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OrganiGram Holdings, Inc. (OGI.CA)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rob and I'll be your conference operator today. At this time, I would like to welcome everyone to the Organigram Holdings Second Quarter 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Max Schwartz, you may begin your conference.

Max Schwartz

Director-Investor Relations, OrganiGram Holdings, Inc.

Good morning and thank you for joining us today. As a reminder, this conference call is being recorded and a replay will be available on Organigram's website. Listeners should be aware that today's call will include estimates and other forward-looking information from which the company's actual results could differ. Please review the cautionary language in today's press release on various factors, assumptions and risks that could cause our actual results to differ. Further reference will be made to certain non-IFRS measures during this call, including adjusted EBITDA, free cash flow and adjusted gross margin among others. These measures do not have any standardized meaning under IFRS and are intended to provide additional information and as such should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

Our approach to calculating these measures may differ from other issuers, so these measures may not be directly comparable. Please see today's earnings report for more information about these measures. Listeners should also be aware that the company relies on reputable third-party providers when making certain statements relating to market share data. Unless otherwise indicated, all references to market data are sourced from Hifyre in combination with data from WeedCrawler, provincial boards, retailers and our internal sales papers.

I will now introduce Beena Goldenberg, Chief Executive Officer, of Organigram. Please go ahead Ms. Goldenberg.

Beena G. Goldenberg

Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Thank you and good morning, everyone. With me is Derrick West, our Chief Financial Officer. For today's call, we'll discuss the results for the three months ended February 28, 2023, and the general business update. We will then open the call for questions.

We continued to generate solid financial results in the second quarter of fiscal 2023. We achieved a 24% year-over-year net revenue increase. The quarter reflected the typical seasonalities we have seen in previous years where sales into provincial boards declined from December through March. We delivered record adjusted gross margin and our fifth consecutive quarter of positive adjusted EBITDA while maintaining our number three market position among Canadian LPs. In Q2, we were number one in the milled flower segment, number three in Gummies overall, number one in pure CBD gummies and have had the number one hash brand, national.

I'd like to point out that the wins we've had in the hash segment are a great illustration of our core strength. We acquired Laurentian Organics in December 2021. We leveraged our in-house sales and marketing team to achieve national distribution for Tremblant hash. We then expanded our presence in the segment by introducing Wô Lá and Holy Mountain pressed hash. Additionally, we innovated in the category with the launch of SHRED X Rip-Strip Hash, the first product of its kind in Canada. So to sum it up we identified the right acquisitions, applied our CPG expertise to gain share in a new segment and introduced a new product that created consumer excitement.

Now let's talk about SHRED. It is a well-recognized cannabis brand in Canada [indiscernible] (00:03:35) in the popular market segments. SHRED milled flower holds the number one position in this category by a wide margin and with three of the SKUs Tropic Thunder, Funk Master and Gnarberry have been the top selling SKUs nationally for the six months ended February 28, 2023.

SHRED products are now available in almost 90% of the retail stores in the country and the brand has generated CAD 190 million in retail sales in the past 12 months. This is the brand's platform that continues to deliver success.

Looking at regional board data, we have the leading market share in the Maritime and we're number one in milled flower, gummies, and hash. In Ontario, we were the number two LP. We were number one in milled flower and capsules, number one in hash and number three in gummies.

We are also very pleased with our growth in Quebec where we have held a strong number three position. This was partly from the addition of Laurentian's products, but also due to significantly increased sales of our overall portfolio.

Based on the data from WeedCrawler, we have the number one hash SKU, and we're number one in milled flower. Our strong position in the market and our continued success comes from our focus on creating innovative products that excite consumers as their tastes evolve.

In Q2 we introduced 18 new SKUs including 8 new Holy Mountain SKUs. As I mentioned, we launched SHRED X Rip-Strip Hash at the end of Q2 and the response has been extremely strong. It is an exciting new hash format that addresses many pain points consumers report when using hash products and opens the hash segment to new consumers. The hash is formatted in 10 precut strips that can be used to make their own infused pre-roll and offered in Tropic Thunder and Blueberry Blaster flavor profiles.

Our patent-pending Edison JOLTS continue to lead in the ingestible extract category with 85% growth in sales compared to Q2 of fiscal 2022. On March 13 we announced that Health Canada determined that JOLTS lozenges in the 100 milligrams THC per package format were improperly classified as an extract rather than an edible. Health Canada has allowed us to continue to sell and distribute our inventory of JOLTS until May 31.

