19-Dec-2023

OrganiGram Holdings, Inc. (OGI.CA)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

Max Schwartz
Director of Investor Relations, OrganiGram Holdings, Inc.

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

Paolo de Luca
Chief Strategy Officer & Interim Chief Financial Officer, OrganiGram Holdings, Inc.

Timothy Emberg
Chief Commercial Officer, OrganiGram Holdings, Inc.

OTHER PARTICIPANTS

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Yewon Kang
Analyst, Canaccord Genuity Corp.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Krista and I'll be your conference operator today. At this time I would to welcome everyone to the Organigram Holdings' Fourth Quarter and Fiscal 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. We ask to please limit yourself to one question and one follow-up question. You may re-queue if you have further questions. Thank you. Max Schwartz, you may begin your conference.

Max Schwartz

Director of Investor Relations, OrganiGram Holdings, Inc.

Thank you. Good morning and thank you for joining us today. As a reminder, this conference call is being recorded and a recording will be available on Organigram's website 24 hours after today's call. 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. So, please review the cautionary language in our press release dated December 19, 2023 on various factors, assumptions and risks that could cause our actual results to differ. Further, references 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 figures.

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

Beena G. Goldenberg

Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Thank you and good morning, everyone. With me today is our Chief Commercial Officer, Tim Emberg; and Chief Strategy Officer and Interim Chief Financial Officer, Paolo De Luca.

By way of reminder, Paolo served as the company's CFO for over two years including calendars 2018 and 2019. I'd like to take a moment to thank Derrick West for his contribution to Organigram in his time as our Chief Financial Officer. All of us at Organigram wish him the best of luck as he takes time to focus on his health and recovery following a recent surgery.

Additionally, as you likely saw in our press release yesterday, we are pleased to announce the appointment of Greg Guyatt as our new CFO as of January 8, 2024. Greg joins us from Phoena where we held the positions of CFO and CEO. Previously he was CFO at Greenspace Brands and held various senior finance positions at Kingsett Capital and Sears Canada. We look forward to welcoming Greg to the team in January, and would like to thank Paolo for stepping in as interim CFO in Derrick's absence.

We will now discuss Organigram's performance for Q4 and full-year fiscal 2023. We are pleased with Organigram's progress throughout fiscal 2023, and I'm proud to say that we have continued to differentiate ourselves as Canada's leading pure-play cannabis company. Despite a challenging regulatory and competitive landscape, which did contribute to a reduction in our bottom line during the second half of fiscal 2023, we have grown Organigram's market share through an unwavering focus on the consumer, our strong marketing and sales expertise, and of course, our team focus on industry leading innovation.

As you may have heard, Organigram won that coveted KIND Magazine Innovation of the Year Award once again this year with our revolutionary Rip-Strip Hash. We previously won this award for our JOLTS ingestible extract product. These awards are truly a testament to our strength in developing disruptive new products that are designed specifically to meet the needs of our customers.

As anyone in the industry will tell you, branding and marketing are challenging in the Canadian landscape due to regulation. And as a result, the consumer has been predominantly motivated by price and THC potency. This is one of the many difficulties that every LP in Canada faces. Further the engagement Organigram has seen with its SHRED brand stands out with the community of loyal consumers who affectionately refer to themselves as SHRED heads. SHRED is even in the final round for ADCANN's Social Media Brand of the Year, an accomplishment we're very proud of. The success of this brand is owed to online, and retail marketing, and continued product innovation within the brand including our revolutionary Rip-Strip Hash, whole-flower derived THCV gummies, and our continued success in milled flower where we command over 50% of the market. Consumers are increasingly seeking quality, novel, and differentiated experiences, which SHRED has built its reputation of consistently delivering.

We've seen an impressive growth in several categories in fiscal 2023 compared to the prior year. Shipped sales in gummies have doubled propelling Organigram to the number one position in this category during Q4, and leading position in pure CBD gummies achieving over 50% market share nationally.

Earlier this year, we challenged the Health Canada determination stating that our JOLTS ingestible extracts, one of our higher-margin products were improperly classified and subsequently removed from the market. The company made an application for judicial review. The federal court granted the application and determined that there was a breach of procedural fairness by Health Canada. The matter was remitted back to Health Canada for redetermination. In the meantime, impending the outcome of final redetermination, JOLTS, which are now a patented Organigram product as of September are back in market.

Earlier this year, we shifted our focus to growing our SHRED pre-roll category as ready-to-consume cannabis products are rapidly gaining momentum with Canadian consumers. To achieve this, part of our 2023 CapEx plan included commissioning Cantos rolling and CME packaging machines, which together are capable of producing over 2.8 million pre-rolls per month. The response to our tube-style pre-rolls has been incredible. Consumers are impressed with everything from the aroma, packaging, and flavor, down to the rolling tightness and airflow of these joints.

As a result our pre-roll shipped sales growth between 2022 and 2023 was 54% bringing us from the number 10 market position in Q3 2023 to the number 3 market position in the category by the yearend.

