



NOVEMBER 2019

VALUATIONS AND ACCOUNTING ADVISORY

Did Your Balance Sheet Get High Under IFRS?

The market capitalizations of most Canadian cannabis companies have declined since legalization in October 2018. At the end of 2018, the general expectation in the industry seemed to be that production and selling volumes would improve into 2019.

A year has passed, and the business environment for Canadian cannabis companies post legalization continues to be challenged. It's time for companies that made acquisition along the way, which resulted in intangible value being recorded on their balance sheets, to get ready to test for impairment under IFRS. Read on to find out if you're ready.

BDO's Valuation & Accounting Advisory team has put together a brief overview of impairment testing under IFRS, and a few questions to get cannabis companies thinking about their impairment testing requirements under IFRS.

The basics of IAS 36:

1. Companies that have goodwill and indefinite life intangibles are required to test their cash generating units ("CGUs") for impairment at least annually, whether they believe there is an impairment issue or not. Companies are also required to assess whether there are any impairment indicators each reporting date (typically quarterly).
2. The impairment test date doesn't necessarily need to be year-end, but a year-end test date tends to be the most common.
3. The "recoverable amount" of a CGU is compared to its "carrying amount." If the recoverable amount is higher, there is no impairment. If it's lower, there is an impairment.

If there is an impairment, any reported goodwill is written down first. Recording any remaining impairment is more complicated, but it's generally proportionate to the book values of the remaining assets in the CGU for which individual values cannot be readily determined. A number of cannabis companies have allocated intangible value to licenses, patient lists, and brands, none of which likely have readily determinable values. Working capital and equipment in greenhouses, on the other hand, may have more readily determinable values.



Examples of impairment triggers

While the below is not an exhaustive list, potential indicators include:

- ▶ A significant decline in share price post acquisition
- ▶ Market capitalization falling below book equity
- ▶ Realized price per gram being below forecast prices at the acquisition date
- ▶ Sales volumes being below forecast volumes at the acquisition date
- ▶ Failing to obtain the appropriate licence(s), or loss of licence(s)

Questions cannabis companies should be able to answer heading into year-end

1. Have you determined your company's CGUs?
2. Have you assessed/tested individual assets in the CGU for impairment first?
3. If you're using a year-end test date, were there any impairment triggers prior to Q4?

Impairment testing Q&A

1. Calculating the recoverable amount

Q: Do I need to prepare a forecast?

A: Yes, and it should include capital expenditure and net working capital requirements too.

Q: How many years should my forecast be?

A: Typically five years.

Q: What's the difference between value in use ("VIU") and fair value less costs of disposal ("FVLCD")?

A: The main difference is FVLCD can incorporate market participant synergies that the current owner of the asset may not be able to realize in its VIU.

Q: How do I determine the discount rate?

A: By calculating your weighted average cost of capital, using either a build-up approach or capital asset pricing model.

Q: Should my cash-flows be pre-tax or post-tax?

A: Good question—IAS references the use of pre-tax cash flows and pre-tax discount rates, but in practice companies tend to use post-tax cash-flows to avoid the complexities of undertaking a pre-tax analysis.

Q: Can I include loss carry-forwards in my recoverable amount?

A: No, the present value of the benefit of utilizing the losses will always be less than the corresponding deferred income tax asset. *But I'm not recording a deferred income tax asset for loss carry-forwards?* Then it would be inconsistent to use the benefit of the related loss carry-forwards in a recoverable amount determination in an accounting context.

2. Determining the carrying amount of a CGU

Q: What's normally included in a carrying amount of asset determination?

A: Net working capital, property and equipment used by the operations, and any intangible assets attributable to the CGU.



Q: Do I include cash or other redundant assets or redundant liabilities in my carrying amount?

A: Your carrying amount should be “apples to apples” with the recoverable amount. For example, if the carrying amount includes redundant cash, the recoverable amount should also include redundant cash. Keep in mind, when you’re comparing your carrying amount of equity to your market capitalization, market capitalization includes net redundancies, including cash.

Q: Do I get to deduct my deferred income tax liability from my carrying amount of goodwill?

A: Deferred income tax considerations are complex and cause confusion in an impairment analysis context. There isn’t a right or wrong way per se, and different accounting firms have adopted different approaches to the topic.

Timing

It’s a good idea to start the impairment testing process in advance of your test date, with a view of updating the carrying amount and forecast for any changes to the test date. For example, some companies use September 30th balances as placeholders.

If there are any impairment triggers in a quarter, don’t forget to assess impairment each reporting date as well.

How BDO can help

BDO’s Valuation & Accounting Advisory team works with Canadian and international cannabis companies in varying stages of development and production, and of varying sizes. Our in-depth knowledge of the cannabis sector, and valuation and accounting expertise, will ensure you get the proactive advice you need to avoid any unexpected impairment surprises.

