

# Zacks Small-Cap Research

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## Presidio Property Trust (SQFT-NASDAQ)

### SQFT: Continuing to Advance Model Home Strategy & Extend Debt Maturities

Presidio continued to refresh its real estate portfolio in 1H22, acquiring 8 model homes & divesting 18 for an aggregate gain of about \$3.0M. SQFT collected 98% of total tenant billings, including 100% collections in the model home category. SQFT signed 16 leases in 1H22 – nine renewals & seven with new tenants, including one with DISH Wireless in San Diego, which raised the building occupancy to 96%.

### OUTLOOK

SQFT has extended its debt maturities, with no major debt maturities before mid-2024. With cash & equivalents and restricted cash of \$21.1M, SQFT has the financial flexibility to add new assets to the portfolio, we believe. However, given the interest rate environment and real estate prices, it would not surprise us if acquisition activity slowed in the near-term. Separately, MURF, the company's sponsored special purpose acquisition company (SPAC), continues to evaluate potential acquisition candidates, which gives SQFT exposure to the potential upside of MURF's valuation.

Current Price (8/30/22) \$3.09  
Valuation \$6.25

### SUMMARY DATA

52-Week High \$4.27  
52-Week Low \$2.77  
One-Year Return (%) -11.89  
Beta N/A  
Average Daily Volume (sh) 43,465

Shares Outstanding (mil) 12  
Market Capitalization (\$mil) \$38  
Short Interest Ratio (days) N/A  
Institutional Ownership (%) 10  
Insider Ownership (%) 8

Annual Cash Dividend\* \$0.42  
Dividend Yield (%) 14.00

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 2022 Estimate N/A  
P/E using 2023 Estimate N/A

Risk Level N/A,  
Type of Stock Small-Value  
Industry Real Estate

### ZACKS ESTIMATES

#### Revenue

(in millions of \$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	7 A	7 A	7 A	7 A	29 A
2020	7 A	6 A	6 A	6 A	24 A
2021	6 A	5 A	4 A	4 A	19 A
2022	5 A	4 A	5 E	5 E	18 E

#### Per Share Earnings / Loss

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	-\$0.10 A	-\$0.14 A	\$0.27 A	-\$0.10 A	-\$0.07 A
2020	-\$0.12 A	-\$0.22 A	-\$0.20 A	-\$0.31 A	-\$0.85 A
2021	-\$0.28 A	\$0.08 A	-\$0.13 A	-\$0.14 A	-\$0.46 A
2022	-\$0.32 A	-\$0.07 A	-\$0.16 E	-\$0.11 E	-\$0.66 E

Quarters might not sum due to rounding & share counts

Disclosures on page 9

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## KEY POINTS

### SQFT continues to advance its model home strategy, seek potential IBC candidates for MURF

- Presidio continued to refresh its real estate portfolio during 1H22, acquiring eight model homes during the period and divesting 18 model homes to generate an aggregate gain of about \$3.0M. The company also sold World Plaza for roughly \$10.0 million, incurring a roughly \$0.3M loss.
- The company collected 98% of total tenant billings, including 100% collections in the model home category. Presidio signed 16 office, retail, and industrial leases in 1H22, of which seven were with new tenants and nine were renewals with existing tenants.
- SQFT signed a new lease with DISH Wireless at its Genesis Plaza office building in San Diego and began tenant improvements for DISH. This new lease raised the occupancy at Genesis Plaza to 96%. The company believes this reflects strong leasing demand and activity across its overall real estate portfolio.
- SQFT has fully repaid its loan on its 300 NP office property in North Dakota, maintaining its strategy of opportunistically deleveraging the balance sheet. With this repayment, SQFT eliminated 2022 debt maturities and has no major debt maturities before mid-2024. The company had cash & equivalents and restricted cash of \$21.1 million at the end of 1Q22, up from \$14.7 million at year-end 2021.
- The company's strategy to strengthen its balance sheet enables SQFT to focus on growing and upgrading its real estate portfolio, depending on market conditions. However, given the interest rate environment and higher real estate prices, it would not surprise us if acquisition activity slowed in the near-term.
- Separately, SQFT's sponsored special purpose acquisition company (SPAC), Murphy Canyon Acquisition Corp. (MURF), is evaluating potential acquisition candidates in the real estate industry and targets its initial business combination (IBC) within the first year following its 1Q22 IPO, depending on market conditions.