The pre-roll category has seen 21.5% year-on-year growth, this growth has been driven primarily by two segments, infused pre-rolls, which grew 125%; and tube-style pre-rolls, which have grown 30%. Looking at the sales over the last three months ending November 30, Organigram had the second best sales per SKU of tube-style pre-rolls indexing at nearly 2 times the market leader. And since launching IPRs in Q3 we have achieved the number four market position in the month of November.

Now, we did observe some order fulfillment challenges and cost inefficiencies during the ramp up in the second half of 2023 due to a decision we made to accelerate the launch of these products to hit key seasonality.

Given our clean balance sheet, and cash position, we were able to make this competitive decision to increase penetration of the SHRED brand into these key growth segments. We are already seeing improved fulfillment and throughput in our pre-rolls production processes. Our aim is to continue to expand our pre-roll share while optimizing production to improve our margins in fiscal 2024.

As we have said, consumer preferences are evolving, and we are beginning to see purchasing decisions that are driven more and more by preference for differentiated experiences. As a Canadian leader in innovation, we are extremely excited about our line-up of new products for 2024. Part of this line-up is supported by our first US strategic investment into Phylos conducted earlier this year. With exclusive access to Phylos's whole-flower derived THCV, we plan to bring this novel cannabinoid to consumers in a variety of formats.

It's important to note this is not synthetic THCV. Our THCV products will be enhanced by the natural entourage effect we see with other minor cannabinoids derived from extraction or included in flower with high enough concentration. In 2024, Organigram customers will be able to experience whole-flower derived THCV in edible, weight, and flower format. Our SHRED and THCV gummies have been in market for only five months and we are already seventh most – we are already our seventh most popular gummy out of the portfolio of 13 by the end of the year.

The experience of THCV is reported to be characteristically different from THC in that it has appetite suppressing qualities and a more focused and energizing sensory experience. We anticipate that the introduction of THCV in additional format will help familiarize this novel cannabinoid for Canadian consumers. And according to Cannatrack, a large consumption tracking study, THCV awareness is already starting to build in Canada, which is very exciting.

Beyond the benefit of THCV, our investment in Phylos has enabled us to begin the process of transitioning a portion of our facility to more advanced, seed-based production through the completion of trials.

Seed-based production is the preferred growth method in mature agricultural industry as it results in lower cost grow operations, and more robust stabilized genetics. Organigram intends to establish itself as a Canadian leader in seed-based cannabis production as we roll out this initiative. Our goal is to convert [ph] 30% of our gardens (00:09:54) to seed-based by the end of fiscal 2024 delivering significant cost savings to the organization.

Another target area for Organigram in fiscal 2024 is growth in the vapes category. Organigram made a strategic investment in Greentank in fiscal 2023 in exchange for 18 months of exclusivity for the revolutionary hardware. We are gearing up for launch of our whole-flower derived THCV vape as well as vapes outfitted with Greentank's cutting edge vaporization technology which reduces clogging, improves flavoring performance, and which we believe will increase the perceived potency [indiscernible] (00:10:29) of our vapes compared to other products in the market. There is a tremendous opportunity for Organigram's [indiscernible] (00:10:34) vape, we intend to compete much more aggressively in this category in 2024.

Part of Organigram's corporate DNA as a leader in innovation has been supported by BAT's CAD 221 million investment into Organigram in 2021 and the resultant product development collaboration taking place in our Moncton facility.

I'm pleased to say that we continue to make progress on fundamental science and formulations that will form the basis of our product moving forward. Our nanotechnology formulation is being studied in a clinical setting with pharmacokinetic studies underway, which will provide Organigram with the ability to make claims regarding the onset and half-life of these products.

Other work streams are also underway to develop innovative technologies in the edible, vape, and beverage categories in addition to new disruptive inhalation formats. BAT's support has been a critical differentiator for Organigram. We have observed other strategic investors in the space over the years deploy significant capital only to sit on the sidelines. Furthermore, many large strategic investors elected to opt out of providing further capital.

On the other hand, we have seen our relationship with BAT evolve into something far more collaborative and complementary. This support was further demonstrated by BAT's recent follow-on investment of CAD 124.6 million into Organigram announced on November 6. Approximately CAD 83.1 million of this new investment is earmarked for Jupiter, a strategic investment pool managed by Organigram to increase its global footprint, while the remaining CAD 41.5 million is allocated to general corporate purposes. This investment is a win for Organigram, its shareholders, and the industry in general as we have shown that strategic capital is available to companies that show strong governance and disciplined capital stewardship.

With no debt, capital for global expansion, and general corporate purposes, as well as improving operational efficiencies, Organigram is positioned for long-term sustainable growth on the global cannabis stage.

Now, I'd like to provide an update to the guidance we previously gave regarding our intention to achieve free cash flow by the end of calendar 2023. This timeline has been impacted by the acceleration of THC inflation in the Canadian marketplace, delays in international shipments that we believe would resume in Q4.

