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OrganiGram Holdings, Inc. (OGI.CA)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Casey, and I will be your operator today. At this time, I would like to welcome everyone to the Organigram Holdings Inc.'s First Quarter Fiscal 2021 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 that you please do limit yourself to one question and one follow-up question. You may re-queue if you have any further questions. As a reminder, this conference call is being recorded and a replay will be available on Organigram's website.

At this time, I would like to introduce Amy Schwalm, Vice President, Investor Relations. Please go ahead.

Amy Schwalm
Vice President-Investor Relations, OrganiGram Holdings, Inc.

Thank you, Casey. Joining me today are Organigram's Chief Executive Officer, Greg Engel; Chief Financial Officer, Derrick West; and our Chief Strategy Officer, Paolo De Luca.

Before we begin, I'd like to remind you that today's call will include estimates and other forward-looking information from which our actual results could differ. Please review the cautionary language in today's press release regarding various factors, assumptions and risks that could cause our actual results to differ.

Furthermore, during this call, we will refer to certain non-IFRS financial measures, 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 and so are not directly comparable. Please see today's earnings report for more information about them.

I will now hand the call over to Greg.

Gregory Engel

Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Thanks, Amy. Good morning, and thank you for joining us today. This morning, we reported our fiscal quarter – our first quarter fiscal 2021 results for the period ended November 30, 2020. We're pleased with meaningful growth in our adult rec's sales sequentially from last quarter, strong evidence that our new products as part of our portfolio revitalization are resonating well with consumers. We're excited about the recent launch of another three strains under our Edison brand, and we have more to come in the next few quarters as we continue to reinvigorate this brand.

Encouragingly, Edison was recognized as one of the most searched brands on Ontario Cannabis Store website for the month of November. We've started to ramp up cultivation and staffing such that we can meet overall increased demand in the industry and for many of our new products. And we have the assets and financial strength to support our plans.

In contrast to many of our peers, we generated positive cash flow from operations in Q1, the second quarter of the last three quarters with positive cash flow from ops. Since the second half of fiscal 2020, we've been extremely active introducing new products and improving many of our existing ones. Since July, we have launched 53 new SKUs, with up to 14 more in the pipeline expected to launch before the end of February.

We continue to see dried flower and pre-rolls as the two largest categories in the Canadian rec market. And based on US legal state data, we believe they will continue to dominate the foreseeable future even as alternative product [indiscernible] (00:03:06) gain traction.

We've successfully launched a number of value segment dried flower offerings in the first half of fiscal 2020, particularly in larger format sizes in response to increased demand in that category. I'll talk more about our success there in a moment.

We're also very focused on our higher-margin Edison flower portfolio by introducing new unique strains and higher potency THC products, where we think there is a good opportunity for us to differentiate.

Subsequent to quarter end, we launched three new Indica strains: Black Cherry Punch and Ice Cream Cake, or I.C.C., both with THC ranges of 20% to 26% and Slurricane with 17%-plus THC. We expect to launch at least three more high THC strains under the Edison brand over the next few quarters as a result of our continuous investment in new genetics.

We run trial cultivation cycles to ultimately identify the winners, the ones we decide to move forward with because we expect them to attract the strongest consumer response.

We continue to leverage our indoor facility and our unique three-tier cultivation rooms. Every Edison strain benefits from being grown in one of these data-backed, strain-specific grow rooms with bespoke micro-climates designed to offer a distinct flavor and aroma profile and to ensure consistent quality. Variables such as humidity, temperature and light are customized to optimize the growth, cannabinoid and terpene profile of each strain.

Opportunities to scale up new genetics require patient and deliberate process where cultivation protocols are trialed for each cultivar and adjusted through multiple grow rooms before full rollout to multiple rooms in our facility. We've launched a number of new genetics over the past 18 months, including our high THC Edison Limelight or Ultra Sour, which is now the company's best-selling strain.

Our newest cultivars were developed from genetics that originally sourced from a premium cannabis nursery. The nursery's processes and technology help ensure robust, healthy, high-quality plants.

Our focus on both genetics and the environment in which they are grown, results in a unique phenotype expression. This means even plants grown from the same genetics can be markedly different in terms of physical properties, potency, terpenes and aromas based on their growing conditions. We believe this product development process is a differentiator for us.

Revisiting our more recent launches in the value dried flower category, we believe our value products are differentiated and do not have to compete on price alone. Particularly since the onset of the COVID-19 pandemic, value in large format sizes have become an increasing focus of consumers. In the spring of 2020, we responded with the introduction of Buds, which is indoor-grown whole dried flower and strain-specific.

The company's value segment strategy also includes dried flower offerings that were launched in larger formats sizes of 7 gram and 15 gram under the Trailblazer brand in July 2020. The Trailblazer value brand continues to offer increasingly higher THC levels versus what was offered when originally launched near the start of adult rec – adult use cannabis legalization and at a competitive price point.

At the beginning of Q1, we expanded our value portfolio with the launch of SHRED, a high quality, high potency dried flower that is pre-shredded for consumer convenience. SHRED offers three pre-milled varieties, all with THC levels of 18% or more, and combine specific strains to provide unique flavor profiles for each of the three product offerings.

It is made from whole flower, does not contain any shake or trim and is milled to the same specifications as our existing pre-rolled products. SHRED is currently Organigram's most affordable option on a per gram basis.

Sales of SHRED contributed significantly to our growth in rec revenue in Q1 and was the number one most searched brand on the Ontario Cannabis Store website for both November and December. The product has exceeded our expectation and continues to sell out, one of the reasons we're ramping up cultivation and staffing, which I will talk about more shortly.

At the end of the quarter, we also launched limited edition seasonal offerings, including Trailblazer Kushmas Stix, an affordable 0.5-gram pre-roll, which continues to do well in retail stores.