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## RECENT RESULTS

### 2Q22 Highlights; Revenue & FFO declines reflect 2021 asset sales, costs associated with SPAC opportunity

San Diego, California-based Presidio Property Trust (NASDAQ: SQFT), an internally managed real estate investment trust (REIT) that is transitioning its real estate portfolio towards higher growth / high margin assets, recently reported 2Q22 results. Momentum the company has recorded in earlier quarters continued in terms of improved occupancy rates and lease activities. However, reflecting the absence of rental revenue from properties divested post-2Q21 and expenses associated with the company's SPAC opportunity (see below), revenue and operating results were lower year-over-year. Presidio reported total 2Q22 revenue of \$4.3 million compared to \$4.8 million in 2Q21. The roughly 11% revenue decline mainly reflected the absence of rental revenue associated with commercial properties and model homes that were sold in 2021. At the end of 2Q22, SQFT had about \$119.9 million in net real estate assets, compared to about \$126.3 million at the end of 2Q21.

Operating expenses also fell due to the smaller real estate portfolio. Total operating expense was \$3.9 million compared to \$4.2 million. However, operating expenses as a percentage of total revenue increased (from 86.6% to 89.8%), primarily reflecting additional G&A expenses related to the Murphy

Canyon Acquisition Corp. opportunity (see below). As a result, the company's operating margin was 10% compared to 13% in 2Q21.

Interest expense fell 10%, reflecting the 2021 sale of commercial properties and elimination of related mortgages. Strengthening the balance sheet remains a core objective for Presidio. The company recorded a roughly \$1.2 million gain on the sale of seven model homes sold in 2Q22. This compares to a gain on asset sales recorded in the prior year quarter for 12 model homes and two commercial properties divested, which yielded an aggregate roughly \$2.6 million. The company reported a net loss of about (\$830,000) and a loss per share of (\$0.07) compared to net income of about \$754,000 and EPS of \$0.08 in 2Q21. FFO (funds from operations) was roughly (\$46,000) compared to \$456,000. The swing to negative FFO primarily related to the higher G&A expenses associated with Murphy Canyon Acquisition Corp. activities.

### ... Underlying operating improvements

The company collected 98% of rental billings in 2Q22, including a 100% collections rate in the key model home segment of the real estate portfolio. Presidio also signed 16 office, retail, and industrial leases in 2Q22. Of these, seven leases were with new tenants; nine existing tenants renewed their leases during the quarter, as well. Year to date in 2022, Presidio has signed 32 leases, of which roughly 40% have been with new tenants and the 60% balance have been renewals with existing tenants.

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## REAL ESTATE PORTFOLIO UPDATES

### Portfolio shifts towards high-growth, higher-margin properties

SQFT is proactively managing its real estate portfolio to maximize portfolio value, disposing and acquiring assets at times that management deems appropriate. Overall, the company continues to transition its real estate portfolio towards properties that have solid rental revenue prospects and margins. For example, subsequent to 2Q22, the company purchased a single tenant triple net (NNN) property in Houston, Texas in August 2022, for roughly \$4.9 million. Houston is a rapidly-growing market. The property is a newly-built single story 10,500 square foot building that is completely occupied under a 15-year NNN lease.

### 1H Acquisitions & Dispositions

2022:

Dispositions

- World Plaza on March 11, 2022, for about \$10.0M – resulted in a loss of roughly \$0.3 million
- 18 model homes for about \$10.0M – generated a gain of about \$3.0M

Acquisitions

- Eight model homes for about \$4.6M – paid through cash of roughly \$1.4M & mortgage notes of about \$3.2M

2021:

Dispositions

- Waterman Plaza on January 28, 2021, for about \$3.5M – resulted in a loss of about \$0.2M
- Garden Gateway on February 19, 2021, for about \$11.2M – a loss of about \$1.4M
- Highland Court on May 20, 2021, for about \$10.2M – a loss of about \$1.6M
- Executive Office Park on May 21, 2021, for about \$8.1M – resulted in a gain of about \$2.5M
- 32 model homes for about \$15.1M – a gain of about \$2.3M

Source: Company reports

As Presidio continues to refresh and upgrade its real estate portfolio, the company is interested in expanding the model home segment of its real estate portfolio, as well as the commercial properties segment. SQFT acquired eight new model homes during the first half of 2022. The company's strategy to grow its model home portfolio is to expand into markets that are supported by university and hospital campuses.

