Gilla, Inc.
(OTCQB: GLLA, Target Price: $0.57)

We initiate coverage on Gilla, Inc. ("Gilla") with a price target of $0.57 per share. Gilla designs, markets and distributes electronic cigarettes ("e-cigarettes"). This is a highly fragmented and rapidly growing market, and Gilla plans to pursue a two-pronged business strategy to capture market share. Gilla currently offers a White Label solution to brands, retailers and wholesalers worldwide and also plans to create their own in-house, online subscription service. These two models are highly scalable and, with outsourced manufacturing and a logistics warehouse and sales office already operational in Florida, Gilla offers a very attractive return on capital.

INVESTMENT HIGHLIGHTS

Rapid growth and awareness of e-cigarette market

The e-cigarette market is small relative to traditional cigarettes, but it is rapidly growing and consumers are becoming much more aware of the product offerings in the space. The U.S. market for e-cigarettes was estimated to be roughly $2bn in 2013 (≈$2.5bn worldwide), and has been predicted, by at least one major industry analyst, to grow to roughly $10bn by 2017. Over the past two years, the "big three" tobacco companies have all entered the e-cigarette space through acquisitions and/or by developing organic brands. This entrance should lead to significantly increased marketing spending and therefore, consumer awareness of the products, and is expected to help grow the industry's profits at a CAGR of 7% over the next decade.

Complete, custom turnkey e-cigarette solution

Gilla is especially unique in that they offer a complete, customizable turnkey e-cigarette solution to potential clients. Gilla is pursuing white label opportunities with major retailers and brands with existing clientele and distribution platforms as well as engaging major corporations to brand their own e-cigarette product in the gaming, entertainment and hospitality industries. Gilla can customize a complete marketing package for a partnering client by offering branding, website development, e-commerce platforms, social media and marketing services, product and package design, distribution and logistics, price point optimization, as well as a host of other solutions. Given the fragmented nature of the market and similarity of currently available products, this strategy should allow Gilla to remain flexible in executing their business plans, thereby reducing the marketing risk and cost concentration of any one project.

Online subscription service

The second part of the Gilla model is to create an online subscription service in 2Q14E under the Charlie's Club brand. By offering subscribers a set number of refill caps per month, based on their desired monthly consumption, Gilla hopes to create a convenient, affordable, and unique model for the e-cigarette space similar to the razorblade and print cartridge models. This is an extremely scalable, high margin business, and Gilla feels that they can attract 20,000 subscribers within 12 months of launching www.charliesclub.com. With an average recurring gross profit of $25 per user/per month, this presents a substantial revenue opportunity.

Initiate coverage with a price target of $0.57

Our analysis indicates a fair value estimate of $0.57 per share (detailed on pages 7, 8 and 9), implying an upside of 375% from the recent price of $0.12. We view Gilla as a high risk, high reward pure play investment in the rapidly growing e-cigarette marketplace. Given that recent acquisitions in the space have taken place at roughly 2.8-4.5x sales and Gilla trades at 0.5x our $16.3mn 2014E revenue estimate, we think there is material upside in the name.

Stock Details (03/18/2014)

OTCQB:	GLLA
Sector / Industry	Consumer Goods / Cigarettes
Price target	**$0.57**
Recent share price	$0.12
Shares o/s (mn)	65.4
Market cap (in $mn)	7.9
52-week high/low	$0.32 / 0.02

Source: Bloomberg, SeeThruEquity Research

Key Financials ($mn unless specified)

	FY12	FY13E	FY14E
Revenues	0.0	0.1	16.3
EBITDA	(0.6)	(1.3)	3.4
EBIT	(0.6)	(1.3)	3.4
Net income	(1.1)	(1.4)	3.2
EPS ($)	(0.04)	(0.02)	0.05

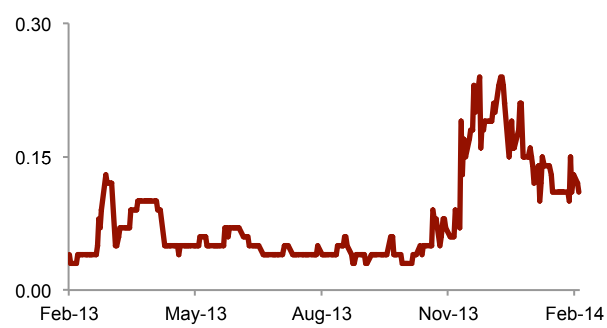
Source: SeeThruEquity Research

Key Ratios

	FY12	FY13E	FY14E
Gross margin (%)	N/A	23.9	33.0
Operating margin (%)	N/A	NM	20.7
EBITDA margin (%)	N/A	NM	20.7
Net margin (%)	N/A	NM	19.6
P/Revenue (x)	N/A	92.3	0.4
EV/EBITDA (x)	(13.8)	(6.1)	2.4
EV/Revenue (x)	N/A	102.8	0.5

