



Update (January 30, 2018)

**PotNetwork Holding, Inc
(OTC: POTN)
Target Price: \$1.25**

PotNetwork Holding (OTC: POTN), through its subsidiary Diamond CBD Inc., focuses on research, development, and sale of premium hemp extracts that contain a broad range of cannabinoids and natural hemp derivatives. CBD is one of the more than 85 cannabinoids identified in marijuana and hemp plants and is non-psychoactive with wide array of therapeutic benefits. Hemp derived CBDs provides a legal alternative to marijuana based CBD (which is banned at federal level) and allows the consumer to enjoy CBD without the risk of getting high and breaking any federal laws. Hemp derived CBD market is projected to grow at a CAGR of ~53% till 2020, positioning it as the fastest growing sub segment within the multi-billion-dollar legal cannabis and hemp market. Diamond CBD continues to report robust top line growth, as indicated by recent 3Q17 results and continued momentum through November. We see POTN as a speculative growth company focused on the burgeoning legal cannabis and hemp market targeting the fastest growing sub segment (hemp derived CBD). Upcoming catalysts new product launches, aggressive marketing initiatives and entry into new markets (specifically China), and efforts to uplist shares to a national market.

Investment Highlights

We are increasing our price target for POTN following strong monthly sales data and 3Q17 filings that indicate continued profitability as the company invests in growth. POTN results have included robust top line growth, with revenue already tracking above our initial estimates and company guidance. The company announced preliminary 2017E sales estimates of \$14.5mn, which were in line with our recently raised estimates for 2017E, and appears well-positioned to meet or exceed our 2018E estimate, assuming continued significant sales momentum in a structural growth market.

Highlights of recent developments at POTN include:

- On January 24, 2018, POTN preannounced positive full year 2017 sales results of \$14.5mn, which implies sequential growth in December following sales data of “at least” \$1.6mn in November.
- With preliminary 2017 sales of approximately \$14.5mn, POTN management appears to be executing its plan in line with our recently raised estimates, and approximately 70% higher than the initial guidance issued by the company at the beginning of the year for sales of \$8.3mn.
- The company now appears to be operating at an annualized revenue run rate of approximately \$20mn, assuming December sales were just under \$1.7mn, positioning POTN well versus our estimates of \$14.5mn in 2017E and \$22.8mn in 2018E.
- POTN CEO Dr. Richard Goulding recently reiterated the company’s plans to uplist shares to the OTCQX, with an ultimate goal of listing on a national exchange, such as the Nasdaq CM. A national listing would likely increase liquidity

and visibility for POTN. The company is preparing a Reg A filing to enable the uplisting to OTCQX.

Increasing price target to \$1.25

We are increasing the target to \$1.25 following recent results and share appreciation, as the company’s execution and profitability should warrant a multiple more in line with peers in the fast-growing legal cannabis market. The \$1.25 target suggests a valuation of 14.7x 2018E revenues of \$22.8mn and 8.2x 2019E revenues of \$41.1mn.

Stock Details (1/26/18)

| | |
|------------------------|--------------------|
| OTC: | POTN |
| Sector / Industry | Cannabis/ Hemp CBD |
| Price target | \$1.25 |
| Recent share price | \$0.85 |
| Common Shares o/s (mn) | 269.9 |
| Market cap (in \$mn) | 229.4 |
| 52-week high/low | \$0.96 / 0.02 |

Source: Thomson Reuters, SeeThruEquity Research

Key Financial (\$mn, unless specified)

| | FY16A | FY17E | FY18E |
|------------|-----------|------------|------------|
| Revenues | \$1,029.5 | \$14,500.0 | \$22,849.3 |
| EBITDA | \$257.0 | \$1,107.2 | \$3,389.9 |
| EBIT | \$255.4 | \$1,088.8 | \$3,361.0 |
| Net Income | (\$520.0) | \$1,057.5 | \$3,327.7 |
| EPS (\$) | (\$0.00) | \$0.00 | \$0.01 |