Reflecting recent equity raised and refinancings, SQFT ended 2Q22 with about \$21.1 million in cash. SQFT's objective is to add new commercial properties to its portfolio to expand this real estate segment. However, reflecting the interest rate environment and higher real estate prices in both the commercial and residential real estate categories, it might be difficult to find new properties that are appropriately priced in the near-term.

The company signed a new lease with DISH Wireless LLC at its Genesis Plaza office building in San Diego, California in 2Q22 and began tenant improvement constructions for DISH. The addition of DISH to the Genesis Plaza tenant base, with DISH leasing 6,000+ square feet there, raised the occupancy at Genesis Plaza to 96%. The company believes this reflects strong leasing demand and activity across its overall real estate portfolio.

## BALANCE SHEET STRENGTHENING

The company's strategy to strengthen its balance sheet enables SQFT to focus on growing and upgrading its real estate portfolio. However, potential acquisitions depend on market conditions and given the current interest rate environment, the company intends to remain opportunistic regarding acquiring new real estate assets.

SQFT fully repaid its loan on the 300 NP office property located in Fargo, North Dakota, maintaining its strategy of opportunistically deleveraging the balance sheet. With the repayment of this debt, SQFT eliminated 2022 debt maturities. The company has no major debt maturities before mid-2024 when the debt on Dakota Center matures.

### Presidio Mortgage Notes Payable on Commercial Properties (as of June 2022)

	<i>Principal as of</i>		<i>Maturity</i>	<i>Interest</i>
Mortgage note property	<u>2Q22</u>	<u>YE21</u>		<i>Rate %*</i>
300 N.P. (2)	-	2,232,923	6/11/2022	4.95
Dakota Center	9,560,814	9,677,108	7/6/2024	4.74
Research Parkway	1,677,119	1,705,438	1/5/2025	3.94
Arapahoe Service Center	7,687,042	7,770,887	1/5/2025	4.34
Union Town Center	8,099,754	8,173,568	1/5/2025	4.28
One Park Centre	6,220,286	6,276,849	9/5/2025	4.77
Genesis Plaza	6,112,415	6,168,604	9/6/2025	4.71
Shea Center II	17,362,510	17,494,527	1/5/2026	4.92
West Fargo Industrial <sup>(6)</sup>	4,089,833	4,148,405	8/5/2029	3.27
Grand Pacific Center <sup>(3) (4)</sup>	3,558,614	3,619,695	8/1/2037	4.02
Baltimore	5,670,000	-	4/6/2032	4.67
Mandolin	<u>3,665,201</u>	-	4/20/2029	4.35
Presidio commercial properties	73,703,588	67,268,004		

Source: Company [10Q](#)

\* As of June 30, 2022

The company's commercial properties had fixed-rate mortgage notes payable aggregating to \$73.7 million with a weighted-average interest rate of roughly 4.53% at the end of 2Q22. SQFT's debt to the estimated market value of these assets is about 60%, according to the company. SQFT had cash & equivalents and restricted cash of \$21.1 million at the end of 2Q22, as noted, up from \$14.7 million at year-end 2021.

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## SPAC OPPORTUNITY

### Murphy Canyon Acquisition Corp.

Separately, SQFT has sponsored a special purpose acquisition company (SPAC), Murphy Canyon Acquisition Corp. (MURF), which is a blank check company that trades on the NASDAQ (currently under the ticker MURFU). MURF is designed to facilitate a merger or form of business combination with one or more businesses. SQFT currently is seeking and evaluating target companies that have interest in merging with MURFU. Given management's experience and expertise, the company plans to focus on identifying businesses operating in some capacity in the real estate industry.

The MURF IPO raised \$132.3 million through the issuance of units consisting of one share and one warrant for \$10.00 per unit. Each warrant entitles the holder thereof to purchase one share of our Class A common stock at a price of \$11.50 per share. If SQFT cannot complete a business combination within 12 months from the closing of MURFU's IPO, this offering, SQFT will redeem all MURF shares. The MURF IPO was over-subscribed and the green shoe was fully executed for an additional 1.725 million units.