Regarding THC inflation, we are still seeing an alarming level of fraudulent THC levels in flower product supported by selected testing and lab shopping. Some milled flower products are now claiming over 30% THC, which we know is truly an unbelievable claim.

Organigram continues to work with industry stakeholders to raise awareness of the THC inflation issue and to advocate for the consumer by working to establish guidelines for THC testing that contribute to a fair and even playing field for licensed producers.

We applaud both Health Canada for their cannabis data gathering programs and the OCS for their recently announced temporary THC testing efforts to uncover THC fraud, and we look forward to seeing positive changes taking place in the market because of our joint efforts to address this growing concern.

On the international front, Organigram had a record year shipping CAD 18.9 million in flower versus CAD 15.1 million in 2022, an increase of 25%. However, in fiscal Q3 we experienced a slowdown in international export due to newly enforced testing requirements in Israel. We believe historical export volumes would resume in Q4. However, we experienced delays relating to cultivar selection and shipping challenges.

Our lower Q4 international sales did impact our margin, but we anticipate stronger demand for our products from the international stage as shipments to Australia and Israel are expected to resume in fiscal 2024.

We will also begin building our export volumes to Europe as we signed two new supply agreements with Sanity Group in Germany and 4C Labs in the UK. The potential for distributing our exclusive THCV cultivars abroad is also very exciting.

Lastly, our EU GMP application for our Moncton facility has been submitted, and we are expecting an audit process to begin in the new year. This is expected to shorten the turnaround time to get products in the hands of international medical patients while expanding opportunities to new markets.

Beyond direct international sales, the creation of the Jupiter investment pool is expected to award us with additional exposure to international market by providing us with a wider array of strategic investment opportunities in the US and other legal jurisdictions.

Operationally, in Moncton, fiscal 2023 was transformative. We harvested 87,000 kilograms up from 54,000 kilograms in fiscal 2022, a 61% increase, and executed game-changing CapEx. We have invested in a variety of efficiency improving and cost cutting projects that will result in significant savings in fiscal 2024. To recap on some of these initiatives, we have internalized some of our testing requirements. We implemented remediation in health. We commissioned rapid drying machines, which has decreased drying time from 7 to 10 days to 2 days while increasing the available footprint in our facility for hand-dried flowers.

We automated our SHRED packaging, which reduced head count. Our new Cantos pre-roll machine is producing tube-style pre-rolls at scale and our new speed mixer has allowed us to infuse our milled cannabis for infused pre-rolls with distillate, diamonds, and botanical terpenes in a one-step process.

With this CAD 29 million 2023 CapEx spend behind us, we are now focusing on dialing in some of the newer processes we have put in place to drive further efficiency. In fiscal 2023 we realized approximately CAD 4.3 million in savings related to these initiatives. In fiscal 2024, these enhancements will deliver an additional CAD 4.6 million and the conversion of a portion of our garden's seed-based production along with other initiatives are estimated to realize an additional CAD 5.3 million in savings to bring the total aggregate savings in fiscal 2024 to CAD 10 million.

At our hash and craft cannabis facility in Lac-Supérieur, we just completed our first harvest resulting from the expansion of the facility. The 30,000 square foot expansion is complete with four net new grow rooms, three drawing rooms, a 5,000 square foot warehouse, and large packing area.

We launched SHRED Rip-Strip, Holy Mountain and Wô Lá pressed hash, Tremblant Black Afghan Hash and [indiscernible] (00:17:26) in fiscal 2023. Our hash production earlier this year was about 100 to 150 kilograms of hash per month, up to a peak of 350 kilograms per month in Q4. Our focus at Lac-Supérieur for fiscal 2024 will be on our continued performance in hash and optimizing our garden to produce high quality, high margin craft flower.

And on that note, I would like to turn the call over to Paolo to discuss our financial results for Q4 and fiscal 2024.

Paolo de Luca

Chief Strategy Officer & Interim Chief Financial Officer, OrganiGram Holdings, Inc.

Thank you, Beena. I am pleased to be speaking here to you today. Before I go any further, I would like to remind everyone that Organigram made a decision earlier in the year to change its fiscal year-end August 31 to September 30. We made this decision for a few reasons including: to align our quarters with more traditional fiscal quarters, which allows better comparisons to our other public peers; and also to ease operational efforts around shipping cutoffs and inventory counts. We believe that this change will streamline financial reporting efforts over time.

As a result of the company's change in its fiscal year-end from August 31 to September 30 and in order to bridge fiscal 2023 to fiscal 2024, the financial information presented here for the current quarterly period is for the four months from June 1, 2023 through September 30, 2023 and for the fiscal 2023 year consists of the 13 months from September 1, 2022 through September 30, 2023, whereas the comparative periods for 2022 are for the three months from June 1, 2023 through August 31, 2023, and the 12 months from September 1, 2021 through August 31, 2022, respectively. Going forward, our quarters will now end with December, March, June, with September being our year-end.