Now Organigram launched JOLTS in 2021 following significant research, development and regulatory work. We remain of the view that the patent-pending JOLTS are properly classified as cannabis extracts and compliance with cannabis regulations. We have filed an application with the Federal Court of Canada seeking judicial review of Health Canada's determination. As court proceedings can take some time, we intend to file a motion for a stay seeking to set aside the decision in the interim.

In terms of production at Moncton we are achieving scale benefits from the completion of the 4C expansion. We continue to implement environmental and technology improvements designed to increase both yields and cultivar quality. Also new cultivars including several developed by our plant science team are being screened with the view to be added to our portfolio. Finally CO_2 extraction has been optimized to generate higher yields.

In Winnipeg we continued to increase our capacity to meet the high consumer demand for Monjour. As of February 2023 the facility produced an average of 3.1 million gummies per month. We also continue to see solid productivity on the packaging line, with 35,000 to 40,000 pouches per day being produced.

Construction is complete at Lac-Supérieur and while we expect the greenhouse to come online in the summer, we have moved our hash production into the new facility.

In February, we commissioned an ultrasonic blade with a capacity of 150 units per minute and automatic labeling equipment to help us meet the demand for our new SHRED-X Rip-Strip Hash.

The vape category is an area of focus for our product development collaboration with British American Tobacco. This includes analysis of vape volume, particle size and pressure. This will help us assess the quality of different devices. In parallel with this, we are conducting a quantitative sensory analysis with our in-house expert trained panel of over 200 individuals. This research will serve as a foundation for future development activities, including consumer safety, product quality and performance.

Further, these insights are expected to enable Organigram to capitalize on the new vapor heating technology garnered from our $4 million investments in Greentank Technologies, a leader in vape hardware and technology. This investment which took place after quarter-end is reflective of our commitment to grow in the vape category. We believe Greentank's technology is the first true innovation in vaporization in almost a decade. It solves many of the clogging and performance issues associated with vape and may also increase the perceived potency per puff. We have obtained exclusivity for this new technology in Canada for 18 months after it is introduced to the Ontario market and expect to launch this improved 510 product format by the end of our fiscal year.

Moving on to international sales, in Q2, we delivered a record CAD 10.7 million of dried flower to Israel and Australia. For the first six months of fiscal 2023, our international sales have reached CAD 16.6 million exceeding the CAD 15.4 million of sales in the full year of fiscal 2022. The significant international sales in the quarter reflected the introduction of several new SKUs in Australia and Israel. Going forward, we expect international revenue to normalize to the levels seen in the past few quarters.

Now before I turn the presentation over to Derrick, I'd like to comment on the continued pricing pressure we are seeing in the market. While many producers have discussed not wanting to participate in a race to the bottom, we are seeing the opposite in the market. Large format 28-gram offerings with a sub-CAD 100 retail price point increased by almost 300% over the past six months. Large format pricing in some markets has reached a point that concerning the cost of production and the excise tax burden the products are being sold at a loss. This is not sustainable and hurts the cannabis industry. While our low cost structure allows us to compete at these reduced prices, we have not matched the aggressiveness of our competitors and have seen some market share erosion in our large format flower.

At Organigram, we are focused on delivering value to our all stakeholders. We are confident that our branding and marketing expertise, proven track record of innovation and operational efficiency will provide long term success and leadership in the cannabis industry. This is supported by our strong balance sheet which allows us to continue to evaluate investment opportunities that increase our competitive advantage. Over to you Derrick.

Derrick W. West

Chief Financial Officer, OrganiGram Holdings, Inc.

Thanks, Beena. As Beena mentioned, in the second quarter of fiscal 2023 we benefited from the increased efficiency and scale we created in fiscal 2022 and Q1 of 2023 supported by strong international sales and product introductions. In fiscal Q2, gross revenue increased 20% while net revenue increased 24% compared to Q2 fiscal 2022. The increase over the previous year was primarily due to increased adult-use recreational and international sales. As Beena mentioned, price compression across the market did have an impact in the quarter.

The cost of sales in Q2 fiscal 2023 was CAD 29.6 million compared to CAD 24.9 million in Q2 of the prior year, an increase of 19% which is 5% lower than the growth to net revenues. The increase in the cost of sales on a year-over-year basis was due to higher recreational and international sales volumes for the same period. A CAD 2.5 million net realizable value provision from salable inventory is included in the Q2 2023 cost of sales figures.