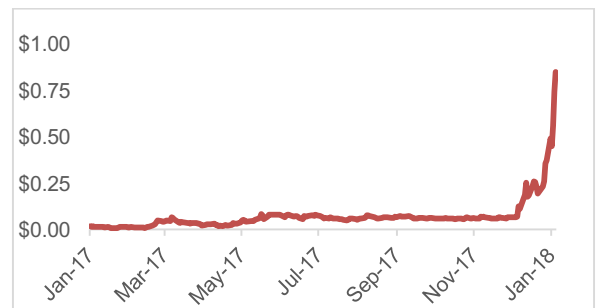
Source: SeeThruEquity Research

Key Ratios

| | FY16A | FY17E | FY18E |
|----------------------|--------|-------|-------|
| Gross margin (%) | 43.5 | 35.0 | 40.0 |
| Operating Margin (%) | 24.8 | 7.5 | 14.7 |
| EBITDA margin (%) | 25.0 | 7.6 | 14.8 |
| Net margin (%) | (50.5) | 7.3 | 14.6 |
| P/Revenue (x) | 222.9 | 15.8 | 10.0 |
| EV/EBITDA (x) | NM | 209.3 | 68.3 |
| EV/Revenue (x) | 225.1 | 16.0 | 10.1 |

Source: SeeThruEquity Research

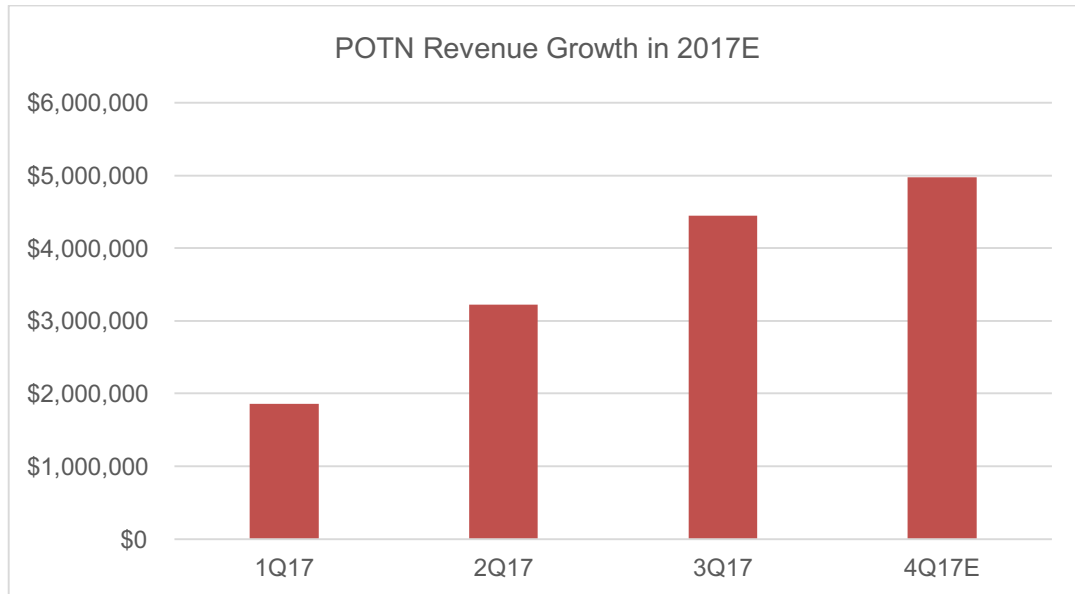
LTM Performance



Source: Thomson Reuters

POTN releases positive preliminary 2017 sales of \$14.5mn, suggesting strong sales trends continued through year-end

- **Impressive sales results in 4Q17.** POTN provided an update to its sales trends on January 24, 2018, in which the company reported that 2017 full year sales were “approximately \$14.5mn”. The announcement followed strong October and November monthly results, suggesting a nice end to the year for POTN.
- Considering the announcement, the company appears to have surpassed record 3Q17 revenues of \$4.4mn. We now estimate that final 4Q17 results to be just shy of \$5.0mn, as illustrated below.



