



Ovation Science Inc. (CSE:OVAT)

Company Description

Ovation Science Inc. (CSE:OVAT) is a skincare research and development company that provides pharmaceutical-grade topical and transdermal cannabis products for the medical, recreational and beauty global markets. Leveraging its patented Invisicare® technology, Ovation develops industry-leading transdermal and topical cannabis products using a licensing/royalty business model along with marketing its own CBD product lines.

Investment Highlights

Passing of the U.S. Farm Bill provides Ovation with a significant market opportunity. The passing of the Farm Bill (December 2018) ended a five-decade-long ban on industrial hemp (defined as cannabis with less than 0.3% THC) and allows interstate transportation and shipment of hemp. The removal of hemp as a controlled substance in the U.S. should positively impact the public’s perception of hemp, which could increase sales of hemp products containing CBD. Additionally, with the barriers to interstate transportation eliminated, Ovation and its licensees can expand nationally.

The Company’s proprietary Invisicare® technology has a 4-10 times higher transdermal absorption rate of CBD/THC compared to other products tested. The advantages of using Invisicare® include enhanced drug delivery to the skin by allowing greater release of cannabinoids. The technology also forms a protective bond that holds ingredients on the skin better than competitor products tested, leading to less rub-off and wash-off and without the use of alcohol, parabens, waxes or other organic solvents in its formulas. As a result, we believe that Ovation’s products have the potential to be of superior quality with competitive pricing. In our view, the product’s high quality should lead to a higher proportion of repeat customers due to its higher CBD levels while delivering on its efficacy promises.

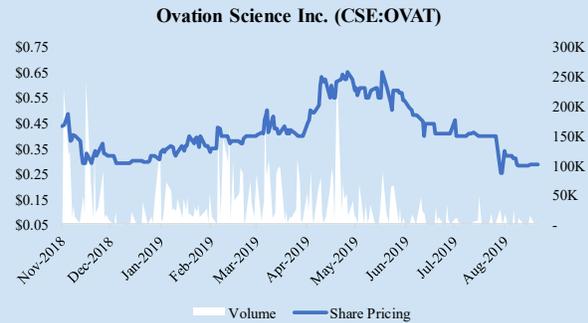
Valuation

Ovation trades at a discount to its peers. We believe the Company can reach revenue of \$10.2M in F2020E and \$19.5M by F2021E. This implies an EV/Sales multiple of 0.5x and 0.3x, a discount to mid cap and small cap cannabis companies, which trade at consensus average F2020E and F2021E multiples of 2.9x, 1.5x and 3.4x and 2.7x, respectively. We are forecasting F2020E, EBITDA of \$4.2M, implying a 1.3x EV/EBITDA multiple, a discount to mid and small cap cannabis companies, which trade at average multiples of 10.0x and 4.3x, respectively. We believe this gap should close over time as the market realizes the strong potential of Ovation’s high-margin, multiple-revenue streams.

An estimated equity value of \$25.4M. Our equity value estimate is based on a 50/50 blend of a 5.0x F2021E EBITDA and a 1.5x multiple of F2021E EV/revenue multiples and a discount rate of 20%. A multiple of 5.0x EBITDA is reasonable, as medium-cap cannabis companies are currently trading at 2021E EV/EBITDA multiples in the range of 1.4x to 12.3x. Additionally, a 1.5x revenue multiple is conservative, in our opinion, with small-to-mid-cap cannabis companies currently trading in a 2021E EV/revenue range of 0.6x to 5.5x.

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Historical Share Price Performance



Market Data (CSE:OVAT)

Price (September 10, 2019)	\$0.30
52 Week High	\$0.65
52 Week Low	\$0.26
Market Cap	\$6.6M
Basic S/O	23.2M
Fully Diluted S/O	29.9M
Free Float	63.8%
Average Daily Volume (3 Months)	27K
Total Debt*	\$0.3M
Cash*	\$1.5M
Total Current Assets*	\$1.7M

*As at June 30, 2019

Headquarters	Vancouver, BC, Canada
Operations & R&D	Las Vegas, Nevada
Website	www.ovationscience.com

Management & Directors

Terry Howlett	Co-Founder, Director, CEO & President
Doreen McMorran	Co-Founder, Director, COO
Logan Anderson	Director, CFO
Dave Ryan	Director, Head of IR
Joan Chypya	Director
Ian Howard	Director
James Roszell, PhD	Head of R&D



Investment Highlights Continued

On May 21, 2019, Ovation Science Inc. (CSE:OVAT) announced plans to launch Invibe MD, a line of CBD wellness skincare products addressing topical skin issues, sore muscles, and sleep issues with the tagline “Better with CBD.” This follows an announcement made on April 16, 2019, when the Company announced its plan to launch ARLO CBD Beauty, its anti-aging skincare line infused with CBD. Both lines, Invibe MD and ARLO CBD Beauty, will be manufactured using the Company’s patented Invisicare® delivery system. The launch of its own in-house CBD lines adds a new revenue stream that is complimentary to the Company’s primary business model based on licensing and royalty revenue streams.

Ovation’s business strategy broadens its market opportunity. Ovation licenses its products made with Invisicare® to global cannabis companies in jurisdictions where CBD and or THC are legalized. Ovation already has one licensee in place, Lighthouse Strategies, which has launched four of Ovation’s products under its BASKIN brand name in the U.S. dispensary market, including the #1 topical product by number of units sold in Nevada in both May, June and continuing each month.

Potential to tap into the US\$29.5B beauty + skin care market, the US\$15.0B pet medicine market, and the US\$13.5B pain market. The Company has developed 25 products with THC and/or CBD or a combination, including a full hemp-derived CBD health and beauty line with seven anti-aging and moisturizing products and three wellness products. Ovation is also examining the animal health market with CBD/THC products for inflammation, skin irritation and dry skin. Geographically, the Company is exploring European opportunities and is in discussions with Canadian cultivators as potential licensees.

Upcoming Catalysts

Over the next 12-month period, we believe there are three main catalysts that could drive potential upside in the Company’s share price. These include:

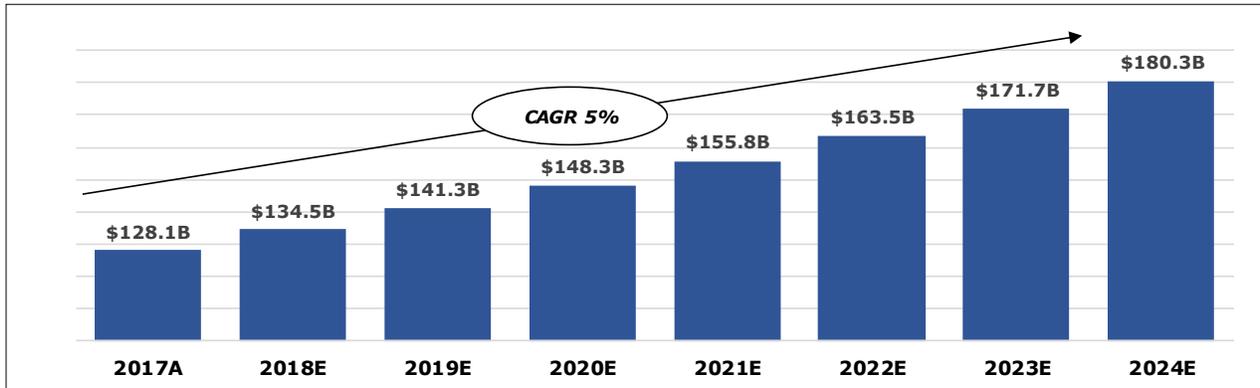
1. Revenue from the four announced products in the ARLO CBD Beauty line, in addition to the additional three wellness products to be launched in the Invibe MD line during Q3/19.
2. Ovation reporting material revenues from fees from new licensing and royalty agreements, in addition to existing revenues from its current licensing agreement.
3. Anticipated legalization of topical CBD products in Canada in October 2019 and mass consumer adoption of the expected \$25B+ cannabis market by 2024 (5 years) for skincare conditions.