Source: SeeThruEquity Research

Share Price Performance ($, LTM)



Source: Bloomberg

SUMMARY TABLE

Figure 1. Summary Table (As of March 18, 2014)

Share data		B/S data (As of 3Q13)		Key personnel:	
Recent price:	$0.12	Total assets:	0.3mn	CEO & Director:	J. Graham Simmonds
Price target:	$0.57	Total debt:	1.0mn	CFO:	Ashish Kapoor
52-week range:	$0.32 / 0.02	Equity:	(1.7mn)	President, COO & Dir:	Danny Yuranyi
Average volume:*	56,224	W/C:	(1.0mn)	VP – Digital:	Mike Connell
Market cap:	$7.9mn	ROE '12:	-133%		
Book value/share:	($0.03)	ROA '12:	-6786%		
Cash/share	$0.00	Current ratio:	0.2		
Dividend yield:	0.00%	Asset turnover:	0.4		
Risk profile:	High / Speculative	Debt/Cap:	(1.6)		

** three month average volume (number of shares)*

	Estimates			Valuation		
FY December	Rev ($mn)	EBITDA ($mn)	EPS ($)	P/Rev (x)	EV/Rev (x)	P/E (x)
2012A	0.0	(0.6)	(0.04)	N/A	N/A	N/A
1Q13A	0.0	(0.3)	(0.00)	N/A	N/A	N/A
2Q13A	0.0	(0.3)	(0.01)	N/A	N/A	N/A
3Q13A	0.0	(0.4)	(0.01)	64.4x	71.7x	N/A
4Q13E	0.1	(0.4)	(0.01)	36.0x	40.0x	N/A
2013E	0.1	(1.3)	(0.02)	92.3x	25.7x	N/A
2014E	16.3	3.4	0.05	0.4x	0.5x	2.3x
2015E	23.9	6.3	0.07	0.3x	0.3x	1.6x

Source: SeeThruEquity Research

INVESTMENT THESIS

Gilla, Inc. ("Gilla") designs, markets and distributes electronic cigarettes ("e-cigarettes"). They have been pursuing the current business strategy since the reverse merger on November 21, 2012, and posted their first quarter of revenues in 3Q13. Gilla currently offers clients a complete, customizable turnkey e-cigarette solution for clients looking to enter the market and the company also plans to launch an online subscription based model under the Charlie's Club brand in 2Q14.

Electronic cigarette market

An e-cigarette is a battery or USB powered device which is used to simulate tobacco smoking. Chinese pharmacist Hon Lik is widely credited as being the inventor of the first generation electronic cigarette in 2003. Electronic were first introduced to the Chinese domestic market in May 2004 as an aid for smoking cessation and replacement. The e-cigarette continued to evolve and a new device, launched in the UK in 2007 under the Gamucci brand, became widely adopted by the majority of 'cigalike' brands. The common elements of an e-cigarette typically include a liquid delivery and container system, an atomizer, and a power source. An e-cigarette user inhales vapor, which is created when a battery-powered tube heats a liquid solution, giving them a hit without burning or inhaling smoke. The liquid for producing vapor in electronic cigarettes is a solution of propylene glycol (PG), vegetable glycerin (VG), and/or polyethylene glycol 400 (PEG400) mixed with concentrated flavors; and optionally, a variable concentration of nicotine.

Some e-cigarettes still contain nicotine, but they are thought to be less harmful than traditional cigarettes as the inhaled vapor has not been proven to contain harmful concentrations of carcinogens. Currently, e-cigarettes are not subjected to the regulations and restrictions which are imposed on traditional cigarettes, and it can be speculated that they provide a potential long-term replacement option for traditional cigarettes. However, there are multiple ongoing studies to determine nicotine vapor's health impact and the FDA has stated its intentions to regulate e-cigarettes in the future. E-cigarettes come in various shapes and colors, and many are being made to look like conventional cigarettes. Companies are working to truly replicate the smoking experience for consumers. In the current e-cigarette form, the liquid cartridge and atomizer have been combined to form a cartomizer, which is then connected to the battery. This convenience over older three part models, and increased liquid storage capacity, has been credited with the increasingly widespread growth in e-cigarette usage.

Consumers can purchase a disposable e-cigarette, which costs around $7-10 or they can purchase rechargable e-cigarettes (as stand alone or part of kits) which range from $12-20. Many popular brands offer complete rechargeable starter kits, which can cost $50-80. Refill cartridges cost in the $2-3 range. Based on a user's consumption habits, e-cigarettes can save a consumer roughly 60-90% compared with traditional cigarettes. Research reports from Euromonitor International, Bloomberg and Wells Fargo estimate the U.S. e-cigarette market reached the $1.7-2bn range in 2013 (roughly $2.5bn worldwide in 2013). Reynolds American Inc. (NYSE: RAI) has estimated the market will grow to $3bn within five years, while Bonnie Herzog of Wells Fargo Securities has estimated U.S. sales topping $10bn by 2017. Bloomberg Industries estimates that e-cigarette usage will surpass that of traditional cigarettes by 2047. In a 4Q13 investor meeting, Philip Morris International (NYSE: PM) CEO Andre Calantzopoulos, in reference to his company's planned entrance into the e-cigarette market in 2H14, was quoted as saying that "2014 will be a key investment year behind our Reduced-Risk products, our greatest growth opportunity in the years to come."