We harvested approximately 21,000 kilos of flower during Q2 fiscal 2023 compared to about 10,000 kilos in Q2 fiscal 2022 which represents an increase of 110%. In Q2, the harvest continued to benefit from the increased annual capacity at the Moncton growing facility. We expect similar harvest levels to continue through fiscal 2023 which positions us well to Canadian and international sales demand.

On an adjusted basis, Q2 gross margin was CAD 13.4 million or 34% of net revenue, over the CAD 8.3 million or 26% in Q2 fiscal 2022. Despite price compression in the market, this is our highest adjusted gross margin rate in the past three years. The significant improvement in adjusted gross margin was primarily due to the higher overall sales volumes combined with a lower cost of production and increased international shipments.

SG&A excluding non-cash share-based compensation increased to CAD 16.1 million in Q2 2023 from CAD 14 million in Q2 2022. While there was a small increase to the total dollars spent, as a percentage of net revenue, SG&A expenses decreased to 41% from 44% in the previous year's quarter. The increased dollar amounts over the prior year's comparison period was primarily due to the following, the increased general corporate and office expenses as a result of the company's growth, increased employee cost and ERP implementation costs.

In the quarter, we achieved positive adjusted EBITDA of CAD 5.6 million compared to CAD 1.6 million in Q2 2022. Adjusted EBITDA for the first six months of fiscal 2023 was CAD 11.2 million exceeding the CAD 3.5 million realized for the full fiscal 2022 year. The primary drivers of this significant improvement in profitability were the higher volume of products sold, the lower per unit cost of production and increased international shipments which collectively contributed to our increased gross margin.

Q2 2023 was our fifth consecutive quarter of positive adjusted EBITDA. Based on our outlook for revenue including international sales and improved efficiencies primarily achieved through scale and automation, we expect this trend to continue.

In the quarter we had a net loss of CAD 7.5 million compared to a net loss of CAD 4 million in Q2 2022. The increase in net loss was primarily due to a lower gain in the fair value adjustment to derivative liabilities.

From a statement of cash flows perspective, net cash used in operating activities was CAD 19.7 million in Q2 2023 compared to CAD 803,000 in the prior year period. The increase in cash use is primarily due to the increase in accounts receivables in the quarter due to increased sales including significant international shipments during February, as well there was a large decrease to payables at the end of February as the company reduced our obligations in preparation for the Phase 1 ERP go-live which was done on March 1.

Cash provided by investing activities in Q2 2023 was CAD 11.7 million compared to cash used of CAD 22.6 million in Q2 2022. The current quarter's cash was provided from a CAD 15 million redemption of GICs net of CAD 5.6 million in capital – CapEx spending.

In terms of our balance sheet, on February 28, 2023, we had CAD 72 million in unrestricted cash and short term investments compared to CAD 99 million as at August 31. The decrease is primarily the result of capital expenditures of CAD 14 million and an increase in net working capital assets of CAD 6 million. With Organigram generating positive adjusted EBITDA, the stabilization of net working capital assets combined with the completion of the fiscal 2023 CapEx spend, we expect to generate positive free cash flow by the end of calendar 2023.

This concludes my comments. I will now turn the call back to Beena.

Beena G. Goldenberg

Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Thanks Derrick. As a leading pure play cannabis company, we aren't just looking for short term wins, we're invested in and advocating for the success of our industry for years to come. We have put in place industry leading production facilities to achieve our goals and are committed to continuously improving our efficiencies. We have brought CPG expertise to the industry and are committed to exciting consumers with novel products that build our brand. This focus and our financial discipline are expected to deliver solid results through the rest of the fiscal year.

Thank you for joining us today. Operator, you may open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Andrew Partheniou from Stifel GMP. Your line is open.

Andrew Partheniou
Analyst, Stifel GMP

Q

Hi, good morning. Thanks for taking my questions and congrats on the great gross margin here. Just wanted to talk a little bit about direct channel and the pricing environment that you were talking about during the call. You mentioned that you are not necessarily going to compete at these – at the same irrational price levels that you are seeing on the value side. That has resulted in a little bit of a market share loss and you've introduced some new products to try and compete a little bit differently in that market. But inventory seems to have had increased this quarter as you expanded production. So I'm just wondering what kind of inventory level do you think is adequate for the business and how are you thinking about this given it sounds like it may be challenging to drive volumes in the segment that's responsible for a large majority of your sales in this irrational price environment?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yes, no problem and thanks for the question, Andrew. I think right now, just to be clear, we feel pretty comfortable with our inventory levels where we're at. Remember, at last year we struggled to supply our consumer demand. We were hand to mouth for most of the year. We were buying significant amount of flower from other LPs to meet our commitments and we were restricting our international sales opportunities. So, right now we don't – we're watching our inventory, we don't anticipate having any kind of issues with the amount of production because we believe we needed to meet our demand for our rec and our international business.