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Industry Overview

Figure 1: Global Skin Care Market

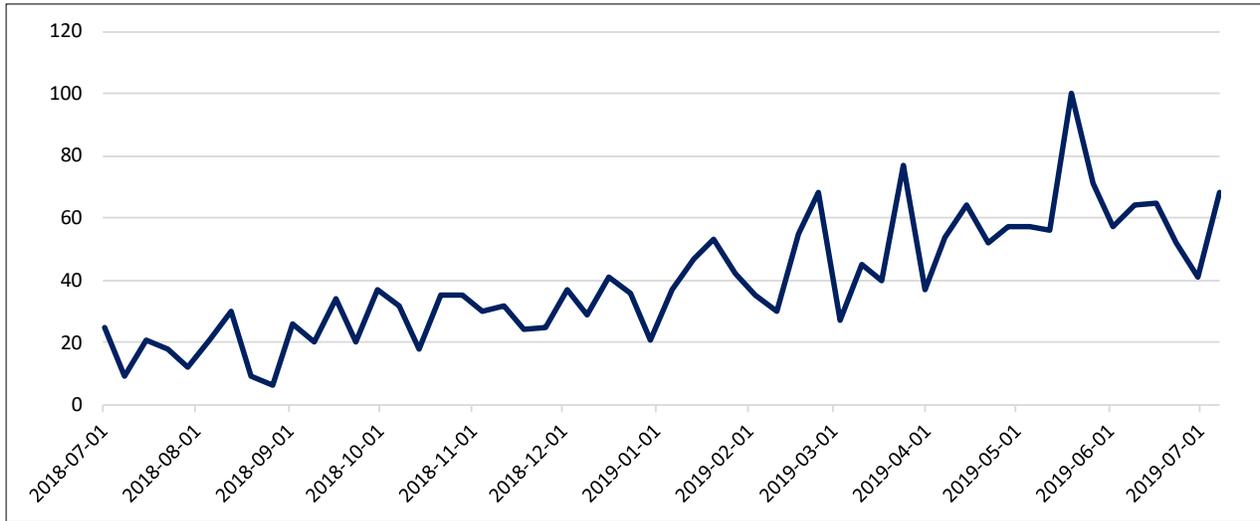


Source: [Statista](#)

According to Statista, the global skin care market was valued at ~\$130.0B in 2017, and the value of this market is expected to grow to ~\$180.0B by 2024E with an implied CAGR of 5.0%. There is some evidence to suggest there is a trend towards CBD/THC beauty and skincare products, especially among the baby boomer demographic. A [study](#) by CBD Marketing, a Chicago-based marketing agency focused on cannabinol branding, analyzed 1.3M U.S. social media posts (Twitter, YouTube, Facebook, Instagram, and blogs) from January 1, 2018, to January 1, 2019. The marketing agency found monthly conversations about CBD increased by ~50% year-over-year. The study found that Baby Boomers (aged 54 to 72) generated 41% of the posts, and conditions discussed most frequently were health & beauty and pain management.

- Additionally, there is historical data from Statistics Canada to back up these anecdotal claims. The Statistics Canada Q1/19 [National Cannabis Survey](#), reported that the rates of cannabis consumption for persons aged 45 to 65, rose to 14% from 9% in Q4/18.
- The Statistics Canada survey showed that 646,000 cannabis users declared they used cannabis for the first time during the past three months. This number is significantly higher than the estimated value of 327,000 from a year ago. This increase has happened after the legalization of recreational cannabis.
- Of the new users from the post-legalization consensus, about half were aged 45 or older. In comparison, in 2018 this demographic represented one-third of new users. This highlights the growing acceptance among the Baby Boomer demographic, who are expected to be invaluable in growing the support for CBD and THC-infused skincare.

Figure 2: Google Search Term: CBD Beauty

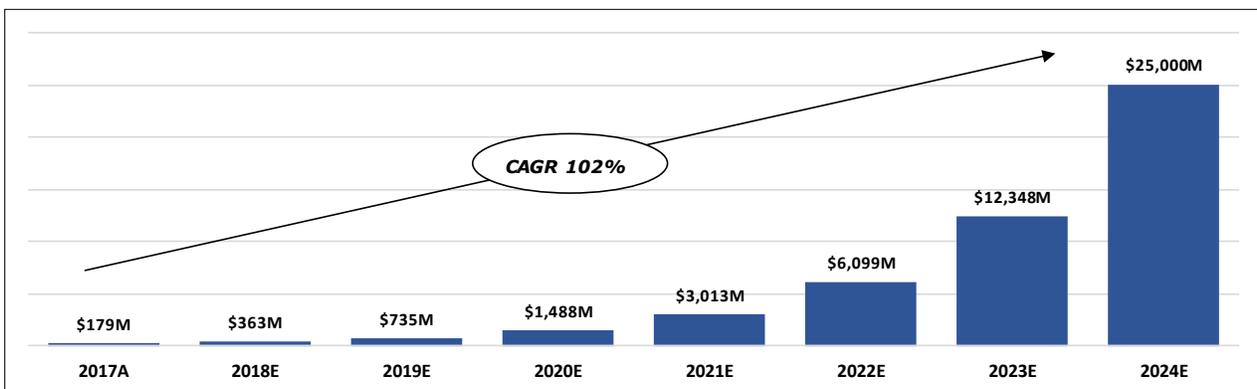


Source: Google Trends

Cannabidiol is becoming the hot new ingredient in skin-care products. Data from Google Trends indicates that searches for “CBD Beauty” have increased ~400% from the same time last year. The spike in search results coincides with the passing of the U.S. Farm Bill (December 2018). Since the Farm Bill’s passing, there have been many publications such as [CNN](#), [LA Times](#), and [New York Times](#) that have reported on the health and beauty benefits of CBD-infused lotions and oils. This is in addition to endorsements from celebrities such as Kim Kardashian, who threw a CBD [themed baby shower](#). In our opinion, all this media attention further adds validity to CBD’s popularity as a health and beauty product.

De-scheduling hemp from the definition of a Schedule I substance classified hemp as an agricultural commodity, allowing for its use as a plant-based supplement in skincare products. The Farm Bill also lifts restrictions on distribution, banking, advertising, and marketing. Hemp/CBD companies will also be able to accept other forms of payment other than cash, including debit and credit cards (Source: [American Agriculturalist](#)). With the elimination of barriers to national distribution and banking, we believe Ovation Science has positioned itself for significant revenue growth.

Figure 3: U.S. CBD Beauty Market: Market Outlook (US\$M)



Source: Jefferies

Figure 4: ARLO CBD Beauty

Source: Ovation Science

According to Jefferies, the CBD segment of the Beauty market has the potential to reach \$25B in annual revenues by 2024E. Jefferies predicts CBD beauty products could make up approximately 15% of the total skincare market. Analysts also predict that CBD beauty products have strong potential to become a separate category from recreational and medical cannabis. CBD/Hemp also has the potential to disrupt the pet care, sport, and CPG markets. CBD is also gaining popularity as a natural alternative to pharmaceutical drug categories, such as: topical pain/muscle relaxant, sleep aid, and mental wellness. In addition, the passing of the Farm Bill opens the possibility to mass retail hemp at outlets such as Wal-Mart, Costco, Target, Kroger, and Whole Foods. As well, potential CPG beauty companies, such as Estée Lauder, NIVEA, L’Oréal Paris, and Neutrogena, could enter the space. In our view, Ovation Science is an ideal partner for a CPG company, as its patented Invisicare® delivery technology delivers better efficacy than the competition and it has a pipeline of products that are ready for market.