Recent surveys suggest that e-cigarettes still have very low penetration rates, a 2013 study by Action on Smoking & Health ("ASH") that tracked roughly 13,000 adults in the UK reported that frequent (more than weekly) use of e-cigarettes was confined almost entirely to ex-smokers and daily smokers. Use is most common among daily smokers with 11% reporting current use and 25% having used them in the past. Among ex-smokers, current use is slightly more common than with non smokers, with 3% reporting current use and a further 5% reporting having tried them or used them in the past. E-cigarette use is constant across ages and socio economic groups.

Source: Company filings and investor materials, www.euromonitor.com, www.bloomberg.com, www.reuters.com, www.ash.org, SeeThruEquity Research

Complete, custom turnkey white label e-cigarette solution

Gilla is unique in that they are not currently attempting to launch their own retail brand; instead, they are pursuing white label opportunities with major retailers and brands with existing clientele and distribution platforms in place, as well as engaging major corporations in the gaming, entertainment and hospitality industries to brand their own e-cigarette product. Through their Turnkey E-Cigarette Solution, Gilla can provide clients a customized, comprehensive e-cigarette solution, helping them design and develop a product that fits their customer base and meets their required price point. Gilla can work with a client on product and packaging design, their executives have years of product branding and marketing expertise, they will assist in the implementation of websites and e-commerce platforms, and provide distribution and logistical support as well. Gilla provides a low risk, high profit potential proposition for businesses that are looking to add value to their existing client base. Gilla currently has an active sales pipeline with major retailers in North and South America, Europe and the UK.

Gilla hopes to partner with 3-4 white label clients over the next 18-24 months and 10-12 over the next five years. With average annual revenues of $3-4mn per client and gross margins in the 30-35% range, this is a very attractive business opportunity for Gilla. It also reduces company risk as Gilla will not have concentrated exposure to any one brand, client or marketing campaign.

White label case study

In 2H13, Gilla partnered with their first white label client, a maker of cigarette lighters. Due to the increasing popularity of e-cigarettes, the client was looking for ways to use their existing retail distribution footprint and client base to expand revenues. Gilla stepped in and created a turnkey solution for the client, creating a branded e-cigarette, designing the packaging and creating a countertop/point of sale display. The client was a perfect match for Gilla, but this partnership illustrates how flexible Gilla can be at providing clients with rapidly deployable solutions in the e-cigarette market. For established brands with cache and customer loyalty, Gilla offers an attractive solution in a highly profitable, rapidly growing space.

Charlie's Club online subscription service

To complement their white label efforts, Gilla plans to launch an online subscription service in 2Q14 under the Charlie's Club brand. Subscribers will be charged a monthly fee for a set number of refill caps per month based on their desired monthly consumption, very much the razor blade or printer cartridge recurring revenue model. Charlie's Club will offer consumers a convenient, affordable, and unique model for the e-cigarette space. Centered on the life of a fictional main character "Charlie," Gilla plans to launch a focused digital media strategy, which will be optimized through affiliate marketing, loyalty rewards and downstream referral fees. In today's world of rapidly expanding social media generated product awareness, Gilla's Charlie's Club strategy stands out as the type of campaign that could generate significant "buzz" and awareness of their offerings.

Gilla has estimated that they can capture roughly 20,000 subscribers in the first 12 months of the Charlie's Club launch. They also predict average monthly revenues and gross profit per customer/per month of $40 and $25 respectively. Over the longer term, this is a highly scalable operation which could generate $40-50mn annually with EBITDA margins in the 43-47% range.

Acquisition of Ireland-based e-cigarette distributor

On February 28, 2014, Gilla closed the acquisition of Drinan Marketing Limited ("Drinan") of Dublin, Ireland. Drinan was founded in 2010 by Mr. Andrew Hennessy as a marketing and consulting firm to the tobacco products industry in Ireland. During 2013, Mr. Hennessy expanded his business into the sales and distribution of electronic cigarettes and developed Drinan's reach to approximately 400 storefronts, and that number is still growing. The acquisition gives Gilla a platform for further European expansion and a strong existing pipeline into the Irish e-cigarette market. Mr. Hennessy will continue to operate Drinan and take an active corporate role with Gilla assisting with product development and leading European business development and sales.

