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OrganiGram Holdings, Inc. (OGI.CA)

Q3 2023 Earnings Call

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 Third Quarter 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. We ask you to please limit yourself to one question and one follow-up question. You may re-queue if you have further questions [Operator Instructions] thank you. Max Schwartz, you may begin your conference.

Max Schwartz – Director-Investor Relations

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.

Please review the cautionary language in our press release dated July 13, 2023 on various factors, assumptions and risks that could cause our actual results to differ. Further reference will be made to certain non-IFRS measures during this call, including adjusted EBITDA, free cash flow and adjusted gross margin among others. These measures do not have any standardized meaning under IFRS and are intended to provide additional information and as such should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

Our approach to calculating these measures may differ from other issuers, so these measures may not be directly comparable. Please see today's earnings report for more information about these measures. Listeners should also be aware that the company relies on reputable third-party providers when making certain statements relating to market share data.

Unless otherwise indicated, all references to market share data are sourced from Hifyre in combination with data from WeedCrawler, provincial boards, retailers and our internal sales papers. I will now introduce Beena Goldenberg, Chief Executive Officer of Organigram Holdings Inc. Please go ahead, Ms. Goldenberg.

Beena G. Goldenberg – Chief Executive Officer & Director

Thank you, Max and good morning everyone. With me are Tim Emberg our Chief Commercial Officer and Derrick West, our Chief Financial Officer. For today's call we'll discuss the results for the three and nine months ended May 31, 2023 and a general business update. We will then open the call for questions.

In Q3, the team at Organigram continued to position the company for sustainable long-term success while navigating the short-term challenges present in the industry. We were successful in the continued growth of our Canadian recreational business versus last quarter with a 7% increase in net revenue driven largely by success in hash and a late rebound in flower.

Year-to-date recreational net revenue also increased by CAD 8 million or 10% over the same prior-year period reflecting growth in pre-rolls gummies and hash. Despite this positive momentum, three factors outside of our control contributed to the softening we saw in our Q3 financial results.

Lower than expected growth in the flower category for Organigram delayed international shipment and the impact of our patent pending Edison JOLTS being removed from the market had the largest impacts on our net sales and gross margin for the quarter.

Regarding our flower growth trajectory, I want to first address the issue of THC-inflation. The increasingly widespread practice by certain licensed producers of inflating the stated THC potency on flower products through selected sampling and testing practices.

As Health Canada's regulations prevent dialogue in education around Canada's products, the consumer is left with fewer tools to make educated decisions about which products best suit therm.

The result is that price and THC content have become their paramount decision drivers when purchasing flower, which has led LPs to rate to the bottom on price with many falsely overstating the THC content of their products.

Let me be clear, as an industry leader in the nascent cannabis industry, Organigram has not nor do we intend to engage in the practice of inflating THC levels on our label. We firmly believe that we have a responsibility to act ethically and responsibility – and responsibly in our regulated industry.

We are dedicated to our consumers and believe they have the right to transparency when it comes to our label and we also believe that it's our responsibility to build an industry that we can be proud of, THC fixing deceives consumers and hurts our credibility as an industry.

In the context of today's regulations this is happening because Health Canada has not yet prescribed specific and rigorous testing standards for cannabis as they have in other categories like tobacco as an example. Given the strength of our balance sheet, Organigram can weather the financial impact of irrational pricing in TCH fixings and as such we're tackling the issue the right way.

First, the THC contents of our flower cultivars is trending upwards to recent operational optimization and the addition of new more potent cultivars. Second, we are working collaboratively with key stakeholders in the industry on several initiatives aimed to bringing solutions regarding standardized testing and sampling.

The second advance impacting our results in Q3 was our international sales. In Q2 we achieved a banner a quarter in export sales due to a pipeline of new cultivars. We anticipated that Q3 would return to normal replenishment levels.

However, a newly enforced CU MCS testing protocol meant that we were unable to ship product to Israel in the quarter. During Q3, we have refined our testing protocols in line with these regulations and have built inventory to meet demand going forward.

The third event impacting our results which was stopped sale of Health Canada on our high-margin, patent-pending Edison JOLTS product. We remain confident in our categorization of JOLTS as an indigestible extract and a way to judicial review in late July that will determine whether Organigram can resume producing and selling JOLTS under the ingestible extracts category.

We still believe that JOLTS in an important product within the extracts category as its format, potency and price point was highly successful in converting illicit market users to legal product. Now, I'd like to move on to discuss some of the exciting developments from this quarter and what they mean moving into Q4 in fiscal 2024.

Our strong balance sheet continues to be an asset in this competitive landscape and has allowed us to make investment in synergistic companies while maintaining our competitive edge in both consumer-centric innovation and production efficiency.

In March, we made a CAD 4 million US investment into Green Tank Technologies, the investment provides Organigram with access to new, industry-leading vaporization technology that will be exclusively available with Organigram products for a period of 18 months post commercialization.

