



ASX Announcement

1 August 2017

Q and A on Mernova Medicinal Inc acquisition

Creso Pharma Limited (ASX:CPH, the “Company” or “Creso”) wishes to provide a Q & A on the acquisition of Mernova Medicinal Inc., as announced on 27 July 2017.

1. About Creso Pharma Ltd

Creso Pharma brings pharmaceutical expertise and methodological rigour to the world of medicinal cannabis and strives for the highest quality in its products. It is the leader in cannabidiol (CBD) innovation and develops cannabis and hemp-derived therapeutic-grade CBD nutraceuticals and medical cannabis products with wide patient reach for human and animal health. Creso uses Good Manufacturing Practice (GMP) development and manufacturing standards for its products as a reference of quality excellence with initial product registrations in Switzerland. It has worldwide rights for a number of unique and proprietary innovative delivery technologies which enhance the bioavailability and absorption of cannabinoids.

2. Why Canada?

When Creso was founded and listed on the ASX, the founders had identified that Canada was a potential future market for cannabis cultivation and sales given that the Canadian jurisdiction is the most advanced in the world from a legal access perspective and legal sales market size. This intent was expressed in the Prospectus and remains a core focus of the Company’s business strategy.

Health Canada’s projections for the medical marijuana sector in Canada estimate 450,000 patients by 2024, representing C\$1.3 billion in sales. The adult recreational market (due to be legalised by 30 June 2018) is forecast to add between C\$4.9 – C\$8.7 billion in sales over the same period.

The current supply from existing licensed producers in Canada will not be able to keep up with the demand, without more supply coming onto the market. Therein lies the opportunity for Creso.

In addition, Canada’s regulations are evolving and open up potential additional opportunities for Creso beyond local supply. With this acquisition, there exists the potential to take Creso’s medicinal cannabis expertise, nutraceutical human health product CannaQIX[®] and animal health product anibidiol[®] into Canada using the Company’s own local cultivation, extraction and R&D capabilities.

Furthermore, there already exists an export precedent for Canadian medicinal cannabis products, something that is not currently an option for Australia, US, Israel and other markets. Having this ability also allows Creso to pursue global medicinal cannabis opportunities as they arise and build a dedicated team of professionals with the technical competencies to manage global expansion.

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3. Who is Mernova Medicinal Inc.?

Mernova Medicinal Inc. (Mernova) is a privately held company based in Halifax, Nova Scotia, Canada. The founder and CEO is William (Bill) Fleming. Mernova is establishing a team of experts qualified to build the proposed cannabis growing, production and extraction facilities to Creso's requirement of a GMP standard. Mernova has land available to construct an initial growing/production facility totaling 20,000 sq ft, with plans to expand this to 200,000 sq ft subject to market conditions and the Company's plans.

Creso also intends to build a state-of-the-art CO2 extraction facility that is fully GMP compliant at the Mernova site. This is an important strategic step for Mernova to ensure that it is fully able to capitalise on the Canadian market opportunity.

Extracts and other cannabis derivatives are the future in Canada (and all other legal markets). Creso, through Mernova, intends to be a market leader in this field.

4. How advanced is Mernova in obtaining a cultivation license?

Mernova, in cooperation with municipalities and Office of Controlled Substances and Health Canada, has an application for a cultivation license under review by the Access to Cannabis for Medical Purposes Regulation (ACMPR). This process was started in May 2014 and is progressing through the multiple steps as required by the authorities.

Currently, there are no Nova Scotian licenses issued of the 52 licenses granted to date in Canada. Mernova's could be the first licence issued in Nova Scotia and the first that is focused on more than dry bud production and that leverages a pharmaceutical approach to the market. All facilities are inspected as part of the final federal license approval process to ensure safety, professionalism and compliance.