Low cost, outsourced manufacturing model and distribution in place

Most e-cigarettes are manufactured in China, and while they come in different sizes, colors and shapes, there is typically little to no differentiation between the liquid part of the product. This makes it very easy and inexpensive for Gilla to offer their clients customized colors and sizes. On May 20, 2013, Gilla entered into a supply contract with a Chinese e-cigarette contract manufacturer to produce and supply Gilla with e-cigarette products and related accessories. This relationship provides Gilla with significant capacity to scale up operations with no additional capital expenditure requirements. In addition, Gilla maintains a logistics warehouse and sales office near Miami, Florida. Gilla has the infrastructure in place to rapidly expand operations at minimal additional cost.

Source: Company filings and investor materials, SeeThruEquity Research

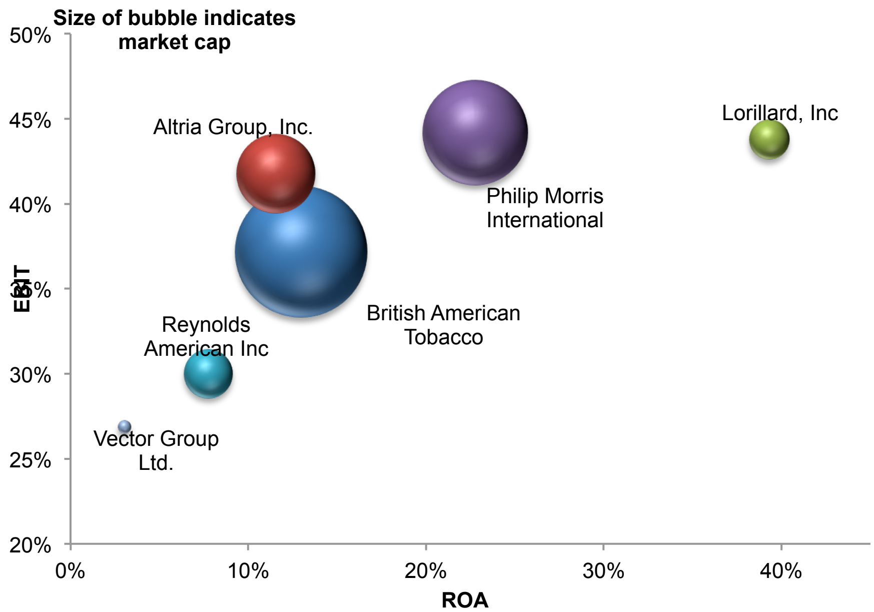
COMPETITIVE LANDSCAPE

Gilla operates in the highly competitive and very fragmented e-cigarette market place. As previously discussed, most e-cigarettes are manufactured in China and follow the same cartomizer + battery model. Thus far, there has been very little to distinguish one brand from another besides the look of the e-cigarette and the flavors a company offers. Vapor Corp. (OTCQB: VPCO) was the first fully reporting and publicly traded pure play e-cigarette company. They sell e-cigarettes under the Krave, Fifty-One, Green Puffer and other brands. Privately held NJOY, Inc. holds a roughly 36% market share and their NJOY King is the most popular e-cigarette in America. In June of 2013, NJOY raised $75mn from investors, including noted entrepreneur Sean Parker. The major tobacco companies have all entered the market over the past 18 months, as Lorillard, Inc. (NYSE: LO) bought Blu eCigs® for $135mn in April of 2012 and UK company SKYCIG for $49mn (with an additional $49mn in earnouts) in October of 2013. Lorillard now has a 49% market share, as Blu accounts for roughly 34% share of the U.S. market. Altria Group, Inc. (NYSE: MO) launched their own e-cigarette brand, MarkTen, in limited markets in 2H13, and in February of 2014, they announced the acquisition of privately held Green Smoke for $110mn. Reynolds American Inc. (NYSE: RAI) released Vuse, their own internally developed brand, in Colorado in 2H13. Within one month of launch, Vuse had a roughly 56% market share, demonstrating what marketing dollars and existing retail relationships can mean for the rapid uptake of new product in the space. British American Tobacco (NYSE: BTI) offers the Vype brand in the UK and, as previously mentioned, Philip Morris International plans to enter the space in 2H14E. Privately held LOGIC Technology Development LLC is another large player in the space, with roughly 14% share in the U.S.

While there is significant competition and a lot of capital is flowing into the e-cigarette market, there does not appear to be notable brand loyalty and user awareness and penetration of the available products are still in their infancy. Gilla will attempt to differentiate by aligning with established brands and providing an e-cigarette solution and by carving out an online subscription model of convenience and cost effectiveness.

Compared to the majority of the peer group, Gilla is much smaller in market capitalization and has only just begun to recognize revenues from the sales of its products. Although a pure play e-cigarette model is not a true comparison to a traditional big tobacco company, they are the most effective publicly traded companies to compare to Gilla. Vapor Corp. is still an emerging company, but they recently reported 10% EBIT margins. We have modeled EBIT of 20.7-38.9% over the 2014-2018E timeframe, which would put Gilla at or near the top of the peer group. We feel that Gilla can achieve an ROA in the 30-40% range eventually.