In addition to new Rec 1.0 products, we've launched a number of innovative Rec 2.0 offerings in vape, edible and beverage categories. Just after quarter end, we launched Trailblazer Spark, Flicker and Glow 510-thread Torch vape cartridges in a new 1 gram format. This extended our lineup to a suite of trial-size 0.5 gram and full-size 1 gram cartridges for the 510 vaporizer. Trailblazer Torch offers consumers 510 cartridges, high-quality CO_2 extract and three unique terpene-infused flavors.

Our vape portfolio also includes products for the mainstream and the premium segments. Edison + Feather ready-to-go distillate pens and Edison + PAX ERA distillate cartridges. We're focused on increasing THC concentrations in many of our vape products to meet consumer demand. So, stay tuned for changes to come in this category.

Our chocolate portfolio includes Trailblazer Snax, a value-priced, cannabis-infused chocolate bar available in both mint and mocha flavors and we expect to launch a new flavor this quarter. Our state-of-the-art chocolate equipment allows for each of the five sections of the bar to be filled separately, allowing for higher accuracy of infusion. We also offer Edison Bytes truffles available in both milk and dark chocolate formulations as well as a gingerbread flavor for a limited time.

At the end of the quarter, we launched Edison RE:MIX dissolvable cannabis powder. This product's distribution has expanded listings to eight provinces and we expect to secure listings for the remaining two provinces in the near future. We believe that beverage segment could have greater potential than we have seen in the US – than what we have seen in the US to-date.

As mentioned on our last earnings call, but worth repeating, estimates suggest that recreational cannabis beverage market represents a CAD 467 million opportunity in Canada and results of a recent Organigram survey indicate a significant majority of current consumers, 74%, would prefer to add cannabis to their beverages versus consuming a premixed one.

This is also supported by sales data in Colorado, where cannabinoid-infused powders have rapidly risen to the top of the beverage category in popularity, representing 55% of the state's beverage market sales. This is from Headset data in Colorado Market Insights from July 2020, last year.

We believe Edison RE:MIX offers a unique experience for consumers, made possible by our R&D department. They developed a proprietary nanoemulsion technology that generates nano droplets which are very small and uniform. This provides improved absorption compared to traditional solid edibles and beverages, potentially allowing for more reliable and controlled experience.

The nanoemulsion technology is also anticipated to have increased stability to temperature variations, mechanical disturbance, salinity, pH and sweeteners. And the dried powder formulation offers discretion, portability and a potentially extended shelf life compared to a liquid.

It's available in three formats two sachets with 5 milligrams of THC each, two sachets with 5 milligrams to 5 milligrams of THC to CBD, and five sachets with 10 milligrams of CBD each. As we've said, we're encouraged by the consumer response to-date for many of our new products.

However, we understand the frustration consumers have when they can't get what they want because of inventory [ph] stocks (00:10:47). We've already begun to ramp up staffing with plans to hire 100 staff, mostly in cultivation and up to another 30 staff in packaging by early in our third quarter. We know we have missed out on significant sales opportunities and remain focused on improving supply chain processes and order fulfillment rates.

For example, internally, we've identified a list of core SKUs for which we aim to ensure never go out of the stock in an effort to drive maximum distribution and continue to build brand equity. Increased production and staffing should result in efficiencies from greater economies of scale. Benefits to revenue and margins are not expected to be recognized in Q2 as we take this quarter to hire staff.

Further, we do note that the industry demand may be dampened and negatively impact Q2 sales due to lockdowns related to COVID-19. For example, since November 23, cannabis retail stores in the densely-populated regions of Toronto and Peel in the province of Ontario have been closed to physical retail traffic. And since December 26, the remainder of stores in Ontario have been closed to in-store purchases. The stores have still been able to offer click and collect and limited delivery services.

In the near future, we expect to resume shipments to Canndoc in Israel. We're seeking Good Agricultural Practice certification by the Control Union Medical Cannabis Standard to comply with Israel's updated standards for imported cannabis. We're making good progress. And subject to successful completion of a required inspection likely to be conducted remotely, we anticipate being certified as early as our third quarter. Shipments will also depend on availability of the desired product mix as we work on ramping up staffing and production to accommodate demand.

In addition to revenue upside beyond fiscal Q2, we've identified a number of opportunities which have the potential to greatly enhance gross margins. We expect to gain economies of scale and efficiencies as we scale up cultivation and packaging, including the decline in charges for unabsorbed fixed overhead costs.

The recent launches of higher-margin Edison strains, with more launches on the horizon, have the potential to positively impact gross margins over time as these products gain traction in the market and comprise more of our total revenue.

A greater proportion of our portfolio is being dedicated to higher volume SKUs such as multi-pack pre-rolls and 1 gram vape cartridges, which attract higher margins. We continue to invest in automation to drive cost efficiencies and reduce dependence on manual labor. For example, a new pre-roll machine is expected to be fully commissioned and operational by the end of fiscal Q2 2021. And as a result of a packaging task force project, a number of cost reduction opportunities have been identified with the potential to benefit margins starting in Q4 2021.

I'll now pass the call over to Derrick to go through our financial position and results in more detail before I wrap up.

Derrick W. West

Chief Financial Officer, OrganiGram Holdings, Inc.

Thanks, Greg. Starting with our financial position, we ended the quarter with CAD 134 million of cash and short-term investments. On December 1, we used CAD 55 million to pay down our term loan to CAD 60 million, which left us with a pro forma cash and short-term investment balance of CAD 79 million. The repayment on our term loan was agreed as part of the amendment and restatement of our credit facility completed during the quarter.

As we discussed last quarter, we raised CAD 69 million in gross proceeds in Q1 from an underwritten public offering, with strong institutional support. As Greg mentioned, this past quarter represented the second quarter of the last three, which generated positive cash flow from operations.

In Q1, net cash provided by operations of CAD 0.3 million compared to net cash used by operations of CAD 26.9 million in the prior-year period. The improvement was largely due to the prior period's increase in working capital assets as we scaled operations ahead of Rec 2.0 legalization.