Research has shown that cannabidiols have stronger antioxidant properties than Vitamin C and E. Antioxidants diminish the aging process by decreasing our body’s free radical production, which in turn helps slow down the rate at which our collagen decreases. We highlight that a 2008 [study](#) conducted by researchers at Bonn University, found that cannabis has strong anti-inflammatory properties. By counteracting free-radicals and decreasing inflammation, CBD anti-aging creams, such as Ovation Science’s ARLO CBD Beauty line, may be able to reduce wrinkles, fine lines, dark circles, and dry skin.

Additionally, while seasoned cannabis consumers prefer to smoke cannabis, novice consumers are drawn to alternative forms that the plant comes in. A survey conducted by [New Frontier Data](#) about cannabis preferences of novice users reveals that 44% percent of U.S. cannabis consumers would try topicals:

- 69% solid edibles
- 54% liquid edibles
- 44% topicals
- 36% joints or blunts
- 32% vaporizers (vapes)
- 29% tinctures
- 21% concentrates
- 19% pipes / water pipes

The rising popularity of retail cannabis-derived products is being driven by consumers – and they are using products for everything from relaxation to pain management.

Other potential use cases for CBD as a topical cream

Figure 5: Invibe MD CBD Wellness Creams



Source: Ovation Science

CBD market for sport and muscle recovery. CBD can be used as a topical to help treat muscle stiffness and soreness. Anecdotal evidence suggests that CBD can be used to treat post-workout inflammation, as well as pain from workout and sport-related injuries. CBD works with our body’s endocannabinoid system, by binding with CB2 receptors and THC binds with CB1 receptors, which are found along the central nervous system in our bodies. Cannabis advocates say that this is a healthier alternative to the use of powerful opioids or other anti-inflammatories, which can lead to addiction and dependence.

Recently, the U.S. Anti-Doping Agency (USADA), [removed topical CBD](#) from the list of prohibited substances that can be used by Olympic athletes. This follows a January 2018, decision by the [World Anti-Doping Agency](#) that removed CBD from the banned list of prohibited substances. Additionally, CBD is gaining popularity among PGA golfers. Two-time Masters champion Bubba Watson has spoken highly of the benefits of CBD for pain, inflammation, and anxiety. The NFL Players Association, in conjunction with the NFL, [announced](#) back in May that both organizations would work together to research CBD and pain management. Recent decisions by numerous sports organizations add validity to anecdotal claims that topical CBD can help reduce muscle recovery, and has anti-inflammatory properties.

Figure 6: CBD and Animal Health



Source: www.dailyhive.com

CBD and the pet care/animal health market. In U.S. for 2018, US\$72.6B was spent on pets with US\$18.1B attributed to vet care and US\$30.3B spent on food (Source: American Pet Products Association). A [survey](#) of over 1,000 pet owners found that Americans spend on average US\$126.20 every month on their pets. When pets get older, they face many of the similar degenerative diseases that humans face. CBD products for pets can help treat anxiety, chronic pain and skin ailments, among others. Ovation is planning to enter the animal health market with CBD/THC powered topical and transdermal products to help animals with pain and arthritis, inflammation, skin irritation/dry skin, and insect bites. In our opinion, this could be one of the fastest-growing market segments within the next three to five years.

Other common conditions with potential uses of Ovation’s Invisicare® technology include joint pain, inflammation, arthritis, and muscle tension or strain. According to a report by The Brightfield Group, 54% of joint pain and inflammation patients reported using hemp-derived CBD products to treat their condition. Importantly, 28% of arthritis patients and 35% of people suffering from muscle tension and strain reported pain improvement by using hemp-derived CBD products. In our opinion, Ovation’s Invibe MD product line is favourably positioned to disrupt the medicated skin market, which is predicted to be worth US\$8.0B by 2022, and the global topical pain market, which was worth \$7.5B in 2017 and expected to grow to \$13.3B by 2025. We believe that Invisicare® delivery technology has the potential to disrupt these categories as the absorption rate is 4-10 times higher than the competitors tested, which should lead to higher product efficacy.

Additionally, demand for CBD health products is expected to increase as the products’ benefits should provide similar offerings as over-the-counter prescribed medication. With prescription drug overdoses being one of the leading causes of accidental death in the U.S., CBD provides an alternative to opioids that can be effective for pain while decreasing the likelihood of dependence and avoiding the risk of fatal overdose. From a 2017 [study](#), 81% “strongly agreed/agreed” that using cannabis on its own was more effective at treating their conditions than taking cannabis with opioids. An additional 2018 [study](#) showed that from the 2,400 sampled population, 42% chose to stop taking traditional medications in favour of CBD. CBD health products would, as a result, provide an easier alternative as, depending on the legalization in the country/state, no doctor prescription is needed, while eliminating the risk of patients dying from an overdose.

Cannabis has been treasured for its [medicinal and therapeutic properties](#) for centuries by many cultures, including ancient China, India, and the Romans. In the present, it has re-emerged in an intersection with the wellness industry. In fact, many consumers are already using CBD-infused products in their daily life:

- Relieving anxiety
- Enhancing sleep
- Managing pain
- Personal care

Importantly, retail cannabis products are also helping consumers reduce their dependence on medications, and to kick unhealthy habits.

Business Overview

Ovation Science currently generates revenues from 5 main verticals:

1. Licensing fees for product formulations made with Invisicare®. Currently, Ovation has one U.S. licensee, Lighthouse Strategies LLC, that has launched its product line called BASKIN, made up of three CBD products, as well as the first THC-infused cream to be sold in the U.S.
2. Ovation generates revenue from the sale of Invisicare® polymer to its licensees.
3. Ovation generates royalties (packaging fees) from products marketed by Ovation’s licensees, such as Lighthouse.
4. The Company generates development fees when Ovation develops new products for licensees. Of note, Ovation has 25 products fully developed in its pipeline and ready for market.
5. Ovation expects to generate significant revenue from the new ARLO CBD Beauty and Invibe MD product lines. The Company plans to launch additional products in this line during Q3/19.

Figure 7: Ovation Science Licensee – Lighthouse Strategies' Products



Source: Company Reports

ARLO CBD Beauty is an anti-aging skincare line infused with CBD, which uses the Company’s patented Invisicare® polymer technology. The initial products in the line include an anti-aging Day cream, Night Cream, Eye Cream, Body Lotion, and a SPF30 broad-spectrum sunscreen, which will be launched later.

Ovation Science is also launching a broad-spectrum sunscreen that offers UVA/UVB protection as well as eight hours of photostability. Broad-spectrum sunscreen is unique compared with normal sunscreen because it protects against both UVA and UVB sunrays. Protection against UVA rays is significant as only sunscreens with a critical wavelength above 370 nm can claim UVA protection. UVA rays can go through glass and clouds and are known to cause more severe skin damage. Ovation’s ARLO CBD Beauty sunscreen offers protection against both sunrays. The advantage of Ovation’s sunscreen over competitor products is derived from the Company’s Invisicare® delivery technology. The sunscreen is also protected by a U.S. patent for stabilizing sun filters. The sun filter avobenzene, an ingredient used to absorb UVA rays, typically breaks down in the sun in less than two hours. Ovation’s formulation was granted a U.S. patent, as studies verified that it stabilized avobenzene for over eight hours. This is substantial as the patent provides Ovation with a unique advantage for its ARLO CBD Beauty sunscreen. According to [Grandview Research](#), the U.S. sunscreen market generated ~\$2.0B in revenues in 2016.