Figure 2. ROA vs. EBIT– Gilla Peers



Source: Company filings, SeeThruEquity Research

FINANCIALS AND FUTURE OUTLOOK

Revenue/Drivers

Gilla has just begun to generate product revenues from their white label strategy. Given the Drinan acquisition, the launch of Charlie's Club and the addition of one or two additional white label clients, we think 2014E will be a significant growth year for Gilla. In a recent investor presentation, Gilla management outlined their 1-5 year plan, with white label and online subscription revenues in the $12.5-15mn and $7.5-9.5mn ranges, respectively, over the next 12-24 months. We are modeling in $16.3mn in total 2014E revenues, with $10.5mn coming from white label and $5.8mn coming from an online subscriber base of 12,000.

We see steady growth in white label sales from 2015-2019E and significantly higher revenue growth from online subscriptions. We have modeled in a 24.9% CAGR on white label sales, with revenues growing to $40mn in 2019E, and a 39.9% CAGR from online subscriptions, growing to $43.2mn in 2019E (subscriber base of 95,000). We feel these estimates are reasonable against a backdrop of an industry expected to grow in the 35-50% range annually from 2013-2017E in the U.S. alone. We have modeled in some pricing decreases in our online subscription model from 2014-2019E, roughly 1% per year, as we feel any near term price competition to gain share will be relatively short lived. If the e-cigarette market grows to $5bn by 2019E, that would give Gilla a 1.7% market share. We have not added any other foreign sales to our model.

Margins/Expenses

In their first quarter of revenue generation, 3Q13, Gilla reported gross margins of 16.5%. We view these as artificially low, as Gilla only recorded $28k in revenue. By comparison, Vapor Corp. reported 38.9% and 30% gross margins in their last two quarters, respectively. Gilla has guided to 30-35% margins on white label sales, regardless of scale, and 42-47% gross margins on online sales growing to 52-57% as they achieve a larger sales base. We have modeled in 33% gross margins for 2014E, growing to 46.4% in 2019E, as we predict online subscription revenues will account for roughly 52% of total Gilla sales in that time frame.

Gilla has done a very solid job of keeping costs low during this build up phase, with $581k of SG&A spend in 2012 and $937k of SG&A and consulting fees incurred through the first nine months of 2013. We have modeled in $2mn in operating expenses in 2014E, growing to $3.5mn in 2019E. We do not anticipate Gilla having to spend material amounts on capital expenditures, as their production is completely outsourced and their distribution facility is in place.

Gilla has incurred $93k of interest expense through the first nine months of 2013, and we would anticipate this number to increase as Gilla will likely need to raise more capital until their revenues become self-sustaining. We have modeled in $170k of interest expense in 2014E but feel that Gilla will have adequate cash on hand by year end to reduce or eliminate their debt in 2015E.

Gilla reported a net loss of $(1.0mn) or $(0.02) per share, for the first nine months of 2013. We have modeled in net income of $3.2mn, or $0.05 per share, for 2014E.

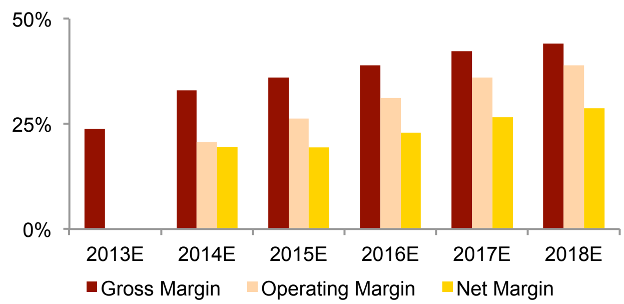
Balance Sheet & Financial Liquidity

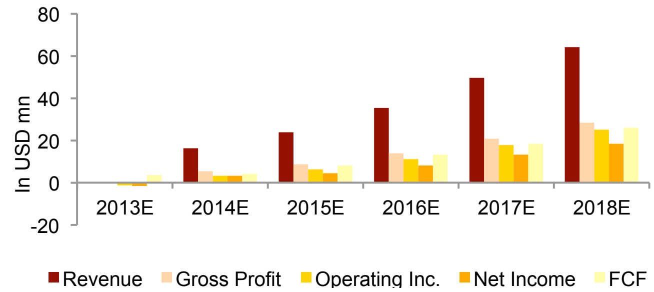
Gilla ended 3Q13 with $210k in cash and $82k of deposits on inventory making up the bulk of their $312k in assets.

Gilla had total liabilities of $2mn as of September 30, 2013. These liabilities included $109k of accounts payable, $724k due to related parties and $1mn in total debt. Subsequent to the end of 2013, Gilla announced the issuance of a CAD $500,000 Secured Promissory Note with Gravitas Financial Inc., due on or before August 13, 2014, bearing an interest rate of 10% per annum. Gilla also announced the repayment of a $225k note payable to Credifinance Capital Corp. on February 14, 2014. We anticipate Gilla will need to raise capital again in the next 3-6 months, and have modeled an additional $500k in debt issued in 2014E.