We did build in sort of extra safety stock so that we could improve our customer service levels. Last year, we struggled with on-time in fall and by building some extra safety stock we're able to maintain higher levels of service to our customers which was important. And just remember a lot of people look at market share erosion and they're looking at dollar market share but we're selling more KGs to get to the same level, right. So we're watching that difference as well. Our current difference between the kilos that we're selling and our dollars is about 1.5 market share point. So just to be clear we need the volume to compete even when we're not driving down to the irrational pricing, means we're pulling back from certain markets that are less rational to say but we are still competing in the flower segment. We are – we have a strong SKU in our Big Bag o' Buds that continues to perform at a much higher price than others with our Pink Cookies offerings.

And we've introduced some new large format flower under Holy Mountain and we believe that brand really speaks to a specific consumer. So we're not walking away from large flower format. We're out there, we will complete, we will continue to bring new specific strains that add good quality, higher THC offerings. But we just won't compete at the very low prices, it's just not sustainable. And we have by the way had conversations with some of the boards where there aren't price floors in the market and have said, introducing a consumer price point when you go below – even below sub-CAD 100 that isn't sustainable and it's really tough to move consumers off of a price point once it's established. It's really not a good practice for the industry and we have received recognition that there needs to be something done here. So, as I said in my comments, we're in it for the long term. We want to make sure we're being responsible and we're going to generate profitable growth and if there is a short term impact in terms of loss of some market share, we're accepting that as we move forward.

Andrew Partheniou
Analyst, Stifel GMP

Q

Appreciate that. And just thinking about your gross margin outlook, your international sales outlook and your operating cash flow. So, you did have the best gross margin in three years and you did seem some – correct me if I'm wrong, but you did – it seems to adjust your gross margin outlook higher for this fiscal year. You mentioned, international sales could normalize a little bit below what we saw in this quarter Q2 and just wondering if you can expand a little bit on that, where are you seeing the drivers of gross margin – of the better gross margin outlook for this fiscal year and the negative operating cash flow before working capital, could we see that reverse in the next quarter?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

So, let me make – talk a little bit about international sales and then I'll turn it over to Derrick to respond to your gross margin question. So just to be clear on international sales, as I mentioned earlier, last year we were restricting our sales in international markets because we just didn't have the flower input. With the completion of our 4C expansion we were able to build our flower inventory that allowed us to do a certain amount of price line sale to Australia and Israel in this quarter with some new cultivars in the market. And so that was a higher than expected growth [ph] in international (00:23:49) sales. We do expect it to normalize back to the level of repeat purchases that we're seeing in the last two quarters. So, this was really a pipeline impact on the international sales after not being able to supply last year. But with that note, I'll pass it over to Derrick to talk about gross margin.

Derrick W. West
Chief Financial Officer, OrganiGram Holdings, Inc.

A

Yes, thanks Beena. Additional question about the increase in the current quarter, the high watermark for our adjusted margin of 34%, was assisted by the larger international shipment that did occur in this quarter. But I would note there are other factors that have allowed us to achieve the current quarter's margin rates and really it's been driven by the cost of cultivation which is not just the expansion of the 4C, but higher flower yields that we've been achieving over the end of Q4 last year and Q1 of this year that lowered our cost of cultivation in total and improved our flower margins on all product categories – all our flower categories not just on the international shipments.

But of course our margin, as we look forward, is impacted not just by the product category mix, but the channel on the rec versus international and so we do think that moving forward the margin rate will modulate somewhat from the Q2 print that we just have, but we are comfortable in providing guidance that we do believe that we can achieve a gross margin rate at greater than 30% for the rest of this fiscal year even given the price compression [ph] and again it's a (00:25:30) combination of just lower operating cost and continued initiatives that we're doing around automation and process efficiency.

In terms of the operating working capital statement, we did build – we did have a working capital adjustment that was negative that put our operative cash flow negative for the quarter. And part of that would be reversible. Part of it is just the growth of the sales in the month of February that put receivables up and there was a small increase to the inventory level which we wouldn't expect to see large changes from here now that we've been operating at this higher level for a couple quarters now. But we did reduce our payables by over CAD 13 million in the quarter and that did create a significant reduction to our cash position and our cash flow working capital change in the quarter, and part of that was actually just done that part of our Phase 1 implementation of our new ERP system. We did do – [indiscernible] (00:26:34) in order to pay down all payables that we could at the end of February because our goal line was March 1. So we do have an abnormal adjustment that has negatively impacted current quarter's operating cash flow and some of that would reverse itself as we get back to more normalized working capital assets and liabilities in the next few quarters.

