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COMPANY PARTICIPANTS

Beena Goldenberg Chief Executive Officer

Derrick W. West Chief Financial Officer

OTHER PARTICIPANTS

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to OrganiGram Holding Inc.'s First Quarter Earnings Conference Call for the Fiscal Year 2022. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session with analysts.

We ask you to please limit yourself to one question and one follow-up question. You may re-queue, if you have further questions. As a reminder, this conference call is being recorded and a transcript will be available on OrganiGram's website.

Listeners should be aware that today's call will include estimates and other forward looking information. Please review the cautionary language in today's press release on various factors, assumptions and risks that could cause the company's actual results to differ. Furthermore, during this call, reference will be made to certain non-IFRS 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 these measures may not be directly comparable. Please see today's earnings report for more information about these measures. I would now like to introduce Beena Goldenberg, Chief Executive Officer of OrganiGram Holdings, Inc. Please go ahead, Ms. Goldenberg.

Beena Goldenberg Chief Executive Officer

Thank you and good morning, everyone. With me is, Derrick West our Chief Financial Officer. For today's call we'll discuss the financial results for the three months ended November 30, 2021, and I will provide a general business update. We will then open the call for questions.

The first quarter of fiscal 2022 showed continued momentum from the progress we achieved in the last quarter of 2021. We achieved record net revenue in the quarter, the highest in the history of the company. We solidified our number four market share position among Canadian LPs in the recreational market in Canada, becoming one of the few larger Canadian LPs registering market share growth.

Subsequent to quarter end we completed an accretive acquisition of Laurentian that expands our product and brand portfolio and bolsters our geographic presence in Québec.

And we made further progress on our goal to achieve profitable adjusted EBITDA which should be accelerated with the purchase of Laurentian.

Our net revenue in Q1 was CAD 30.4 million a 57% increase over Q1 in fiscal 2021. This record level of net revenue speaks to our success at innovating to best address consumer needs and introducing compelling brands that resonate with consumers.

We continue to hold the number four market share position among Canadian LPs in the quarter at 7.5%. A year ago before our product revitalization program our market share was 4.4%.

The HiFyre data provides detail on how our products are being received in the market. SHRED continues to be the most popular flower brand with Tropic Thunder and Funk Master SKUs holding the number one and two positions respectively for November. And Tropic Thunder and Gnarberry as the top two SKUs in December based on sales and volume.

SHRED also remained the number one searched brand on the OCS website for 13 of the past 14 months. These sustained positive results while the price of SHRED was increased in Alberta and Ontario demonstrates its exceptional consumer demand.

SHRED and gummies, were introduced in August 2021 and are quickly gaining distribution and traction in the market. In November they were ranked number three in terms of both sales and volume of units sold.

Edison JOLTS our unique high potency THC lozenge maintained its best-selling position within the ingestible extracts category. Our momentum continued after quarter end. December data from HiFyre highlights that OrganiGram achieved 7.6% market share up 10 basis points from November holding the number one position in the imported flower category, number three position in gummies and moving up to the number four position in pre-rolls.

We're very pleased with these results. And you should also note that this market share does not reflect the contribution from the sales of Laurentian products that will get us closer to an 8% market share.

In November we launched Monjour our wellness brand providing large-format CBD infused soft chews in Berry Medley and Citrus Medley flavors. Both flavors are available in vegan-friendly and sugar-free formats for maximum consumer choice. In the short time since its launch last month Monjour has already shown strong momentum in the market. We're very pleased with the start and look forward to this new brand achieving the same success as our recent brand introduction.

We continue to focus on the needs of premium cannabis consumers through our flagship Edison brand. As stated last quarter Brightfield data has shown growth in Edison's brand awareness and a significant increase in its number of social mentions and positive consumer sentiment scores.

Seven new high-potency strains were introduced in fiscal 2021 and fiscal 2022 started off with the launch of several new products, including the Edison Blue Velvet vape and yet another first- to-market product the Edison Pinners combo pack. The first pre-roll ten pack in the market to offer consumers two unique genetics within one pack.

Consumer demand has been strong on these innovations and we're excited to continue to offer new relevant products to the market throughout the rest of the year.

Now let's look at our operations. In Q1 our yield per plant was 129 grams compared to 86 grams in Q1 of fiscal 2021. As we have brought our new grow rooms and improved operational efficiencies, our cost per gram has been reduced by half while increasing THC levels.

At the Moncton cultivation center upgrades to the facility are currently underway. This includes increasing capacity through our 4C expansion, a second harvesting area, adding environmental enhancements and performing upgrades to the irrigation system. These will further enhance yields and flower quality.

