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Company: **OrganiGram Holdings, Inc.**

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COMPANY PARTICIPANTS

- Unverified Participant
- Beena G. Goldenberg - OrganiGram Holdings, Inc., Chief Executive Officer & Director
- Derrick W. West - OrganiGram Holdings, Inc., Chief Financial Officer

OTHER PARTICIPANTS

- Aaron Grey - Analyst
- Tamy Chen - Analyst
- Matt Bottomley - Analyst
- Douglas Miehm - Analyst
- Ty Collin - Analyst
- Frederico Gomes - Analyst
- Owen Bennett - Analyst
- Aidan Giangregorio - Analyst
- Michael Freeman - Analyst

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 Fiscal 2022 results 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. Thank you.

Craig MacPhail (00:00:37) you may begin your conference

Unverified Participant

On today's call, you should be aware that it will contain estimates and other forward-looking information in which the company's actual results could differ. Please review the cautionary language on 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 IFRS measures during the call, including adjusted EBITDA and adjusted gross margin. These measures do not have any standardized meaning under IFRS and our approach in calculating these measures may differ from that of other issuers. So these measures may not be directly comparable. Accordingly, these non-IFRS measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

Please see today's earnings report for more information about these measures. Listeners should also be aware that in making certain statements relating to market share data, the company relies on reputable third-party data providers. I would now like to introduce Beena Goldenberg, Chief Executive Officer of Organigram Holdings, Inc. Please go ahead, Ms. Goldenberg.

Beena G. Goldenberg

Thank you and good morning, everyone. With me is Derrick West, our Chief Financial Officer. For today's call, we'll discuss the financial results for the three months ended February 28, 2022, and I will provide a general business update. We will then open the call for questions.

I am happy to report that second quarter of fiscal 2022 we continued the progress of past several quarters. We again achieved record net revenue in the quarter, the highest in the history of the company. We grew our market share and now hold the number three position among Canadian LPs in the recreational market in Canada and most importantly, we achieved a positive adjusted EBITDA of CAD 1.6 million, two quarters earlier than we projected at the start of the year.

Also in the quarter, as we announced in our last call, we acquired Laurentian, an artisanal craft grower and premium hash producer based out of Québec. Net revenue in Q2 was CAD 31.8 million, a 117% increase over Q2 of fiscal 2021. This is a record level of net revenue for Organigram and demonstrates our continuing success at understanding consumer needs, innovating to best address market demand and introducing compelling brands and products that resonate.

And we continue to grow our market share. In February, we secured the number three position in market share among Canadian LPs for the second month in a row with a share of 8.2% according to Hifyre. In March, the momentum continued with another 20 basis point gain for a market share of 8.4%. We also continue to hold the number one position in the flower category which represents about half of the Canadian cannabis market. Our SHRED milled flower product are the top sellers in Canada with SHRED Tropic Thunder being the best-selling flower product in the country.

We also hold the number three position in the gummies category, having doubled our market share quarter-over-quarter with two of our SKUs amongst the top 10 bestsellers in the country. This market position includes SHRED'ems gummies which were introduced this past August and Monjour, our large format CBD infused soft chews introduced this past November.

Edison Jolts, our unique high potency THC lozenge maintains its position as the bestseller in the injectable extract category. Now moving on to innovation, we recognize the need to bring news to the category so we continue to launch new products. We have leveraged our SHRED brand that has achieved high visibility among the cannabis consumers. In March, we shipped SHRED-X kief-infused blends, an innovative product that combines the convenience and popularity of SHRED milled flower with the potency of kief in a 50/50 ratio.

We also launched SHRED-X vapes. These are 510 cartridge vapes with the flavor profile of SHRED milled flower products, Tropic Thunder, Megamelon and Funk Master. And how are we doing? Well, within days of launch, SHRED-X Tropic Thunder was the fourth best selling vape in Ontario.

Building on the success of SHRED'ems gummies, we added unique line extensions. SHRED'ems POP! gummies in the classic pop flavors of cola, root beer and cream soda were introduced in March. We've also added two new sour flavors, Sour Apple Slap and Sour Blue Razzberry. With eight SKUs now available to consumers, we expect to strengthen our market position in the gummy category.

We've also added two new premium strains to our Edison line. With Edison Kush Cakes and Edison Frozen Lemons. These high potency and terpene rich addition will create further engagement with cannabis enthusiasts.

With Big Bag O' Buds, our large format value brand, we added Pink Cookies, a high potency Indica strain. This expansion of our product line addresses the desire for specific strains by value-seeking consumers and reflect the evolution of the Canadian cannabis market. International sales also bolstered our Q2 results. We shipped approximately 1,700 kilograms of dried flower to Israel and Australia in the quarter, marking the highest international B2B shipments in the history of the company.

We expect to have further shipments to Canndoc in Israel and Cannatrek in Australia in fiscal 2022. And we look to expand our international partners to ship more wholesale dry flower.

Now let's look at operation, beginning with Laurentian. After acquiring Laurentian in December, we began working on integration. One of our priorities was to increase the distribution of its unique Tremblant hash and Laurentian craft flower products. At acquisition, Laurentian products were available in four provinces. By the end of the fiscal year, we will be available in all 10.

In Ontario, we've been successful of increasing distribution levels of Tremblant hash from 25% to almost 40% of Ontario's 1,500 stores and have grown sales by 21%.

This Ontario example underscores our success in leveraging our marketing, distribution and field sales capabilities to drive results. We expect to be able to achieve the same success across Canada as we increase the footprint of Laurentian brands.