Year-over-year, growth and net revenue increased by 12% and 11%, respectively, apparently due to net increases in recreational revenue of CAD 15.1 million and net increases in international revenue of CAD 3.7 million, partially offset by a decrease in domestic medical sales. In fiscal Q4, gross revenue increased by 9% and net revenue increased by 1% compared to Q4 fiscal 2022. The increases over the comparative periods were primarily due to the extended reporting period, offset by a decrease in international revenue in fiscal Q3 anQ4, as Beena mentioned. Price compression as a result of THC inflation did have an impact on the quarter.

Year-over-year, cost of sales increased to CAD 136.4 million from CAD 119 million in fiscal 2022. Organigram's cost of sales in Q4 fiscal 2023 was CAD 42.9 million compared to CAD 36.7 million in Q4 2022, an increase of 16%. The increase in the cost of sales over the prior year period was primarily due to an increase in inventory provisions and sales volume in the adult use recreational cannabis market. Included in Q4 fiscal 2023's cost of sales was CAD 4.8 million of inventory provisions that primarily related to NRV adjustments for whole flower now being used for derivative production including, for example, kief and extraction, with a smaller amount related to unsellable inventories.

We harvested approximately 28,000 kilos of flower during Q4 fiscal 2023 compared to 16,000 kilos in Q4 2022, which represents an increase of 74%. The increase was primarily attributable to the extra month of cultivation, but also the availability in 2023 of increased cultivation, planting and additional grow rooms being available.

In Q3, we accelerated a change in the operational conditions for plant care to increase THC levels. This resulted in a decrease to plant yields, which had a negative impact to our cost of cultivation and which temporarily reduced the company's gross margins and gross margin rate. By the end of Q4, plant yield increased over 16% to 163 grams of plant from 141 grams of plant at the end of Q3 and average THC increased by 14% since fiscal 2022.

We continue to optimize growing conditions during Q4. While yield and THC content will fluctuate over time, the trend we have seen over the last six months has been larger yield and higher potency. These higher yields will reduce the cost of cultivation in the long run as will the cost saving production initiatives Beena outlined earlier. As this flower is sold, we will achieve a higher gross margin rate, but we expect to be able to have an overall lower cost of cultivation for fiscal 2024 as a whole.

As I mentioned, month-to-month and quarter-to-quarter harvest, yield and cost of cultivation will fluctuate for a variety of reasons, but the overall long-term trend has been clear improvement. In fiscal 2023, which includes the extra month, we harvested just under 90,000 kgs of flower, which even normalized for 12 months would be 83,000 kgs. That works out to approximately 6,900 kgs a month. Our goal is in 2024 to improve upon that 6,900 average kilos a month average we saw in 2023.

Year-over-year adjusted gross margin increased to 25% or CAD 40.2 million, up from 23% or CAD 33.4 million in fiscal 2022. The increase was primarily due to an increase in recreational revenue and international revenue, partially offset by a decreased amount in sales and the temporary cessation of JOLTS sales between April and September.

On an adjusted basis, Q4 gross margin was CAD 7.9 million or 17% of net revenue compared to CAD 10.4 million or 23% in Q4 fiscal 2022. The compression in adjusted gross margin was primarily attributable to price reductions, lower net revenues, temporary higher flower costs, a decrease in international sales and higher cost of sales per unit, which was correlated to higher inventory provisions for unsellable inventories and NRV adjustments.

On a year-over-year basis, SG&A increased to CAD 71.8 million compared to CAD 59.8 million in fiscal 2022. The increase in expenses mainly relates to the extended fiscal period, higher employee costs due to more G&A full-time employees to support the company's growth, general wage increases and higher professional fees and higher technology costs, which included CAD 7.7 million in ERP installation costs for the year. By way of comparison, ERP installation costs in fiscal 2022 were CAD 3.2 million.

SG&A, excluding non-cash share-based compensation, increased to CAD 21.6 million in Q4 2023 from CAD 15.7 million in Q4 2022. The increase in expenses was primarily due to the extended fiscal period and to a lesser degree higher professional fees. ERP is also a factor in explaining Q4 2023 increase over Q4 2022. In 2023, Q4 ERP costs were CAD 2.4 million in the period versus CAD 1.8 million in the prior period.

We're pleased to report that the heavy lift on our current ERP implementation is mostly behind us and we have just over CAD 1 million budgeted for fiscal 2024, mostly in Q1 2024.

In fiscal 2024, we anticipate some fluctuations in adjusted EBITDA between quarterly periods, with stronger adjusted EBITDA metrics expected in the second half of the year as the company's production optimization of recent high growth categories, such as tube style pre-rolls and infused pre-rolls is fully recognized in the financials. However, we remain confident in the upward trajectory of our earnings on an annualized basis, as seen over the last three fiscal years, supported by the newly enhanced production processes and cost-saving initiatives Beena outlined, and beginning international shipments to Germany and the UK while continuing to supply Australia and Israel.