Andrew Partheniou
Analyst, Stifel GMP

Q

Appreciate the answers. I will get back in the queue.

Operator: Your next question comes from the line of Tamy Chen from BMO Capital Markets. Your line is open.

Tamy Chen
Analyst, BMO Capital Markets Corp. (Canada)

Q

Thanks, good morning. First question is I want to go back to your flower sales in the recreational market. It was quite a decline sequentially. Beena, I know you called out seasonality but I guess I'm just surprised that it was such a large sequential decline. You've also then mentioned some of the share erosion in large format flower, so I was wondering can you help us understand I guess how much was seasonality, how much was that share erosion in large format flower?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Certainly. So, this isn't different than what I talked about last year as well. This is our lowest quarter sales every year. We do see the reduction. It's seasonality in this business which is why sequential – like I struggle with sequential growth when you have seasonality in the business. Remember we did grow year-over-year. So, still seeing strong growth versus Q2 of last year and that's where we like the comparison where you take out the impact of seasonality. In terms of large format flower, we did see erosion. As I mentioned, we didn't chase some of this low, perhaps non-profitable sales, however, we've seen really strong growth in some of our other categories.

We're very excited about higher margin hash growth and higher margin gummies growth and we continue certainly in the quarter with really strong sales on our JOLTS and these are all things that make sense for us to put our time and effort, drive our distribution because those are things that are going to grow – drive profitable growth as opposed to just empty calories on the top line. So that's been our focus and you don't get perhaps the tonnage in those categories but you certainly get the dollars and that's what's really driving the gross margin improvements and our EBITDA improvements.

So, we're balancing. We could have chased some of that lower volume, achieved higher growth in our sales by chasing it and seeing more diluted margins, not the choice we made in terms of how we want to operate in this category.

Tamy Chen
Analyst, BMO Capital Markets Corp. (Canada)

Q

Okay. Got it. And my follow-up is on a separate topic, the Greentank investments. Can you elaborate a little bit more on this all-in-one product or technology that they've got. So is there nothing else like it in the market right now? I guess it sounds like it's something they recently developed. Do you know that this is something consumers would want and would attribute a higher price point to? Thank you.

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Sure, so let me start by saying this Greentank technology we believe really is a game changer in the vape space. And we believe that it will – the new technology will address some of the pain points that have been associated with the vape category. So, first of all, we – you asked about the all-in-one, let me start by saying that we're going to start by launching a 510. We know that a significant – over 90% of the industry today in vape is the 510 offering. So we want to have a 510 offering out there that incorporates this new technology. And down the road we will introduce the all-in-one which would be the battery and the cartridge units all-in-one, calibrate it for the optimal – calibrate it to power the heating element at a optimal level. So that will be down the road, but our going in position is 510, because that's where the market is today.

What we like about this is that this new technology replaces ceramic coils with a precision heating biocompatible material. And that vaporizes all the oil that comes in contact with it, in every puff. So, it doesn't have the oil – the partially cooked oil that saturates the old ceramic coils that causes the clogging and leaks and the unpleasant flavor. When we look at the vape category and you look at mature markets like California where vapes represents 29% of the category, and you look at Canada where we're at 17%, excluding the impact of Québec, we believe there's a lot of room for growth and we think the real opportunity is bringing in something that addresses those pain points. And the other thing on Greentank is, we believe it produces a higher quality vapor cloud that could lead to a higher potency per puff.

And when you ask sort of what research we've done, look we've done research in our R&D facility, testing the product. We've actually tested the technology in our product development collaboration labs and of course Greentank has obviously done some of their testing on the technology as well. So, we're really excited about this because we really think that it is a demonstrable difference in the vape space and 510 offerings that will allow us to differentiate our products in the market. We recognize that we're underdeveloped in vapes relative to other players and we really believe that finding something that was differentiated, that brought news to the category, that consumers would notice the difference would really make us – set us apart and give us a reason to grow our position in the vape category.

With respect to margin, your question on margin, look, it is – the carts are going to be perhaps a little bit more expensive than a traditional cart, but at the end of the day we're such a small player in what is a higher margin category that this is truly an opportunity for us to break out in the vape segment.