In terms of automation, the second pre-roll machine was commissioned last quarter and investment in high-speed porch lines for Big Bag o' Buds and SHRED is underway.

Our product development collaboration with BAT advanced in the quarter with the completion of the quality assurance and control laboratory. Construction has also begun on the bio lab which will conduct advanced plant science research and on the GPP food and edibles facility both of these are expected to be completed in February of 2022.

This is an important milestone. The research conducted as part of our PDC will contribute to ongoing development activities which could result in new products in the future, support market share growth and our reputation as a consumer centric innovator.

Initial development is focused on CBD and other cannabinoid edibles, drinks, vapes and ingestible products with focus on products set improved delivery, efficacy, convenience and create new usage occasions.

Our commitment to innovation is also reflected in our increased investment in Hyasynth Biologicals. Hyasynth is a leader in cannabinoid science that is using biosynthesis to produce THC, CBD and rare cannabinoids without the use of cannabis plants.

This greatly reduces the cost and production time of the compounds with a smaller environmental footprint. In December, we increased our total investment in Hyasynth to CAD 10 million. This provides us with approximately 49% interest in the company and two Board seats.

Once Hyasynth commences commercial production we've the option to purchase cannabinoids at a discount to the wholesale market price for a period of 10 years.

Producing any major or rare cannabinoid quickly and at scale opens up multiple possibilities for medical, wellness and recreational products, as well as only three large LPs investing in biosynthesis OrganiGram is well-positioned to take advantage of these opportunities.

Finally, I'd like to highlight the acquisition of Laurentian we made in December. Laurentian is a Québec -based LP of our seasonal craft cannabis sold under the Laurentian brand and Québec's top selling hash sold under the Tremblant cannabis brand. Laurentian's current annual capacity is about 600 kilograms of flower and 1 million hash units.

We intend to invest CAD 7 million in growth CapEx behind Laurentian's expansion program which will increase capacity to about 3,000 kilograms of flower and 2 million units of hash by the second half of 2022.

We are excited to further expand the distribution of Laurentian brands outside of Québec leveraging the strength of our national salesforce.

The acquisition cost was CAD 36 million consisting of CAD 10 million in cash and CAD 20 million in shares as well as potential earn out considerations.

This is a significant acquisition and that strengthens our premium portfolio with high margin products and increases our presence in Québec.

It is also accretive as Laurentian has been averaging since it entered the Ontario market in November an annual net revenue run rate of CAD 17 million with CAD 6 million in EBITDA.

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

Derrick W. West Chief Financial Officer

Thanks Beena. Turning to our earnings results for Q1 fiscal 2022. Gross revenue grew 75% from Q1 2021 to CAD 44.3 million and net revenue grew 57% from the same period in fiscal 2021 to CAD 30.4 million.

These revenue increases were primarily due to higher recreational net revenue which grew 9% from Q4 of fiscal 2021 and 49% from the same period in 2021 and the resumption of shipments to Israel under our agreement with Canndoc. While gross revenues grew 75% cost of sales increased only 21% year-over-year to CAD 28 million.

There was no charge for unabsorbed fixed overhead for continuous growth rooms in Q1 fiscal 2022 compared to CAD 2.7 million in Q1 of the prior year. We harvested approximately 11.6,000 kilograms of flower during Q1 fiscal 2022 compared to both 3,900 kilograms in Q1 of the prior year, an increase of 197%.

This increase was directly related to increased yield per plant along with the increased cultivation planting during Q4 fiscal 2021 and Q1 of fiscal 2022 to meet the growing demands for our products.

Largely due to lower cultivation and postharvest cost, lower changes in fair value of biological assets and inventory provision the gross margin in Q1 improved to CAD 610,000 from negative CAD 16.7 million in Q1 2021.

On an adjusted basis gross margin was CAD 5.5 million compared to CAD 1.9 million in Q1 2021.

We expect that the price increase to SHRED, the addition of higher-margin premium products to our offering and lower production cost will further improve margins.

SGA excluding non-cash share-based compensation increased to CAD 12.6 million in Q1 2022 from CAD 10.5 million in the prior year's comparison quarter largely due to higher employee cost due to increased head count, general wage increases, increased professional fees due to technology fees and the fees from the new requirement to have an integrated audit and higher trade investment in marketing spend initiative spend to support the launch of our new gummy and other derivative products.

Also due to improved revenue and margins the negative adjusted EBITDA was reduced from CAD 5.7 million in Q1 of 2021 to CAD 1.9 million in the current quarter. We also reduced our net loss year-over-year from CAD 34.3 million to CAD 1.3 million. Overall, we're pleased with our improving financials and the continued momentum we are seeing.