In the quarter, while adjusted EBITDA was negative CAD 2.4 million compared to positive CAD 3.2 million in Q4 2022, on an annual basis, adjusted EBITDA in fiscal 2023 increased to positive CAD 6 million compared to positive CAD 3.5 million in fiscal 2022, an increase of 71%.

On a year-over-year basis, SG&A increased to CAD 72.4 million compared to CAD 59.8 million in fiscal 2022. Net loss in fiscal 2023 was CAD 248.6 million compared to CAD 14.3 million in fiscal 2022. The vast majority of the net loss for the year is attributable to full year impairment charges of CAD 210 million, consisting of CAD 165 million on property, plants and equipment and CAD 45 million on intangible assets and goodwill. Of these impairments, CAD 191 million of the impairments were taken in Q3 and announced last quarter, of which CAD 38 million related to intangibles and goodwill and CAD 153 million was attributable to PP&E. The impairment test completed in Q3 was warranted by the company's market capitalization trading significantly below its shareholders' equity combined with Q3's operational results.

A meaningful contributing factor to the quantum of the impairment charge was related to the impact of flower sales and margins due to THC inflation. When considering the significant sales and margin that flower product categories collectively contribute to Organigram's financial results, this was a key driver to the amount of the impairment loss. It should be noted that all things remaining equal, impairment losses recorded on the company's PP&E will result in an improvement to the gross margin rate going forward. In Q4, additional impairments were taken in the amounts of CAD 11.6 million on PP&E and CAD 7 million on intangibles mainly due to refinements in the impairment model related to macro, sector and company-specific assumption inputs.

During Q4 2023, Organigram's net loss was CAD 33 million compared to a net loss of CAD 6.1 million in Q4 2022. The increase in net loss was primarily due to the aforementioned impairment losses and collectively totaled CAD 18.7 million in the quarter and to a lesser extent lower international revenue in the previous quarters and the lingering effects of price compression.

From a statement of cash flows perspective, net cash used in operating activities after working capital changes was CAD 38.8 million in fiscal 2023 compared to CAD 36.2 million in the prior year. The increased year-over-year includes higher R&D costs and higher ERP implementation costs, both of which are investments into company's long-term success. Cash provided by investment activities in fiscal 2023 was CAD 4.9 million compared to cash provided of CAD 44 million in 2022. Much of the explanation for the positive figures in both years is the redemption of short-term investments into cash. But on the outflow side, Organigram deployed CAD 29 million in PP&E during the year and another CAD 10 million related to the investments in Greentank and Phylos. These expenditures are all geared to obtaining long-term competitive advantages and to drive productivity gains.

In the previous fiscal year 2022, Organigram had invested CAD 48.7 million in PP&E. Thus, 2023 represented a reduction in PP&E investment and 2024 will be a further reduction of the CapEx programs almost entirely complete now. This is a good news story for the company as we will now be in harvesting mode as we optimize all these additions to the company and are on the path to long-term sustainable margins.

In terms of our balance sheet, we are pleased to say that we have one of the healthiest balance sheets in the space. As of September 30, 2023, and by way of reminder, none of this takes into consideration the recently announced deal of BAT on the Jupiter private placement. We had unrestricted cash of CAD 33.9 million and restricted cash of CAD 17.9 million for our total cash position of CAD 51.8 million, with negligible debt.

While the company expects to continue to report growth in year-over-year adjusted EBITDA [indiscernible] (00:30:36) when the company achieves significant increase in sales will result in increases of receivables and this will negatively impact cash from operating activities. However, given that our major CapEx spends are now behind us, we're seeing increased yield, improving production efficiency, and are anticipating increases in international sales. Achieving free cash flow positivity in fiscal 2024 is an achievable target, which we are currently budgeting for in the second half of the year.

Our existing cash balances already have us in a strong position. The BAT private placement expected to close in January will only buttress the company further. We believe that balance sheet strength will be one of the key determinants of the long-term winners in the space, along with market share strength, operational efficiencies and investment in R&D and product innovation.

We also believe that balance sheet strength will offer financial flexibility as M&A and commercial opportunities increase in Canada, as players struggle with debt loads, stretched payables including unpaid excise taxes and the inability to invest in automation and other production efficiencies needed to get down the cost curve in a highly competitive market. In short, many of the recent financial and strategic transactions that we've announced are geared with a view to sustainable, long-term competitive advantages.

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

Beena G. Goldenberg

Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Thanks, Paolo. And as Paolo just said, the Canadian industry continues to grow, yet is saddled by high excise taxes and restrictive regulations. We've seen LPs shuttering operations and entering creditor protection while others are seeking short-term extensions on their maturing debt. Further, an astonishing number of LPs are in arrears on their excise taxes, and we are beginning to see the CRA hold these LPs accountable. Given these issues, it is not surprising that some LPs would mislabel products to artificially inflate THC levels to increase sales. However, this is simply not sustainable, and we expect to see more of our peers struggle to survive in the coming year.