We're also making progress in expanding and automating production at Laurentian. Construction and licensing for the additional space is expected to be complete by the summer of 2022, with a four times increase in cultivation capacity and increased automation, processing and storage space to be achieved by the end of 2022. Hash production at Laurentian is now supported by high quality and high potency kief coming from our Moncton facility. This was identified as an acquisition synergy.

At our Moncton Campus, we are completing the Phase 4C expansion and expect to reach upwards of 80,000 kilograms of dry flower capacity. Environmental enhancements are currently in place in approximately 40% of the facility and should be fully implemented by the end of the year. These upgrades have and will continue to further enhance yields and flower quality as they are completed.

We currently have two automated pre-roll lines and will be adding high-speed pouch filling lines for SHRED and Big Bag O' Buds by the end of fiscal 2022.

In Winnipeg adding on to our highly automated gummy production line, we have automated labeling and excise stamping and are commissioning pouch packaging equipment. We have also upgraded and leveraged our warehouse to optimize our logistics network and drive freight savings.

These changes help improve our efficiencies, margins, and customer service. The build out and improvement in Moncton and Winnipeg reflect our strategy to make investments based on recognized business needs and strong payback.

In the quarter, all large-scale construction projects were substantially completed at the product development center of excellence in Moncton. The bio lab is being fully equipped in Q3 and then we will begin to conduct advanced plant science research.

In the quarter, our joint R&D efforts continue to progress well. And we look forward to applying the discoveries and deep scientific knowledge to both strengthen our existing market products as well as develop new consumer-centric innovation.

It's important to note that BAT support for the product development collaboration and Organigram as a whole was further showcased at the beginning of March when they invested CAD 6.3 million into the company. This investment was made through the exercise of their top-up rights pursuant to an investor rights agreement and increased their equity position from 18.8% to 19.4%.

Also as mentioned in our call last quarter, in December, we increased our cumulative investment in Hyasynth Biological by CAD 2.5 million to CAD 10 million for a strong minority position. Hyasynth's advanced research into using biosynthesis to produce THC, CBD and rare cannabinoid without using cannabis plants provides us with another avenue to innovate in the future.

Through these collaborations and in addition to our in-house R&D capabilities, we will continue to produce unique, exciting products for the Canadian consumers and subject to terms of the PDC create proprietary IP that we can introduce globally.

Now, I will turn it over to Derrick to present the financial overview. Derrick?

Derrick W. West

Thanks, Beena. Turning to our earnings results for Q2 fiscal 2022, gross revenue grew 128% from Q2 2021 to CAD 43.9 million and net revenue grew 117% from the same period in fiscal 2021 to CAD 31.8 million. These revenue increases were primarily due to higher recreational net revenue which grew 108% from Q2 of fiscal 2021 and the completion of international shipments to Israel under our agreement with Canndoc and to Australia through Cannatrek.

While gross sales grew 128%, cost of sales decreased 20% year-over-year to CAD 25 million. Lowering our total cost of sales during a growth period was as a direct result of increased efficiencies at our production facilities combined with improved inventory management.

We harvested approximately 10,000 kilos of flower during Q2 of fiscal 2022, compared to about 4,500 kilos in Q2 of fiscal 2021, an increase of 125%. Over the past year, the company has experienced a growing demand for its products and this led to increased planting and cultivation levels which when combined with higher flower yields per plant and as compared to the prior year's comparison quarter, this resulted in the doubling of our herbs.

Largely due to higher net revenue, a reduction in inventory provisions, unabsorbed inventory cost and a lower cost of sales per unit, the gross margin in Q2 improved to CAD 6.9 million from a negative CAD 16.5 million in Q2 of 2021.

On an adjusted basis, gross margin was CAD 8.3 million compared to a negative CAD 700,000 in Q2 of fiscal 2021. We expect that we can continue to achieve efficiencies and better economies of scale from the three facilities lowering production cost. This combined with contributions from higher-margin products will further improve margins.

SG&A excluding non-cash share based compensation increased to CAD 14 million in Q2 2022 from CAD 10.3 million during the prior year's comparison quarter. And this was largely due to higher employee cost due to increased head count including the acquisition of Laurentian, general wage increases, increased professional fees due to technology investment and higher trade investments and marketing spend initiatives.

In the quarter, we achieved positive adjusted EBITDA of CAD 1.6 million, a CAD 9.4 million improvement over a negative CAD 7.8 million in last year's comparison quarter. This is the result of the continual improvements in our business including higher sales volume, lower production cost which generated higher gross margins and operating income.

We achieved positive adjusted EBITDA two quarters earlier than projected at the start of the year. Based on the momentum we see in terms of increased sales and improved efficiencies, we expect to generate positive adjusted EBITDA into the future.

Net loss for the quarter was CAD 4 million compared to a net loss of CAD 66 million in Q2 of fiscal 2021. This large reduction in the net loss was due to the increased sales and higher gross margins I've already mentioned.

In terms of our statements of cash flows, cash used in operating activities was less than CAD 1 million during Q2 of fiscal 2022, compared to cash used of CAD 10 million in Q2 of fiscal 2021.

The year-over-year improvement is primarily due to current period's operating income. Cash provided by financing activities was CAD 6 million during Q2 fiscal 2022, compared to CAD 51 million cash used in the prior year's quarter.

During the current quarter, the company received CAD 6.3 million from proceeds from shares issued to BAT.