As of their most recent investor presentation in February, Gilla had 65.4mn shares outstanding and an additional 6.1mn shares outstanding in convertible debt. Gilla also issued 1mn warrants in connection with the Drinan acquisition. The warrants will vest upon Drinan achieving cumulative e-cigarette sales revenues of over $1.5mn beginning on the closing date of February 28, 2014. The warrants are exercisable over three years with an exercise price of $0.25 per common share.

Figure 3. Key Performance Indicators of Gilla, FY13E–18E





Source: Company filings, SeeThruEquity Research

VALUATION

We have valued Gilla using two different valuation methods; discounted cash flow ("DCF") and Peer Group Valuation. Our blended valuation, combining the two methodologies mentioned above, yields a fair value of $0.57 per share, representing an upside of 375% from the recent price of $0.12 as of March 18, 2014.

DCF

We expect very significant revenue growth for Gilla over the next few years as they gain white label clients and build the subscriber base at Charlie's Club. We project free cash flow to move from 3.4mn in 2014E to $25.9mn in 2019E. We discounted cash flows at a weighted average cost of capital of 25.1% and assumed a terminal growth rate of 1% at the end of 2019E to arrive at an enterprise value of $58.3mn. Adjusting for the cash balance of $210k and debt of $1mn as of September 30, 2013, we arrived at a fair value of $0.91 per share.

Figure 5. Discounted Cash Flow Analysis

$' 000	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
EBIT	3,359	6,270	11,036	17,888	24,978	35,138
Less: Tax	0	1,646	2,897	4,696	6,557	9,224
NOPLAT	3,359	4,624	8,139	13,193	18,421	25,914
Changes in working capital	205	(399)	90	99	107	116
Depreciation & Amortization	1	1	1	1	1	1
Capex	(2)	(2)	(2)	(2)	(2)	(2)
FCFF	**3,564**	**4,225**	**8,229**	**13,291**	**18,528**	**26,030**
Discount factor	0.83	0.66	0.53	0.42	0.34	0.27
PV of FCFE	2,949	2,794	4,349	5,613	6,253	7,020
Sum of PV of FCFE						28,977
Terminal cash flow						108,909
PV of terminal cash flow						29,369
Enterprise value						58,346
Less: Debt						1,026
Add: Cash						210
Equity value						**59,582**
Outstanding shares (mn)						65.4
Fair value per share ($)						**0.91**

Summary conclusions		**Key assumptions**	
DCF FV ($ per share)	0.91	Beta	2.5
Recent price ($ per share)	0.12	Cost of equity	27.7%
Upside (downside)	651%	Cost of debt (post tax)	7.2%
WACC	25.1%	Terminal Growth Rate	1.0%

Figure 5. Sensitivity of Valuation – WACC vs. Terminal Growth Rate

Terminal growth rate (%)	WACC (%) 24.3%	24.6%	25.1%	25.6%	26.1%
0.00%	0.93	0.91	0.89	0.86	0.84
0.50%	0.95	0.93	0.90	0.87	0.85
1.00%	0.96	0.94	**0.91**	0.89	0.86
1.50%	0.97	0.95	0.92	0.90	0.87
2.00%	0.98	0.96	0.94	0.91	0.88
2.50%	1.00	0.98	0.95	0.92	0.89

Source: SeeThruEquity Research

Peer Group Valuation

We compared Gilla with Lorrilard, Inc., Altria Group, Vapor Corp and Reynolds American Inc., among others, using a market multiple approach.

We arrived at a fair value range of $0.36 to $0.50 per share based on EV/Revenue and P/Revenue multiples of selected peers. We considered a target multiple of 1.5x for the EV/Revenue multiple and 2014E revenue of $16.3mn to arrive at a fair value of $0.36 per share. Similarly, we used a P/Revenue multiple of 2x our 2014E revenue forecast to arrive at a fair value of $0.50 per share. We felt a discount to the industry group was warranted considering that Gilla has only just commenced generating product revenues. We would like to highlight that the acquisitions of Green Smoke and Blu came at 2.8x and 4.5x trailing revenues, respectively.