Through a subsidiary, SQFT is the sponsor of Murphy Canyon Acquisition Corp. and purchased about 3.2 million founder shares, which equates to roughly 23.5% of MURF shares outstanding. The company had ample liquidity for this transaction; SQFT ended 3Q21 with \$27.8 million in cash, cash equivalents and restricted cash compared to \$11.5 million at year-end 2020. The company intends to use the net proceeds from the above-noted offerings to potentially acquire additional properties, as well as for working capital and for other general corporate purposes. SQFT thereby retains exposure to participate in the potential upside of MURF shares.

Murphy Canyon began to evaluate potential acquisition candidates in the real estate industry immediately after the IPO. Potential candidates include construction, homebuilding, real estate owners and operators, among other related companies. The goal is for Murphy Canyon to complete its initial business combination (IBC) within the first year of its IPO, depending on market conditions.

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## VALUATION

### Core Business Opportunity

We are optimistic that SQFT can continue to manage its property portfolio to produce attractive returns. As the company continues to transition its portfolio away from retail and into attractive commercial and industrial and model home properties, we estimate resumed steady growth commencing in approximately 2022 – 2023.

We value SQFT on a price-to forward FFO basis. We estimate FFO of \$3.5 million in 2022. We think the current share price at this level does not fully reflect the fundamental value of the company's portfolio, particularly as SQFT continues to shift into properties that management believes are more attractive. At \$6.25 in the near-term, the shares would trade at a multiple of roughly 16x our forward FFO forecast, which is a multiple that many other REITS command.

As the portfolio reaches the targeted property type composition and the economy stabilizes, we believe SQFT can achieve steady FFO growth in the 20% to 25% range, consistent with historical trends, and we would anticipate further share price appreciation. While a longer than currently anticipated economic downturn represents a potential risk to our valuation, we believe the risk / reward ratio could be attractive for investors who have a higher than average risk tolerance and longer time horizon.

## SPAC Opportunity

Given the company's stake in MURF, if SQFT successfully finds a target real estate company to leverage the MURF SPAC, the company stands to benefit through the upside valuation of its holding in MURF. We have not included that in our valuation at the moment. However, as the company continues to hit milestones related to this transaction, we would expect SQFT shares to begin to reflect some of this potential upside. Upcoming milestones that we expect include the expected announcement of a business combination target and the subsequent shareholder proxy vote.

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## RECENT NEWS

- SQFT reported 2Q22 results on August 11, 2022.
- Presidio announced that DISH Wireless had signed a lease in its San Diego office building on June 15, 2022.
- SQFT reported 1Q22 results on May 16, 2022.
- The company announced the closing of the SPAC offering on February 7, 2022, coincident with the closing of Murphy Canyon Acquisition Corp.'s \$132.25 million IPO.
- Murphy Canyon Acquisition Corp. announced the full exercise of the underwriters' over-allotment option on February 4, 2022.
- On January 24, 2022, Presidio issued a special warrant dividend to trade under the symbol SQFTW.
- Presidio announced the closing of its \$10 million registered direct equity offering on July 14, 2021.

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## RISKS

Risks to SQFT achieving its objectives, and to our valuation, include the following.

- Another economic downturn.
- A decrease in real estate values could have a negative impact on SQFT's portfolio.
- Competition from other REITs and/or property developers could increase.
- A default by one of SQFT's tenants could have a negative impact on FFO.
- The company's might need to raise additional capital sooner than management anticipates.
- Rising interest rates could impact the company's ability to grow its real estate portfolio.