Organigram continues to fortify itself as current market forces put pressure on the industry and is positioned to be highly opportunistic. To summarize our success against this backdrop, we've seen impressive growth in several product categories throughout 2023. Despite the industry challenges, we defended our market share as our brands and market-leading innovations are continuing to resonate with consumers.

Organigram ended the year on the number two position among LPs in the recreational market. We were number one in milled flower, number one in hash, number one in gummies, number three in flower and number three in pre-rolls. We invested heavily in cost cutting and efficiency driving projects in our facilities to help us realize additional savings for fiscal 2024. We also invested strategically to acquire rights to technologies like Greentank vaporization hardware and Phylos for seed-based genetics. Our focus is now on further strengthening our pre-roll offerings and shifting towards winning in the vape category while introducing products in the higher margin craft flower market.

The recently announced CAD 124.6 million follow-on investment from BAT is designed to better assist us in capitalizing on opportunities in domestic and international markets. While the product development collaboration continues to work on the development of novel cannabinoid innovations and formulations that will support our product pipeline in the years to come. We are set up to achieve an improved margin profile in fiscal 2024, supported by production efficiencies, better fulfillment, and expansion into more international market. We have effectively no debt, sufficient cash and an industry leading portfolio of products and brands that consumers love, supported by industry-leading production capabilities.

And with that, I want to 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 Aaron Grey from Alliance Global Partners. Please go ahead.

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Q

Hi. Good morning and thank you very much for the questions. So first from me is I want to touch on gross margins. So, you called out a couple of things that impacted some of the gross margin pressure, including pricing from the higher flower cost, higher cost per unit as well as [indiscernible] (00:35:23) inflation impact and international. So, as we think sequentially, down 200 basis points, 90% to 70%, can you help to quantify maybe or rank-order which one has been the biggest impact to that margin pressure and then how we should think about the margins on the near term, you spoke to international [indiscernible] (00:35:41) back up in fiscal year 2024, is that more of a next quarter dynamic or is it going to be more in the back half? And then how do we think about the impact in terms of the Canadian marketplace on gross margin as THC inflation remains? So any color on your gross margin expectation in the near to medium term will be helpful. Thank you.

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

A

Perfect. Paolo, I'll put that one over to you.

Paolo de Luca
Chief Strategy Officer & Interim Chief Financial Officer, OrganiGram Holdings, Inc.

A

Great. Thanks, Beena; and thanks for the question, Aaron. On margin, look, the highest margin opportunity for us always is international. So, to the extent that we have international sales, that's going to drive margin and that obviously will depend on the mix, of the size of those sales and in comparison to the sales that we have in the rec market. And so just by nature historically, international sales have been lumpy, and that's something that we're working to address and we are working to address that by diversifying the countries that we solve to, to have more than two countries, so we're moving to four countries, so we hope to expand that even further; and then where possible to diversify within customers within those countries and then also to spread out the shipments. So, by doing that over time, we'll avoid the issue that we've had historically, which is essentially lumpy margins. At least – I would say, at least half of that is related to international sales. So, to answer your question, international by far is the most important thing in terms of determining margin mix for the quarter.

All of the products that we're now growing in have good margin profiles for us when they are operating and when we're producing them at the steady state and avoiding all the ramp up issues that we have, as almost any LP will have with the initiation of those products. So, we spent a lot of time on the call in the prepared comments talking about infused pre-rolls and tube style pre-rolls. I could tell you that right now the way that we're producing them right now is a lot better than the way we're producing them three or four months ago. And so, while we could have made a decision to just optimize and not be in market, we would have lost the opportunity to gain market share, and I think it's very important that especially in growing categories that you get in there when you can, and I think we're happy with the way that we kind of claim share in those spaces and that's going to continue to grow.

And so, I would say if you want to look at the margin profile of our quarters in 2023 versus the way that we expected to play them in 2024, it's almost a mirror image. So, whereas in 2023, we started off strong with margin and then a decline, in 2024 will be the exact opposite. So, I think that certainly our budget – and I don't want to make this forward guidance, but the way we plan the year out, our margins should get back to the same levels they were historically and slightly even better.

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Q

Okay. Great. Thanks for that color. That was really helpful. Second question from me. I know still relatively early days just in terms of the Jupiter initiative and the potential investment there. Any color in terms of what you're seeing in the marketplace and how you might have narrowed in on some opportunities, particularly geographically some catalysts ahead on the international front with Germany medical reform and potential adult-use down the line with Phase 2 and then obviously in the US where potential rescheduling as well. So any color in terms of what you're seeing out there in the marketplace, US internationally or maybe potentially in Canada that might be appealing to where you might be able to deploy some capital first and invest in opportunities? Thanks.