In addition, starting in December of 2021, we began to recognize revenue from the Laurentian acquisition. Based on this we have now advanced our view on achieving positive adjusted EBITDA by Q3 of fiscal 2022.

In terms of our statement of cash flows, net cash used in operating activities was CAD 9.3 million during Q1 of fiscal 2022 compared to cash generated of CAD 294,000 in Q1 of the prior year. The change was primarily due to the current periods investment in working capital assets as we supported the growth of the business.

Net cash used by financing activities was CAD 270,000 during Q1 fiscal 2022, primarily driven by reduction in debt and lease liability.

Net cash generated from investing activities was CAD 54 million during Q1 of fiscal 2022 an increase of CAD 38 million from the prior year's comparison quarter. During the current period there was CAD 60 million from short-term investment proceeds, CAD 1 million from restricted bonds, net of CAD 7 million incurred for capital expenditures.

In terms of our balance sheet, on November 30, 2021, we had CAD 168 million of unrestricted cash and short-term investments compared to CAD 184 million at the end of fiscal 2021.

The decrease during the period is primarily due to the company's investment in both its working capital assets and capital expenditures for facility improvements.

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

Beena Goldenberg Chief Executive Officer

Thanks Derrick. To close, we are very pleased with the record results in the past quarter. We continue to generate significant momentum that I believe positions us for a successful fiscal 2022. Investors can continue to expect strong revenue and volume growth, more new and exciting product introductions, increased brand penetration and further improvements in our adjusted gross margin.

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

QUESTION AND ANSWER SECTION

Operator

Your first question comes from the line of Rupesh Parikh of Oppenheimer & Co.

Unidentified speaker

Question – Unidentified speaker: Good morning. Thanks for taking my question. So, I guess just first I wanted to go just market share so significant increase in market share year-over-year. What would you guys attribute the key efforts that turned out market share increase?

Answer – Unidentified speaker: Sure, thank you for the question. So, we saw significant growth in the interest in our SHRED brand. It's really been quite an increased demand from consumers, really related to not only the convenience but the high flavor profile of the offering, that's attracted consumers and we've seen really strong growth behind that brand.

In addition, we have started – we launched things to the Gummies category after our acquisition of EIC back last April. We launched into the category in August and saw significant traction behind our SHRED'ems brand. We came in with the cost, competitive cost into the marketplace and built to the number three position in the market by November. So, pretty quickly so we continue to focus on building our derivatives offerings.

And in addition as I mentioned earlier, we launched our pinners, our Edison pinners [17:07] which is a pre-wall offering 10-pack that has two different strains in it. It's a unique offering to the marketplace, so we're just listening to our consumers, understanding what they're looking for and launching products that meet their demand and this has helped us gain our market share.

Unidentified speaker

Question – Unidentified speaker: Great, that's helpful color and maybe just one follow-up question on the Laurentian Organics acquisition. So, it's pretty impressive, you already have CAD 6 million EBITDA run rate and the sales base of CAD 17 million, what's unique about the business that already generates that strong EBITDA on a fairly low a revenue base?

Answer – Unidentified speaker: Right, so I mean their focus in Laurentian is predominantly on selling hash products and they are the number one selling hash in the Qubec marketplace. So -- and it's a premium product offering with good margins on it and that has been really – drove great consumer appreciation for its taste and the flavor and feel of the product.

So, they've been able to manage -- maintain really strong margins on that offering. They complement that with some craft flower, we know craft flower is good margin products. So, their focus has been on the Qubec market, we'll continue to expand those offerings as we build our capacity to take advantage of those higher margin offerings to our overall portfolio.

Unidentified speaker

Question – Unidentified speaker: Great. Thank you.

Operator

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

Unidentified speaker

Question – Unidentified speaker: Hi, good morning. Thanks for the question. First, I wanted to ask a bit more about the cost structure and margin. So, can you help us understand once you are up and running on the expanded capacity as I recall somewhere around the 70,000 kilograms a year. What sort of minimum sales level would you need at that level of capacity to maintain positive margins and EBITDA? I ask because while you are gaining share now which is a positive, the market does change a lot and who was gaining share could fluctuate from time-to-time. So, I wanted to understand the flexibility or operating leverage or deleverage nature of your cost structure?

Answer – Unidentified speaker: Hi, Tammy, it's Derrick here. We're revising the outlook in terms of the total capacity from 70,000 to 75,000 based on the improved yields that we have been getting consistently over the last three or four months. And we're operating at capacity now based on the available and just like increasing over the last few quarters, we have significantly reduced our cost structure to the point that we have gone from negative adjusted gross margins to positive adjusted gross margin.