This technology not only sorts the clogging and declining flavor performance issues we see in the legacy vapes in the market. But we anticipate that consumers will experience a noticeable difference in potency. Greentank enables vape cartridges are slated to hit the market in Q4, with two new SKUs and an additional SKU extending through into 2024.

Our investment in Greentank reaffirms our commitment to accelerating our focus on the vape category, by delivering meaningful differentiation to consumer.

Yet another example of our commitment to innovation is the strategic investment we made in May into Phylos Bioscience, an industry leader in deed genetics. Aside from being our first US investment, this arrangement is exciting from multiple perspectives.

First, Phylos has delivered cultivars with THCV concentrations that are significantly higher than anything else we've seen in the market. This makes these cultivars commercially viable for extraction for derivative products containing THCV.

Given that it's very difficult to grow cultivars with high concentrations of THCV, it is our belief that we will maintain a competitive advantage in whole flower derived THCV product.

Now consumers are excited about THCV because like CBD, it is non-psycho active and acts as an antagonist for some of the qualities associated with THC, for example, THCV is reported to mitigate the appetite simulation associated with THC, earning it a nickname, diet weed in the media.

Further, it is reported to enhance focus, creativity and calmness. We intend to incorporate THCV into various formulations across different formats, starting with gummies followed by vapes.

Our investment in Phylos goes beyond THCV, our technical relationship with Phylos will allow us to convert a portion of our gardens to seed-based production as opposed to the clone-based propagation we see across the industry today.

This is exciting because seed-based production is cheaper, faster and results in more robust, disease-resistant, and consistent plants across key characteristics such as potency, tripping content and aroma. Clone-based production has a foothold in the industry now as it is faster for creating and experiment with different cultivars.

However given its many advantages, we believe that seed-based production is the future of cannabis, while clone-based experimentation will remain on a smaller scale. We have already begun converting a portion of our garden to seed-based production and will increase our seed footprint over time.

Our investment at Phylos is consistent with our commitment to becoming the most advanced cannabis company in Canada.

On the international front, in May we added Germany to our list of export partners for medical cannabis through our supply agreement with Sanity Group. We continue to grow our list of international business partners and are actively pursuing opportunities in this business segment.

Operationally in Moncton, we have invested in a variety of efficiency improving and cost-cutting CapEx projects that will realize CAD 7 million in annualized savings.

We have internalized some of our testing requirements, implemented remediation in health, commissioned rapid drying machines which decrease drying time while increasing the available footprint in our Moncton facility for hang dried flower.

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

In addition to these initiatives, we are currently targeting further productivity savings of CAD 8 million over the next 12 to 18 months.

It's amazing to see how our Moncton facility has developed over the 10 years Organigram has been in operation. This quarter we achieved the company milestone, our 2,500th harvest. Over a decade ago, our first harvest tested a 13% THC. Given our steady approach to growth and our disciplined, data-driven strategies to optimize micro environments, our 2,500th harvest tested over 26% THC with over 3% terpene content.

Incredibly, we have now cultivated and harvested over 200 different cultivars.

At our hash and craft cannabis facility in Lac-Supérieur, our newly commissioned ultrasonic knife and automatic labeling has allowed us to keep up with the strong demand for our newly launched SHRED X Rip-Strips, while cutting head count by over 50%. Further, construction of our craft is complete and we expect them to come online this October.

In Winnipeg, our state-of-the-art edibles production facility continues to drive impressive results producing approximately 3.2 million gummies per month to support our SHRED EMS and Monjour brand.

Finally, I'd like to provide an update on our research and development activities with BAT at our Center of Excellence in Moncton. Both the product development collaboration and the Organigram commercial business are seeing significant benefits from a scientific development standpoint and in terms of revenue driving commercial capabilities.

The in house extraction laboratory has resulted in the imminent commercialization of high potency THCV extracts derived from exclusive whole plant flower.

Organigram has been able to test and learn about the inclusions of several minor cannabinoids which has allowed it to expand into more complex, minor cannabinoids stacks across several brands in the Winnipeg facility.

The PDC is a late stage development of the suite of emulsions, novel vapor formulations, flavor innovations and packaging solutions which are planned to be used alone and in combinations across the Organigram portfolio of products.

The broad focus of the PDC has been the development of improved cannabinoid delivery, rapid and predictable onset and products that target and satisfy a range of consumer needs. For ingestible innovations, Organigram is currently beginning recruitment for clinical studies so that the company can quantify and substantiate the benefit of these innovations.

So, after two years of R&D with the PDC we are excited to begin commercializing the technologies developed within the Center of Excellence.

And so to recap, we continue to grow our recreational business in Canada and despite the softer net revenue and gross margin in Q3, we feel confident that we are entering Q4 in 2024 with a strong foundation in place that sets us up for long-term success.

We've positioned ourselves to drive further cost out of our facilities, we continue to focus on the consumer with our investments and innovation and we have a strong balance sheet with responsible stewardship of capital all geared to delivering shareholder value in the long run.

And on that note, I'd like to invite our Chief Commercial Officer, Tim Emberg to provide his insights on Organigram's market share performance this quarter, new product performance and commentary on trends we are seeing in the market.