The Invibe MD line is focused on health and wellness. Invibe MD will launch with three products in the pipeline: Troubled Skin, Keep Fit Sports Relief, and R&R (Rest & Relaxation). Additionally, Ovation plans to launch additional products that have completed development in the near future.

- Importantly, we note that both lines utilize the Invisicare® polymer technology, which provides many benefits to topical and transdermal cannabis products, including increased moisture levels in the skin, resistance to wash-off and rub-off, and a greater release of the active ingredients, including CBD.

Figure 8: ARLO CBD Beauty Products



Source: Ovation Science

Ovation Science’s Invisicare® polymer technology is backed by 20 years of R&D. The R&D process is conducted using prescription drug protocols, including good manufacturing practices (GMP), along with other drug development techniques to develop fully-tested, pharmaceutical-quality products. which are stable with a long shelf-life.

High-performance liquid chromatography (HPLC Analysis) is used to determine the purity of the CBD and THC used.

1. Accelerated stability testing is conducted over a 120-day period, thus providing a three-year shelf-life.
2. Topical release studies are conducted to determine the efficacy of the product by identifying the amount of THC/CBD released to the skin, both immediately and over a six-hour period.
3. Franz cell diffusion analysis, a methodology used for transdermal formulation quality assessment, is conducted to determine efficacy and drug release of ingredients trans-dermally.

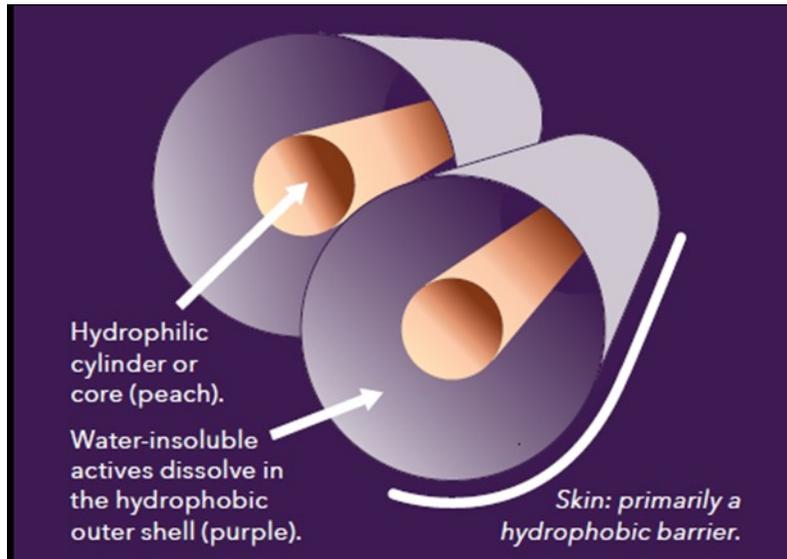
Ovation Science is a unique play on the CBD/THC market due to its exclusive worldwide license of Invisicare® polymer technology, a technology that combines hydrophilic and hydrophobic polymers used to enhance the release and delivery of both CBD and THC to the skin.

Ovation Science’s Competitive Advantage:

- The Company’s main advantage over its competitors is its patented skin-delivery technology Invisicare® that delivers more cannabinoids compared with other products, leading to higher efficacy (topical delivery and transdermal penetration) and premium pricing.
- Ovation’s products are expected to be game changers in the infused topical cannabis marketplace, replacing *homemade* lotions with scientifically-proven products.
- Ovation’s topical products release ~4-10x more CBD from the formulas tested, at a 40% delivery rate compared with 3% for the leading competitor’s products tested. Ovation’s transdermal products release 4-8x more CBD, resulting in an 81% penetration over a six-hour period, compared with 10%-25% from leading competitor’s products tested.

Ovation’s patent portfolio. The Invisicare® technology is covered by 11 patents, covering the composition, manufacturing, and use of the technology. The technology is patented in the U.S., EU (France, Switzerland, UK, and Germany), Canada, Australia, China, India, Hong Kong, and South Korea. Invisicare® allows licensees to sell a patent-protected product that has higher efficacy than its competitors, which provides a new product that should help generate repeat customers.

Figure 9: Invisicare® Technology

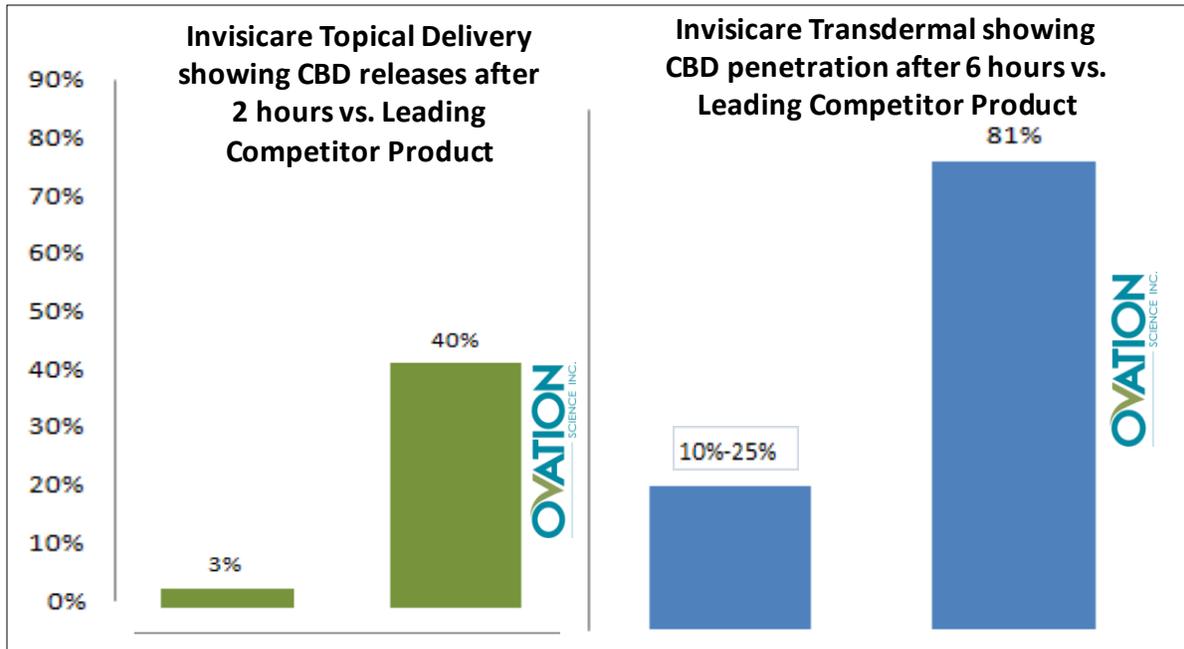


Source: Ovation Investor Presentation

Invisicare® is a combination of hydrophobic and hydrophilic polymers that incorporate key ingredients within its structure. Below is a description of Invisicare®:

1. Skin binding: The polymers form a protective bond that hold ingredients on the skin, resisting both rub-off and wash-off while the skin still breathes naturally (non-occluding).
2. Delivery and release: The polymer *super charges* ingredients and delivers targeted levels to the skin.
3. Stabilization polymer: Has a stabilizing effect on ingredients so they don’t break down and are available to do what they are intended to do.
4. Skin barrier: Improves the skin barrier function by retaining water / moisture in the skin and prevents damage from outside elements and toxins.
5. Formulations do not contain alcohol, parabens, waxes or other organic solvents.