Turning to our results for Q1, Canadian adult use rec net revenue grew 30% to CAD 16.8 million from CAD 12.9 million in the prior-year quarter. And gross rec revenue grew 42% to CAD 22.5 million from CAD 15.9 million in Q1 2020. The year-over-year increase was mainly driven by the legalization of Rec 2.0 products.

Despite overall revenue being down sequentially due to the temporary pause in sales to Canndoc, gross and net adult use rec revenue grew 14% and 11% respectively from Q4 2020. Q1 total net revenue of CAD 19.3 million declined from CAD 25.2 million in the prior-year quarter, largely due to significantly lower wholesale revenue, and a lower average selling price in Q1 2021. The higher wholesale revenue in the prior-year period reflected opportunistic sales to a single licensed producer and was not necessarily expected to recur each quarter at those levels or at all.

Total gross revenue of CAD 25.3 million compared to CAD 28.4 million in Q1 2020, largely due to similar factors impacting net revenue and reflected the increase in excise taxes as a percentage of gross revenue in Q1 2021.

Q1 2021 cost of sales of CAD 23.2 million increased from Q1 2020 cost of sales of CAD 15.8 million. Higher cost of sales this past quarter was largely due to higher production costs, a greater inventory provision, and a charge related to unabsorbed fixed overhead as a result of lower production volumes in Q1 2021.

Adjusted gross margin decreased to CAD 1.9 million from CAD 10.2 million in prior year's quarter primarily due to lower net revenue, and value segment offerings comprising a larger proportion of total revenue in Q1 2021.

Negative IFRS gross margin of CAD 15.7 million declined from positive gross margin of CAD 11.2 million in Q1 2020, largely due to net non-cash negative fair value changes to bio assets and inventories sold in Q1 2021 versus positive changes in Q1 2020.

SG&A of CAD 11.1 million increased from the prior year's amount of CAD 9.4 million as a result of higher insurance costs and general wage increases. Q1 2021 negative adjusted EBITDA of CAD 6.8 million (sic) [CAD 6.4 million] (00:17:19) declined from a positive adjusted EBITDA of CAD 5.7 million in Q1 2020, mostly due to lower adjusted gross margin this past quarter.

The net loss of CAD 34.3 million, or $0.17 per share on a diluted basis, in Q1 2021 compared to a net loss of CAD 0.9 million, or $0.01 per share, in the prior-year quarter, primarily due to greater negative gross margin in Q1 2021.

That concludes my remarks, so I'll pass the call back to Greg.

Gregory Engel

Chief Executive Officer & Director, OrganiGram Holdings, Inc.

Thanks, Derrick. The industry continues to make progress with the latest run rate estimated at CAD 3.2 billion for the rec market based on Stats Canada data for October 2020. A large driver of the growth is coming from the increase in the number of retail stores, mostly in the province of Ontario. Since July, the store count in the provinces grew by approximately 47% to 1,414 stores as of last week, driven by Ontario's cannabis retail stores more than tripling to 330 stores. And in early December, Ontario announced it was doubling the number of store authorizations again to 80 per month.

Outside of Canada, we continue to serve international markets including Israel and Australia, via export permits and look to expand international sales channel.

Finally, I like to make a few comments about the United States, because recent developments are significant for cannabis. As everyone is likely aware, the US election results in particular the Georgia runoff elections that tipped Senate control to the Democrats is positive for pro cannabis initiatives. While we believe the timing of full legalization is unclear, and will likely still take considerable time to happen, it is clear the political landscape has changed.

We've patiently followed the market and in particular exploring paths to enter the CBD market. To-date, we have not found opportunities that meet our risk/reward criteria, but we continue to monitor closely. Many of the R&D initiatives and new products that we work on, we believe will ultimately be commercialized in US CBD markets, and ultimately THC markets when federally legal. For example, our Edison RE:MIX is an innovative product that we believe would translate well in the US.

In preparation for US activities, Christy Zhou, our Vice President of Legal and Regulatory Affairs is now an active member of the Board of Directors at the American Trade Association of Cannabis and Hemp. This is a trade organization registered in Washington, D.C., founded to promote expansion, protection and preservation of businesses engaged in legal trade of industrial, medical, and recreational cannabis and hemp-based products. The organization is ushering in the next phase of marketplace expansion by providing a bridge from the cannabis industry to mainstream name brand businesses who will be partners in advancing the industry and ending prohibition.

And we are pleased to welcome Marni Wieshofer to the company's board of directors. Ms. Wieshofer is based in California, and represents our first US-domiciled board member. We believe she will be a tremendous asset given her deep US and international M&A and finance experience combined with her board experience. Notably she was recognized by Variety Magazine in the 2018 Dealmakers Impact Report.

Her former roles include Chief Financial Officer and Executive VP of Corporate Development at Lions Gate Entertainment, a multi-billion dollar global entertainment company. She oversaw M&A, including acquisitions and integration of Trimark Pictures, Artisan Entertainment, and Redbus Films Distribution U.K. We look forward to Ms. Wieshofer's contributions and insight as we continue to charter the ambitious path of the company nationally and internationally.

In closing, we are well through the revitalization of our product portfolio, and are starting to see it come through in top line growth. This will only be aided by the additional resources we are now bringing on. We remain focused on cost management, and have identified meaningful upside potential for gross margins to drive profitability and sustained attractive returns on investment for shareholders.

So, that concludes my prepared remarks. Operator, if you could go ahead and open up the line for questions.

QUESTION AND ANSWER SECTION

Operator: Great. Thank you. [Operator Instructions] And your first question here comes from the line of David Kideckel from ATB Capital Markets. Please go ahead. Your line is now open.

David M. Kideckel
Analyst, ATB Capital Markets, Inc.