Source: Company filings, SeeThruEquity Research estimate

- **POTN management outperforming initial view:** We note that with revenues expected to be \$14.5mn, POTN management appears to have exceeded its initial 2017 guidance for revenue to exceed \$8.3mn by approximately 70%.
- **POTN looks on track to meet estimates:** With sales of at least \$1.6mn in each month in 4Q17, POTN has reported consistently strong revenues and appears to be gaining momentum. Revenues of \$14.5mn revenues would be on track to meet our recently updated 2017E top line estimate.
- **Annual run rate has already reached \$20mn.** Additionally, with November and October monthly sales reported of at least \$1.6mn, POTN appears to have reached an annualized revenue run rate of \$20mn in December.
- This level of revenue, which management has attributed to a recent expansion of products and strong sales execution, should position the company well to meet or exceed the 2018E revenue estimate of \$22.8mn, assuming continued growth into next year. The estimate of \$22.8mn assumes 125% annual growth over 2017 revenues, which seems achievable by the company in light of the fact that POTN has already reached an annualized rate of \$20mn.
- We are introducing 2019E revenue estimates of \$41.1mn, which assume continued growth and execution by the company in terms of sales distribution and expanded products. The estimate of \$41.1mn assumes 80% YoY growth from 2018 to 2019, assuming strong industry growth trends and company sales execution.
- **Profitable growth driving results.** As detailed in the following table, POTN has been able to achieve the growth in 2017 while maintaining attractive profit margins. The company has reported gross margins of 37% for the first nine months of the year, with operating margins of 7.0%.

RECENT FINANCIAL SUMMARY

Figure 1. Income Statement Summary

| Figures in \$ unless specified | 3Q17 | 2Q17 | 1Q17 | 9 mos 2017 |
|--------------------------------|------------------|------------------|------------------|------------------|
| Total Revenue | 4,444,800 | 3,219,278 | 1,858,347 | 9,522,425 |
| Cost of Revenues | 2,654,026 | 2,140,294 | 1,196,014 | 5,990,334 |
| As % of Revenue | 66.5% | 64.4% | 62.9% | 62.9% |
| Gross Profit | 1,790,774 | 1,078,984 | 662,333 | 3,532,091 |
| Gross Margin | 40.3% | 33.5% | 35.6% | 37.1% |
| Operating Expenses | 1,496,777 | 863,334 | 508,746 | 2,868,857 |
| As % of Revenue | 33.7% | 26.8% | 27.4% | 30.1% |
| Operating Income | 293,997 | 215,650 | 153,587 | 663,234 |
| Operating Margin % | 6.6% | 6.7% | 8.3% | 7.0% |
| Taxes | 0 | 0 | 0 | 0 |
| Net income/(loss) | 293,997 | 215,650 | 153,587 | 663,234 |
| Net Margin | 6.6% | 6.7% | 8.3% | 7.0% |

Source: Company 10-Q filing

POTN files 3Q17 10-Q, revealing continued profitability

- As detailed above, POTN has reported revenue growth throughout 2017 while maintaining profitability. For the first nine months of the year, the company has reported revenues of \$9.52mn, with operating profit of \$0.66mn. POTN pre-announced preliminary full year sales of \$14.5mn.
- We have been impressed by POTN management's ability to grow the business while maintaining attractive profit margins. The company reported operating margins of 7.0% in the first nine months of 2017.
- POTN ended 3Q17 with cash on hand of \$576,880 and \$2.8mn of debt outstanding. According to its 10-Q, the company generated operating cash flow of \$576,780 during the first nine months of the year.
- According to OTC Markets, POTN has 269.9mn shares outstanding. The company announced the retirement of retired 300mn shares held by principal shareholders on November 27, 2017, which were exchanged for non-trading preferred shares. According to the announcement, the move reduced common shares outstanding by 52%, from 569.9mn to 269.9mn.
- Our model estimates 2017E and 2018E revenues of \$14.5mn and \$22.8mn, respectively. POTN appears to be on a trajectory to meet these estimates, given an annualized revenue run rate of approximately \$20.0mn as of December 2017, and positive commentary by management related to demand and market trends.
- The adjusted EBITDA estimates for 2017E and 2018E are \$1.1mn and \$3.4mn, respectively.
- For 2019E, we now forecast revenues of \$41.1mn, with EBITDA of \$7.0mn. The estimates assume that POTN benefits from operating leverage as it grows.