Figure 10: Invisicare® Transdermal Penetration vs. Leading Competitor Product



Source: Ovation Investor Presentation

On April 23, 2019, Ovation Science announced that it has entered into an exclusive agreement with Skincareguide.com LTD, an international peer-reviewed publisher and source of dermatology information, to act as its Medical Dermatology Advisory Board. The purpose of the partnership is to provide strategic, clinical, scientific, and guidance to the Company to advance its product development. The Medical Dermatology Advisory Board is comprised of four physicians (Charles W. Lynde, M.D., FRCP, Richard Thomas, MD, FRCPC, Jeffrey S. Dover, M.D., FRCPC, Leon Kircik, MD, FAAD), who are renowned leaders within dermatology. Of note, Dr. Charles Lyne is a Professor in the Faculty of Medicine at the University of Toronto. We believe this board will provide an advantage to the Company as the board members help guide Ovation Science in its clinical review of cannabis products. This board will also aid in helping to expand the Company’s dermatology-focused product line development.

Financial Analysis
Figure 11: Summary of Ovation's Financial Results

<i>(dollars CAD)</i>	FQ2/19	FQ1/19	<i>(+/-)</i>
	Jun-30	Mar-31	QoQ
Net revenues	\$55,701	\$59,166	(6%)
COGS	-	11,754	<i>nmf</i>
Gross profit	55,701	47,412	17%
Management & director fees	89,399	81,890	9%
Advertising and promotion	78,982	27,400	188%
Office & general	51,124	23,593	117%
Professional fees	25,670	27,407	(6%)
R&D	14,981	28,180	(47%)
Stock based compensation	-	14,432	(100%)
Total SG&A	260,156	202,902	
EBITDA	(204,455)	(155,490)	31%
Depreciation & Amortization	-	-	
EBIT - Operating income (loss)	(204,455)	(155,490)	
Other (income) / expense	(495)	32,758	
EBT	(203,960)	(188,248)	
Provision for taxes	-	-	
Net income (loss)	(203,960)	(188,248)	8%
Cash balance	1,497,047	1,722,499	(13%)

Source: Company Reports, Ubika

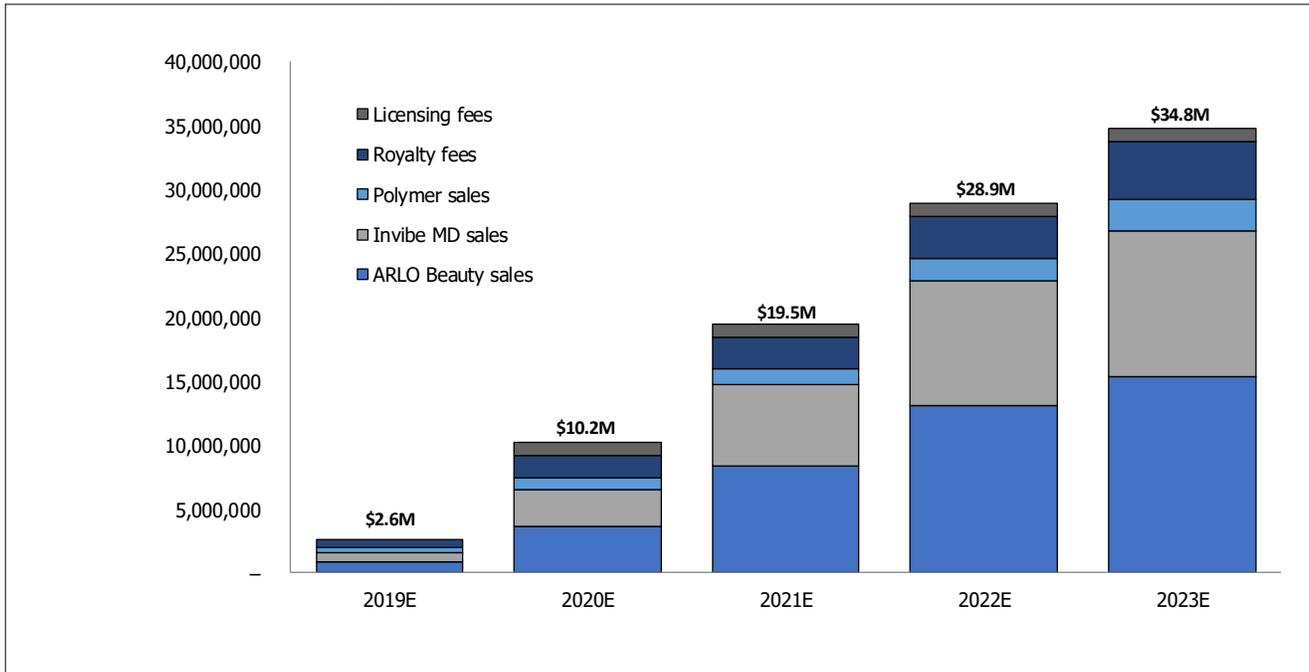
On August 28, 2019, Ovation Science released Q2/19 financial results.

Gross profit increased 17% quarter-over-quarter. Increase in gross margins can be primarily attributed to an increase in revenues from royalty payments which increased by 45% to \$55,701 (was \$38,498 in Q1). Net revenue had a modest decrease of 6%, to \$55,701 (was \$59,611). Ovation's main source of revenues currently is its relationship with Lighthouse Strategies. We are expecting Ovation's revenues to increase significantly in the second half of 2019, as the Company's in-house ARLO CBD Beauty and Invibe MD come online (Figure 12).

EBITDA loss widens by 31%. The larger loss over the prior quarter is due to increased spending on advertising and promotion (188% increase) and office and general (117% increase), the loss was partially offset by lower R&D expenses (47% decrease).

Fully funded for global expansion with \$1.5M in cash on the balance sheet. Ovation Science raised \$2.2M at its IPO back in November of 2018, with ~75% of the funding available the Company is cashed up and ready to execute on its growth strategy. The remain proceeds are expected to be used for marketing purposes and entering new sublicensee agreements.

Figure 12: Ovation Science Revenue Breakdown



Source: Ubika Research Estimates

We are forecasting revenue of ~\$2.6M in 2019E, increasing to \$34.8M by 2023E, implying a compound annual growth rate (CAGR) of 76.4%. We believe revenues are going to be driven primarily by sales of Ovation’s in-house brands, ARLO CBD Beauty and Invibe MD, which we estimate should achieve revenues of \$15.3M and \$11.5M annually by 2023E, implying 47.0% and 29.4% of total revenues, respectively. We have modelled an average wholesale price of \$24/unit for ARLO CBD Beauty, which we believe should decline to \$20/unit by 2023E, as the cost of hemp-grown CBD decreases. Similarly for Invibe MD, we have modelled an average wholesale price of \$22/unit, which should come down to \$18/unit by 2023. Ovation is planning on launching ARLO CBD Beauty in August 2019 and Invibe MD in September 2019.

In addition to revenues from its own in-house brands, we are forecasting that polymer sales and royalty jointly should contribute to 20.0% of revenues, or ~\$6.9M in revenues by 2023. Currently, the BASKIN line is being sold in Nevada, however it is expected to launch in seven additional states shortly, as well as additional states in 2020 (for a description of Ovation’s revenues streams please refer to page 9).