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

A

Thanks, Aaron. So I'll start and then I'll hand it over to Paolo as well on this one. But just to start with, certainly our intention on Jupiter, I would say 60% to 75% of the investment will be focused on the US market. That is an area that we dipped our toe slightly this year with the Phylos investment. So we understand the complexities and making sure we do something that is compliant with our Nasdaq listing. But we're significantly focused on the US and the inbound that we received after the announcement of this Jupiter pool has been just a testament to the opportunities out there and we're currently narrowing down the areas that we're going to focus. I would say there is a portion of that investment looking at other international markets. But again, the priority is US first and then what is the best opportunity globally moving forward from there. So, that's in terms of the focus. Paolo, if there is anything else you want to add?

Paolo de Luca
Chief Strategy Officer & Interim Chief Financial Officer, OrganiGram Holdings, Inc.

A

No. The only other thing that I would add is that I would say it's relatively early days and the fact that some of the expected changes that people have called for, whether it be in countries like Germany or in the US, they haven't manifested as quickly as anticipated. I think it bodes well for us for a couple of reasons. One is, it just allows us more time to expand our scouting and develop relationships with all the people and all the participants in those markets. And two, as these markets have been slow to move in terms of the initial expectation, the capital markets have been hampered as a result for cannabis companies. We're lucky because we are one of the two companies to pull off a very large investment at a very favorable valuation to where we were trading that and I think that will set us up well because I don't think there is that much capital floating around for companies that need capital. So I think we are in a very good position and I think we'll have a lot more to announce on that in the calendar 2024 year.

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Q

Okay. Great. Thank you very much for the detail. And I'll go and jump back in the queue.

Operator: Your next question comes from the line of Frederico Gomes from ATB Capital Markets. Please go ahead.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Hi. Good morning. Thank you for taking my questions. My first question is just going back to your comments on international and that being the largest margin opportunity for you. So I'm just curious tying that to your free cash flow guidance for the second half of fiscal year 2024. Does that guidance sort of relies on international growth and if you could unpack a bit of the drivers behind that guidance and how much of it is about – in terms of the sales mix of domestic sales, international, that would be great. Thank you.

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

A

Yeah. Sure. No problem, Fred. So, our intention, as we said in the script earlier today, was that we are working on our EU GMP certification, which we expect to get in the back half of the year. So, while the first half of the year in international shipments we will expand outside of just Australia and Israel, we will add the two new countries we already announced supply agreements, that's to Germany and to the UK. But our goal, as we look forward, is to leverage the EU GMP certification to get into more countries. And as regulations continue to change, there are more opportunities out there. So we do see the international sales growing, sort of phasing further into the back half as we grow out new international opportunities.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Thank you. My second question is just looking at the Canadian rec market. And I guess, in your outlook, you mentioned the many LPs are behind the payment of your taxes. And there's obviously a lot of challenges to raise capital, and some bankruptcies happening, but at the same time it just seems that now this process of rationalization among LPs is always around the corner and never arrived. So, just curious on your perspective for next year? Why could it be different from this year? How do you see that playing out, going to be – is it going to accelerate into 2024? Or is it going to be more of a gradual process? How do you see that happening? Thank you.

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

A

Right. So, thank you Fred. It is, we have been saying, for a while now that this industry is prime for consolidation, and it hasn't happened because honestly the fact that the CRA has allowed companies to be in arrears it is unbelievable to us. We have seen, and we've talked to a bunch of LPs, like the arrears are astonishing. And CRA has started to clamp down, we have heard that they've been in up on license renewal, and asked for actual payment plans to get back – to get the people back, and I think, there are some companies that will never be able to do the payment plan getting back.

So, we've seen some closures as CRA has clamped down. We've also seen some closures as debts have come due, and not been extended further, so banks have shut down LPs. So, it's starting to happen. We have companies not only going into CCAA, but companies just going into bankruptcy and shutting their doors. And it has to happen right? I mean there's just, the dynamics right now are unsustainable. By having testing on THC inflation which gave some LPs an extra year of runway by claiming they had products that were 30% to 35% THC that only tested it were sitting on average between 17% and 21% potency, it gave them runway. So what you have is companies out there really pressuring what is approved regulation just because they're doing it to survive. And they've been able to survive an extra period of time. But it's not sustainable.

And this is, it's crashing in on them while access to new capital isn't available. So, is it happening as soon as we thought? No. Is it continuing to happen? Absolutely. So, you're hearing about it, you're seeing these changes over the next whether it takes 12 months or 24 months, what we know is that we're sitting on cash, we have strong brand, and we have innovation, and we will be here on the other side of it. And in the short term, while there's an unfair playing field because people are exaggerating their THC potency or aren't paying their taxes, that's going to come to an end at some point. They are going to go away and the strongest will survive. And we're going to be one of them and that's how we see it.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Thank you very much.

Operator: Your next question comes from the line Yewon Kang from Canaccord Genuity. Please go ahead.

Yewon Kang
Analyst, Canaccord Genuity Corp.

