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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Auscann-Cannpal Merger

By **TIM BOREHAM**

ASX codes: AC8 (Auscann), CP1 (Cannpal)

Share prices: Auscann 15 cents; Cannpal 17 cents (Cannpal ceased trading March 11)

Market caps: \$47.6 million (Auscann), \$16.15 million Cannpal (at the close on March 12, combined entity about \$66.7 million)

Shares on issue: Auscann 317,047,357; Cannpal 95,000,000; **Shares on issue (post-merger):** 440,547,357 (123,500,000 to be issued to Cannpal holders)

Chief executive officer (merged entity): Layton Mills

Board (proposed for merged entity): Max Johnston (chair), Chris Mews, Krista Bates, Bruce McHarrie, Geoff Starr*, Robert Clifford*, Dr Kathryn Adams* (*Cannpal directors)

Finances (December half 2020):

Auscann: sales \$39,364 (previously nil), loss of \$4.6 million (previously \$3.4 million deficit), cash of \$15.23 million (down 20%)

Cannpal: sales \$16,655 (previously nil), loss of \$273,000 (previously a \$512,000 deficit), cash of \$1.4 million (down 26%)

Substantial shareholders (merged entity): Merchant Opportunities 15 percent, Layton Mills 2.3%, Tania Vidovic 2%, Mal Washer Nominees 1.6%

After years of talk about a pending rationalization of the underachieving ASX-listed cannabis sector, the first full-blown merger of two locally listed pot stocks has been duly implemented.

At a virtual meeting on Monday, Cannpal shareholders agreed to a scheme of arrangement that sees the company subsumed by Auscann.

Given the tight nature of the Cannpal register the union was never really in doubt and was duly approved by holders accounting for 99.9 percent of the shares and 94 per cent of the participating investors.

(Schemes of arrangement require consent from at least 50 percent of voting holders by numbers and 75 percent of shares by value).

The scrip-based deal melds Cannpal's veterinary drug program with Auscann's two-legged one.

As well as generating the usual cost benefits, the proponents argue the union will imbue greater liquidity, attract more institutional investors and meld two complementary product portfolios.

The union is also expected to expand the company's presence not just locally, but in the US, the Middle East, Asia and Germany.

While Cannpal has more advanced programs, Auscann delivers a crucial element - cash - to the table.

A key aspect is that while Cannpal disappears from the ASX boards, the new Auscann will be headed up by Cannpal founder and CEO Layton Mills.

Auscann chief Nick Woolf handed in his resignation in early January, but committed to keep running the show until the merger is complete.

What Auscann brings to the table

The greater Auscann will have two products on market and two to be launched in the next 12 months.

On the Auscann side, Neuvis, is a hard-shell capsule containing a controlled dose of cannabidiols (CBD) and the psychoactive tetrahydrocannabinol (THC) in equal parts.

Neuvis has been available under the local Therapeutic Goods Administration's special access scheme and the network of approved prescribing doctors.

The company recently completed a phase I study of 28 volunteers and plans a phase IIa trial for chronic neuropathic pain. This 60-patient effort is expected to start at local sites this year.

Meanwhile, what Auscann isn't bringing is its joint venture with Chilean grower Dayacann, entered into in 2016.

After the Chilean government last year banned the export of cannabis products, Auscann sold its stake to two offshore parties in November last year, for \$US1.5 million (\$A1.9 million). Of this, Auscann received \$US200,000 upfront.

And Cannpal?

Cannpal brings along CPAT-01, a liquid medication for canine inflammation. The company carried out a phase I study that enrolled 100 dogs, including 46 with osteoarthritis.

Cannpal has lodged an investigational new drug application with the US vet regulator, the Food and Drug Administration's Centre for Veterinary Medicine. This is something to crow (or howl) about, given no other drug company has this status for a CBD-related application.

But Cannpal's's closest path to commercialization is with Dermacann, a CBD derived food additive to promote healthy skin and immune functions. A liquid oral version has been tested on some willing hounds = or at least their owners consented on their behalf - for atopic dermatitis.

Cannpal intends to seek regulatory approval for Dermacann in "key markets", with first sales targeted for this year in the US and South Africa.

"We are in the final stages of working through a distribution agreement with a major partner in South Africa." Mr Mills says.

The US approach harnesses the recent liberalization of products containing CBD derived from hemp, which makes getting to market easier in at least some states. The regulatory framework is still complex, but in effect the company can market Dermacann as a food additive if it makes the right claims (and does not over reach).

If approved in Australia, Dermacann would be the only approved veterinary cannabis therapy and only the third approved cannabis drug overall (the others are Epidiolex for epilepsy and Sativex for multiple sclerosis).

Cannpal also has Micromax, a canine food additive based on encapsulation technology developed by the venerable CSIRO (Cannpal acquired the rights to the tech in 2019).

Cannpal plans a pilot launch in the US of a non-prescription dietary supplement for hip and joint health.

A pot-ted history of Cannpal

Cannpal was founded by Mr Mills and listed in October 23, 2017, raising \$6 million at 20 cents a pop.

It was - and remains - the world's only listed, pure-play, pet, pot stock.