Tamy Chen
Analyst, BMO Capital Markets Corp. (Canada)

Q

Got it. Thank you.

Operator: Your next question comes from the line of Frederico Gomes from ATB Capital Markets. Your line is open.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Hi, good morning. Thanks for taking my questions. My first question is on your revenue outlook. So, you guided for sequential growth in Q3 and obviously as you mentioned in Q2 you had a large contribution from international which you expect to normalize. But first, when you say normalized, what sort of level of repeat purchases are we talking about? Then second, I imagine that because of that most of the sales growth that you're expecting is coming from rec side, so what's the key driver here, is it about timing of shipments or are you regaining share this quarter, can you talk a little bit about that?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Sure, so first of all let me answer the question on the international sales. When we say normalized back to the last two quarters, so if you look at our run rate on international sales in Q4 and Q1, that would be sort of our normalized level and the incremental sales in Q2 were really some pipeline on some new SKUs into the markets that we deliver to. So, that's kind of what the normalized level we expect on international sales. Still significantly higher than year-over-year in Q3 of last year, we'll have higher sales, but not at the level we had in Q2 of this year.

In terms of our sequential growth, we actually do see every year an improvement in Q3 over Q2 and then again in Q4 over Q3. And that is really again back to seasonality where our highest seasonal quarter is always our fourth quarter during the summer where there is a significant consumer uptick in consumption. So, we do see there some of it is really coming from category dynamics and just as seasonality will help drive some of the sequential growth. But when you get down to where do we expect to see our sales, we do expect flower sales will be a challenge in the short term, but we have a strong innovation pipeline to help drive our back half revenue.

We have – we're still ramping up on Holy Mountain. I mentioned we launched 18 SKUs in the quarter, 8 of them were behind Holy Mountain. We introduced that brand to help us not only enter into a value offering that could get into smaller formats and not only playing in the 28-gram large format flower, but into 3.5-gram format. So, we're excited about ramping that brand up and getting distribution across the country. We are actually very excited about some of the work we have on our hash introduction SKUs that I talked about. We have a really strong pipeline of pre-rolls. Pre-rolls are heavily – they grow significantly in the summer months and we've invested in a high-speed pre-roll machine as well as new technology to improve the efficiency of infused pre-rolls. And we have a strong innovation pipeline on both those that will hit the market at the end of Q3 and into Q4.

And then we're also looking at introducing a new premium brand that we could put into the marketplace in the fourth quarter. And that would be featuring some high potency THC, but it would be from flowers that have been hang-dried, so we've introduced hang-drying into our facility with some unique genetics, some improved terpene profiles, right. So we're excited about balancing our portfolio with a little bit more premium brands as we move our Edison brand into a more mainstream position given its value profile to consumers. So, we expect also Lac-Supérieur products will help us gain some of that momentum as well. So, we've a lot of things in terms of innovation coming, some stronger entries into the flower segment on the 3.5-gram and premium brands. And we have confidence in what we could do with these products.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Thank you. That's great color Beena. And then my second question's just on your balance sheet. So, you finished the quarter with CAD 72 million in cash, you have no debt, but at the same time you are investing for growth for the remainder of the year. You have a pretty ambitious CapEx plan. So how should we look at that, your cash balance, what sort of minimum cash balance are you comfortable with? Thank you.

Derrick W. West
Chief Financial Officer, OrganiGram Holdings, Inc.

A

Yeah, I mean during the quarter we did have a larger drain on our operating cash that brought our expected cash level slightly below what would be our normalized level and again some of that operating portion [indiscernible] (00:39:08) reverse itself, to a certain extent. particularly [indiscernible] (00:39:12) that large accounts payable paydown. But we do have a larger CapEx program that we're partway through the spend on this year. We expect to have it complete this year in terms of the expansion at Lac-Supérieur along with the automation at all facilities and we'll have that complete the end of the year. So we would end up – ending the year post that in a lower cash position than we are today because of that CapEx spend. However, we are forecasting that given our profitability metrics and the stabilization of working capital assets and the CapEx spend behind this that we will in fact not just be operating cash flow positive but free cash flow positive at the end of this calendar year.