Tim Emberg – Chief Commercial Officer

Thank you, Beena and good morning everyone. As Beena mentioned Q3 saw the continued growth of our Canadian recreational business. This increase is a testament to our continued focus on growth here in Canada by bringing innovative and consumer focused products to the market and by executing with excellence at retail.

While our overall market share dipped in Q3, we quickly reversed this trend at the midway point in April and regained the number three position nationally in May and June with solid market share gains and positive momentum on several fronts.

We continued to strengthen our market share position in Gummies in Q3 growing 1.2 market share points versus Q2 and reaching the number two position nationally in May. We also maintained our strong number one position in pure-CBD gummies driven by continued success with our Monjour brand, which holds more than half of pure CBD gummies sales in the country increasing our share in Q3 to 50.2% from 48.2% in Q2.

In Q3, we maintained our leadership position in the hash segment achieving a 25% growth versus Q2 which was heavily driven by our truly innovative SHRED X Rip-Strips. We increased our overall market share by 2.5 points moving from 19.3% to a 22% overall national market share.

Our success in hash and gummies highlights our strength of identifying right targets for M&A that are complementary to our business and leveraging our expertise in consumer insights, marketing, sales and operations to deliver maximum value to the business. Our acquisition of both EIC and the Laurentian comebacks has proven to be accretive to our business.

From a flower standpoint we're really happy to experience rebound in Q3 with sequential quarter-over-quarter growth. Our flower volume remain stable year-to-date. Flower dollar sales were down versus the same period last year due to inflated THC levels in the market essentially forcing us to reduce our prices to maintain our competitiveness in the marketplace.

Given our high market share in flower, any type of price compression are questionable competitive practices really impact our flower business disproportionally. As mentioned previously though, we're actively working on industry-wide solution to this issue and at the same time we continue to improve our THC levels on all of our flower SKUs.

It's no surprise that we continue to dominate in the milled flower segment with our phenomenally successful SHRED brand. In May we achieved our highest market share since November of 2022 as 53% of the milled flower segment. So in other words, one of every two Canadians that go into a retail store or buy a milled flower online are purchasing our SHRED branded milled product.

From a pre-roll standpoint, we expanded significantly into the fast-growing infused pre-roll segment with our SHRED X Heavies which are performing extremely well after initial shipments helping fuel our growth in this segment.

Our Heavies clocked in at over 40% THC and are infused with botanical terpenes as well as diamonds at distillate. We are going to continue to expand nationally in Q4 and are committed to further this trusted into this fast-growing category.

We're very active in Q3 with product launches and will be listed and rolled out the highest number of launches for us at any given quarter with 28 new SKUs. Many of these new innovations are performing well above expectation with HOLY MOUNTAIN Tropical Rain, SHRED Desert Storm and SHRED X Rip-Strip hash which was launched in late Q2 leading the way.

The success of SHRED-X Rip Strips is yet another first to market innovation similar to what we've done with SHRED lengths and Edison JOLTS. It highlights our continued success in delivering consumer centric innovation and addressing unmet needs of cannabis consumers in Canada.

From our provincial perspective we continue our growth momentum in the second most populated market in Canada, Quebec and based on the latest WeedCrawler data we increase our market share by 0.7 points in the province. Moving from 7.6% share in Q2 to

8.3% share in Q3.

This was our highest market share ever in the province and we continue to grow hitting the 9% market share mark for the month of May.

We grew by 17.6% sequentially and almost 28% versus Q3 of last year. We're very much looking forward to our craft rolls, rooms at our Lac-Superieur facility coming online in October to help meet this growing demand.

In Ontario, the largest addressable market we continue to be one of the top LPs in the marketplace. In May, in June we maintained the number three market position in the province.

And we continue to hold the number one market position in Atlantic Canada in Q3 with a whopping 14.8% overall market share.

As we look to continue our rebound in flower we're also focused on growing our foothold in our underindexing categories of regular pre-rolls infused pre-rolls and vapes.

And we're extremely bullish about our innovation pipeline including the launch of THCV a full portfolio of new tube style pre-rolls and a new and innovative vape technology which you will expect will offer consumers a differentiated experience.

We believe this new line for products will help drive growth across these categories as consumers discover the next big thing in cannabis through Organigram's relentless focus on innovation.

With that I will now turn the call over to our Chief Financial Officer Derrick West to review our financial results for the quarter. Derrick?

Derrick W. West Chief Financial Officer

Thanks Tim. In fiscal Q3 gross revenue decreased 12% while net revenue decreased 14% compared to Q3 fiscal 2022. The decrease over the previous year was primarily due to market share fluctuations and recreational flower sales.

As Tim mentioned, price compression in combination with THC inflation did have an impact on the quarter. The cost of sales in Q3 fiscal 2023 was CAD 32.3 million compared to CAD 29.4 million in Q3 fiscal 2022, an increase of 10%. The increase in the cost of sales on a year-over-year basis was due to a CAD 2.8 million net realizable value adjustment on low-potency flower repurposed as inputs for Organigram's growing derivative business and a CAD 2.8 million provision for excess and unsellable inventories.