5. What are the deal terms?

Creso is acquiring Mernova for three milestone cash payments of C\$1.8 million (A\$1.82 million) and three milestone issues of Creso shares to the value of C\$8.3 million (A\$8.38 million). These staged payments can be summarised as follows:

- Upon settlement of the acquisition, Creso will make an initial cash payment of \$C600,000 and issue C\$8,300,000 of fully paid exchangeable preferred shares (Exchangeable Shares) in the capital of Canadian subsidiary of Creso (Creso Sub) at an issue price equal to the 10-day volume weighted average trading price (VWAP) of the ordinary shares of Creso (Creso Shares) as traded on the ASX over the 10 trading days immediately prior to settlement (the Consideration Shares);
- Upon Creso announcing to the market of the planting by Mernova of its first crop following completion of construction of the production facility (Milestone 1), Creso will make a further cash payment of C\$600,000 and C\$2,400,000 of the Consideration Shares will become convertible into Creso Shares at an issue price equal to the 10-day VWAP of the Creso Shares at the date the relevant Mernova shareholder elects to convert the Consideration Shares; and
- Upon Creso announcing to the market of the granting of a sales licence to Mernova under the ACMPR (Milestone 2), Creso will make a further cash payment C\$600,000 and C\$3,500,000 of the Consideration Shares will become convertible into Creso Shares at an issue price equal to

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the 10- day VWAP of the Creso Shares at the date the relevant Mernova shareholder elects to convert the Consideration Shares.

To satisfy the arrangement, Milestone 1 must be achieved within 24 months of settlement, and Milestone 2 must be achieved within 12 months of Milestone 1 being satisfied, otherwise the Mernova shareholders' entitlement to the Consideration automatically lapses. These dates may be extended if agreed force majeure events occur.

The transaction has been structured so that the Mernova shareholders receive "Exchangeable Shares" in the Creso Sub to enable them to secure tax deferral in Canada on the disposal of their shares in Mernova (in much the same way that CGT roll over relief applies under Australian tax laws).

In addition, the Consideration Shares for Milestone 1 and Milestone 2 will be convertible into Creso Shares based on a VWAP after these milestones are achieved. Importantly, this will result in less dilution for existing Creso shareholders if the trading price of Creso's shares on ASX appreciates in the intervening period.

The agreement with Mernova remains subject to completion of due diligence by Creso, and receipt of any required regulatory approvals.

6. What is the strategic rationale for the deal?

The main strategic rationale is for Creso to drive greater revenues and hence profitability. Creso outlined in its Prospectus that it was looking to establish a presence in Canada and also to pursue opportunities in the medicinal as well as recreational cannabis space, so this acquisition delivers on the Company's overall strategy.

As mentioned above, Canada is one of the only legal jurisdictions in the world where it is currently possible to make real money (revenue and profit) in the cannabis industry. It has a real and growing consumer market (medical and soon to be recreational) and a regulatory framework that facilitates sales to consumers. Unlike Australia, where the existing regulatory framework makes it near impossible to get medical cannabis products into the hands of patients.

Once Mernova has secured all of its ACMPR licence approvals and grown its first cannabis crop, there is market demand to sell this product either on a wholesale or retail basis. This demand is growing year on year. Therefore, Mernova expects to be in revenue soon after completing its first crop harvest.

In addition, the acquisition gives Creso the ability to rationalise and vertically integrate its supply and production chain by building its own Good Manufacturing Process (GMP) cultivation and extraction facility.

The acquisition also gives Creso Pharma:

- A presence in the growing and well-regulated Canadian market for its innovative animal and human health nutraceutical products;
- In the past two years, the number of Canada's registered patients has grown six-fold, from about 24,000 in June 2015 to nearly 168,000 by March 2017;
- Diversification into the Canadian adult, medicinal and recreational use market from July 1 2018 when recreational use is expected to be legalised in the Canadian market;



- Cost-effective entry into its own production in the Canadian market where licences are expected to become more expensive as quality standards increase;
- Greater integration of its supply chain, allowing the Company to produce its own medicinal cannabis as well as supply its existing planned products to the Canadian market;
- The ability to bring its significant pharmaceutical expertise and rigour to medicinal cannabis production as well as cultivation and extraction in Canada;
- The growing facility offers optionality for Creso and increases its diverse portfolio; and
- The ability to potentially expand geographically into the emerging US market.