Cash used in investing activities was CAD 23 million during Q2 fiscal 2022 compared to cash provided of CAD 18 million in Q2 of fiscal 2021. The cash used in Q2 of this year reflects the CAD 7 million in cash consideration for the acquisition of Laurentian, CAD 2.5 million for the additional investment in Hyasynth, CAD 8.7 million for facility expansion and improvements and CAD 4.5 million invested into restricted cash to be used to fund the center of excellence.

In terms of our balance sheet, on February 28, 2022, we had CAD 151 million in unrestricted cash and short-term investments compared to CAD 184 million at the end of fiscal 2021. The decrease during fiscal 2022 is primarily due to the company's investment in its working capital assets and capital expenditures for facility improvements, the purchase of Laurentian and the additional investment in Hyasynth.

This concludes my comments. Thank you. I would like to turn the call back to Beena.

Beena G. Goldenberg

Thanks, Derrick. The first half of fiscal 2022 has shown the success of our strategy to create exciting products and brands that are embraced by the market, to maintain efficient operations and deploy capital wisely. This will continue to be our focus which positions us for success for the rest of the year.

I'll reiterate that our investors can continue to expect strong revenue and volume growth driven by expanded distribution, more new and exciting product and brand introductions, continued international sales, further improvements in our adjusted gross margin and continued positive adjusted EBITDA.

Thank you for joining us today, I look forward to updating you on our progress. And now operator, you may open the call for questions.

QUESTION AND ANSWER SECTION

Operator

Our first question comes from the line of Aaron Grey from Alliance Global Partners. Your line is open.

Analyst: Aaron Grey

Question – Aaron Grey: Hi, good morning, and congratulations on the quarter in reaching the EBITDA target two quarters ahead of your originally expected. So first question from me just on EBITDA, so thinking about EBITDA margin opportunity longer term (00:18:00) profitability, expect that to continue going forward. Just how best do you think about the EBITDA margin opportunity maybe in the next 18 to 24 months as you expect continued improvement on the gross margin side and sales ramping up? Thank you.

Answer – Beena G. Goldenberg: Derrick, over to you on that one.

Answer – Derrick W. West: Okay. We're confident that we'll continue positive adjusted EBITDA based on momentum over the past few quarters into the future with the increase to our capacity in all our facilities. This will result in economies of scale which will lower our production cost which will improve margins.

There is also as well the additional contribution from Laurentian which has a higher average price per unit just based on it being a premium product and this as well continues to a positive margin, but bear in mind that as we – we need to continue to invest in our business to support the continued growth and so while we expect to have a growing

EBITDA, we're not providing specific guidance at this time, in terms of the percent of revenue, but we do expect (00:19:13) with increasing sales demand, increased capacity to have higher sales throughput with lower cost per unit that ultimately we're well-positioned to have increase to our EBITDA over time.

Question – Aaron Grey: Okay. Thanks so much for that color and detail. Second question from me on international, right, saw a nice sequential increase once again in the quarter, looks like you're expecting for continued momentum down that front. Just wanted to clarify particularly in terms of the shipments during the quarter, was there anything on the timing side you feel like those are going to be reoccurring, is this a good run rate on the go forward and then just any color you could provide maybe on the margin? I know it's a higher margin and we have had over (00:20:01) this before but, the margin differential in terms of the international versus the domestic revenue? Thank you.

Answer – Beena G. Goldenberg: Right. So thank you for the question. So first of all, we do expect to see ongoing shipments to both Israel and Australia. We obviously turned the paperwork, import quotas – import documents, export documents and need to get those turned before every shipment so that continues to be the regular cadence of our business and we expect to see more shipments obviously for the balance of this year.

In terms of your question on margin, I mean the real answer is there is no excise tax on international – on any B2B sales and that's the significant improvement in margin over just general recreational sales. It obviously comes with different kind of testing requirement, so there is a bit of offset to that but it's good margin business and nicely complements our recreational business.

Question – Aaron Grey: All right. Thanks very much and congrats on the quarter. I'll turn back to the queue.

Answer – Beena G. Goldenberg: Thank you.

Operator

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

Analyst: Tamy Chen

Question – Tamy Chen: Great, thank you, good morning. First question I have is specifically on your rec sales. You described how you're continuing to see momentum and your market share has continued to expand, so I'm just curious like why did your net rec revenues decline a little bit quarter-over-quarter

Answer – Beena G. Goldenberg: So we have a bit of timing – so, overall Tamy, our momentum is solid and we saw our market share grow again in March. We had a bit of a challenge during the month of January with Omicron as it ran to our facility and we had some high absenteeism that impacted our fulfillment. We had the highest shipping month in February to get product out, but we had some sort of a little bit of timing issue that rolled into some solid momentum into the month of March, so that's what you are seeing on the rec side of the business. Our market share continues to grow, so the offtake isn't a problem, but we did have a little bit of timing issue through the quarter as a result of that disruption.

Question – Tamy Chen: Okay, I understand. And then my follow-up question is, so if I look at the broader Hifyre, even the StatCan retail sales data for the industry, it seems to be slowing down or stalling a little bit the last several months really since the fall and I notice that you also produced less flowers, I suppose that attributed to the Omicron aspect, but I guess two-part question here with respect to what's been happening in the market. First is, you called out for your fiscal Q3 that you are expecting market growth in your outlook. So are you seeing now that the industry is growing again to new high? And second part of the question is based on where the market is today and what you expect over the near term, do you still believe that once you're at the, I think, almost 80,000 kilograms capacity, the market can still more than absorb that from you? Thank you.