Q

Oh, hi. Good morning. Congrats on the quarter and thanks for taking my question. So, just looking at your gross margin profile here, Greg, I'm wondering if you can comment just over the next several quarters, and knowing that you won't be providing a formal guidance here, just with respect to product mix, whether its value or you're [ph] premium (00:22:17) segment 2.0 versus 1.0 products, how should we think about the overall splits in revenue just so we can get a better grip here on gross margin? Thanks.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, I know. Thanks, David. It's a great question. I mean, certainly as we indicated, dried flower makes up the greatest proportion of our revenue, and over the last couple of quarters, the value segment has been a higher proportion over those two quarters than we'd seen in the past.

As I alluded to earlier, one of our keys is our genetics program, and introducing new cultivars. So, we did introduce three new cultivars in late December: Black Cherry Punch, I.C.C. and Slurricane as I mentioned. And we have plans to introduce additional new products under Edison coming forward. So, those new higher THC, new genetics in the Edison banner are of higher margin, because they have a higher average selling price. So, that's been a big shift for us.

It's important to note as well, while in a couple quarters previously, we had reduced pre-roll production due to COVID, we were able to start ramping pre-roll production up, but those do also have a lower margin than Edison for example.

One big advantage for us, as I mentioned earlier as well, going forward is that we have new automation equipment. We expect to be fully commissioned and operational by the end of this quarter or early Q3, which again will reduce the cost of goods on pre-rolls, and allow us to not only be efficient in the pre-roll production, but as our plan involves, what we're looking to do is continue to increase SKU size, and efficiency, and margin by going to higher volume. I talked earlier about on our Trailblazer vape cartridges going to a 1 gram. On the pre-rolls, we're going to multi-packs as well, which we've seen very good consumer response from.

And I think when you look at our overall picture, one of the things that's impacted us certainly is part of the good news on the genetics program is that we've really been able to sort through, and come up with these new products, but it does have an impact in the near term as you're working on a number of different new genetics, and getting through that genetic mix until you optimize the conditions takes time. So, we're confident that we're going to be able to continue to improve that on a go-forward basis.

I think one of the other things that's really impacted us, as we said, we're in the process of staffing up, because we were producing less than the market demand for our products, which is good news in terms of on a go-forward basis, so increasing that will reduce – this isn't gross margin specifically, but will reduce some of the unabsorbed overhead and [ph] in fact (00:25:07) adjusted EBITDA, and really optimize, and continue to improve efficiencies, and that's one of the keys for us as an organization. We've proven in the past that we can run very efficiently, and now we're kind of scaling back up. We believe that will be the case going forward.

And the last thing I'd say, David, is just that we also have a packaging task force. It's been working over the last two quarters to look at other opportunities for cost reductions. And I think one of the key area – we identified a number of key areas is to bring, by Q4, some of those initiatives into place to really have an impact on efficiencies in packings. So, just I guess in summary, I would say that ultimately we believe that our investments, as I said, in these new strains and new genetics to really meet the consumer demand are going to pay off, but it takes time to get there.

David M. Kideckel
Analyst, ATB Capital Markets, Inc.

Q

Okay, thanks. That's really great color. My follow-up question has to do with kind of in the month of December, and given these unusual times of COVID, but have you noticed any seasonality effects, any particular – have any particular products within your 2.0 product portfolio, whether that's chocolates, vapes or beverages, have any of those products kind of stuck out to you just from a consumer, overall revenue perspective during the month of December and even in two weeks of holidays? Thanks.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, no, it's a good question, David. I mean certainly it's too early to tell on our RE:MIX beverage product because we've just launched that, and we don't have distribution in every province as of yet. We did look to some seasonal offerings, and when I think that was one of our approaches, right, with our Kushmas Stix pre-roll 0.5 gram specific for the Christmas season, as well as Gingerbread Edison Bytes, a milk chocolate truffle that was gingerbread flavored. And so, the response to both of those was very good.

The only thing I would say, we have seen an impact during COVID, and through the whole period of COVID on areas like disposable vape pens. Revenue in that area has not been as high as expected and we understand that. Those are all driven in some cases more by tourism, and travelers, and areas like that, and those are also things that people take to share at events and stuff, so those have been [indiscernible] (00:27:29), but we didn't necessarily see a seasonal, but, again, typically like anything people may have been diverting kind of some of their disposable income to other areas, but overall I think part of our way of taking advantage of some seasonality was to offer a couple unique seasonal offerings, which both were very well received in the market.

David M. Kideckel
Analyst, ATB Capital Markets, Inc.

Q

Okay, got it. Thanks very much for that color. I'll hop back in the queue and congrats on the quarter.

Operator: You're next question comes from the line of Andrew Partheniou from Stifel GMP. Please go ahead. Your line is now open.

Andrew Partheniou
Analyst, Stifel Nicolaus Canada, Inc.

Q

Hi, thanks for taking my questions. Maybe if we can continue the conversation on gross margin, I think you mentioned the restaffing activities only benefit gross margin in Q3, but unabsorbed cost could be reduced in Q2. Just wondering if restaffing activities are the main source of the unabsorbed cost and lower production utilization. Could you provide a little bit more detail and reconcile these two items?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, maybe I'll turn it over to Derrick to answer that question.

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

A

Sure, thanks, Greg. Yeah, during the quarter, we had unabsorbed overhead fixed cost. It's actually depreciation, insurance, and taxes of CAD 2.7 million, and that was as a consequence of operating at the capacity level we have, which was approximately 40% during Q1. As we add to our planting and cultivation, and add to staff, we would be utilizing more of the rooms, and as a consequence, as it relates to our overall margin, a lower dollar amount or – of these unabsorbed overheads would impact Q2 as well as Q3. It would be staggered in terms of the direct benefit, but there would be some benefit in terms of the overall direct charge to cost of sales during the second quarter. But to Greg's point, on an overall basis, the cost and production of [ph] grams (00:29:51) that go into your inventory really normally impact the subsequent quarters' margins and cost of sales, and that was why he's providing perhaps a [ph] comment that the (00:30:03) true benefit of operating at a higher level, and getting a lower cost per unit starts to impact Q3 and later quarters.