Price target increases to \$1.25 for POTN

- POTN shares have been strong performers in our coverage universe, with shares up significantly since the last update on the company following results and corporate activities that may position POTN to list shares on the OTCQX, with a goal to eventually list on the Nasdaq CM.
- There is no question that valuations in POTN's sector reflect market enthusiasm, and that there is risk throughout the industry that lofty growth expectations may be difficult to achieve as competition and regulations evolve in this new and quickly growing market.
- Nevertheless, POTN does appear to stand out for its growth and profitability in the segment of companies producing cannabis-based products, as indicated in the following table of peers.

| TCKR | Name | Price | Shares | Market Cap | EBIT % | TTM | Price/Sales |
|---------------------------|---------------------------|--------|---------|------------|----------|---------|---------------|
| MJNA | Medical Marijuana Inc | \$0.11 | 3,204.5 | \$342.9 | (55.2)% | \$8.0 | 42.9x |
| INSY | Insys Therapeutics | \$9.59 | 73.3 | \$703.1 | (26.1)% | \$164.1 | 4.3x |
| CVSI | CV Sciences Inc | \$0.45 | 90.5 | \$40.7 | (53.0)% | \$16.7 | 2.4x |
| AMMJ | American Cannabis Company | \$1.11 | 47.4 | \$52.6 | 11.6% | \$2.9 | 18.1x |
| MCIG | mCig Inc | \$0.29 | 405.3 | \$117.5 | 21.4% | \$9.1 | 12.9x |
| CNAB | United Cannabis Corp | \$1.56 | 60.2 | \$93.9 | (853.9)% | \$0.5 | 202.9x |
| CANN | General Cannabis Corp | \$7.52 | 33.1 | \$248.6 | (228.0)% | \$3.3 | 75.1x |
| Peer Group Average | | | | | | | 51.2x |
| POTN | PotNetwork Holding Inc | \$0.85 | 269.9 | \$229.4 | 7.0% | \$14.5 | 15.8x |
| Peer Group Average | | | | | | | -69.1% |

Source: Yahoo Finance, peer company data as of 1/22/2018

- Considering what appears to be accelerating market penetration selling legal hemp-based products, and POTN's relatively strong margin profile versus peers, we are increasing the target price to \$1.25.
- The target considers a valuation multiple of 14.8x 2018E revenue of \$22.8mn and 8.2x estimated 2019E revenues of \$41.1mn. The multiple appears justified in light of apparent momentum at the company, valuations in the industry, and industry growth dynamics.
- Through its subsidiary Diamond CBD, POTN focuses on the research, development, and multi-national marketing of premium hemp extracts that contain a broad range of cannabinoids and natural hemp derivatives. The company's products are distributed in more than 10,000 retail locations, led by its CBD infused Chill Gummy line, which includes flavors such as traditional Gummy Bears, Watermelon Slices, Tart Sour Snakes, Sprinkled Rainbow Bites, Yummy Gummy Worms, Tangy Sour Bears, and Quenching Ocean Gummies, among others.
- We see POTN as a high-risk, high potential growth company in the burgeoning legal cannabis and hemp industry. POTN targets the fastest growing sub segment (hemp derived CBD). The target of \$1.25 assumes further expansion of the market and also that the company is successful in executing its growth strategy underpinned by expanding distribution, new products, and aggressive marketing campaigns. Key risks include changes to the regulatory environment or new competition that could impact damage the company's growth prospects.