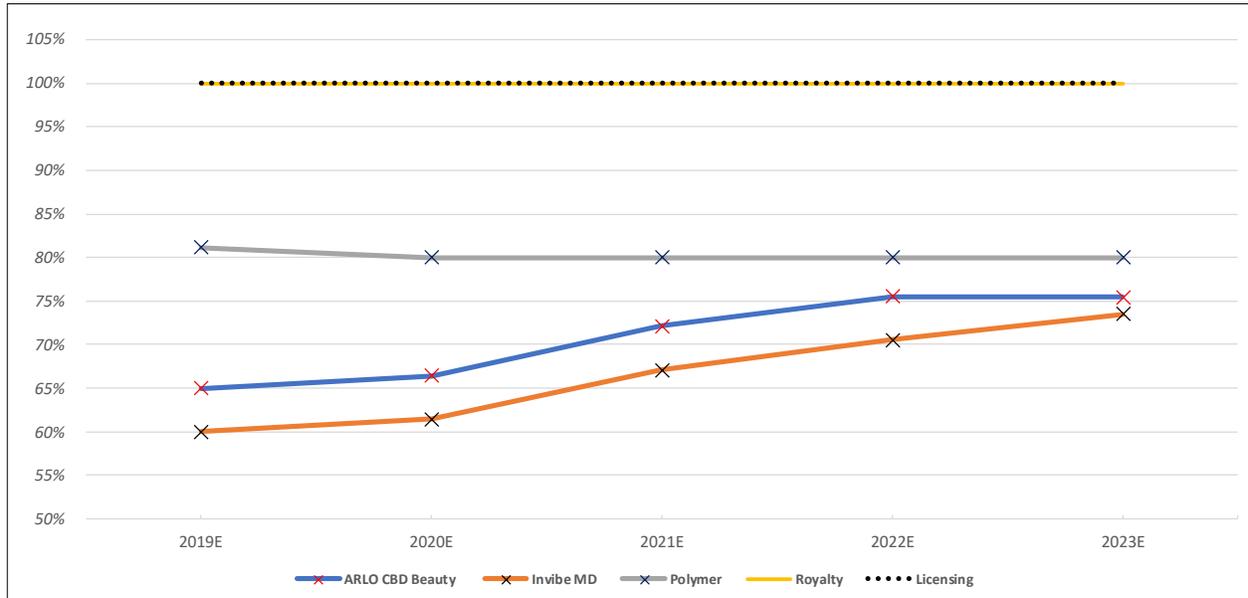
We are also forecasting revenues from additional licensees. Using a conservative estimates we have forecasted Ovation to add one new licensor annually from 2020 through to 2023.

Figure 13: Ovation Science Margin Analysis

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>
Blended gross profit margin	74.3%	75.5%	75.9%	77.8%	79.0%
EBITDA margin	21.4%	41.4%	46.6%	47.0%	48.3%
Net income margin	12.8%	30.5%	34.5%	35.1%	36.4%
Advertising / sales	18.4%	19.1%	20.5%	24.4%	25.1%

Source: Ubika Research Estimates

Figure 14: Ovation Science Segmented Margin Profile



Source: Ubika Research Estimates

We believe Ovation can achieve blended gross margins of ~70-80%, once the Company’s products are widely available throughout the U.S. We are estimating Ovation can achieve 65% to 75% gross margins with its anti-aging ARLO CBD Beauty line. Ovation uses third-party manufacturers to produce its products and as sales volumes increase, we believe the Company can take advantage of economies of scale and negotiate lower manufacturing costs. Based on pricing of competitor products, evidence suggests that anti-aging creams can command higher-margin profiles (see page 21 for a full competitor pricing analysis). Additionally, the margin estimates are in-line with large-cap beauty companies, which generate gross margins of 58% to 83% (Figure: 15). For the Ovation Science’s wellness line Invibe MD, we are estimating gross margins between 60% to 72%. Our competitor pricing analysis (page 21) suggests margins for wellness products are slightly lower than beauty products. The estimates are also in-line with mid-to-large cap pharmaceutical/wellness companies, which generate gross margins between 44% to 90% (Figure: 15).

We are estimating EBITDA margins between ~21%-48% and net income margins between ~13%-~36%. We are projecting increasing EBITDA margins over our projection period. This is because much of the Company’s expenses are fixed costs (salaries, rent, and professional fees), and the Company does not manufacture its products in-house, instead it contracts out manufacturing. As such, operating expenses and capital expenditures are expected to be lower, as the Company will not need to hire additional staff or purchase additional building as revenues ramp-up. We estimate that the Company can be run with approximately 8-10 employees. The Company’s primary variable cost is advertising required to establish a brand-name beauty and wellness product. We are modeling Ovation’s advertising and marketing spend to increase from ~18% of revenues in 2020E, to ~25% of revenues in 2023E. This is comparable to large-cap beauty companies, such as L’Oréal and Revlon, which spend 30.2% and 25.4% of revenues on marketing and advertising, respectively. In our view, robust EBITDA and net income margins should be driven by Ovation’s proprietary Invisicare® technology, which has a 4-10 greater release factor of CBD/THC compared with similar products. There is already some evidence to suggest positive consumer acceptance of the Invisicare® technology, as the Ovation’s licensee BASKIN has been the top-selling CBD product in Nevada for the past three months. Thus, we are estimating that Ovation can achieve margins towards the high end of the range of large-cap beauty and mid-large cap pharmaceutical /wellness companies, which generate EBITDA margins between 30%-45% and net income margins up to 42% (Figure:15).

Figure 15: Comparable Beauty and Dermatology/Wellness Margin Profile

Beauty Company Margin Profile				
Company	Products	Gross Margin	EBITDA Margin	Net Income Margin
Estee Lauder (NYSE:EL)	<i>Beauty Products, Skin Care & Makeup</i>	80.0%	20.0%	9.5%
Avon Products (NYSE:AVP)	<i>Beauty and Personal Care</i>	61.0%	8.0%	n/m
Revlon (NYSE:REV)	<i>Cosmetics and Skin Care</i>	58.0%	8.3%	n/m
L'Oréal (EPA:OR)	<i>Cosmetics and Skin Care</i>	72.0%	22.0%	13.6%
Coty Inc (NYSE:COTY)	<i>Beauty, Cosmetics, and Skin care</i>	62.2%	14.0%	n/m
Shiseido Co (TYO:4911)	<i>Skin care and Personal Care</i>	78.0%	12.0%	4.6%
L'Occitane International S.A. (SEHK:973)	<i>Beauty and Skin Care</i>	82.8%	16.5%	8.6%
High		82.8%	22.0%	13.6%
Mean		70.6%	14.4%	9.1%
Low		58.0%	8.0%	4.6%
Health / Wellness (Pain, Dry Skin, Acne) Company Margin Profile				
Company	Products/Indications	Gross Margin	EBITDA Margin	Net Income Margin
Sanofi-Aventis (NYSE:SNY)	<i>Icy Hot (Pain Relief)</i>	68.3%	29.1%	12.5%
GlaxoSmithKline (LSE:GSK)	<i>Voltaran Gel (Pain Relief)</i>	68.5%	28.0%	12.5%
Johnson and Johnson (NYSE:JNJ)	<i>Aveeno (Dry Skin/ Eczema)</i>	43.6%	27.4%	18.4%
Crescita Therapeutics Inc. (TSX:CTX)	<i>Dermatological (Psoriasis, Rosacea, Acne)</i>	57.7%	n/m	15.5%
Cipher Pharmaceuticals Inc. (TSX:CPH)	<i>Dermatological (Psoriasis, Inflammation, Acne)</i>	89.5%	33.0%	15.9%
Taro Pharmaceuticals (NYSE:TARO)	<i>Dermatological (Eczema, Dermatitis, Allergies)</i>	66.5%	46.4%	42.1%
Delivra Corp. (TSXV:DVA)	<i>Joint and Muscle Pain</i>	68.8%	n/m	n/m
High		89.5%	46.4%	42.1%
Mean		66.1%	32.8%	19.5%
Low		43.6%	27.4%	12.5%