Answer – Beena G. Goldenberg: Perfect. So a couple of key questions there, Tamy, so first of all we do see the market picking up. So it has been a little bit stalled over the last few months as StatCan has reported, but given the opening of the communities and we expect to see concerts this summer and fares and we expect to see the opening up generally of social activity. We do expect to see the market to rebound over the course of the next few months, especially expecting a nice big lift coming up at 4/20. So, yes, we think that it will rebound over the summer and we'll start to see the benefit of those interactions.

I think we missed – some of the challenges we had even in the last few quarters where it stalled, Québec had this issue where they had required the vaccine passport to just get into the cannabis retail stores. So there was a little bit of a disruption from COVID over the last few months that had stalled the category, but we expect with all the openings coming that we will see a rebound for sure. So that's with regard to the market growth. And, sorry, could you repeat your second part of the question?

Question – Tamy Chen: Yeah, sure, I was just wondering where you see it going, the near-term (00:25:10) the medium-term of the market. Are you still confident that once you reach your full capacity at Moncton, the market can still more than absorb that from you? Thanks.

Answer – Beena G. Goldenberg: Right, okay, sorry. Yes, so on that front, number one, we do see some continued growth. As I mentioned on our last call, our current situation is that demand is outstripping our supply. So we have – our SHRED product is currently only being shipped to Ontario, Alberta and we have some shipments going into Québec. Not meeting those needs, so we have limited our distribution to other provinces which is something that we will certainly expand once we have more capacity.

And then for now we're a net buyer of product. We have to buy flower to meet the current demand. So we don't have any concerns about using the capacity we have in our Moncton expansion as we're already using product – buying products from external suppliers that we will buy from in-house once we have it up and running.

Question – Tamy Chen: Great, thank you.

Operator

Your next question comes from the line Matt Bottomley from Canaccord Genuity. Your line is open.

Analyst: Matt Bottomley

Question – Matt Bottomley: Good morning. Congrats on the print this morning, and thanks for taking these questions. Maybe just wanted to start maybe just at a higher level when it comes to what's happening in the Canadian market, just sort of piggybacking off of what Tamy was talking about as well. Just the fact that if you look at some of the incumbents in the space that started with close to 20% market share on recreational implementation in Canada, it's consistently been coming down where I think the leader in the space now has maybe little over 10% market share. So where do you see this bottoming out, even though that Organigram has been doing very well and reaccelerating as of late, if you look at commoditized markets in the US like Colorado or again market leaders there barely sort of eek out 5%. So I am just curious where you think this is going in Canada barring any sort of major change in excise tax or federal regulations in terms of the ability to secure outsized market share.

Answer – Beena G. Goldenberg: Right, thank you, Matt. So first of all, I think that when you look at some of the bigger players who had 20% market share that dropped down to 10%, I think one of the things that we see when we look at their performance is that you can't sit on your laurels, you can't sit with a product that's out in the marketplace and think it's going to keep delivering the sales delivered last quarter or the quarter before. You have to keep innovating. A lot of focus of my comments this morning was around innovation. We know this is a category that needs to constantly be refreshed, bring new news, bring new innovation, excite the consumers, and I think that's something that we focused a lot our time on. We introduced 90 new products over the course of the last 12 months. We focused a lot on rationalizing, taking out slower movers, bringing in new products just to keep it fresh and this is something that I think has helped our momentum continue over the course of time.

I think the question about what's going to happen long term, it's a highly fragmented market. We all know that there is a lot of small players that have less than 1% of market share and that amount of players has grown. However, we also know that the provincial boards are starting to tighten up. They don't want to carry thousands of duplicate products. They want to manage how many items they have in their lineup. And one example I could share is as we took our Tremblant hash out to some of the new provinces to get it listed, the feedback we got was they were excited that it was part of our portfolio because we're already a supplier to them and they don't have to set up another vendor.

And so they might not have taken the Tremblant hash from a unique vendor but they were happy to have it in our portfolio. And I think that's the message that we have to recognize as this market matures, the provinces are going to want to deal with less vendors and the vendors that are sole suppliers of a cross portfolio are going to be prioritized. We're going to have first access. We're going to have better opportunity to get better distribution, get our listings in, and that's going to help. So I think two things that as it matures, you're going to find some of those smaller players sort of drop off. You are going to see a consolidation, but in the bigger players the need to keep it fresh, keep bringing in new news is very important, and that's been our focus.

Question – Matt Bottomley: Great. Much appreciate it. And just one follow-up for me on the consolidation part. We've seen over the last several years, half dozen or more acquisition for these types of craft growers. Many of them have actually turned out quite favorably in terms of their penetration or market share being a little more sustainable when it comes to pricing. Is there any other product categories or SKUs or classifications you think are kind of next in line for the industry to consolidate, or just sort of any other commentary on where you think M&A is going in the domestic element of Canada?

Answer – Beena G. Goldenberg: Right. So first of all I think we've seen different types of M&A over the last few years. So there has been the big players who've acquired other big players, and as a result had a lot of duplication in offering, and drove some obviously synergies, but some rationalization of brands as well. Whereas one of the things that we focus on on our M&A strategy have been looking at our portfolio and seeing where there is gaps in our portfolio, and really looking to find acquisitions that could fill those gaps. So the example when we acquired EIC, Edibles & Infusions Corporation last April, we worked in the gummies space, right? We acquired it in April. It was pre-revenue. By August we launched the new gummies into the marketplace. We're now the number three gummy player, right, within six months from when we launched into the market. So we found that full. We recognized with our Laurentian acquisition that we needed a craft flower provider.