So, we believe that we will have a strong balance sheet at the end of the year. Of course, it will not be as strong as it was at the beginning, but we knew that coming in as a consequence of the investment that we're going to need to do on both the CapEx and on the net working capital assets to support just the business. But again I think we get there at the end of the year with all three facilities at full capacity, probably not looking to provide exact guidance on what the minimum cash balance would be but we're very comfortable on our ability to manage our cash flows without the need for additional capital. Of course we'll always consider options that are available to us but at this time we're not concerned about our cash liquidity.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.
Q

Thank you. Great color. Thanks.

Operator: Your next question comes from the line of Aaron Grey from Alliance Global Partners. Your line is open.

Aaron Grey
Analyst, Alliance Global Partners
Q

Hi, good morning and thank you for the questions. So just want to talk a little bit about some of that value segment. Certainly understand why you don't want to be participating in those lower prices, but want to get some color in terms of whether or not you're starting to see some signs of stabilization there and do you believe this is more sell-off of excess inventory to get some cash versus some write-downs or just given – because of how long this has lasted, do you see this more of a structural issue of cultivation efficiency, and if so, like how long can that persist [indiscernible] (00:41:40), sometime chicken will not come home to roost. So, wanted to get your perspective in terms of how long you believe this type of dynamic can lack and what you're seeing out there in terms of this low-grade offerings? Thanks.

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.
A

Certainly. So, let me start by saying I think it's a combination of couple of those things that you mentioned. When you think about some of the low prices, I mean we've seen 28-gram offerings at CAD 70 out in Alberta and if you take a look at what that markup model would be and then you subtract CAD 28 related to excise tax and [ph] there's certainly (00:42:19) nothing left. As you can imagine, this is something that people are selling off either aged inventory, inventory that they don't have a home for and will take whatever – monetize whatever cash. I don't think that's around for the long term. I think that is an impact we're having now in the industry because there's still excess capacity out there.

On the good news side, we are closely tracking the market and there are a number of LPs with meaningful market share who have significant financial – they'll have significant financial difficulty by the end of the year. So we're looking at these, and we're thinking as companies go through CCAA, take cultivation out of the market, that will help the situation. Also listening to some of our competitors, converting some of their cultivation into vegetable or fruit growing facilities, that's good news. Canopy took cultivation out, Aurora took cultivation out. With the acquisition announced yesterday between Tilray and HEXO, they are taking out some of the HEXO cultivation. I think as the market stabilizes in Canada where the cultivation capacity is more approximating the demand, some of this activity or rational pricing behaviors would change. So, I do think we're living with this for probably another year while we see perhaps some other cultivation capacity come out of the market but longer term, if this isn't sustainable and I do believe it will – pricing will move up.

I'm happy that Ontario has a floor on large format flower at their just below CAD 100 per ounce. Love to see pricing floor in Alberta. That would improve the situation. But the other good news is one of our competitors, and if I go back a year ago between Organigram and Village Farms, we were the combined market leaders on the flower category. I think that hearing Village Farms talk about the fact that they might take some pricing increases is a good sign, right. So this is the moving forward position when you have quality products out there, high potency quality, why not get it out there at a price point that is great for consumers, but also that the companies can make a decent margin on. And so there are signals that things will turn, but I do suspect that we're in this compression for perhaps another maybe hopefully not longer than a year as we see the cultivation capacity normalize.

Aaron Grey
Analyst, Alliance Global Partners

Q

Great. Thanks. That was really helpful color there. Second quick question from me just in terms of Edison JOLTS, right, so, obviously, [indiscernible] (00:45:32) nice growth there, but can you talk about potential timing and remedies and if you don't win in terms of the classification that you believe is appropriate, are there other things that you have available or is it best to assume that for right now that will be – take off the market until you get that resolved? So just any further clarity in terms of a pause in the production – I think that you said it in the press release and then potentially getting that back up outside of getting that resolved and any timing within that? Thanks.

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, it was a good question and I'd love to be able to answer it. Listen, we fundamentally believe in the strength of our position on JOLTS. We believe they are properly classified as ingestible extracts. We really can't comment further on what is a pending legal matter between [indiscernible] (00:46:21). We hope that we're able to achieve a stay which would allow us to continue to sell our products while we go through this judicial review, but that is still something that is underway and we don't know the answer whether we can. So, that's our approach right now.

Love to be able to get this product back on the market. We're still in the market until May 31, but get it back into the market. We know and we have consumer research that shows that if consumers can't buy this product in the legal market, they will turn to the illicit market and we have expressed that concern to Health Canada as they claimed concern of our product health and safety. We've been on the market for 18 months. We don't have any issues and if people turn to illicit market, we know that's where the problem exists with product health and safety. So, it is our position that we believe we are an ingestible extract. We'd love to be back full-time in the market for the balance of this year with our product and we're going to go through the motions because we just don't feel like shoving it down when we feel strongly that we're compliant is the right move. As a leader in the industry, this is a battle we feel is right to fight.