We harvested approximately 19,000 kilos of flower during Q3 compared to about 13,000 kilos in Q3 of the prior year which represents an increase of 46%. During the quarter, we accelerated a change in the operational conditions for planned care to increase THC levels. This resulted in a decrease in planned yields which had a negative impact to our cost of cultivation which temporarily reduced the company's gross margins and gross margin rate.

We have optimized growing conditions during Q3 and we have now realized higher flower yields commensurate with historical levels during June and July while maintaining increased THC levels.

These higher yields will reduce the cost of cultivation during Q4 and as this flower is sold we will achieve a higher gross margin rate. Furthermore, we expect to be able to consistently achieve these higher flower yields and lower cost to cultivation through 2024.

On an adjusted basis Q3 gross margin was CAD 6.1 million or 19% of net revenue compared to CAD 9.3 million or 24% in Q3 fiscal 2022. A compression in adjusted gross margin was primarily attributable to lower net revenues and higher flower cost combined with the impact of the lost contribution from the sale of Edison JOLTS occurring as a consequence and restrictions imposed by Health Canada.

SG&A excluding non-cash share-based compensation increased to CAD 19 million in Q3 2023 from CAD 17.5 million in Q3 2022 the increase in expenses was largely due to higher audit and legal fees and ERP implementation costs.

In the quarter, adjusted EBITDA was a negative CAD 2.9 million compared to CAD 583,000 in Q3 2022. The decrease was primarily due to lower net revenues combined with a lower gross margin rate. However, looking at a broader picture, adjusted EBITDA for the first nine months of fiscal 2023 was CAD 8.3 million exceeding the CAD 3.5 million realized for the full fiscal 2022 fiscal year by 137%.

As we dial in on further production efficiency, consumer trends resume international shipments to Israel and begin shipments to Germany we anticipate an improvement in our adjusted EBITDA on Q4.

International shipments which for the first nine months of fiscal 2022 was CAD 18.3 million exceeded the CAD 15.4 million realized for the full fiscal 2022 year by 19% and we expect international growth to continue through fiscal 2024.

During Q3, subsequently as a consequence of the company's market capitalization trading significantly below it's shareholder's equity combined with the current quarter's operational results management determine that there were economic indicators of impairment, warranty and calculation of the recoverable amount of the assets. This analysis was done on a consolidated basis and also by cash generating Units. The impairment test considered several factors including forecasted operational cash flows, net of the tax impact, ongoing investments in the working capital and sustaining capital expenditures, post tax discount rates, terminal value growth rate and this analysis results in the recognition of an impairment loss of CAD 191 million.

A meaningful contributing factor to the quantum of the impairment charge was related to the impact to flower sales and margins due to THC-inflation.

When considering significant sales and margin in the flower product categories, specifically all our dried flower, milled flower, pre-rolls, IPRs and international flower sales collectively contributed to Organigram's financial results. This was a key driver to the amount of the impairment loss which was allocated to intangible assets and goodwill in the amount of CAD 38 million, and CAD 153 million in relation to property plants and equipment.

In the quarter, we had a net loss of CAD 213 million compared to a net loss of CAD 3 million in Q3 2022 and this was mainly driven by the CAD 191 million impairment charge. It should be noted that all things remaining equal this impairment loss recorded on the company's PTE will result in an approximate 5% improvement to the gross margin rates as we move forward.

From a statement of cash flows perspective, net cash used in operating activities before working capital change was 5.5 million in Q3 fiscal 2023 compared to 6.4 million in the prior-year period which is primarily due to favorable changes from working capital partially offset by lower adjusted EBITDA.

Cash used in investment activities in Q3 to be more CAD 3.5 million compared to cash provided a CAD 51.7 million in Q3 2022.

Net cash outflow for Q3 was primarily from CAD 8 million related to CapEx at the facility combined with CAD 10 million cumulative investment in Greentank and Phylos net of redemptions on short-term investment.

On a year-to-date basis the company utilized cash for capital expenditures of CAD 22 million investments of CAD 10 million and CAD 5 million was invested into its net working capital assets.

In terms of our balance sheet on May 31 we had unrestricted cash of CAD 53 million and restricted cash of CAD 22 million for a total of CAD 75 million with very low debt. We believe our capital position is healthy and that there is sufficient liquidity available for the near to medium term.

While the company is back to resume generating positive adjusted EBITDA in Q4 2023, periods when the company achieved significant increases to sales will result in increases to receivables and this will negatively impact cash from operating activities.

The company forecast for remaining cash CapEx spend of approximately CAD 10 million in fiscal 2023 and is completed as planned during this fiscal year, the company expects to generate positive free cash flows by the end of calendar 2023.

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

Beena Goldenberg – Chief Executive Officer

Thanks Derrick. As a leading pure play cannabis company, we're constantly evaluating market opportunities, investing in the industry-leading R&D both internally and in partnership with BAT and fine-tuning our long-term growth strategy to drive down cost and gain market share domestically and internationally.