Management Team

Gary L. Blum, Chairman

Mr. Gary L. Blum is Chairman and has previously served as the Chief Executive Officer at PotNetwork Holding, Inc. from January 12, 2016, until October 4, 2017. Prior to that, Mr. Blum had been the Chairman of the Board, Chief Executive Officer, President, Principal Accounting Officer, Chief Financial Officer and Secretary at Thunderclap Entertainment, Inc. since September 15, 2009, and Celpad, Inc. since August 30, 2010. Over nearly the past three decades, Mr. Blum has provided legal counsel for a broad range of closely-held and public companies. He has extensive experience conducting private and public offerings, mergers and acquisitions, achieving SEC and NASD compliance, among other areas of expertise encompassing general corporate and securities law. He has been a practicing attorney since 1986. He is the Principal of the Law Offices of Gary L. Blum, Los Angeles, California, which he founded in June 1988. He also served as Secretary of Arrin Corporation. He has substantial experience in sophisticated business planning and advising clients in connection with the purchase and sale of businesses and has served as a director for many private and publicly traded companies. He has been a Director of Celpad, Inc. since August 30, 2010. He served as a Director of Arrin Corporation since 2009. He has been a Member of the California State Bar since 1979. Mr. Blum received his B.S., Magna Cum Laude, in Mathematics from Loras College in 1962; an M.A. in Philosophy from the University of Notre Dame in 1966; and J.D. and M.B.A. degrees from the University of Southern California Gould School of Law and Marshall School of Business respectively in 1978.

Richard E. Goulding, Chief Executive Officer

Dr. Richard E. Goulding, M.D. is the Chief Executive Officer of for Potnetwork420 at PotNetwork Holding, Inc. Prior to this role he serviced as Medical Director from March 26, 2014, until October 4, 2017. Prior to that, Dr. Goulding served as Chairman of the Board, Chief Executive Officer and President of Real American Capital Corp. Prior to that, Dr. Goulding was employed at The Nutmeg Group, LLC. Previously, Dr. Goulding has been a Corporate Director of Physicians Healthcare Management Group Inc. since April 2005. Also, he served as a Corporate Secretary of Phyhealth Corp. since January 1, 2008. From 1979 to 1984, he was a General Surgery Resident, Otolaryngology Resident and Chief Resident, Otolaryngology or the Head and Neck Surgery and Facial Plastic Surgery at Jackson Memorial Hospital and University of Miami. He serves as a Director of Real American Brands, Inc. He served as a Director of Phyhealth Corp. since March 12, 2008. He has also been an eminent speaker at various forums. Mr. Goulding graduated, with honors, in 1975 from the University of Florida and received his Doctorate of Medicine in 1979 from Loyola University of Chicago.

Kevin Hagen, President Diamond CBD Inc.

Mr. Kevin Hagen is the President at Diamond CBD, Inc. Mr. Hagen is a practicing attorney with Hagen & Hagen Law Firm with over 22 years of experience. He is also a member of the Florida Bar Association. He completed his BS from University of Florida and JD from Nova Southeastern University.



About Diamond CBD, Inc.

Diamond CBD focuses on the research, development, and multi-national marketing of premium hemp extracts that contain a broad range of cannabinoids and natural hemp derivatives. Diamond CBD's team consists of hemp industry pioneers and natural product experts, chemists, doctors and scientists, dedicated to producing the finest and purest cannabidiol (CBD) oils. The result is a robust selection considered among the most powerful natural CBD oils, tinctures, edibles, and vape liquids found anywhere. www.DiamondCBD.com.

About PotNetwork Holding, Inc

PotNetwork Holding, Inc. (OTC Pink: POTN) is a publicly traded company that acts as a holding company for its subsidiaries, First Capital Venture Co., the owner of Diamond CBD, Inc., the maker of Diamond CBD oils.



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