Q

Hi, good morning. This is Yewon Kang on behalf of Matt Bottomley. Thank you for the question. I just wanted to shift gears back to the Canadian adult-use market and wanted to ask about the THC innovation that you guys have been rolling out recently. I wanted to ask if there is a dollar premium that you are able to attach to the THCV product versus non-cannabinoid THC product? And as well, also curious to see how you guys have been thinking about the cost-benefit analysis of how the THCV products have been performing although its early days against the investment dollars that you guys have spent on Phylos with partnership so far.

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

A

So, thank you for the question. First, I'll pass it over to Tim Emberg, our Chief Commercial Officer to answer the question on THCV and other products that we have in market. Tim?

Timothy Emberg
Chief Commercial Officer, OrganiGram Holdings, Inc.

A

Sure. Thanks, Beena. So, currently we have two THCV gummy products in the market. One under the Trailblazer brand and one under SHRED'ems brand. And we don't have it as a premium currently from a pricing perspective. But the reception in the market is quite strong. So, as Beena mentioned earlier, we have got 30 SHRED'ems SKUs in the market and it is sitting at about the seventh position from a performance perspective, and early days into the market. So, THCV also, for us, it requires a lot of education to not only the consumer, but to the budtenders. So, part of our mandate from a commercial perspective right now is to really educate the consumer, educate the budtender on THCV so he understands the attributes of THCV, and be able to recommend it comfortably. And as we ramp up to our next portion of our THCV launch, which is our THCV vape which we are launching very shortly, we expect significant lift in the THCV section of our portfolio.

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

And just to – thank you, Tim. And just to build the second part of your question, which is the payback on the investment with our Phylos investment. I want to remind you that it was really strategically two-fold, that it was not only access to THCV, but it was also the ability to move our production to seed-based production.

Now Phylos is known for being able to develop F1 hybrid seed that will give us significant cost savings by converting a portion of our garden over to seed-based production. Our plan for fiscal 2024 is that we'll have 30% of our garden converted over to seed-based by the end of the year. And what that does is not only does it shorten the cycle time in the garden, but it gives us more robust flowers, more predictable attributes to the flower. And when you have F1 hybrid seeds, we could take those to other markets around the world to deliver the exact same cultivar and experience in other markets.

So, it just gives us some stability and predictability. So, we're very excited about that, and truly the payback on the Phylos very much links back, and is a huge payback based on the conversion to the seed-based production.

Timothy Emberg
Chief Commercial Officer, OrganiGram Holdings, Inc.
A

And sorry Beena, I'll just add to it one more point is that there is a lot of interest on THCV from an international perspective. So, we've been in discussions with our current partners, but also potential future partners on exporting THCV into their potential markets as well.

Yewon Kang
Analyst, Canaccord Genuity Corp.
Q

Great, thank you for the color. And just my second question on the international shipments for fiscal 2024 going forward. I know that you guys are going through an audit to get your facility EU GMP certified, so is it fair to expect that the international exports will likely – that the sales will likely accelerate in the back half of fiscal 2024 as you guys receive the EU GMP certification for shipments going to the UK and Germany? Thanks.

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

Tim, why don't you take that one as well?

Timothy Emberg
Chief Commercial Officer, OrganiGram Holdings, Inc.
A

Yeah. So, that's the idea. We're going through the EU GMP certified process right now. We expect to set up the audit fairly soon, and once we establish the certification, we will be able to expand. And it's not only about market expansion, it's about turnaround time. When we go into a country like Australia, it takes longer if you don't have the EU GMP, to convert to EU GMP and get into the marketplace. So, it'll allow us to get a quicker turnaround in reorder process because we'll be able to ship finished goods versus bulk into this market, which we'll put it into the hands of the patients sooner, and then get reorders in a more timely fashion versus taking eight weeks or so.

So, we expect it to benefit us from a market expansion perspective and open doors, but also to eliminate some of that lumpiness that Paolo referred to earlier.

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

A

But let me just build on Tim's comment which is we will be audit ready, we are dependent on getting an auditor over from Germany to certify the facility, and while we hope to have that early in 2024, we are – this isn't something that we could tie down. So, we'll continue to drive towards that. But we do believe that even without the certification in the first half of the year, just resuming some of our shipments to partners as well as adding the new supply agreements. So our agreement with both Sanity Group and with 4C Labs that we announced are predicated on us selling out of a non-EU GMP facility, so they will go through conversion, whereas in the back half if we should get the certification, that should go faster as well.

So, we will see increase even if there is delay in the certification, but we – because of new customers, but we do hope to see the certification because we believe there's even more upside by the end of the year once we get that.

Yewon Kang
Analyst, Canaccord Genuity Corp.

Q

Great, thank you for the color. I will jump back into the queue.

Operator: And we have no further questions at this time. I will now turn the call back to Beena Goldenberg for closing remarks.

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

Thank you everybody for joining the call today. I know that we're coming up on the holidays. So, I want to wish everybody a happy and healthy holiday season, and I look forward to sharing with you more updates as we report our Q1 in mid-February. Thank you for joining the call.

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