## PROJECTED FINANCIALS

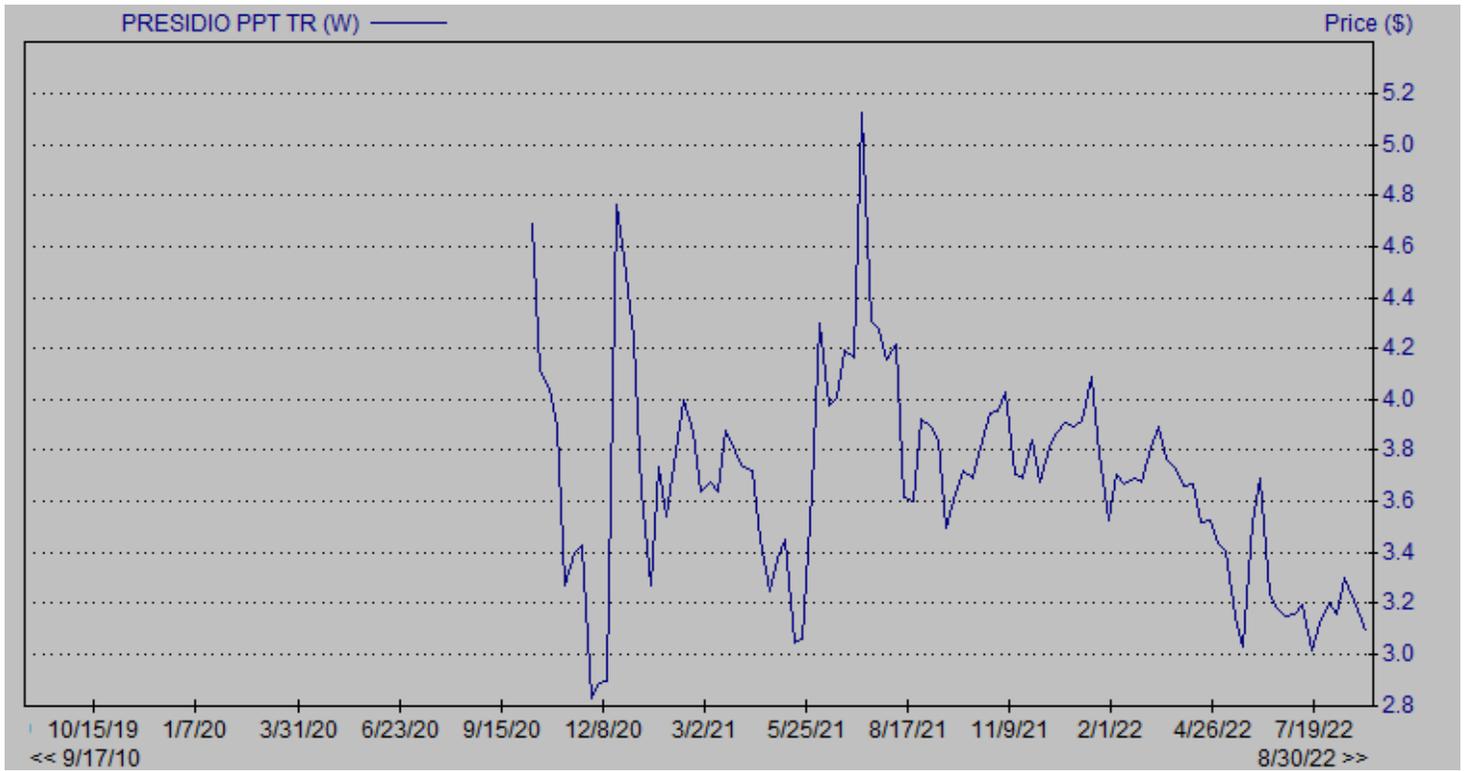
### Presidio Property Income Statement & Projections (\$)