We did rework in concentrates, and concentrates was a growing segment, and we wanted to bolster our presence in the Québec marketplace, and that's working really well for us. Not only do we get the benefit of the higher margin products that Laurentian has provided, but we strengthened our relationship with the SQDC in Québec, and we're seeing that reflected in the growth of our core Organigram SKUs, not just the Tremblant SKUs. So we've been very focused at looking at the portfolio and figuring out where we have to go that meets it. So it is accretive and incremental as opposed to just chasing market share that ends up with duplication, might result in some rationalization.

So that's sort of our approach. In terms of your thoughts where it's going to go, look, there's a lot of players in flower, and flower is a big part of the category, but how do you differentiate over time is going to be important. And I think some of the fragmentation in the flower spaces – people want news, but the bigger players keep bringing new strains, new news, and you don't need to have a separate LP come out, and set up for a one time offer in and out.

We're really focused on our quality of our flower, growing it, improving both our terpenes and our THC and developing high quality products for our Edison brand, and bringing some new strains out in the marketplace so the retailers don't feel they need to chase those craft or specialty producers. And of course we have our Laurentian craft flower as well. So, that's how we see it, and hopefully could keep growing and driving our market share as a result of that M&A approach.

Question – Matt Bottomley: Great. Appreciate all the color.

Answer – Beena G. Goldenberg: Thank you.

Operator

Your next question comes from the line of Douglas Miehm from RBC Capital Markets. Your line is open.

Analyst: Douglas Miehm

Question – Douglas Miehm: Thanks very much. My first question really has to do with your strategic thinking. Beena, as it relates to pricing in the marketplace, it seems you've done an excellent job from that perspective, but do you think some of the pricing declines in the marketplace that we've seen over the last 12 months are over? Are we at a base or could we see some further erosion in overall pricing in the Canadian marketplace?

Answer – Beena G. Goldenberg: Right, Doug. And I think I talked about this last quarter. I think a lot of the price compression that we saw in flower has happened. I think we got to a point where flower pricing on the value segment is actually at or even slightly below what the illicit market is at, and so I think that pressure on flowers is mostly behind us. We've also seen with less supply in the market in Canada, we've had some grow cultivation sites that have been shuttered. We've got a bit more balance between supply and demand that was pushing some of that price compression as well.

So the flower piece I think is mostly behind us. There is more compression that we'll expect to see. We see it in vapes, we see it in concentrates, and I think the important thing is that for us recognizing that we don't shy away from the value segment. We think it's an important segment. It's a high volume segment. If you could make margin in the value segment and then build some more premium offerings in terms of your mix, you've got it nailed (00:35:36). You can continue to drive your positive EBITDA.

So, I think that there could be other compression in some of those other segments. Until they reach that point where they are lining up to what the illicit market was offering, that's the pressure point, and once people could buy the product through retail stores, legal retail stores, and get at the same price and really if you look at some of the research results more better quality product, like why would – that's where it will settle down. So hopefully that provides the color you are looking for.

Question – Douglas Miehm: Yeah. No, very helpful. As a follow-up what we're finding and I don't think this is a surprise, but budtenders play a key role in focusing on what type of product people should buy. And what do you think, an apparent preference for the smaller guy as well relative to larger LPs, so they do support the craft growers probably to a more significant extent than the larger players. What's your thinking on that? I know that you'll probably describe your strains and your innovation, but is there anything else that you can add as well?

Answer – Beena G. Goldenberg: So listen, I think you're right, budtenders do play a very important role because consumers – there are consumers that come into those retail stores, and they're asking questions, and want some guidance on what to buy. I think one of the things that we pride ourself at Organigram is we have our own dedicated sales force. We have feet on the street across the country. We spend a lot of time engaging with budtenders not only sharing with them what our products or strains are, but we do education programs with them we run.

We go in and we set up in-store activations, and so we have relationships in store, and we promote the breadth of our portfolio. And so if there is a budtender that's focused on craft or more premium flowers, we'll focus a lot of our attention on our Edison brands or bring in our Laurentian craft flower now. You've got some budtenders that are really looking for the innovative products, so when we introduce something like our SHRED-X kief-infused blends, we're introducing something new and exciting, that high potency, really great feedback on our Tremblant hash as we've taken the education of what hash is out to the marketplace, how it's used, and done a lot of education with the budtenders.

And then on our gummies PLUS (00:38:33), we came into the market with products that were at a price point that was more accessible to a lot of consumers, and we got a lot of positive feedback from the budtenders that now people could buy four gummies for under CAD 5 as opposed to the CAD 8 that was being charged before, and so a significant benefit, so I think there is – it's not all about price, it's about price and value and uniqueness and offering, and all those factor into what a budtender might recommend to a consumer. So we spend a lot of time with that connection with budtenders, talking about our portfolio and we feel that they often recommend our products, so it's not just solidified (00:39:20) that they recommend. They're recommending quality products and we feel we have a really good portfolio.

Question – Douglas Miehm: Excellent. Thank you very much.

Answer – Beena G. Goldenberg: Thank you.

Operator

Your next question comes from the line of Ty Collin from Eight Capital. Your line is open.

Analyst: Ty Collin

Question – Ty Collin: Hi. Thanks for taking my question and congrats on a really solid improvement in gross margin this quarter. Could you help us unpack the key moving pieces there in terms of what drove that gross margin improvement? Just how much of that was due to Laurentian? How much from the larger international shipments? How much from product mix for example? Appreciate any color you could provide there. Thanks.