Aaron Grey
Analyst, Alliance Global Partners
Q

Okay, great. Thanks very much for the color and I'll jump back in the queue.

Operator: [Operator Instructions] Your next question comes from the line of Michael Freeman from Raymond James. Your line is open.

Michael W. Freeman
Analyst, Raymond James Ltd.
Q

Good morning, Beena. Good morning, Derrick. Thanks very much for taking our questions. I wonder if you could provide an update on that – the production capacity levels at each of your facilities – each of the facilities, Moncton, Lac-Supérieur and Winnipeg, perhaps, percentage of total or units per year basis?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.
A

Derrick, do you want to [indiscernible] (00:48:31)

Derrick W. West
Chief Financial Officer, OrganiGram Holdings, Inc.
A

Sure. I guess for the Moncton flower facility that we have, we – a conservative estimate would be that we're at 85,000 kilos a year of flower and of course in addition we would have the trend that we would fully utilize for our derivative products. With Lac-Supérieur, with regards to our hash, we're now at, based on the ownerships that we have, about 2 million units – hash units a year is what our capacity is and the craft flower [indiscernible] (00:49:06) 2,400 kilos. For Winnipeg, we measure gummies I guess in units and Beena, I don't have that top of hand. I know that you were looking at that yesterday, do you have that number?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.
A

So, our monthly volume – average volume is 3.1 million gummies, but just for perspective that's running really maybe a 10-hour shift 5 days a week. So obviously lots of excess capacity if we run the second shift and run to seven days a week.

Michael W. Freeman
Analyst, Raymond James Ltd.
Q

Okay. All right. That's very helpful and then I wonder if – I guess among those facilities, as you said to me on the Winnipeg capacity – available capacity, where do you see potential places where capacity could increase materially in your other facilities?

Derrick W. West
Chief Financial Officer, OrganiGram Holdings, Inc.
A

I think just as a general statement we have been investing quite a bit last year and this year to get our three facilities up to a certain capacity level but we do believe that we can ultimately operate at or near capacity and flow through and sell the product but I would say that in all three cases that at the end of this fiscal year that we would be I guess done the spend to maximize the capacity. I guess there is always extra shifts that can be run particularly in Lac-Supérieur and Winnipeg that I guess could allow us to flex on capacity, but I would say without significant changes in that structure that we are [ph] what we think in this year approximating (00:50:59) capacity of all three facilities.

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

And let me just...

Michael W. Freeman
Analyst, Raymond James Ltd.

Q

Okay...

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

...add to what Derrick said to just expand on the automation. So, we talked about capacity, but the automation has allowed us to increase our throughput on the packaging side, on the milling side, on the – just – on the pre-roll side, we'll have significant automation. So, there is expanded capacity in those areas simply through automation that we've invested in as well.

Michael W. Freeman
Analyst, Raymond James Ltd.

Q

Okay. All right. Thank you. That's very helpful color. Now, looking at international sales, I wonder if you could give us I guess your most recent understanding of price fluctuations in Israel in particular, wondering if you've seen any variations or compression in price in that market?

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

We've certainly seen commentary [indiscernible] (00:52:05) there is price compression happening in Israel. I continue to see from Organigram's perspective, we offer product that is seen as premium in the market, it's Canadian indoor grown, it's differentiated from what's available in domestic market. So, we haven't seen pressure on pricing from our end on international shipments, but certainly there is a domestic industry in Israel that is driving the value segment down and that's just not where we compete right now [audio gap] (00:52:43)

Michael W. Freeman
Analyst, Raymond James Ltd.

Q

Okay. Thank you very much. I'll pass it on.

Operator: And there are no further questions at this time. Ms. Beena Goldenberg, I turn the call back over to you for some final closing remarks.

Beena G. Goldenberg
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Perfect. Well, thank you everybody for joining us this morning for our call. We're very excited about the results that we announced this morning. We're happy with our improved gross margin, adjusted gross margin. We're very happy reporting a fifth consecutive quarter of adjusted EBITDA, providing an outlook that we will grow Q3 over Q2 in terms of net revenue and still holding to our forecast on positive free cash flow by the end of the calendar year.

So, we continue to navigate this challenging industry. We have some great products, some great brands and we're excited to continue to grow in the space. Thank you and have a good day.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.