Andrew Partheniou
Analyst, Stifel Nicolaus Canada, Inc.

Q

Okay, thanks for that additional color. And kind of on the same line, when you – we've noticed that when you talked in the past that you're planning on lowering yields to increase quality, so when you combine the lower yields but also the higher margin new Edison strains and obviously taking into context that you won't be providing any kind of formal guidance, around what levels do you think we can see gross margins stabilizing? Do you have any internal goals in this metric? And maybe as part of that, could you also remind us where your production levels were before restaffing activities and what kind of increase we can expect once you're fully staffed?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, so, maybe I'll start off and answer that, Andrew. I think, again, when we commented before that we knew we would be decreasing yields on a per gram basis and part of that also keep in mind because of COVID and the amount of inventory we had of extractable product and concentrate, we also stopped harvesting trim, right, in Q2 of 2020, which made up 30% of the product or material from the plant, so that had an impact on our overall yields to begin with.

We knew to optimize THC we would have to kind of work to optimize yields, and it wasn't necessarily improving THC, as I said, with that investment in genetics, you don't have the ideal conditions, you know that impacts the drop, and it takes a number of different rooms and cycles to really get to the point. We are seeing yields improving over the last quarter, certainly along with THC levels. So, we've been able to continue to see progress in both areas as you can see by the product launches that we've recently had in that 23% to 27% THC range, and yields are starting to go back up.

I don't want to give kind of necessarily a specific target relative to what yield – where we need to be on the yield per THC basis because every strain is different and you have to treat them accordingly, and there is room depending on the strain to have some differential pricing as well for the product based on the demand.

One comment I would make before answering the second part of your question also is that we returned – or we started using street names in the marketplace and it's actually had a very positive impact in terms of response, people know the strains, we've seen the legal market attract a lot of people from the illicit market and that's been very, very helpful for them to identify the products and certainly something that's been a positive move.

I think Derrick just indicated that in answer to the second part of your question that when we look at our facility and utilization prior to staffing up, we're at about 40% utilization rate at the facility, so by adding these 100 cultivation and 30 packaging people, again, this will be [ph] staggered (00:33:41) in over time, and we expect to continue to progress on that. It's not only just a Q2 initiative as we see opportunities not only domestically but internationally growing and opportunity to continue to expand and increase cultivation levels going forward.

Andrew Partheniou
Analyst, Stifel Nicolaus Canada, Inc.

Q

Thanks for that additional color, and I'll get back in the queue.

Operator: Your next question comes from the line of Aaron Grey with Alliance Global Partners. Please go ahead, your line is now open.

Aaron Grey
Analyst, Alliance Global Partners Corp.

Q

Hi, good morning, and thanks for the questions. First one from me is kind of I want to go back to the commentary you made kind of around the US and kind of how you're looking at it because obviously been lot of focus on that given the election results. So, you've seen some of your peers kind of get into the US market via CBD, MSOs or other CPG businesses, so just curious as you kind of talked about not liking some of the risk/rewards you're seeing right now, could you kind of give some more color in terms of what you believe might be the best way to play it today given there's still uncertainty in terms of whether there will be federal laws passed and how those federal laws will look, and if you're now kind of thinking about play the wait and see game to see how it evolves or if you might be a little bit more aggressive in terms of making a potential move into the US? Thanks.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, no, it's a great question, thanks for the question, Aaron. I think, as I alluded to, I mean one of our focuses has been always our focus and investment in R&D, in developing new and differentiated products because, again, ultimately we believe in order for the legal market to displace the illicit market, whether or not that's in Canada, in the US or in other jurisdictions, offering differentiated products that change the whole cannabis consumer experience is going to be important, so that's why in products like our RE:MIX, dried powder beverage that we've developed and invested, we believe there are opportunities potentially to license that to other markets and to look at how do you take those platforms and bring them into the markets.

As I said earlier, we have spent a lot of time over the last two years really looking at the CBD market and as a potential entry point into the US, and I think, ultimately, to be frank, we just haven't found the right partner on how to do that. I think for us, as we look at – we continue to focus on the US as an opportunity, there isn't a clear path as a Canadian company that traded on – that dual listed on the NASDAQ and the TSX with the regulations that exist there currently to enter the US in the THC market certainly, we've seen some companies take some option approaches relative to – our approach is really about developing branded products, developing innovation and technology that we feel will lend itself to the market and that may be something we either look to license out or we look to do ourselves in the future as the regulations allow.

Aaron Grey
Analyst, Alliance Global Partners Corp.

Q

All right, great, thanks a lot for that color. And then second one would be specifically kind of around the province of Ontario. Obviously, everyone is looking for a lot more stores to come online in 2021 as we've started to see towards the end of 2020. So, I was just curious, from your perspective in terms of like as those incremental stores come online, how are you seeing in terms of like saturation within specific geographies, right? So, I know there's some [indiscernible] (00:37:19) Toronto, where there is a lot of retail stores in one specific area, so do you feel like that might start to impact maybe the incremental dollar sale we're going to be seeing per new store that you're seeing in Ontario? And how do you feel like that might impact kind of the overall competitive landscape for you guys going forward? Thanks.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

No, yeah, it's a great question, Aaron. I think you're bang on in terms of not every new store is the same in terms of the ability to generate additional revenue. I think what you're seeing, for example, you referenced in Toronto, there is a couple key areas in Toronto along Queen Street, along Yonge Street, the two in the major [ph] arteries (00:37:54), where there is an abundance of stores going in, and so that does lead to some level of saturation. So, we'll grow the overall market but at the same time the revenue per store will not be at the same level because of that saturation point.

