
YOY Growth	*99%*	*-99%*	*-44%*	*70%*	*881%*	*-12%*	*88%*	*29%*
Adjusted EPS	**$0.06**	**$0.00**	**$0.02**	**$0.02**	**$0.02**	**$0.05**	**$0.09**	**$0.12**
YOY Growth	*136%*	*-99%*	*-47%*	*68%*	*347%*	*-19%*	*89%*	*29%*
Basic Shares Outstanding	67.7	75.2	75.4	75.6	75.7	75.5	76.0	77.0
Diluted Shares Outstanding	71.3	76.8	77.1	77.3	77.4	77.1	77.7	78.7

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

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HISTORICAL STOCK PRICE

Ceapro Inc. - (TSXV: CZO)[1]



[1] Source: Google Finance

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