7. What is Creso's funding position?

Creso remains very well funded with A\$9.23 million cash on hand as at 30 June 2017. These funds will be used by Mernova to accelerate construction of its Nova Scotia production facility and the granting of a production licence by Health Canada.

8. What are the benefits of a licence under the ACMPR?

The granting of a licence to Mernova will give Creso Pharma a significant competitive advantage as it will be one of the few companies globally and the only medicinal cannabis company listed on the ASX with the capacity to commercially cultivate medicinal-grade cannabis in the Canadian federally regulated environment. Similar licences, once granted, are valued at between C\$50-C\$250 million.

A licence would also be a significant strategic asset with current production levels from existing licence holders under the ACMPR forecast to only be able to meet 5% of the future demand from the recreational/adult sector.

It will also allow Mernova to establish operations and begin to produce cannabis products.

9. What are the benefits for Creso and its shareholders?

- Access to recreational market valued at between C\$4.9 – C\$8.7 billion in sales;
- Enhanced margins, revenue and profit through control of seed to sale;
- Clear regulatory path to cultivation licenses and development of core capabilities early in the development of the Canadian market;
- Scalable 150-200,000 sq. ft. state of the art R&D, cultivation, production, extraction and secure storage facility in a market where legal exportation can be established;
- Accelerates Creso's ability to innovate and develop intellectual property;
- Creso can establish a state of the art R&D facility to build the most appropriate plant genetics and stable cannabis strains to produce standardised products. The initial products will be dry bud and oil extracts based on stable cannabis strains for the management of various medical conditions such as pain management, cancer, multiple sclerosis and post traumatic stress disorder. Creso will then develop and commercialise a variety of medications in innovative, proprietary, smokeless formulations and delivery systems, offering new choices to patients beyond smoking. The Company's patented buccal delivery technologies will enhance the bioavailability and absorption of the cannabinoids in the new proposed products in a unique manner. The products will be manufactured according to strict pharmacological and therapeutics protocols and will contain various, standardised amounts of active ingredients

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from cannabis extracts. Creso will thus be able to control the dose and formulation with fully GMP, standardised formulations;

- Creso has the resources, expertise and manpower to understand the development, production and distribution through the pharma sales and marketing channels;
- The growing facility offers optionality for Creso and increase its diverse portfolio; and
- The Canadian location also allows Creso to potentially expand into the emerging US market.

10. How long will it take for Creso to pay off the acquisition costs?

Approximately 8-10 months after being granted a sales licence under the ACMPR depending on achieving aforementioned revenue.

11. How does the acquisition accelerate Creso's path to significant revenues?

The acquisition will augment Creso's revenue stream. The Company already expects first revenues from the launch of its hemp-based complementary feed product for companion and zoo animals (anibidiol[®]) in Switzerland later this year and human nutraceutical CannaQIX[®] early in 2018. The cultivation, production and sale of medicinal recreational cannabis in Canada will further diversify the revenue stream.

12. How did you arrive at the purchase price of C\$10.1mn?

The valuation was based on arm's length negotiations with reference to other transactions occurring in the Canadian market place. A number of other potential acquisitions were also considered but Mernova was ultimately determined to be the best strategic fit for Creso due to the factors outlined above and also Mernova's strategic location with the necessary access to power, water, zoning and land for future expansion. The provincial jurisdiction (Nova Scotia) offers many low-cost advantages and has access to many universities for human resources, training and research as well as access to scientific research and development tax credits.