I think when you look outside of the core of Toronto, there are certainly lots of opportunities and we are seeing new stores happen in areas that have limited stores or no stores today, and I think that's been one of the keys. And I think that's where the growth opportunity certainly exists is to kind of people that have had to rely upon online-only sales getting access to a store or multiple stores now is one of the key facets.

So, it's a bit of combination of both, but certainly – and I look at Alberta as an example, where with the number of stores, Alberta has the highest number of stores per capita right now is that they probably did reach a saturation point kind of last year and we've seen where a small number of stores have closed or there has been a little bit of consolidation happen in optimization. So, Ontario is a long way away from that happening because there's still tremendous room for growth and in terms of where we see the growth happening, but again certainly along a couple quarters, there is some saturation happening.

The other area I would comment on is, there are still a couple municipalities especially in and around Toronto that don't allow cannabis stores. So, if you recall, when legalization happened, the Ontario government allowed each municipality to opt in or opt out. I think certainly smart retailers should be looking to put the stores on the border of kind of those municipalities and I think that's kind of one of the opportunities that exist right now. Especially kind of north of Toronto, there is a big opportunity where some border stores along Steeles Avenue, for example, would have a huge impact on revenue.

Aaron Grey
Analyst, Alliance Global Partners Corp.

Q

All right, great. Thanks for the color and I'll pass it along.

Operator: Your next question comes from the line of Graeme Kreindler with Eight Capital. Please go ahead, your line is now open.

Graeme Kreindler
Analyst, Eight Capital

Q

Hi, good morning, and thank you for taking my question. I wanted to ask a follow-up with respect to the adjusted gross margin. And I appreciate the comments made in the prepared remarks and the discussion earlier about the unabsorbed fixed overhead. I wanted to dig a little deeper. Greg, you mentioned on the call that you're going to be bringing in a pre-roll machine in the middle of the year and the packaging task force is expected to complete their work by the end of the year. Can you give any indication of what those initiatives will do [ph] just really (00:40:46) for the gross margin, maybe there is some internal modeling you've done there? And you can compare that to what the baseline is right now, that would be helpful. Thank you.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, Graeme, I don't want to give guidance necessarily specifically about the impact. I mean the one – I will give a comment on the pre-roll equipment, I mean that equipment's been on site now, we've been working with it and we have seen during test runs it producing 40 to 50 pre-rolls per minute, and reducing labor required with pre-roll production from 22 people down to 3, so that's an example of just directionally what we've seen.

Now, it's not fully optimized, we're still on playing around with the blends in terms of the appropriate blend of mix of material for it, but we expect that to have a significant impact in the near term. And then part of our shift for Q4, as I said, is really looking at some of the shift in some of our packaging types and designs and trying to be more consistent in terms of utilizing a couple [ph] new approaches (00:41:55) for example, for multiple different product lines, which allows us not only efficiency in packaging but also allows us in terms of packaging inventory and always availability.

One of the things I commented on in the prepared remarks was we know we left revenue on the table in the quarter, we certainly – we did not have sufficient product and/or capacity and staffing to meet the demands for our product, which is why we're staffing up, but – so I don't want to give specific direction in terms of what we expect on savings. We have done modeling but until we get to the point where – one of the challenges always with automation and equipment is until you get it commissioned and up and running, you don't know what impact it's going to actually have.

Graeme Kreindler
Analyst, Eight Capital

Q

Okay. I understood and I appreciate the anecdote there, that's helpful. Then – perhaps then in terms of order of magnitude and what your expectations are between increasing your staffing levels, which are going to give you higher throughput there, and then the pre-roll initiative, the packaging initiatives, can you give any sense directionally in terms of what you're expecting will have the most outsized impact in terms of increasing the gross margin there?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Again, directionally, I would say it's definitely a combination of both. I think increasing staffing and increasing output and throughput is going to have the most significant impact because, again, producing more sellable product especially as we've now optimized conditions around some of these new high THC genetics will create significant opportunities for us, and the initiatives on packaging are more of a longer-term impact and will have an improvement in margin, but at the end of the day, increasing revenue on a high THC product, which has a higher margin, is going to have more impact.

Graeme Kreindler
Analyst, Eight Capital

Q

That's very helpful. Thank you very much, Greg.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Thank you.

Operator: Your next question comes from the line of Adam Buckham with Scotiabank. Please go ahead. Your line is now open.

Adam Buckham
Analyst, Scotia Capital, Inc.

Q

Good morning, and thanks for taking my questions. So, first, [ph] in terms of (00:44:02) capacity, is it possible to speak to the potential size of missed revenue opportunities in fiscal Q1 as a result of production constraints, maybe in terms of missed purchase orders or something along those lines?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, Adam, I mean internally we do know, now, some of these purchase orders we were able to fulfill in Q2, so they weren't necessarily completely missed. But we did have between CAD 5 million and CAD 6 million of POs we were not able to fulfill in the quarter.

Adam Buckham
Analyst, Scotia Capital, Inc.

Q

Okay, that's great color, thanks. Secondly, in the prepared remarks, the team indicated that there is – there could be some cooling off in the market given the [indiscernible] (00:44:42) in Ontario. To-date, have you seen any impact to buying patterns from the OCS? And then just a bit of a follow-up to that, the OCS has recently [indiscernible] (00:44:53) comments about potentially rationalizing SKU counts. Obviously OGI has [indiscernible] (00:44:58) much of its portfolio but with this potentially coming, do you think it could eventually be a bit of tailwind for the products there that's left remaining on the OCS?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, no, it's a good question. So, to answer your first question, I think, certainly, we have not seen a shift in order patterns, but certainly we've been notified by OCS, again, as they are continuing to kind of monitor daily, weekly the impact of now going to click and collect and local delivery only will have on retail sales that they could change. So, an existing PO, for example, that's due to be shipped three weeks out could be reduced. So, we have not seen that happen yet but they've given us indication that that could happen.