Source: Capital IQ, Ubika

Comparable Companies Analysis and Valuation
Figure 16: Ovation Comps Table

Ovation Science - Public Company Comparables - 10-Sep-19				EV/Revenues			EV/EBITDA		
Company Name	Last Price	Mrkt Cap (\$'000)	EV (\$'000)	2019E	2020E	2021E	2019E	2020E	2021E
Mid Cap Cannabis									
Curaleaf Holdings, Inc.	\$10.17	\$4,733.7	\$4,795.3	14.0x	4.1x	n/a	96.7x	13.0x	n/a
Charlotte's Web Holdings, Inc.	\$21.54	\$2,099.4	\$2,043.5	12.3x	5.1x	3.4x	49.3x	16.1x	9.9x
CV Sciences, Inc.	\$4.04	\$401.1	\$388.0	4.0x	2.6x	1.8x	25.3x	10.7x	6.1x
Green Growth Brands Inc.	\$1.81	\$373.1	\$373.1	11.6x	1.2x	0.5x	n/a	4.8x	2.0x
Khiron Life Sciences Corp.	\$1.60	\$182.3	\$129.9	13.1x	3.0x	0.9x	n/a	n/a	6.8x
4Front Ventures Corp.	\$0.74	\$392.8	\$397.4	21.2x	1.3x	0.8x	n/a	5.3x	2.9x
Mean Mid Cap Cannabis				12.7x	2.9x	1.5x	57.1x	10.0x	5.5x
Small Cap Cannabis									
Abacus Health Products, Inc.	\$8.21	\$179.4	\$137.9	5.4x	1.4x	0.9x	n/a	4.3x	2.9x
Tetra Bio-Pharma Inc.	\$0.31	\$66.0	\$64.7	n/a	n/a	n/a	n/a	n/a	n/a
True Leaf Brands Inc.	\$0.25	\$25.1	\$26.5	11.5x	n/a	n/a	n/a	n/a	n/a
The Yield Growth Corp.	\$0.27	\$26.4	\$22.1	4.3x	3.5x	2.0x	1.9x	n/a	n/a
Kalytera Therapeutics, Inc.	\$0.05	\$22.5	\$26.1	5.2x	5.2x	5.2x	n/a	n/a	n/a
NanoSphere Health Sciences Inc.	\$0.12	\$12.5	\$12.3	n/a	n/a	n/a	n/a	n/a	n/a
Canntab Therapeutics Limited	\$0.55	\$13.9	\$11.5	n/a	n/a	n/a	n/a	n/a	n/a
Mean Small Cap Cannabis				6.6x	3.4x	2.7x	1.9x	4.3x	n/a
Ovation Science Inc.	\$0.30	\$6.9	\$5.5	2.1x	0.5x	0.3x	9.4x	1.3x	0.6x

Source: Capital IQ, Ubika

Ovation trades at a discount to its peers. We believe the Company can reach revenue of \$10.2M in F2020E and \$19.5M by F2021E. This implies an EV/Sales multiple of 0.5x and 0.3x, a discount to mid cap and small cap cannabis companies, which trade at consensus average F2020E and F2021E multiples of 2.9x, 1.5x and 3.4x and 2.7x, respectively. We are forecasting F2020E, EBITDA of \$4.2M, implying a 1.3x EV/EBITDA multiple, a discount to mid and small cap cannabis companies, which trade at average multiples of 10.0x and 4.3x, respectively. We believe this gap should close over time as the market realizes the strong potential of Ovation's high-margin, multiple-revenue streams.

Figure 17: Ovation Valuation Summary

<u>Valuation - EV/EBITDA</u>	
Blended Average	5.0x
Ovation Science Metric - FY21 EBITDA	9.1M
Enterprise Value	45.3M
(-) Net Debt	(1.4M)
Equity Value	46.7M
<u>Valuation EV/Revenue</u>	
Combined Average	1.5x
Ovation Science Metric - FY21 Revenues	19.5M
Enterprise Value	29.2M
(-) Net Debt	(1.4M)
Equity Value	30.6M
Implied - Blended 50/50 Equity Value (Market Cap) - F2021	38.7M
<i>Discount Rate</i>	20.0%
Fair Value of Equity, en bloc (CAD)	25.4M

Source: Ubika Research Estimates

An estimated equity value of \$25.4M. Our equity value estimate is based on a 50/50 blend of a 5.0x F2021E EBITDA and a 1.5x multiple of F2021E EV/revenue multiples and a discount rate of 20%. A multiple of 5.0x EBITDA is reasonable, as medium-cap cannabis companies are currently trading at 2021E EV/EBITDA multiples in the range of 1.4x to 12.3x. Additionally, a 1.5x revenue multiple is conservative, in our opinion, with small-to-mid-cap cannabis companies currently trading in a 2021E EV/revenue range of 0.6x to 5.5x.

Competitor Analysis

Green Growth Brands Inc. (CSE:GGB)

The Company runs a vertically-integrated cannabis facility that is located in Las Vegas, Nevada. Green Growth distributes products through mall-based shops, partnerships with traditional retailers and e-commerce platforms. Currently, the Company has had successful retail strategies with large specialty retail companies, such as Bath & Body Works, Designers Shoe Warehouse and L Brands. The Company offers a skincare line called Seventh Sense Botanical Therapy, which includes lotions, anti-aging creams, and muscle balms.

Khiron Life Sciences Corp. (TSXV:KHRN)

Khiron is a vertically-integrated Canadian cannabis company that has operations in Latin America. The Company focuses on both scientific and medical-based research for cannabis-based products. The launch of the Company's CBD skin and body care cosmetic brand Kuida was announced on July 18, 2018. Kuida currently offers a night cream, a day cream and an eye contour.

4Front Ventures Corp. (CSE:FFNT)

4Front Ventures (formerly Cannex Capital Holdings) provides a wide range of services, including real estate, management, financial, branding, and IP to licensed cannabis business operators domestically and internationally. 4Front is focused on premium indoor cultivation, extraction, manufacturing and branding of edible and derivative products as well as retail operations. On February 25, 2019, 4Front announced the acquisition of Pure Ratios, which was founded in 2015 with a focus on CBD wellness-oriented products.

Charlotte's Web Holdings Inc. (TSX:CWEB)

Charlotte's Web Holdings a vertically-integrated cannabis company that is headquartered in Boulder, CO. With an initial focus on hemp-based, cannabidiol wellness products, the Company is starting to expand its offering with pet-focused products. The Company offers a hemp extract oil, infused balm, and soon to be released hemp extract chews for pets.

Curaleaf Holdings Inc. (CSE:CURA)

Curaleaf is a vertically-integrated, U.S.-based cannabis company that cultivates, processes, markets and/or dispenses a variety of cannabis products, including vape oils, flower, pre-rolls, topical lotions, mints and edibles. The Company currently operates 44 dispensaries in 12 different states. Curaleaf has a line of topicals and transdermal patches under its brand Curaleaf Hemp. Additionally, on May 10, 2019, the Company announced its entrance into the pet market with the launch of Bido, a line of hemp-based CBD products for pets.

True Leaf Medicine International Ltd (CSE:MJ)

True Leaf is headquartered in Vernon, Canada and operates in two main divisions: True Leaf Medicine Inc. and True Leaf pet Inc. The Company's pet line was one of the first hemp-based offerings for pets in the world with its chews, dental sticks and supplement oils that are offered in 3,500 stores and online in North America and Europe. True Leaf's medical division is a licensed producer in the Canadian market for medicinal cannabis.