13. How many tonnes of cannabis does Creso expect to sell and at what price?

Based on the initial facility design (20,000 sq ft), a conservative revenue model could be 2000kg per annum @ C\$7.87 price per gram = C\$15.74 million, based on five crops per room, per annum.

14. What are the benefits of the entry into the Canadian market?

Canada is a well-regulated and growing market:

- There are 52 licensed producers operating under Health Canada's ACMPR program
- Health Canada's projections for the medical marijuana sector in Canada estimate 450,000 patients by 2024, representing C\$1.3 billion in sales
- Actual participation in the ACMPR is outpacing estimates and many observers have adjusted projections upwards to C\$3 billion in sales
- Legislation to open a recreational market was tabled by the federal government in 2017 and is expected to be implemented by the end of June 2018
- Proposed legislation would allow Canadians over the age of 18 to legally use recreational cannabis, which would significantly expand the market from the current limited medical sector

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- Delivery methods have not yet been fully determined, but it is expected that there will be access through both physical and mail-order systems
- The recreational market would immediately create significant opportunity for medical producers to expand into recreational production. The base retail market value is projected to stand between C\$4.9 to C\$8.7 billion, with significant industry growth expected following legalisation
- Geographical proximity to the emerging US market

15. How does this position Creso Pharma versus peers?

The production and cultivation licence will mean Creso Pharma will be one of the few companies worldwide and one of the few medicinal cannabis companies listed on the ASX with the capacity to commercially cultivate medicinal grade cannabis in a federally regulated environment. Similar licences, once fully developed, are valued at between C\$50-C\$250 million.

In terms of its Australian peers, Creso becomes one of the only ASX-listed medicinal cannabis companies with a Canadian presence and a Canadian cultivation ACMPR licence in the queue:

COMPANY	LISTING	MARKET CAP (\$ million)	FACILITY SIZE (sq. ft. in planning)	PRODUCTION YIELD (kg/annum)
MMJ Phytotech	ASX:MMJ	A\$65	78,000	62,000
AusCann Group Holdings	ASX:AC8	A\$53		
MGC Pharmaceuticals	ASX:MGC	A\$44		
Creso Pharma	ASX:CPH	A\$37*	200,000	20,000 - 40,000
Zelda Therapeutics	ASX:ZLD	A\$28		
Botanix Pharmaceuticals	ASX:BOT	A\$19		

*Market cap at 42c

In terms of Canadian peers, Creso Pharma's market cap is significantly lower:

COMPANY	LISTING	MARKET CAP (\$ million)	FACILITY SIZE (sq. ft. in planning)	PRODUCTION YIELD (kg/annum)
Canopy Growth	TSX:WEED	C\$1,200	472,000	5,355
Aurora Cannabis	TSX:ACB	C\$810	800,000	100,000
Aphria	TSX:APH	C\$746	300,000	18,000
MedReLeaf	TSX:LEAF	C\$714	210,000	35,000
Cronos Group	CVE:MJN	C\$310	315,000	8,000
OrganiGram Holdings	CVE:OGI	C\$253	227,500	26,000
Supreme Pharmaceuticals Inc	CVE:FIRE	C\$215	342,000	10,000
Emblem Corp	CVE:EMC	C\$187	32,000	16,000

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COMPANY	LISTING	MARKET CAP (\$ million)	FACILITY SIZE (sq. ft. in planning)	PRODUCTION YIELD (kg/annum)
Maricann	CNSX:MARI	C\$110	217,500	20,000
Merapharm Ventures	CNSX:MDM	C\$94.8	22,000	N/A
ABcann Global	CVE:ABCN	C\$86	100,000	625
Harvest One	CVE:HVST	C\$54	16,000	1,000
Valens GroWorks	CNSX:VGW	C\$51	17,000	N/A
TerrAscend	CNSX:TER	C\$38	67,000	6,000
Weed MD	CVE:WMD	C\$34	220,000	1,200

16. What does this mean for Creso's involvement in the Australian medicinal cannabis market?

Creso remains committed to the medicinal cannabis market in Australia and the LOI with LeafCann, signed in May 2017, is aligned to the goal of locally produced medicinal cannabis products cultivated, extracted and produced in Australia.