There is as, there is a fixed cost element to the facility that's beyond the variable cost on the labor and as such we do plan based on the demand on our products that at this point far exceeds, it exceeds our current capacity. But we're only going to be planting in the rooms as this demand continues to outstrip our current capacity and based on the success of our products and our plans for innovation and launching new products, we do feel that as we complete the construction, add the rooms to take us from this 55,000 capacity we have today to the 75,000 that we will be able to be operating at or near capacity.

So, we're not viewing this from the perspective grew by there is significant downside to doing the expansion just given where the demand is today based on the capacity that we have today moving from this 55,000 run rate to 75,000. But, of course as we lack in the schedule there is an element where you are non-operating at capacity with the competition in the marketplace. There is a cost to a fixed cost element that really challenging to cost of sales should we be not be our operating capacity. But we feel there is so much more that we can provide on cost reduction just based on 55,000 to 75,000 and especially, we think it will be sufficient by far should there be sufficient selling demand in our product which again we do not expect.

Answer – Unidentified speaker: Great, let me just add one more comment on top of what Derrick just said. Tammy right now, our very popular SHRED brand is really only available in two marketplaces and in two provinces in Ontario and Alberta.

We have some small volume that is in Qubec but we haven't been able to expand the distribution to other markets due to the lack of supply. We do believe there is a lot more opportunity for us to expand that brand.

And take advantage of what if we believe is a great product offering out in the marketplace. So, we're not -- we while I recognize your comment that consumers have been swapping between brands, we've seen some pretty sustained demand on our SHRED brand and continued great performance, and we're looking forward to having that extra capacity to be able to expand our distribution.

Unidentified speaker

Question – Unidentified speaker: Got it. Thanks for the comments there, that's actually a good segway to my follow-up question. So, Beena that's very interesting on SHRED because I was going to ask how much more upside in consumer demand you see in the SHRED brand because it's gotten so much success over the last year. So, just to clarify SHRED is really only in Alberta and Ontario and not really in the other provinces. So, I see the upside there how about in the provinces Ontario and Alberta that SHRED is already in? Do you continue to anticipate or see like there is still even more demand upside on SHRED? Thank you.

Answer – Unidentified speaker: Yes, so we absolutely see opportunities in those markets and I should correct, we do have a little bit of business also in SHRED in Qubec in a 15-gram format versus the 7-gram format we have in Ontario and Alberta. But we do see upside because currently we're on allocation.

We can't supply the demand that's currently out there. This is why the increase in our production capacity and our improved deals is helping us. We'll continue to be able to fulfill orders as they come in but in just having our joint business planning meetings with the OCS, they are basically telling us there is big demand from the retailers and we can't supply that demand at this point. We're really looking forward to our expanded capacity so we could fulfill that demand.

And I think it all comes back to the fact that we're offering a product that is competitively priced to the illicit market, and so we're bringing people in from the illicit market into the legal market through this brand, introducing them to high-quality offerings and so, I do think there is lots of upside as more people move over from the illicit market to the legal market as well.

Unidentified speaker

Question – Unidentified speaker: Great. Thank you.

Operator

Your next question comes from the line of Aaron Grey of AGP.

Unidentified speaker

Question – Unidentified speaker: Hi, good morning and thank you for the questions. So, first question for me, I just wanted to touch on the Israel sales will begin again this quarter. So, just on the go forward two questions and first of all, could you comment maybe on the margin profile that you guys are receiving for some of the products in Israel and then how do we think about sales going forward that they could – should continue into 2022? Just want to know relative to the revenue that you received in the first quarter whether or not it should it continue to be lumpy, invest good base . Thank you.

Answer – Unidentified speaker: Right, so thank you for the question. At this point, we had strong -- we resume shipments to Israel in Q1 of fiscal 2022. We have a great partnership with Canndoc and they are very interested in ongoing -- receiving ongoing products from what they are selling their market is premium indoor grown cannabis from Canada. They see it as a big drop, they get a premium price for that product and with our shipment that we made in Q1 of fiscal 2022 they were very pleased with the performance of our strains. I believe, we shipped them MAC 1 that sold well in their stores within 24 hours.

So, they are very pleased they are looking for more product. We expect to be on a cadence of a shipment once a quarter to Canndoc obviously that does depend on no changes to the regulatory environment. But at this point, we have a strong partnership with Canndoc and we do expect to see ongoing shipments throughout the balance of our fiscal year.