	2019	2020A	1Q21A	2Q21A	3Q21A	4Q21A	2021A	1Q22A	2Q22A	3Q22E	4Q22E	2022E
Revenues:												
Rental income	\$27,467,410	\$23,444,119	\$5,477,223	\$4,553,798	\$4,185,212	\$4,204,024	\$18,420,257	\$4,452,318	\$4,188,076	\$4,394,473	\$4,526,307	\$17,561,173
Fees and other income	<u>1,173,701</u>	<u>907,673</u>	<u>191,531</u>	<u>292,785</u>	<u>190,967</u>	<u>135,569</u>	<u>810,852</u>	<u>120,823</u>	<u>132,784</u>	<u>192,877</u>	<u>198,663</u>	<u>645,147</u>
Total revenue	28,641,111	24,351,792	5,668,754	4,846,583	4,376,179	4,339,593	19,231,109	4,573,141	4,320,860	4,587,349	4,724,970	18,206,320
Rental operating costs	10,410,574	8,818,283	1,838,923	1,485,815	1,414,518	1,443,933	6,183,189	1,583,473	1,348,083	1,599,347	1,607,344	6,138,247
General and administrative	5,268,315	5,751,754	1,537,265	1,344,770	1,479,261	1,864,214	6,225,510	1,583,691	1,214,005	1,559,777	1,567,576	5,925,049
Depreciation and amortization	7,364,688	6,274,321	1,428,934	1,368,209	1,306,874	1,293,481	5,397,498	1,339,225	1,316,193	1,332,462	1,339,124	5,327,004
Impairment of real estate assets	-	<u>1,730,851</u>	<u>300,000</u>	-	-	<u>308,000</u>	<u>608,000</u>	-	-	-	-	-
Total costs and expenses	23,043,577	22,575,209	5,105,122	4,198,794	4,200,653	4,909,628	18,414,197	4,506,389	3,878,281	4,491,586	4,514,044	17,390,301
Operating income	5,597,534	1,776,583	563,632	647,789	175,526	(570,035)	816,912	66,752	442,579	95,763	210,925	816,019
Operating margin	20%	7%	10%	13%	4%	-13%	4%	1%	10%	2%	4%	4%
Interest expense mortgage notes / other	(2,226,101)		(1,305,021)	(1,207,036)	(1,030,883)	(999,772)	(4,542,712)	(1,017,713)	(1,085,860)	(957,159)	(947,587)	(4,008,320)
Interest expense	(8,423,545)		(279,373)	-	-	-	(279,373)	-	-	-	-	-
Interest and other income (expense)	141,306	(8,833,703)	(32,785)	(20,657)	(13,886)	63,911	(3,417)	73,605	93,128	69,226	68,533	304,492
Gain/(loss) on sales of real estate	6,319,272	1,245,460	(1,161,328)	2,594,341	627,322	427,193	2,487,528	1,522,785	1,227,484	396,000	392,040	3,538,309
Other	<u>(635,532)</u>	<u>(449,738)</u>	<u>10,000</u>	-	<u>(182,607)</u>	<u>182,607</u>	<u>10,000</u>	-	-	-	-	-
Total other income (expense)	(4,824,600)	(8,037,981)	(2,768,507)	1,366,648	(600,054)	(326,061)	(2,327,974)	578,677	234,752	(491,934)	(487,014)	(165,519)
Net (loss) income	772,934	(6,261,398)	(2,204,875)	2,014,437	(424,528)	(896,096)	(1,511,062)	645,429	677,331	(396,171)	(276,089)	650,500
Taxes			(50,199)	(238,701)	-	336,520	47,620	(265,239)	(259,285)	-	-	(524,524)
Net income / (loss)			(2,255,074)	1,775,736	(424,528)	(559,576)	(1,463,442)	380,190	418,046	(396,171)	191,931	593,996
Less: (Loss) income - noncontrolling interest	(1,383,140)	(1,412,507)	(406,608)	(925,697)	(427,303)	(402,532)	(2,162,140)	(1,208,676)	(709,202)	(1,033,418)	(1,012,750)	(3,964,046)
Attributable to Presidio	(610,206)	(7,673,905)	(2,661,682)	850,039	(851,831)	(962,108)	(3,625,582)	(828,486)	(291,156)	(1,429,589)	(820,819)	(3,370,050)
Less: Preferred Stock Series D dividends				(95,836)	(539,056)	(539,056)	(1,173,948)	(539,056)	(539,056)	(539,056)	(539,056)	(2,156,224)
Less: Series A Warrant dividends								(2,456,512)				(2,456,512)
Presidio net income (loss)			(2,661,682)	754,203	(1,390,887)	(1,501,164)	(4,799,530)	(3,824,054)	(830,212)	(1,968,645)	(1,359,875)	(7,982,786)
EPS/(LPS)	(\$0.07)	(\$0.85)	(\$0.28)	\$0.08	(\$0.13)	(\$0.14)	(\$0.46)	(\$0.32)	(\$0.07)	(\$0.16)	(\$0.11)	(\$0.66)
Avg shares out (FD)*	8,862,957	9,023,914	9,508,363	9,508,363	10,833,847	11,513,327	10,340,975	11,773,649	11,799,689	12,364,689	12,365,089	12,075,779

Source: Company reports, Zacks estimates

\*Pro forma for reverse stock split.

# HISTORICAL STOCK PRICE



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