In early 2017 Cannpal entered a term sheet with the then Zelda Therapeutics to bestow Zelda with the first use of its clinical data for human purposes. But the deal lapsed after Zelda merged with Ilera Therapeutics of the US and became Zelira Therapeutics.

Earlier on, Cannpal and Auscann had a chat about the latter taking on the former's human health research and development, but nothing eventuated.

With a background in consumer goods, Mr Mills zeroed-in on the work on alternative health therapies spearheaded by Californian researchers.

In the pain space, that meant alternatives to opioids.

“In the animal space there hadn’t been so much innovation,” he says.

As a result, non-steroidal anti-inflammatory drugs remain the key treatment for canine osteo, despite myriad side effects.

Initially Cannpal targetted an alternative therapy for doggy bone cancer, but accessing the beasts proved to be difficult.

Lest we be seen as specie-ist, Cannpal is also interested in cats, but as we all know they are more finicky and have trickier metabolisms.

The full dope on Auscann

Auscann listed on February 3, 2017, by way of a reverse takeover of TW Holdings and a \$5 million capital raising at 20 cents apiece.

Auscann wasn’t the first ASX pot stock - that honor went to Perth based peer Phytotech, now owned by Canada’s Harvest One - Auscann was a fast follower.

Initially, Auscann was run by the ‘A-team’ of Dr Stewart Washer and Elaine Darby, the son and daughter of former Federal MP Dr Mal Washer (who not only chaired the Joint House Committee on Environment and Climate Change, but later chaired Auscann).

The company’s plans first focused on growing the stuff in Chile and producing pharmaceutical grade product, but things never quite clicked.

Ms Darby resigned in September 2018, to be replaced by former Teva executive Ido Kanyon on an eye watering base salary of \$420,000 a year.

Mr Kanyon lasted less than a year and the board then decided it was time for Mr Woolf.

The movers and shakers behind the deal

Under the deal, Cannpal holders receive 1.3 Auscann shares for each Cannpal shares. At the time of the November 16, 2020 announcement, the implied valuation of 18.4 cents per Cannpal share and was a 54 percent premium over the weighted average price of Cannpal shares (11.95 cents) for the previous five trading days.

A key driver of the merger was the assent of the ubiquitous Merchant Funds, which held 19.88 percent of Cannpal and 13.6 percent of Auscann, a stake acquired in 2019 from original Auscann investor Canopy Growth (a leading Canadian pot stock).

Post-merger Merchant will own 15 percent of the entity.

As an aside, Merchant was also a common shareholder of cancer diagnostic houses Bard1 and Sienna, which merged last year.

The odds of a 'yes' vote were also enhanced because Mr Mills owns 8.4 percent of Cannpal and Tania Vidovic, another friendly party and former Cannpal director accounts for another 7.4 percent.

Finances and performance

Both companies could be politely described as pre-revenue: Auscann managed \$13,000 of receipts in the December quarter, while Cannpal chalked up \$11,000.

The companies lost \$1.8 million and \$553,000 respectively.

As of December 30, Auscann had \$16.8 million of cash, with a further \$US1.5 million to flow from the Dayacann divestment.

Cannpal had \$1.4 million in the kitty (or doggy, if you prefer) with an R&D Tax Incentive to come, but still copped a 'going concern' comment from audit firm BDO.

Auscann's loot is courtesy of a \$33 million placement in a July 2018 placement. Earlier, in May 2017, the company pocketed \$15 million from a placement to poppy grower Tasmanian Alkaloids.

Auscann shares are well off their January 2018 peak of \$1.74, while Cannpal shares hit their high of 21 cents in early December last year.

Elsewhere ...

The merger is in keeping with the popular trend of cannabis 'vet' plays seeking human cannabis exposures, or vice versa.

For example, hemp play Ecofibre has been focused on food additives but is expanding into pet care markets.

The owner of vitamins giant Suisse, the Hong Kong based Health & Happiness Group (H&H Health) owns 17 percent of ASX pot stock BOD Australia.

H&H has acquired the Solid Gold pet nutrition brand and will access CBD formulations from BOD.

Creso Pharma plays in both the human and fur-clad sectors with Anibidiol, a hemp-based CBD complementary feed for companion animals.

Mr Mills notes that it makes perfect sense to leverage the veterinary trial data with the human side of things, given human drug development also requires animal-based studies.

Dr Boreham's diagnosis:

Generally speaking, mergers have a habit of disappointing, at least initially. But at the very least, we can't see this one doing any harm.

We won't know for some time whether one plus one equals more than two, and the union is a howling success. But at the very least the merger looks like it will do no harm and save money at corporate HQ level, as well as in the labs (laboratories, not the golden or tan varieties).

Personally, we're more excited about the veterinary side, given the near-term promise for Dermacann and the longer-term prospects for CPAT-01.

The local human medical cannabis sector is growing, but from a low base and, if anything, there's an oversupply.

What's really paws for thought is the veterinary sector, given the lower regulatory hurdles and the ever-expanding market as our fur-babies work their way up the evolutionary chain to true household dominance.

Disclosure: Dr Boreham is not a qualified medical practitioner. He does not possess a doctorate of any sort but does own a dopey hound who has never inhaled.