We continue to position Organigram to deliver a long-term shareholder value through industry-leading production facilities, compelling and differentiated consumer product introductions that leverage our highly successful brands, and synergistic strategic investments.

This vigilant and consistent long-term focus combined with our financial discipline are expected to deliver solid results through 2024.

Now on a final note on the state of the industry, we take no pleasure in saying this but the majority of Canadian publicly listed LPs are now trading at market capitalization of less than CAD 50 million and in many cases are caring material debt balances stretching payable are in arrears on paying their excise taxes to Canada, revenue HSC and regulatory fees to Health Canada. Many may not have enough cash to operate as a going concern.

We've also seen trading stock market volume strength for many of these years and the ability to successfully pull off financing diminish. As a result of this, we believe we're going to see the pace of corporate structuring including bankruptcy increase and as this unfold, we will capture marketshare that becomes available.

Our plan is as it has always been to remain prudent from a financial management perspective and to ensure that our actions are aligned with being of respected industry leader. Thank you for joining us today, operator you may open the call for questions.

QUESTION AND ANSWER SECTION

Operator: We ask you please limit yourself to one question and one follow-up question. Your first question comes from the line of Tamy Chen from BMO. Your line is open.

Q

Hi good morning. Thanks for the question. I wanted to ask about the THC-inflation. The phenomenon you are describing, I think it's been happening for quite some time now just given consumers are very fixated on higher THC. So, I'm just wondering why all of a sudden this quarter you're calling it out and it seems to have quite an impact on your flower business?

Q

Thanks for the question Tamy, and yes, well, it might have been happening for a very long time, it really just increased that it was more widespread in the last year I would say it really started to unfold and just to give you some stats on that. We look at like in the third quarter, almost 50% of flower sales came from 26 plus THC flower and the number of SKUs that have THC labeled values above 26% has doubled in the last 10 months, and really another step that we look at is the number of SKUs labeled above 30% grew tenfold versus last year. So while this might have been out there for longer, really the problems of this have really shown up in the last year, in the last 10 months.

And in particular and where the impact has really been felt by us has been in the 28 gram flower category where the number of SKUs above 27% THC has increased fivefold since last July where historically there has been no product selling on 28 grams at that level. So we look at this data and there is a national retailer out there that does post data flower sales based on the different THC levels. And we see that there are some licensed producers who were averaging sales of flower in the 21% to 22% range, and all of a sudden has a step change, and now are showing 28% to 32%. This is not something that even the most advanced cultivation techniques can make happen. There is something and I think it's the increasing behavior that's really starting to impact the results. And as we said on the call really we get the impact disproportionately, because of our reliance on whole flower especially in the 28 gram, so it started to have its effect.

We did have to respond by taking pricing down so we could address the value equation to consumers, because our lower potency. And I would say that potency at 23% flower should be considered good quality product and yet we have to discount our pricing to get the movement, because they were seeing a lot of product at the 27% to 28%, but then when you test it, it's not really 27% or 28%, so it's that substantial impact, and the more wide spread of this practice that has been impacting our results. Basically we start to see the dip in our flower market share in January. We took actions in our own facility.

We accelerated some changes to really get to a higher potency product to get it out there to compete. And it did have a short term impact on our cost of flower as we made those changes in our facility. But we're doing what we can to move up our potency in a proper way with proper testing. And at the same time we have been talking to key stakeholders. We've been sending in comments to Health Canada. We've been talking to the Board, and we've been talking to other labs, and really looking at finding solutions to address this issue, because we feel strongly that it's not fair to our consumers. It's deceiving them and so that's our way of approaching this issue in what we consider a leadership position.

Q

I see okay. Thank you for the added context on that. So it impacted particularly the 28 gram format for you. We also noticed looking at HiFyre the top products that are sold every month I think SHRED before would quite dominated the top five, I think three of your products before were in the top five base. It since dropped out of that. So did this key phenomenon also impact SHRED and your milled flower products too?

A

And so certainly it impacted all flower and it affected pre-rolls, it affected our milled flower.

But you could find milled flower out in the marketplace that claims 30% plus. And everybody knows that when you mill flower you lose tricones and that's just not something that could happen. Like that's just not a correct label, so there is impact there as well. But I think the other impact to our SHRED milled flower is that because pricing has come down so significantly on whole flower, the value equation of milled is not as it used to be as people are getting higher potencies at lower prices on just whole flower. And so to address this on milled flower when we started to see again some good momentum as we moved out of the quarter, we started to introduce some new flavors.

We brought in a strong Desert Storm offering that has received great reviews, but on top of that we started to introduce a 14 gram offering so we have historically been in 7 grams. So we are addressing it, but yes, absolutely we're seeing it in milled flower. And just one more comment around pre-rolls. You're seeing it improve in pre-rolls as well. And we had a third party lab go out and had -- sorry eight different labs testing a sample of pre-rolls for their potency. And the eight labs on average came in at 18.7% potency for those pre-rolls and yet the package was labeled as 24.5%. So we are seeing this across formats in flower, and pre-rolls, and it's an issue, and it's why we have highlighted as a big important issue the industry has to deal with.