To learn more, [contact your local BDO office](#) or cannabis@bdo.ca

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Select Metrics of Canadian Cannabis Companies

As at October 31, 2019

\$CAD Millions, unless \$/Share

		As at October 31, 2019							
Ticker	Company	Share price at October 17, 2018	Closing Share Price	Book Value / Share	Book Value / Share Price	Market Cap.	Equity Book Value	Intangible Book Value	
									1
2	TSX:ACB	Aurora Cannabis Inc.	13.57	4.72	4.31	91%	4,856	4,858	3,876
3	NasdaqGS:TLRY	Tilray, Inc.	192.51	29.36	4.84	16%	2,893	771	637
4	TSX:APHA	Aphria Inc.	19.40	6.60	6.88	104%	1,660	1,960	1,058
5	TSX:HEXO	HEXO Corp.	7.74	2.83	3.02	107%	727	848	240
6	TSX:OGI	OrganiGram Holdings Inc.	7.34	4.39	2.19	50%	686	379	2
7	TSX:LABS	MediPharm Labs Corp.	2.36	4.64	0.93	20%	606	168	-
8	CNSX:TER	TerrAscend Corp.	10.97	4.65	1.57	34%	575	212	144
9	NasdaqGS:SNDL	Sundial Growers Inc.	-	4.28	0.25	6%	402	152	19
10	TSXV:VGW	Valens GroWorks Corp.	1.95	2.73	0.98	36%	337	124	13
11	TSX:TGOD	The Green Organic Dutchman Holdings Ltd	5.73	1.02	1.46	143%	281	434	25
12	TSXV:PCLO	PharmaCielo Ltd.	-	2.85	0.54	19%	278	57	-
13	TSXV:FLWR	The Flowlr Corporation	5.10	2.18	0.67	31%	226	97	3
14	TSX:FIRE	The Supreme Cannabis Company, Inc.	2.02	0.71	0.70	99%	251	256	25
15	TSX:TRST	CannTrust Holdings Inc.	13.67	1.48	1.80	122%	209	209	-
16	CNSX:SLNG	SLANG Worldwide Inc.	-	0.60	0.98	163%	144	321	248
17	TSXV:WMD	WeedMD Inc.	1.87	1.12	0.84	75%	128	112	-
18	TSXV:KHRN	Khiron Life Sciences Corp.	1.71	0.99	0.78	79%	113	97	25
19	TSXV:EMH	Emerald Health Therapeutics, Inc.	4.56	0.81	1.33	164%	123	247	91
20	CNSX:CANN	Heritage Cannabis Holdings Corp.	0.28	0.25	0.16	65%	116	81	40
21	TSXV:NRTH	48North Cannabis Corp.	0.65	0.58	0.51	88%	99	91	8
22	CNSX:LOVE	Cannara Biotech Inc.	-	0.16	0.03	20%	110	16	-
23	TSXV:VIVO	VIVO Cannabis Inc.	1.26	0.27	0.73	275%	78	265	169
24	OTCPK:CPMD	CannaPharmaRX, Inc.	3.43	2.30	0.46	20%	82	18	10
25	CNSX:SPR	Sproutly Canada Inc.	0.74	0.33	0.31	95%	74	60	54
26	CNSX:ROMJ	Rubicon Organics Inc.	2.95	1.97	0.49	25%	79	21	2
27	TSXV:HVT	Harvest One Cannabis Inc.	0.80	0.30	0.48	162%	63	102	34
28	CNSX:MPXI	MPX International Corporation	-	0.49	-	0%	66	27	23
29	CNSX:SNN	Sunniva Inc.	5.27	1.35	1.87	139%	57	93	44
30	CNSX:HUGE	FSD Pharma Inc.	128.64	7.91	8.88	112%	62	69	25
31	TSX:ZENA	Zenabis Global Inc.	-	0.24	0.75	319%	49	205	62
32	TSX:DN	Delta 9 Cannabis Inc.	1.86	0.59	0.42	71%	52	40	0
33	CNSX:HITI	High Tide Inc.	-	0.25	0.12	47%	52	27	15
34	TSXV:EVE	Eve & Co Incorporated	0.42	0.18	0.07	37%	48	19	0
35	TSXV:WL	Westleaf Inc.	-	0.33	0.64	194%	48	103	62
36	CNSX:PUMP	World Class Extractions Inc.	-	0.07	0.09	122%	42	53	31
37	CNSX:CHOO	Choom Holdings Inc.	1.06	0.25	0.08	31%	48	16	2
38	TSXV:JWCA	James E. Wagner Cultivation Corporation	0.90	0.45	0.17	38%	42	21	0
39	CNSX:EAT	Nutritional High International Inc.	0.31	0.12	(0.00)	-1%	42	15	9
40	CNSX:CGRO	Citation Growth Corp.	1.48	0.39	0.57	146%	41	41	21
41	CNSX:EASY	Speakeasy Cannabis Club Ltd.	0.64	0.37	0.20	55%	32	19	-
42	CNSX:BIO	Biome Grow Inc.	1.66	0.26	0.12	49%	28	14	6
43	TSXV:GTEC	GTEC Holdings Ltd.	1.03	0.21	0.31	146%	27	40	18
44	CNSX:RQB	RavenQuest BioMed Inc.	0.93	0.24	0.17	69%	30	25	16
45	TSXV:SUGR	SugarBud Craft Growers Corp.	0.13	0.07	0.04	55%	25	15	3
46	CNSX:GLH	Golden Leaf Holdings Ltd.	0.24	0.03	0.09	292%	26	66	62
47	CNSX:EPIC	Leviathan Cannabis Group Inc.	0.87	0.30	0.43	142%	25	41	37
48	TSXV:CANB	CanadaBis Capital Inc.	-	0.19	0.03	17%	21	4	-
49	CNSX:THC	THC Biomed Intl Ltd.	0.78	0.14	0.11	77%	21	17	0
50	TSXV:GENE	Invictus MD Strategies Corp.	1.70	0.14	0.80	596%	17	117	53

Source: S&P Capital IQ & BDO Analysis