The Yield Growth Corp. (CSE:BOSS)

Yield Growth is a vertically-integrated asset company that provides cannabis-infused products. The Company's subsidiary, Urban June, offers skin and personal care products that use oil from hemp (not CBD) as the main ingredient. The subsidiary offers 11 products that are currently able to be purchased in Canada and the U.S. and will be soon offered in Asia.

Competitor Pricing Analysis

On the next page is a competitor pricing analysis of topical CBD creams. The average price of CBD for beauty and anti-aging CBD creams is \$0.30/mg, compared with topical CBD pain products, which have an average price \$0.24/mg of CBD. A higher price point suggests that beauty and anti-aging could have higher gross margins compared with topical pain products. Additionally, a report conducted by [SIS International Research](#), found that over the next 20 years spending on anti-aging/beauty products by people over the age of 50 is expected to increase by 58% to reach US\$4.7 trillion annually. It is no secret that Baby Boomers wish to look younger. Thus, Baby Boomers are willing to spend money on an increasing number of beauty and skincare products, including those that are innovative and often utilize new technologies. In our view, Ovation's products are a prime candidate for Baby Boomers to revitalize their anti-aging/skincare routines.

Figure 18: CBD Topical Products Pricing Analysis

Anti Aging / Moisturizing					
Product	Company	Quantity	Price (\$US)	Concentration	Price/MG CBD
CBD Night Cream	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	50 ML	\$34.50	200MG/bottle	\$0.17
Moisturizing Day Cream	Khiron Life Sciences (CSE:KHRN) <i>Kuida Cannabis Cosmetics</i>	50 ML	\$25.78	Not available	Not available
Regenerative Night Cream	Khiron Life Sciences (CSE:KHRN) <i>Kuida Cannabis Cosmetics</i>	50 ML	\$24.50	Not available	Not available
CBD Body Lotion	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	265 ML	\$16.50	75MG/bottle	0.22
CBD Face Oil	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	30 ML	\$39.50	100MG/bottle	\$0.40
CBD Lip Balm	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	5 ML	\$7.50	25MG/bottle	\$0.30
CBD Eye Cream	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	15 ML	\$24.50	200MG/bottle	\$0.12
Eye Contour	Khiron Life Sciences (CSE:KHRN) <i>Kuida Cannabis Cosmetics</i>	15 ML	\$29.83	Not available	Not available
CBD Lip Balm	Cannex (CSE:CNNX) <i>Pure Ratios</i>	4 G	\$12.00	20MG/bottle	\$0.60
Average			\$23.85		\$0.30
Pain Relief					
Product	Company	Quantity	Price (\$US)	Concentration	Price/MG CBD
BASKIN Sport	Ovation Sciences Licensee (CSE:OVAT) <i>BASKIN</i>	90 ML	\$50.00	300MG/bottle	\$0.17
BASKiN Wellness Cream	Ovation Science's Licensee (CSE:OVAT) <i>BASKIN</i>	60 ML	\$40.00	150MG/ bottle	\$0.27
BASKiN + Wellness Cream	Ovation Science's Licensee (CSE:OVAT) <i>BASKIN</i>	60 ML	\$60.00	400MG/bottle	\$0.15
CBD Muscle Balm	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	65 ML	\$19.50	200MG/bottle	\$0.10
CBD Deep Relief Cream	Green Growth Brands (CSE:GGB) <i>Seventh Sense Botanical Therapy</i>	60 ML	\$34.50	500MG/bottle	\$0.07
CBD Transdermal Patch	Cannex (CSE:CNNX) <i>Pure Ratios</i>	1 G	\$18.00	40MG/bottle	\$0.45
Patches	Curaleaf Holdings (CSE:CURA)	3 patches	\$49.99	25MG/patch	\$0.67
Topicals	Curaleaf Holdings (CSE:CURA)	4 OZ	\$44.99	300 MG	\$0.15
BASKiN + Glow	Ovation Science's Licensee (CSE:OVAT) <i>BASKIN</i>	60 ML	\$89.99	50mg CBD/ bottle 500MG THC/bottle	\$0.16
CBD Topical Cream	Cannex (CSE:CNNX) <i>Pure Ratios</i>	50 ML	\$35.00	500 MG/bottle	\$0.07
Average			\$44.20		\$0.23

Source: Google, Ubika

Investment Risks

International business and government regulations have the potential to impact the Company's product offerings and its ability to generate revenue. The Company is planning to operate internationally and, as a result, is subject to local business risks, which could impact the Company financially as well as operationally. Additionally, the Company could face issues in being subjected to different governmental regulations or laws that would impact operations and/or income. The Company will also be impacted by changes in Canadian laws, regulation and guidelines in the Controlled Drug and Substances Act. Similarly, in the U.S. cannabis is a controlled substance under the United States Federal Controlled Substances Act and, as a result, Ovation will be impacted by any changes in regulations. As the medical cannabis industry continues to expand, additional research into medical therapies may be needed, with such research being restricted in the U.S. and is new to Canada. This will potentially impact how the Company conducts research as they look at expanding into the medical field. Lastly, uncertainty of the political relations between countries may lead to changes in legal regulations

There is potential concern for product liability and how the media will portray CBD health and wellness products. Ovation will face liability issues if users of the product get harmed from the formulation of the product or from unforeseen contamination. Similarly, Ovation may be impacted by negative publicity about CBD health and wellness products.

Potential concern that as the Company is new, it may not be able to keep up with competitors or be able to increase their market share. This will become difficult if the Company is unable to manage growth or develop new products and methods without infringing on the intellectual property rights of third parties. The Company's success will also be dependent on attracting new sublicensees and customers or continue expanding into new profitable markets. This will be dependent on the Company's ability to continue investing in research and development.

However, while the Company is new the technology and management are not; management has researched Invisicare® for 20+ years and has developed over 40 products utilizing the technology in the dermatological and healthcare space. We believe that management's extensive experience in the dermatological space is an advantage for the Company and will allow them to execute on successful commercialization of ARLO CBD Beauty and Invibe MD, as well as bringing on new licensees.

Management Team

Terry Howlett, President, Director, Co-Founder

Mr. Howlett has had diverse experiences during his 35 + year career with market initialization and development, sales and venture capital financing for emerging growth companies, including over 20 years working with the developer of the Invisicare polymer delivery system.

Doreen McMorrان, COO, Director, Co-Founder

Ms. McMorrان has focused on catalyzing business growth through the new licensee and acquisition for Ovation's formulated products and technologies. She has 25+ years of background experience in the medical and pharmaceutical industry with a focus on strategic planning, sales and marketing, including 12 years working with the developer of the Invisicare polymer delivery system.

Logan Anderson, CFO, Director

Logan B. Anderson has served as CFO and Secretary at Ovation Science Inc. since 2017 and Director since 2017. Mr. Anderson is an Associated Chartered Accountant (New Zealand). He has vast background with 30+ years experience in mining and health companies.

Dave K. Ryan, Head of IR, Director

Mr. Ryan has 25 years experience bringing multiple Initial Public Offerings to the market.

Ian Howard, Director

Mr. Howard has over 40 years of extensive experience in marketing, government and health care and over 25 years of business experience with Fortune 500 companies.

Joan Chypyha, Director

Ms. Chypyha has 25 + years experience in the pharmaceutical industry in various senior management positions and has completed over 20 licensing deals and product launches.

James Roszell, PhD, Head of Product Development

Dr Roszell is a doctoral chemist and developer of Invisicare®, with over 40 years experience in product formulation, experimental design, analysis, and method validation, including 20 years developing over 40 topical skincare product formulations utilizing the Invisicare delivery system. Dr. Roszell is the holder of over 15 U.S. patents and 11 international patents, including both Invisicare and product formulations.

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