Q

Thank you.

A

Thank you.

Operator: And your next question comes from the line Frederico Gomez from ATB Capital Markets. Your line is open.

Q

Hi. Good morning. Thank you for taking my questions. Still on this THC-inflation topic and this higher THC trend. I'm curious what is this strategy to better compete with these higher THC flower pre-rolls going forward. Now is it just about adjusting your cultivation, or is there anything else you can do now to differentiate your product given that new consumers are mostly interested about THC content?

And then longer term, what is your view on this sort of THC rate. Well where are we going to end up here as we continue to get flowers with higher and higher THC levels? Thank you.

A

Right. Thank you Fred. And yes there is a lot of things that we're doing, and there is sort of long term, and then there is longer term. We recognize that going to government, and to Health Canada, those are the right things to do. We need to get standardized testing protocols regulated from Health Canada, but those things take longer term.

We have approached the Provincial Boards and they are exploring the potential of requiring a second certificate of analysis from licensed producers on any flower over a 27% or 28% potency. And they are exploring yet, and what's interesting about this is that has been put into place in Michigan where they saw similar issues with elevated potency levels, so this isn't a unique phenomenon in Canada. It happens wherever cannabis is sold, and in the legal market, so there is an opportunity to for secondary certificates of analysis in the short term that might cut down on this.

But interestingly, yesterday Health Canada came out with, an article came out in which they were saying that they are now going to start testing potencies, so they are feeling the pressure, because this is widespread and they are looking at ways to address it as well. So I think from a marketplace there are some things that could impact short term. For us internally we are working on new cultivars, introducing new cultivars with higher potency into our garden. We are looking at. We have started to hand dry some of our flower to drive higher potencies, and we are seeing our potency rate in our garden go up. So this is just as an example, in Q1 of this year, 25% of our flower was above 23%, and in Q3 almost 50% of it is above 23%, so we're making the moves internally as well. And while this is going on our focus really will be on our gummies, our hash, on bringing innovation to the market.

And really while we have to make sure we have the right value equation out there for consumers we're looking at putting in these cost savings initiatives to drive our cost down to improve our margin. So there was a lot of talk about how much capital we have invested in our facility, but we're starting to realize the savings. We've identified the CAD 7 million that will start to flow through our P&L, and we have CAD 8 million more in savings that we expect to come. So we're here for the long term Fred.

We're here. We have the balance sheet to live through this short term issue. We're doing the right thing and trying to address it through all stakeholders, but at the same time we're working on getting our cost down so we could become again, improve our margins in this price compressed margin. And sorry I forgot one last thing. As you know, the Ontario the OCS has changed their market model. We expect to see that flow through in the fall, and again that's something that one of the Board's is doing to help us address margins in this category. So the Boards are involved. The government, Health Canada is involved. We're acting. We're working with other labs to get this addressed.

Q

Thank you. And then just about your investment on seed based production. Can you maybe provide a little bit more color about why have you decided to make this investment at this moment given that it appears that you are one of the first movers in this regard? And when should we expect to see some impact of that in your financials? As well as what are the potential risks that you see in that initiative given that again you are one of the first movers to try to move to a seed based production at scale, so how should we look at those risks? Thank you.

A

Great. Thanks for that question. So we're going to be rolling out our seed based production slowly with the test-and-learn. We're not obviously going to go out and convert our whole facility, so this is going to be something that we have started already in forgrowing [ph] rooms. We're excited about this, because it is a significantly fast to grow. So when you have cloning and propagation it takes 21 days and when you cultivate with seeds it's zero days. Just put a seed into the pot. You know the flower grows probably in the same amount of time but in total you're going from what it's like a 100 days to like 65 to 80 days.

So, you are reducing significant number of days in these like in the grow but that reduce a significant amount of labor and then one of the things that's really great about working with seed production is that you don't have some of the disease that you would get in normal clone production, so something like powdery mildew. You have the every seed, it's clean and grows clean and so you have more standardized flowers, so the lollipopping in the leasing becomes more standard. So, there is a whole bunch of reasons why this is good, it's less cost, it will turn our rooms faster and we're excited about it.

Now, we're not as I mentioned going to change our whole production facility over. There is currently still a need to experiment looking cultivars bringing new, you know because new is always what consumers are looking for. So, there will always be a portion of our garden that's going to be clone, you get that faster because it takes a long time to get F1 seeds that are strong and will be able to produce predictable plants. So, this is going to be a process we expect to see some cost savings into next year, part of the CAD 8 million that I identified as next years, over the next 12 to 18 months part of that is coming from the benefits of seed based production.

Q

Thank you, I'll hop back in the queue.

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

Q

Hi, great, thanks for the question, just one from me. So, just in terms of your commentary in terms of the restructurings and bankruptcies increasing that you're expecting to come, can you talk more about the timing that you might expect this to come into fruition, it's something that cannot be recalled from the industry sometimes no consolidation actually more of a shift to people claim that we need to checkout. So, what do you see kind of giving, what the confidence that we might start to see that now, we talk about some of the payments in the years, some of the taxes so do you think there is going to be more important or at least talk about something to see in the industry to why the mark to now sort of come to fruition? Thanks.