Figure 6. Comparable Valuation (Data as of 03/18/14)

Company	Mkt cap ($ mn)	EV/Revenue(x) FY14E	EV/Revenue(x) FY15E	Price/Revenue(x) FY14E	Price/Revenue(x) FY15E
British American Tobacco	101,579	5.0x	N/A	4.3x	N/A
Lorillard, Inc	18,958	3.7x	3.5x	3.6x	3.4x
Altria Group, Inc.	72,759	4.6x	4.6x	4.1x	4.1x
Philip Morris International	128,255	5.1x	4.9x	4.3x	4.1x
Reynolds American Inc	28,974	3.6x	3.5x	3.5x	3.5x
Vector Group Ltd.	2,001	N/A	N/A	N/A	N/A
Vapor Corp.	555	1.3x	0.9x	12.9x	8.7x
Average		**3.9x**	**3.5x**	**5.5x**	**4.8x**
Gilla, Inc.	7.9	0.5x	0.4x	0.5x	0.3x
Premium (discount)		(86.3%)	(89.6%)	(91.1%)	(93.1%)

Source: Bloomberg, SeeThruEquity Research

RISK CONSIDERATIONS

Financing and dilution

Gilla ended 3Q13 with $210k in cash and has guided to expenses of roughly $2mn for 2014E. In February 2014, Gilla announced that they had issued a $500,000 Secured Promissory Note to Gravitas Financial Inc., which is due August 13, 2014 and bears interest at 10% per annum. Gilla also has $425k of Unsecured Subordinated Convertible Debentures outstanding. The Debentures mature on January 31, 2016, bear interest at a rate of 12% per annum and are convertible to Gilla common stock at a conversion rate of $0.07 per share at any time prior to the maturity date. Depending on the timing and rate of revenue growth in 2014E, Gilla may be required to raise capital again over the next 12 months. If they are forced to raise capital at unfavorable terms, current Gilla shareholders may find their positions diluted. We also note that the number of shares outstanding rose from an average of 28.9mn in 2012 to an average of 62.3mn over the first nine months of 2013.

Lack of operating history

Although Gilla's management team has a history of success building brands, marketing, global distribution and M&A, this is a completely new venture for the Gilla. Establishing key white label relationships and building a profitable online subscription service from the ground up is an ambitious business plan and there is no guarantee Gilla will be able to accomplish either. We have modeled revenues and costs based on our industry and comparative assumptions. If Gilla takes longer than we anticipate generating revenues, our estimates will be materially impacted.

Competition

As previously mentioned, the e-cigarette market is intensely crowded and competitive. With major tobacco companies all in or planning to enter the market by the end of 2014, Gilla will be facing competitors with significantly greater resources, distribution networks and client bases than they currently possess. These competitors will have more flexibility to compete on price to gain share and will have much larger advertising budgets than Gilla.

Regulation

Currently, there is no regulation around e-cigarettes. However, there are numerous studies being conducted and the U.S. FDA has stated that they intend to regulate this market in the future. If the cost to Gilla of selling these products in the U.S. and abroad is materially increased due to regulation and/or taxation, our estimates will be impacted.

Share liquidity

Gilla currently trades on the OTCQB. The stock has averaged approximately 56.2k shares traded a day over the past three months. At the recent price of $0.12, this comes out to roughly $6,747 in daily traded volume. Getting into or out of a position in Gilla may be difficult depending on the market environment.

Management Team

J. Graham Simmonds, Chief Executive Officer and Director

Mr. Simmonds has over 15 years of experience in public company management and business development projects within both the gaming and technology sectors. Mr. Simmonds developed and launched the first in-home digital video horse racing service in North America and is currently a Director and partner in eBet Technologies Inc., a licensed ADW operator and software developer for the online horseracing industry in the United States. He is also the founder, President and CEO of Baymount Incorporated, an innovative wagering products and horse racing properties developer; Chairman of InterAmericanGaming Inc., a company developing social platforms for the health and fitness industry; and Chairman and CEO of DealNet Capital Corp., a merchant banking company focused on Business Process Outsourcing (BPO) and Consumer Financing.

Ashish Kapoor, Chief Financial Officer

After obtaining his Chartered Accountant designation at Ernst &Young, Mr. Kapoor has gained over 10 years of experience in investment banking, advising clients across various industries. Mr. Kapoor has experience in corporate finance, investment banking and private equity with global institutions in Toronto and New York. Most recently, as a Senior Vice President at Macquarie Capital Markets Canada Ltd., Mr. Kapoor was responsible for the Canadian telecom, media, entertainment and technology investment banking and principal investing group. During his 10 years at Macquarie, Mr. Kapoor completed in excess of $3B in successful principal investments and advised on a further $4B of mergers and acquisitions for third party clients. Mr. Kapoor has gained extensive experience in identifying, structuring and executing on investment opportunities, to aid in the development of his clients' respective business plans. Prior to Macquarie, Mr. Kapoor obtained his Chartered Accountant designation as part of the Ernst & Young's Toronto practice and was awarded the Gold Medal for first place in Ontario, and the Bronze Medal for third place in Canada on the 2000 Chartered Accountancy Uniform Final Examination. Mr. Kapoor is also a CFA Charterholder and holds a Masters of Accounting and a Bachelor of Arts degree from University of Waterloo.