Answer – Beena G. Goldenberg: Okay, perfect. Thanks, Ty. Derrick, I'll pass that over to you.

Answer – Derrick W. West: Perfect. I would say you outlined a couple of the point that were key in terms of improving the margin, but it was a little bit of everything in terms of product mix, no question there was more with the international shipments which has been outlined earlier without the excise tax. It has a much higher margin than most rec flower does. That was helpful. Generally, we have an – as well as the contribution from Laurentian which as a craft grower and with the hash product does attract higher margins in that business and there was a contribution there that did assist the quarter.

But I think the other element that's really key is just with overall continued sales growth over the last few quarters and with higher levels of production, we're just starting to achieve economies of scale and getting a lower cost of production on an overall basis which is helping the margin in all the product categories and we expect that lift to continue as we look forward given that we harvested 10,000 kilos in the quarter, that's an annualized rate of 40,000 kilos. We do believe leaving (00:41:18) the fiscal year at 80,000 kilos and that we have the capacity to sell that product as the quarter (00:41:24) flow through and where just a large component of our costs are fixed in nature just by operating at these higher levels. We do over time get a lower cost per unit and this is just providing a general lift for the company in the quarter as was partially seen in last quarter as well and we expect this to continue.

Question – Ty Collin: Great, thanks for that. And then just for my follow-up, more of a market level question. Given some of the pressures on consumers' pocketbooks here between inflation and rising borrowing cost, are you seeing customers starting to trade down into value categories at all and is that a risk to your plan to kind of emphasize more premium SKUs in your sales mix?

Answer – Beena G. Goldenberg: Yeah, so first of all, I think our sales mix – look, we have a lot of value products and I think that we don't shy away from them. We could make margin on our value products as well as our premium. You have to be able to meet – different consumers are driven by different sensitivities and obviously there is a big consumer group that are looking for the lower priced products, still high quality but lower price. But there are the cannabis enthusiast then sort of craft seekers that want the higher quality products. So we want to make sure we're offering the different products to the different consumers what they're looking for.

In terms of pressures to the pocketbook, there is no question. We all know that cost of living has gone up. I think what we saw over the course of COVID was that people were buying into the cannabis market to address stress, to address relaxation, it wasn't all about partying and discretionary. It became more of something to help them get through some of the challenges and look, well, I would like to admit that we are excited about more of the recreational time over the summer, the pressure on inflation and cost increases is out there and we think that our products offer consumers an opportunity to address those stresses and feel good about their day, right? So it's a little bit of help and a little bit – and it's an important addition to, I think, to their lifestyle. So I don't really expect there would be a very big impact other than perhaps more of a shift to the more value products and that will of course benefit us. We're happy to be a value supplier along with the premium supplier.

Question – Ty Collin: Great. Thanks, Beena. Thanks, Derrick.

Operator

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

Analyst: Frederico Gomes

Question – Frederico Gomes: Good morning. Thanks for taking my questions. Just on your gross margin, you guys are showing some good growth there, good expansion. Can you talk about the differences in margins between your rec sales in Canada and your international sales and how much of that margin expansion is coming from the mix with higher international? Thank you.

Answer – Beena G. Goldenberg: Derrick?

Answer – Derrick W. West: Thanks for that. Yes. Well, I guess our international revenues were CAD 4.4 million in Q2 which is one of the highest that we had as a total and as a percent to our total revenue as a company. As noted, we don't have the excise on it, it does attract a much higher margin than our rec business, despite our margins also improving in our rec business as well. We have been lowering the cost of production at the facility and this is helpful for all product categories including pre-rolls as well. So, we don't technically disclose, I guess, our margin by distribution channel and so it's a difficult question to answer in the sense that we just don't provide that specific guidance.

But we do – the international shipments are important part of our business. We do have a cadence of ensuring that we try to have a quarterly shipments and we expect to continue to do so, but both businesses are growing and we expect to have more flower available at the end of the year to supply both these markets and when we do so, it will be at a lower cost per unit just from economies of scale but in terms of getting granular on what is the margin by distribution channel, that's just guidance we haven't historically provided or published, so apologies, it is not the clearest answer to the question but it's just not guidance we provide.

Question – Frederico Gomes: Yeah. No, sure, I understand that. Thank you and then when you look at your market share and your growth outlook for the remainder of this year, in which product categories do you expect you'd gain most market share in? We know that you are a leader in flower but do you expect to gain a lot of share in edibles, vapes or continue to gain share in flowers? So any color on specific product categories. Thank you.

Answer – Beena G. Goldenberg: Right. So, thanks Fred. I think – listen, we just launched a bunch of new products. We are very excited about our SHRED-X vapes. It is a known fact that we are very underdeveloped in this segment and we have great brand in SHRED with bold flavors and we can reproduce those flavors in our vape offerings. Initial offtake, we have shipped to New Brunswick, sold out very quickly on our initial shipment. So we do expect to see some growth coming from our vape launch. As I mentioned in my points earlier, we have a bunch of new innovation coming into the gummies space, really on our SHRED'ems building out that line up from three SKUs to eight provides us bigger presence. We expect to continue to drive our market share on the gummies segment and are seeing great results in certain retailers where we're already the number one gummies suppliers. So that certainly is a goal of ours to continue to drive the growth in the gummies space.