A

Sure, thanks. So, look we're already seeing it. I think somebody had said the start last year was I think 40% of bankruptcies in Canada the last year where cannabis companies. We've seen a handful of companies just in last two months that have announced restructurings. So, it's happening now. We track how much cash these players have and what their payables look like and we see these stretched payables. This isn't new news, CRA has identified over 70% of LPs out there that are behind on paying their excise taxes and they actually sent out an article saying they would work on payment plans but they are starting to put their foot down on people that aren't paying and just think about it this way, if companies aren't paying their excise taxes and are using the money perhaps to drive some retail activity with their brands like this is again not a level playing field, they are using borrowed money. Their runway is going to run out and so we have heard from CRA, the Health Canada stats just came out in an article last week that people the people that haven't paid is up 225%.

So, back to your original question how long do I think this is going to happen or when are these changes going to happen, I think it's going to accelerate over the course of the next 12 months. The capital markets are very tight, people can't raise money and their runway is going to be up right and so we are just we're there, we are watching it, we are understanding and we're going to go after listings where a company who has gone into some form of restructuring is likely not going to continue to replenish at that level and if we have competitive products, we're using our data which stores, where the listings, how do we gain that market share and continue to strengthen our business as this turbulence goes on to our industry.

I think your comment is right that we need to see consolidation in the industry, it is way too fragmented and I think the dynamics in the market will see that happen over the next 12 months.

Q

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

Operator: And your next question comes from the line of Andrew Partheniou from Stifel. Your line is open.

Q

Hi, good morning, thanks for taking my questions. I wanted to talk about a little bit about your guidance and as well as the impairment reported. So, you had lower international sales this quarter that was just delay and higher production cost from lower yields among some other things that is to us seems to be the main causes of the lower EBITDA but both of these things are seem to be quickly reversed and you're guiding for positive EBITDA next quarter. There could be maybe a rather large international shipment in Q4 and that could bring your sales back to the levels that we saw in prior quarters in the low CAD 40 million range, so that all suggest a pretty quick rebound but at the same time you had CAD 190 million impairment.

So, just a two-part question, first, is on the positive EBITDA guidance for next quarter, do you think that could occur including R&D cost and the second part of the question is just to reconcile you know the quick rebound and the large impairment that if you could talk a little more about that it could be helpful?

A

Okay.

A

Derrick, over to you.

A

Thanks, Beena. Thanks for your question, Andrew. Okay, I think I'll start first with EBITDA and the turn that we would see and there is no question with the current quarters was impacted just we were heavy in flower and where we did have a significant decrease in our yields as we were marginally some of the plant trying the facility to get improved THC, this increased our cost of cultivation, quite significantly, quite quickly and getting into the cost of the flower that essentially was part of our cost of goods sold this quarter. Now by the very end of Q3 and in the first part of Q4, we have returned to prior higher yields and that is the main driver on the overall cost of cultivation and the cost of cultivation is the main driver for our fall in margins which may accounts for 70% of our revenue.

So, at flower, we'll need to push through our P&L. I would say we will get a pickup during Q4 on the poor cost of flower that we're starting to harvest now. There will be a bit of a drag still from some of the higher cost that did occur during Q3 but overall, we will see an improvement to our flower margins. I think that our international, our B2B sales were lower in Q3 than one more [indiscernible] on a normalized quarter for us reduced those tentatively higher margins category force and we do see a pick up there for Q4. As well, we have other cost initiatives that we have done that Beena spoke to and more automation allows for throughput.

So, we do feel that we will be able to further improve our margins and throughput of the facility with the automation helping us to Q4 to get back to positive well a couple of [indiscernible] my specific guidance on that and we're getting to exact but we do believe that we'll get it back to a positive EBITDA in Q4 and into fiscal 2024 growing as we move forward. As it relates to the impairment, the consequence of the impairment was really driven by two factors, one, cannabis share prices being so low for us and others than as compared to what that means for our market cap compared to our carrying value so that becomes an indicator where there is a review.

Secondly, when you consider that our Q3 operational results are below our internal expectations and that taken to close to providing together to lead us to require to do a detailed analysis and review as we did those reviewing and we are starting on a lower point I mean when we did this review in the past in the sense that there is with THC inflations and headwinds in the near-term on this that it somewhat impact the modeling as we look out despite optimism and innovation that we do plan to bring to the table allowing for growth to sales and margins as well, the discount rate, the interest rates have gone up, the risk factor for cannabis companies and for forecasting is higher. So, the lack of the discount factor is higher than what it had been in the past and I think that combined to result in the need to book an impairment this quarter.

I would say that the small benefit from doing this adjustment is that the allocation to property plant and equipment will decrease our depreciation and our cost of goods sold moving forward and do we expect a 5-point improvement to our margin rate as this is fully flow through the P&L but based on the economic conditions of the market of the industry, it did feed us to do this review and given all factors that it require to make some impairment.