Yeah, I mean, to your point, we've been probably one of the most active companies and working closely with OCS in terms of revamping our portfolio, switching our products. So, certainly that's been a big focus for us. And we really see with every province and certainly with the two largest provinces for us and for the market, Alberta and Ontario, we've been active in doing that.

So, I think it does – their strategy, I mean they're going to 100 core listing products. They expect those products to always be 100% available, and so there are tailwind opportunities for those products, for core listed products to generate revenue because, again, the commitment from every company will be to make sure those products are always in stock and there's tremendous opportunity. So, retailers know that they will always be able to access those products and carry them at the retail store. But any listing requirement in the province of Ontario now will require a 98.5% inventory level. And so, it's critical for companies to consistently meet that level or you run – as you would see in any normal retail environment, you run the risk of being de-listed. So, companies that have in-demand products and are able to consistently supply the market, are in a great position in terms of revenue against those products.

Adam Buckham
Analyst, Scotia Capital, Inc.

Q

Great, thanks for the color.

Operator: Your next question comes from the line of John Zamparo from CIBC. Please, go ahead. Your line is now open.

John Zamparo
Analyst, CIBC World Markets, Inc.

Q

Hi, thanks. Good morning. I wanted to get a sense of how you feel about the balance sheet at the moment and, of course, you did the recent equity raise but there's still some debt in the balance sheet and industry valuations are pretty robust at the moment. And now there is the prospect potentially of entering US at some stage at least. I just would like to get your thoughts on capitalization levels at this time.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, look, I mean we're very comfortable with our balance sheet as you said. I mean, at the end of the quarter, after using CAD 55 million of proceeds to pay down a portion of the debt facility, we still have CAD 60 million remaining in debt, but we did have CAD 79 million in cash and short-term investments plus CAD 8 million of restricted cash. And I mean, again, one of the things I would highlight is we had for the second of the last three quarters a positive cash flow from operations. So, as a company perspective, I think we're in a strong position on a go-forward basis relative to our own cash position and also kind of how we're operating and our operating consistency.

John Zamparo
Analyst, CIBC World Markets, Inc.

Q

Okay, thanks. And then my follow-up is on the gross margin. When you think about getting back to the previous levels you hit kind of that 35% to 40% number, do you need to get to the same level of net cannabis revenue, [ph] kind of that (00:48:51) CAD 25 million plus in terms of sales or is your cost structure different now that it wouldn't quite need to be so high or is it potentially higher because now you're offering a lot more value products? Just would like to get a sense of what you need to hit on the top line to hit that previous gross margin level. Thanks.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, it's a good question, John. I think there is a mix there, so certainly on one hand, we have become much more efficient as an operator. I hate to say there was a benefit from COVID, but one of the things that with reduced staffing it forced us to do was look at how we operate, how we do things and we've been able to get much more efficient in a lot of things we do and then kind of going forward, as I said, some of the initiatives we've taken on automation or even kind of systems and how we operate. So, do we need to be there? I think yes, there is no question that our mix is – so, [indiscernible] (00:49:53) to say do we need to be there, yes, at the same level of net revenue. I think it's a mix, right, because we are selling more value, large volume SKUs, so your average price per gram there but certainly is lower but your labor costs would go into that and packaging costs are significantly lower as well. But again, our goal is to, as I spoke to you earlier, is to really continue to drive more revenue on the high-margin products and that's why this investment in the genetics program and what we've been doing over the last 12 to 18 months is really starting to pay off now and because that is going to be critically important.

We have seen – there is no question, we've seen price compression in many categories, and it's not just value dried flower categories, it's also been in the vapes category as well. So, again, I don't want to give a specific forecast as we don't give guidance on what level we need to hit, but I guess your comment would be accurate in terms it's a mix between the two, on one hand, we're selling more of the high-volume, lower-priced value products, which do have a lower margin. One of our lowest-margin products historically has been pre-rolls. So, we're looking to improve that dramatically with the automation [ph] range, so (00:51:13).

John Zamparo
Analyst, CIBC World Markets, Inc.

Q

Okay, that's great color, thank you very much.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Thanks.

Operator: Your next question comes from the line of Vivien Azer with Cowen and Company. Please go ahead, your line is now open.

Vivien Azer
Analyst, Cowen and Company

Q

Hi, good morning. I just want to follow up on Aaron's question about the US market and you're posturing there around CBD. There hasn't been a lot of evidence around brand equity transferability between CBD and THC, and frankly the category development in CBD has been quite lackluster. There continues to be regulatory uncertainty around the FDA. So, can you just expand on why that's the appropriate pathway to enter the US? I understand, obviously the regulatory constraints around THC, but why you're going to pursue a CBD strategy? Thanks.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

No, it's a great question, Vivien, ultimately, what you'd outlined is, why we have not entered the US and we have not seen really an impact. I mean, is there transferability between CBD and THC products? Not necessarily, there's only a few areas where that's the case. I think for part of us, our strategy there was as we've evaluated entering the market is simply to get a toehold in the US and look to be an US operator and kind of look to hire people potentially or acquire a company that you could leverage across to the THC market. But I'd agree with you 100% that today we haven't seen that transfer and ultimately that's why we haven't made the decision.

Again, our focus has been, as I outlined earlier in response to Aaron's questions, I think there are technologies and innovations like our dried powder that can be applied in both markets, and one strategy may be to say do we look for someone to license those two or do we look to launch those ourselves? I think there is still a level of uncertainty on CBD in the US with the FDA. I think there is still going to be guidance out where they are going to look at certain forms of ingestion, for example, [ph] our (00:53:24) ingestion products having to undergo some toxicology work potentially. So, the rules still aren't clear on CBD and there is a number of reasons we have not yet entered the market, but certainly we've looked at it as an opportunity to potentially get a toehold into US possibly.

Vivien Azer
Analyst, Cowen and Company

Q

Perfect. Thanks a lot for that color.

Operator: Your next question comes from the line of Rahul Sarugaser from Raymond James. Please go ahead, your line is now open.