With regards to concentrates, remember we only had basically two months of Laurentian in our Q2 results, so we do expect to see not only an increase based on having the full quarter but obviously as I mentioned, we're expanding our distribution, we have started to ship to some of the Atlantic provinces already. We have shipments expected to go to BC, so that expanded distribution on concentrates on top of the extra volume just from a full quarter should help us really increase our market share on the concentrates section as well. So we're very – I would say that while flower is obviously very important, we're number one in flower and we'll keep driving to fulfill flower requirements, where we see our biggest market share gains are going to be from some of those 2.0 categories that we believe could strengthen our full breath of portfolio but will also improve our margins. They tend to be higher margin segments as well.

Question – Frederico Gomes: Thank you. That's really helpful. Congrats on the quarter again. I'll hop back in the queue.

Operator

Your next question comes from the line of Owen Bennett from Jefferies. Your line is open.

Analyst: Owen Bennett

Question – Owen Bennett: Good morning, guys, hope all well. First question, I just wanted to come back to sales mix, obviously really impressive market share traction but those appear to be driven (00:49:47) with SHRED and a lot of the new launches are also with SHRED, so I was just wondering could you give maybe a bit more color on your actual sales mix currently between value and premium and then what are you doing exactly to address the top end of the market? Obviously you bought Laurentian, you bought Edison, we're interested in how you see that sales mix evolving going forward or how you'd you like to see it evolve in an ideal world? Thank you.

Answer – Beena G. Goldenberg: Right. So thank you. Let me say that, so our flower sales if I look at the mix over time, if I go back to fourth quarter of 2021, we had – about 68% of our business was our flower and 18% were our blends which was our SHRED. If you fast forward to this quarter, the flower went from 68% to 58% and blend held roughly the same from 18% to 19%. So, these are percents of our total revenue. So, I guess the message is we're holding our position in flower by continuing to innovate and bring new strains and meet the consumer needs.

But the focus on our growth has really been in expanding some of those other areas, right? I mean, edibles, obviously new to us in our fourth quarter at 3%, now represents 9% of our business in Q2, concentrates which we didn't have, now represents 5%. And I forgot to mention earlier, we have the number one SKU in the injectable extract category with our Jolts. The high lozenge – high potency lozenge that we have out in the marketplace and it really is – it's unique, it's differentiated, patent pending and it continues to grow. There's a lot of interest in that product and we've just introduced a couple new flavors into the marketplace. So, the mix is changing by adding 2.0 products while continuing to make sure we have news and unique offerings in our flower and in our blends.

Question – Owen Bennett: Okay, thanks. And then the next question is, how are you trending currently with the available capacity and then when will construction on Moncton be completed? And then just linked to that, how much of a boost do you think the gross margins would you foresee when Moncton is completed and running at full-scale? Thank you.

Answer – Beena G. Goldenberg: Right. So, I'll start and then I'll pass it over to Derrick to answer the question on the gross margins. So currently we're running at capacity. So, we're – basically as I mentioned earlier, our demand is outstripping our supply. As soon as product comes off the line, gets through our testing and our packaging, we're shipping it out the door. So, what's ending up in the marketplace is fresh, high-quality flower, and we are – we don't have any spare capacity. So, we're currently buying from external customers, making sure obviously the quality meets our specification and look forward to when we'll be able to supply our own product as the expansion comes online.

So your question of when do we expect that, we expect to be planting in the 4C expansion by the end of Q3 and we expect to be harvesting flower out of that – out of those rooms in Q4 of this year. So, we're well on our way, very excited of getting the extra capacity. As I said beyond, there is opportunity to expand our distribution of SHRED into some other markets which we haven't been able to do and we have – we'll explore further opportunities as we have the capacity to provide it. So, we've been somewhat restricted and we look forward to having that extra capacity. Derrick, over to you on the margins.

Answer – Derrick W. West: Yeah, I think when comparing Q2 of this year to Q2 of last year, it sort of demonstrates the impact to the financials just on changing production levels. In Q2 of 2021, we were harvesting approximately 4,000 kilos in the quarter and we ended up recording in that quarter a negative adjusted gross margin. So, a negative 5%, and just by moving up to our current capacity, which was in and around the 40,000 kilos to 45,000 kilos level prior to completing construction along with other process improvements and initiatives at the facility, we've taken that negative adjusted gross margin in this print for Q2. We have a 26% adjusted gross margin, a 31% swing. Now, I'm not indicating that I'm expecting a similar growth to margin with just – with an extra 31% being added on as we go forward to capacity.

But it is only to indicate the level of volatility the margin has as a direct consequence of the cost of production and by doubling – effectively doubling the (00:55:21) facility at the end of – as we go into the early parts of next year from where we are today, will provide a significant lift to our reduction of cost with a significant (00:55:33) will make a meaningful difference to our adjusted gross margin in those future periods. But I'm not going to provide specific guidance on it but the lift that we had to-date is really – we haven't increased capacity yet. We've just increased our planning and have done another improvements at the facility on whether it's labor management or other packaging review on materials et cetera that have allowed us to achieve an improved margin. So, we just think that by getting to this higher level of scale that ultimately there's great opportunity for us to continue to see positive improvements to the adjusted margin that we're otherwise reporting on.

Question – Owen Bennett: Great, thank you. Very helpful.

Operator

Your next question comes from the line of Andrew Partheniou from Stifel GMP. Your line is open.

Analyst: Aidan Giangregorio

Question – Aidan Giangregorio: Good morning. Thank you for taking my question. This is Aidan Giangregorio, speaking on behalf of Andrew. Just curious taking into Québec a little bit more. Could you provide any additional color on how the sales of your products are doing specifically in the Québec market and what's working well there?