Q

Okay, thanks for that and then maybe talking a little bit more about your deals. You talked about changes that you're we're growing condition which lowered deals but it improved THC potency but in the last month of the quarter deals we bounded in the THC levels remained strong.

I'm not sure how much you want to go into details here but any kind of detail would be helpful to talk about what kind of changes did you make that resulted in a temporary loss of yield as I would imagine if you're changing growing condition in an environment and then keeping those growing condition stable then that yield loss would be permanent?

A

Yes. So, Andrew, good question and let me explain that. I think we've talked in earlier calls about the implementation of fractional watering in our facility and we had done a lot of work in our plant science area on the benefits to fractional watering over the course of the day rather than a flooding and in a approach to watering the plants.

We ruled out our fractional watering because we honestly believe that it was going to give us higher THC content but we ran too quickly we rushed it, we accelerated through, didn't get the right conditions. We saw a drop in our yields as we were growing those plants and unfortunately you kind of have to wait three months to see the impact of the implementation. As such we started to adjust our approach to fractional watering. We got it right. We were able to reproduce what we saw in our plants science area so we were able to get back to our historical yield yet keep the higher potency that we saw as a result of moving to that practice.

So, it was a bit of probably accelerated to get to the higher THC faster and didn't execute as well as we could have. But as we work through these details and optimize it, we've got it working properly now and we're starting to see it. So, the THC did come back, -- or the THC came up and the yield did come back. So I think the lesson here was move a little bit slower. But we felt the urgency in the market because our value equation to consumers wasn't working and we needed to get faster, higher THC levels into our flower.

Q

Thanks for that additional color, I'm sure that everything is back on track now.

Operator: And your next question comes from the line of Ty Collin from Eight Capital. Your line is open.

Q

Hey, good morning and thanks for taking my question. Just wondering if you could comment on the price reductions you took in the quarter, were these applied pretty broadly across the product portfolio, we're really kind of just concentrated in the 28-gram flower category and then as an add on to that do you think there's room to causing that pricing back over time as something more important product and new innovations start to hit to the market?

A

Thanks for your question, Ty, maybe I'll turn this over to Tim.

A

Sure. Thanks for the question, Ty. So, we did start looking at price adjustments and primarily on the 28-gram size format, if you look at our overall SKU mix, 60% of our flower in volume comes from SHRED and that's 40% comes from whole flower. And really the impact to us was really around the 28-gram value equation that Beena referenced to. So, we look to do a price increase on our Big Bag o' Buds in the early spring. So, that's where we had the biggest impact. In some cases, we took a price decrease in about 20%. So, we are retailing at about 142 originating with down to 119 and then THC continued to go up but our value equation was in balance. So, our price to THC ratio was up. So, we had to, in order to be more competitive, we had to lower our pricing further. So, we went down to the floor for our Big Bag o' Buds about CAD 0.99 in Ontario. And in some other province -- it depends on the province, that wasn't across the board. But we did make some changes in certain provinces to ensure that our value equation was balanced. So, if we look at overall market right now, volume growth is growing in flower. Last six months versus the previous six months we're seeing volume go up by about 10%, or just seeing sales dollars go down by about 3.5%. So, there is pricing pressure in the market and slightly due to most competitors and most LPs they're making adjustments, the balance of that value equation or the price to THC ratio. In our case, we've gone as deep as 20% adjustment while in some cases it hasn't been that deep.

Q

Okay, great thanks for that. And then, Beena, regarding your continued interest in the US market, obviously, a couple of key catalysts in play there before year end including safe banking and the Biden admin scheduling review, are those catalysts influencing your thinking on how and when to make additional investments in the US and to the extent that you're still considering THC assets, how might that sort of investment be structured particularly given BAT?

A

Right, good question. So, first of all, we do continue to look at the US market, it's obviously an interesting market for us. But while it remains not legal federally, we obviously have to protect our TSX and NASDAQ listings. But we're watching it carefully. I'm not sure safe banking makes a big change, but certainly the de-scheduling is something that we are looking at to understand the opportunities.

But the same time when you think about what we did with Phylos, we did curtail into this, into the US market with that investment through a convertible loan. We found a way to do that kind of investment and still stay on side with our listings. And so, we will continue to look at opportunities. But the market is depressed right now. There are assets in the US that are depressed as well and there are opportunities out there. So, we do have the balance sheet, we do have a great strategic investor in BAT and we'll continue to look at ways that we can take advantage of the market conditions while we focus on strengthening our business in Canada.

Q

Great. Thanks for that, Beena.

Operator: And we have now reached the end of our question-and-answer session. I will now turn the call back over to Beena Goldenberg for some final closing remarks.

Beena G. Goldenberg – Chief Executive Officer & Director

Well, thank you everybody for joining today. We're really playing the long game here at Organigram. We're focusing on what is the right thing to do for this industry. We're focusing on innovation and differentiation and getting our cost lower so we can improve our margins. We feel very confident that we have a winning formula here and we look forward to updating you again on our Q4 results. Thank you for joining.

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