Danny Yuranyi, President, Chief Operating Officer and Director

Mr. Yuranyi has over 30 years of experience in the transportation, logistics, and distribution businesses having successfully built and operated his own companies on a number of occasions. Mr. Yuranyi has held senior positions with Loomis and Gelco Express which was later sold to Air Canada. After helping build a division of Gelco Express from $1million to more than $12 million in annualized sales, Mr. Yuranyi left to start a new businesss of his own called United Messengers which quickly grew to become the largest same-day messenger service in Canada. Most recently, Mr. Yuranyi has invested in building distribution relationships with European brands in the energy drink and bottled water businesses.

Mike Connell, Vice President - Digital

Mr. Connell is a digital strategist and relationship builder with over 15 years of experience aligning communications, marketing and sales strategies with distinct, clear and compelling stories. He strives to be an agent of change, revolutionizing the hows and whys of digital marketing and messaging. He has worked both agency-and client-side and has developed digital campaigns for major home appliance manufacturers and brands, beverage and alcohol brands, entertainment, gaming and software organizations.

Top Institutional and 13F Filer Ownership

Shareholder Major Holders & Key Insiders	Number of Shares Owned	Percent of Shares Outstanding*
Daniel Yurani	15,300,000	24.57%
Credifinance Capital Corp	11,300,000	18.15%
J. Graham Simmonds	525,000	0.85%
Ernest Eves	300,000	0.48%
Ashish Kapoor	300,000	0.48%
Total	**27,725,000**	**44.5%**

** Percentages calculated from 62,277,766 shares issued and outstanding as of April 1, 2013.*

FINANCIAL SUMMARY

Figure 7. Income Statement

Figures in $mn unless specified	FY12A	FY13E	FY14E	FY15E	FY16E
Revenue	**0.0**	**0.1**	**16.3**	**23.9**	**35.5**
YoY growth		NM	NM	47.0%	48.3%
Cost of sales	0.0	0.1	10.9	15.3	21.7
Gross Profit	**0.0**	**0.0**	**5.4**	**8.6**	**13.8**
Margin	N/A	23.9%	33.0%	36.0%	38.9%
Operating expenses	0.6	1.3	2.0	2.3	2.8
EBIT	(0.6)	(1.3)	3.4	6.3	11.0
Margin	N/A	NM	20.7%	26.2%	31.1%
EBITDA	**(0.6)**	**(1.3)**	**3.4**	**6.3**	**11.0**
Margin	N/A	NM	20.7%	26.2%	31.1%
Other income/ (expense)	(0.5)	(0.1)	(0.2)	0.0	0.0
Profit before tax	(1.1)	(1.4)	3.2	6.3	11.0
Tax	0.0	0.0	0.0	1.6	2.9
Net income	**(1.1)**	**(1.4)**	**3.2**	**4.6**	**8.1**
Margin	N/A	NM	19.6%	19.3%	23.0%
EPS (per share)	**(0.04)**	**(0.02)**	**0.05**	**0.07**	**0.12**

Source: SeeThruEquity Research

Figure 8. Balance Sheet

Figures in $mn, unless specified	FY12A	FY13E	FY14E	FY15E	FY16E
Current assets	0.0	0.1	4.7	6.3	14.6
Intangibles	0.0	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0
Total assets	**0.0**	**0.1**	**4.7**	**6.3**	**14.6**
Current liabilities	0.6	1.5	2.5	0.5	0.7
Other liabilities	0.2	0.7	0.7	0.0	0.0
Shareholders' equity	(0.8)	(2.1)	1.5	5.7	13.9
Total liab and shareholder equity	**0.0**	**0.1**	**4.7**	**6.3**	**14.6**

Source: SeeThruEquity Research

Figure 9. Cash Flow Statement

Figures in $mn, unless specified	FY12A	FY13E	FY14E	FY15E	FY16E
Cash from operating activities	(1.1)	(1.4)	3.4	4.2	8.2
Cash from investing activities	0.0	(0.0)	(0.0)	(0.0)	(0.0)
Cash from financing activities	0.0	0.6	1.0	(2.8)	0.0
Net inc/(dec) in cash	**(1.1)**	**(0.8)**	**4.4**	**1.4**	**8.2**
Cash at beginning of the year	0.0	0.0	0.0	4.4	5.8
Cash at the end of the year	**0.0**	**0.0**	**4.4**	**5.8**	**14.1**

Source: SeeThruEquity Research

About Gilla, Inc.

Gilla Inc. designs, markets and distributes electronic cigarettes ("e-cigarettes") and custom, turnkey e-cigarette solutions. E-cigarettes are replacements for traditional cigarettes allowing smokers to reproduce the smoking experience. E-cigarettes do not burn tobacco and are not smoking cessation devices.

For more information, please go to www.gillainc.com

CONTACT:

Ajay Tandon
Director of Research
SeeThruEquity, LLC
www.seethruequity.com
(646) 495-0939
ajay@seethruequity.com

Brandon Primack, CFA
Senior Equity Research Analyst
SeeThruEquity, LLC
www.seethruequity.com
(646) 495-0939
brandon@seethruequity.com

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