Answer – Beena G. Goldenberg: Right. So I think I would say to you that our product in Québec is performing probably short of flatlining a little bit based on what we acquired as it required a little bit of refresh. The product was in the market for a while and the thing that we've seen over and over again is you need to have sort of new news and we've been working on great new innovation and upgrades that we could bring into the Québec marketplace to make sure it continues to be a fresh offering there. But taking what is a tremendous product that was available in the Québec market for the last year and rolling it out to some of the other markets where it's new and seeing great results as a result of that.

So I think one of the things we're doing is getting the right offering into Ontario market. We have been converting from a 24 pack down to a 12 pack to make sure that the independent trade in Ontario will pick it up, not too big a ring (00:57:47) for them to bring it in and we're spending a lot of time educating the budtenders on that product. So we're really excited about what the Tremblant hash could do for us, but in terms of Québec specifically, we're on to some innovation, some exciting innovations that we want to bring into the Québec market to just keep it fresh and make sure that we maintain the momentum and some of the reasons why we bought the business.

I will say as I mentioned earlier that not only is – the acquisition was not only to get the Tremblant and Laurentian brands in Québec, but it was also to strengthen our relationship with SQDC and we have seen a significant increase in our base Organigram business in Québec as a result of building that relationship.

Question – Aidan Giangregorio: Okay. Great. Thank you for the additional color and I'll step back in the queue.

Operator

Your next question comes from the line of Michael Freeman from Raymond James your line is open.

Analyst: Michael Freeman

Question – Michael Freeman: Hi, Beena. Hi, Derrick. Thanks and thanks for taking our questions and congratulations on this booming quarter. I would like to ask some questions about the BAT, PDC research alliance. And wonder if you could provide any color on focuses of this research alliance. You described sort of the R&D facility as being substantially completed now, but I guess if you could describe the activity of those teams that will be working on those innovation products, how perhaps Hyasynth cultured cannabinoid innovations might be folded into those activities and how – and you previously described sort of an IP-driven entry or at least approach to international and specifically US markets. Wonder if you could provide some color on these things.

Answer – Beena G. Goldenberg: So, certainly. So, first of all with regard to the product development collaboration, as we have mentioned before, the focus is predominantly in CBD which is the area that we're doing most of the scientific research. The focus is looking at improving efficacy onset, just the delivery mechanisms. It's a lot of fundamental research that starts with, that we could then leverage as we launch new products to bring into our portfolio so the teams at the product development center and our internal R&D teams work together, so as we learn more about the product, we learn how to improve the offerings that we have in our portfolio through our own R&D.

So, that's an exciting development that's happening already. As I mentioned, we're just completing the bio lab and so what that means is more advanced scientific research on the plants, plant genetics is going to happen as we move forward. So that's what's happening in our PDC.

In terms of Hyasynth, at this point they're not connected but for us the focus is around innovation and we see there is an opportunity that at some point we'll look at API that potentially is higher purity that comes out of biosynthesis that isn't from cannabis plants that might be more appropriate for certain markets. So, we wanted to make sure that we have that opportunity to be connected in the biosynthesis space as well.

And in terms of longer-term IP, we know that moving flower across borders is difficult but if we develop IP that really becomes the opportunity to take into new markets, so it's something that we continue to work on together with our partners.

Question – Michael Freeman: That's perfect. Very helpful. Thanks. And quickly on the 4C expansion, you mentioned that planting is going to be happening there by the end of third quarter, harvesting in fourth quarter. But wondering how you would describe the timelines between cultivation ramp from around 50,000 kilogram run rate capacity sort of today to full capacity with 4C included of around 80,000 kilograms a year, how would you describe the timeline of that ramp.

Answer – Beena G. Goldenberg: Derrick, you want to grab that one?

Answer – Derrick W. West: Yes, I can. I would indicate that right now we're approximately at 45,000 kilograms. We would leave August around 80,000 kilos a year in terms of the annualized rate and I think that the ramp is pretty heavy right now, June, July and August in terms of when that comes up. Just as a consequence of that, we have to sort of complete the construction while we're not planning it all blooms at the same time. It's going to be staggered just in terms of labor-management and taking in consideration the construction work but it would be really starting to ramp up heavily into the July and August period and going from say 45,000 annualized kilos to the 80,000 annualized kilos.

Question – Michael Freeman: All right. And, Derrick I have a very quick follow-up on that. I understand that escalating cultivation should improve margins based on the economies of scale, but do you – might we expect a margin blip as you undergo this aggressive ramp in cultivation and planting out?

Answer – Derrick W. West: Not sure would be a cost blip. It would be more unless there is a delay in terms of when you're harvesting and the cost that you have on it to when it hits your income statement because you almost have that one-month delay to when the product's sold. So, ultimately in terms of all of the rooms turning, we are talking about the end of August and that really starts to impact the cost of the inventory that's expensed during Q1 of next year, but I think there will be – with some of the rooms coming on during – some of the harvest coming on from the new rooms in June, July, that there will be some economies of scale and therefore lower cost that will benefit the Q4 margins but that the real improvement comes after some time as set on operating at that higher level which again we think we're leaving fiscal 2022 with the full capacity room harvest.

Question – Michael Freeman: All right, thank you very much.

Answer – Beena G. Goldenberg: So...

Operator

There are no further...

Thank you. I know we have run a little bit over our time, so I want to thank everyone for joining us today. We're very excited about the momentum on our business and we look forward to updating you on our progress. I will wish everybody a happy 4/20 for next week, and with that I would like to end the call.

Operator

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