Rahul Sarugaser
Analyst, Raymond James Ltd.

Q

Perfect, thank you. Good morning, Greg, Derrick, and Amy [indiscernible] (00:53:55). So, my first question is around market share and all of your comments earlier are well taken. I guess, maybe more – speaking more at the macroscopic level, we've seen a decline in market share over several quarters, at least in this last quarter we've seen that being attenuated somewhat, so you are [ph] spending a lot (00:54:18). Given your earlier comments about increasing appreciation and demand for Organigram's product, do you anticipate that you kind of bottoming out, market share should start to – that should start to increase over time?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, it's a great question, Rahul. I think, as I mentioned, I mean, we had unfulfilled POs in the quarter, there's no question. And I think one of the challenges we've had truly is we've had inconsistent supply of many of our products. So, even our Trailblazer Snax, when it was launched in chocolate category, it was not always available. And part of the challenges you face is that in certain jurisdictions in terms of how much product they carry at launch and then if it sells out quickly. Our SHRED is very similar to that, right? So, SHRED was an overwhelming success. As I said, it was the most searched – number one most searched brand in November, December on the OCS website. And so, we had no idea that was going to be the case.

So, again, it's difficult to just look at our share because there's kind of the lost opportunity there, where we've not been able to fulfill the market demand. And I think certainly, we believe with increased production, we are in a great position to be able to continue to increase share on products like that or some of our core new offerings on Edison because every time we ship SHRED in, it sells out very quickly right now. And as I said, the search metrics that we've seen on OCS would be an indication of the demand. So, what you see in terms of share doesn't represent the demand necessarily. We've got to do a better job in kind of meeting the inventory levels to fulfill that demand.

Rahul Sarugaser
Analyst, Raymond James Ltd.

Q

Great, thanks. And then just a quick follow-up and [indiscernible] (00:56:14) a little bit, so, you're one of two companies that has taken a pretty material [ph] debt (00:56:18) in biosynthesis and we're seeing the states really starting to evolve. And given the [ph] debt (00:56:26) in Hyasynth and its specific somewhat unique strategy of focusing on the major cannabinoids relative to its universe of peers, which are very focused on the minor cannabinoids, do you see this as kind of your ace in the hole particularly when it comes to entering the US market and as you referred to [indiscernible] (00:56:43) around the beverage powders?

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, [ph] I knew (00:56:48), so, again, I'd agree in part with what you said, like, initially, certainly Hyasynth's approach has been – they were the first commercial company that we're well aware of, first biosynthesis company to have a commercial sale of a cannabinoid with CBDa produced through biosynthesis. And so – but I mean they are focused on minor cannabinoids as well. I mean they've got a fulsome portfolio of 23 cannabinoids, 19 minor and 4 major cannabinoids.

Again I think one of the keys of early focus on major cannabinoids is that the process for producing them is somewhat more straightforward and not as complicated, but in parallel, they are also working on minor cannabinoids and I think that's going to be critical for the future. And I wouldn't necessarily agree with your comments that like every other companies are all focusing on minor, we've seen other companies talking about plans to commercialize [ph] CPG (00:57:48) in near term and that's been their focus.

So – but I think, Hyasynth's focus, they've got a – our investment strategy with them is then – we believe they have a strong IT portfolio and that they are working on dual path both with major cannabinoids but potentially for minor cannabinoids in the future, and I think that's one of the key aspects where we believe in the future minor cannabinoids are going to benefit greatly from biosynthetic production because ultimately you cannot produce the majority of minor cannabinoids from a plant in any significant level and the cost would be cost prohibitive, so the benefits of biosynthetic production, as you know, are much higher with minor cannabinoids than major cannabinoids.

Rahul Sarugaser
Analyst, Raymond James Ltd.

Q

Perfect, thanks very much.

Operator: Your next question comes from the line of Pablo Zuanic. Please go ahead, your line is now open.

Pablo Zuanic
Analyst, Cantor Fitzgerald Securities

Q

Good morning. Two quick questions, one, when you see Aphria and Tilray merge, how do you think about that? You have about 3%, 4 % share based on my numbers. As the industry starts to merge, is that a problem for a company like yourselves or how does that manifest itself at the ground level or it doesn't make a difference, it's not something that's keeping you awake at night?

And the second question, in the case of Israel with Canndoc, there's been two or three other companies that have also shipped to Israel, seems like Canndoc is, like you said, cherry picking and they buy something from some companies and other things from other companies. Just talk about the dialog in terms of what are they buying from you and what is it that stands out compared to what other people are exporting to Israel. Thank you.

Gregory Engel
Chief Executive Officer & Director, OrganiGram Holdings, Inc.

A

Yeah, no, Pablo, it's great – your first question, in terms of the overall marketplace, I think we have seen – bigger doesn't necessarily mean better, I mean some of our larger peers have shuttered multiple facilities, so a potential merger of Aphria and Tilray coming together, it may be more about international markets from certainly what I've seen written or kind of looking at other markets and it is about the Canadian market per se, certainly at least that's many analysts' perspective on it.

I think for us the key has to be continue to drive forward with new and innovative products, differentiated products that there is market demand for, and that's going to be one of the critical parts.

To answer your question on Israel, certainly for us with Canndoc, we're an indoor producer and certainly there is a differentiation between their other supplier at this point in terms of the marketplace and certainly the initial response to the product we did sell in on our first shipment was extremely positive. And we're working hard to – with Canndoc to be able to continue to supply them in Q3, and again that will be dependent upon getting the CUMCS certification as well as having the right product mix for them at the time, but certainly for them, one of the big advantages that they saw in us is being an indoor producer, so.

Pablo Zuanic
Analyst, Cantor Fitzgerald Securities

Q

Got it, thank you.

Operator: And there are no further questions at this time. Ladies and gentlemen, this concludes today's call. We thank you for your participation and you may now disconnect.