Canada can and already has exported cannabis products to Australia and other countries that will accept them. Creso already has a non-exclusive deal with CanniMed to do this. This deal with Mernova means that, in the future, Creso will potentially be able to cultivate its own- branded products in Canada to export to the Australian market.

17. Will Creso also be cultivating cannabis to produce recreational products?

Legislation in Canada to open a recreational market was tabled by the federal government in 2017 and is expected to be implemented by the end of June 2018. This proposed legislation would allow Canadians over the age of 18 to legally use recreational cannabis, which would significantly expand the market from the current limited medicinal cannabis sector.

Creso Pharma has never ruled out the prospect of moving into the recreational market. However, if the Company was to do so, it would be in a highly-regulated market for recreational products such as Canada.

18. Who are Creso and Mernova's key personnel?

Creso Board of Directors:

DR. MIRI HALPERIN WERNLI - CEO & CO-FOUNDER

Dr. Halperin Wernli is a senior pharma executive with over 25 years of strategic and operational leadership in global drug and product development in the pharmaceutical and biomedical

industries. She held worldwide executive leadership positions in R&D and in strategic marketing within global pharmaceutical companies in Switzerland and in the US.

BOAZ WACHTEL - CHAIRMAN & CO-FOUNDER

Mr. Wachtel is a leading Medical cannabis expert, co-founder and former managing director of Phytotech Medical (MMJ.ASX), Australia's first publicly traded medical cannabis company. He initiated and helped

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implement the National Medical Cannabis Program in Israel. Mr. Wachtel is a certified Clinical research manager and holds an MA in management and marketing from the University of Maryland.

DAVID RUSSELL - CHIEF OPERATING OFFICER

Mr. Russell has more than 25 years' experience within the pharmaceutical and biotech industry with a number of leading global companies including Roche, Actelion Pharmaceuticals, Celgene and Novogen (ASX:NRT). In particular, he has been responsible for building, leading and growing commercial teams resulting in multiple product launches in China, Australia and Asia in a number of therapeutic areas.

ADAM BLUMENTHAL - NON-EXECUTIVE DIRECTOR & CO-FOUNDER

Mr. Blumenthal has 10 years' experience in investment banking and corporate finance. He has deep exposure to Australian and International markets, having provided capital raising and financing solutions to an extensive number of listed and unlisted companies. He has successfully brought to market several medical cannabis companies spanning Israel, Canada, Switzerland and Australia

DR. JAMES ELLINGFORD - NON-EXECUTIVE DIRECTOR

Dr. Ellingford's professional life culminated in being President of an international publicly listed billion dollar business with its headquarters in Geneva, Switzerland and New York, USA. He has vast experience in the international arena and has successfully developed close ties with both financial institutions as well as governments throughout the world.

Mernova Management Team:

BILL FLEMING - CEO

Mr. Fleming has founded and served as CEO for a number of entrepreneurial companies and has served with senior executive teams dealing with equity and debt financings. He has developed corporate strategies for a wide range of companies, from family-owned businesses to

multinational companies. He is the Executive Chairman of Moz and a Director of NWest Energy Corp.

CHARLES WILLIAMS - QUALITY ASSURANCE

Dr. Williams completed a Ph.D. in Organic Chemistry at McGill University in 1991. He spent four years as an Evaluation Officer in the Health Evaluation Division of the Pest Management Regulatory Agency (PMRA) of Health Canada. He founded CRW Regulatory Services Inc. and has extensive experience and training in Good Laboratory Practice procedures and requirements, Good Manufacturing Practices and an understanding of the techniques related to the production of pure products.

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About Creso Pharma

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