Unidentified speaker

Question – Unidentified speaker: Okay, great thank you. And then just a quick follow-up, could you just comment on any color on the margin profile you're seeing from Israel relative to?

Answer – Unidentified speaker: Sorry, you did ask that. Okay, yes so certainly, we have good margins on the product that we sell to Israel and that's obviously because when you sell export market you don't have the excise tax impact that you have when you sell within the recreational market and so it's a strong margin for us and it helps drive our overall net revenue. I don't know, Derrick if you want to provide any more color quick.

Answer – Unidentified speaker: Yes, I guess we don't normally get into the margin by product categories specifically but we do have healthy margins on the B2B business as a consequence of the excess tax that was noted as well just because the packaging that you are doing in sending on the export is – it's just a bit some more simplified process in terms of both labor and the packaging element and so it does allow for margins that are enhanced than as compared to the flower margins in the Canadian Rec market.

Unidentified speaker

Question – Unidentified speaker: That's helpful qualitative color, I appreciate that. Second question from me then just in terms of high level view on the market and pricing. I guess some peers have talked about potential pricing pressure and using price as a lever to kind of regain market share, just want to get to your overall view in terms of with the recent price increase in SHRED and how you're going to look at pricing and kind of maintain price cap as we go in 2022 just in relative to potential changes in market share as what's nice that we've always seen little fluctuations over time with different brands. Thank you.

Answer – Unidentified speaker: Right. So, I think we've seen the price compression that's happened in the flower category but from my perspective we've basically seen it sort of level off. We got to a place in flower where supply and demand are getting more aligned in the marketplace. The price compression we're seeing now is coming in other segments, you see quite significant compression coming in the Vapes category.

We have a good competitive cost structure for our Gummies, so we're not concerned in that category. In terms of price compression, we know that we have to be competitive in the value segment to prices offered in the illicit market to maintain that momentum.

So, I think we obviously have to watch the pricing. We certainly have seen the compression in the flower category over the last year. But it's I think really a good indication of the strength of our SHRED brand that we're able to take pricing in this category and continue to maintain the momentum on the brand.

So, I do believe that we've kind of leveled on flower, there might be some compression on the high-end in the craft flowered segment. But on the value segment, I think we've sort of leveled off, I could be still proven wrong but that's certainly our what we see as we were able to get that price increase on SHRED.

Unidentified speaker

Question – Unidentified speaker: Okay, great. Thanks so much for the color. Then, I'll jump back in to the queue.

Operator

Your next question comes from the line of Ty Collin of Eight capital.

Unidentified speaker

Question – Unidentified speaker: Hi, thanks for taking my question just looking for some additional color on the Q2 outlook. I think the language in the press release guided towards higher year-over-year in sales in Q2, but not necessarily sequential growth so just wondering if Q2 is looking flattered down, what are you seeing in terms of adult-use, some of the puts and takes that would be great, thanks.

Answer – Unidentified speaker: Perfect thanks for the question, so we are going into the quarter, obviously we have December behind us. We have had some good momentum and we do have the incremental revenue coming from Laurentian, but the careful consideration on quarter-over-quarter which could very well be growth quarter-over-quarter but we do want to recognize the fact that there is seasonality to this business. The second quarter or second quarter is usually our lowest quarter of the year because you have sort of the shutdown over Christmas, you have the shorter February month as well as the provincial boards that year-ends are in March. So we're just being cautious recognizing that while we certainly are striving for a revenue quarter-over-quarter. We are very clearly going to be significantly higher than the same quarter of prior year.

The other thing, I do want to recognize, look, nobody likes to talk about this but COVID backed out there, there are some restrictions in some of the retail stores in terms of capacity limits and in Quebec who is allowed into the stores. There is the impact of labor shortages as people are infected with COVID.

So we're just being cautious on our statements for this quarter but we certainly have momentum of coming in and we certainly have the incremental revenue coming from Laurentian that should help us deliver a great solid quarter in Q2.

Unidentified speaker

Question – Unidentified speaker: Great, I appreciate the color there, and just as my follow-up you mentioned earlier in the call the company still can't keep up with demand for SHRED, for example, is there any way to quantify how much sales were left on the table this quarter and when do you to expect the supply demand picture will start to balance out given the capacity expansion in month end. Thank you.

Answer – Unidentified speaker: Right. So good question, I mean we certainly believe that we will be out of our supply challenges once 4C expansion is up and running so as Erik mentioned earlier we're focusing on 75,000 kilos of product out of the facility and that should be able to address the needs and demand of SHRED and enable us to look at expanding the distribution to other markets on top of feeding the markets we're currently in where we're on allocation.

In terms of how much demand or sales we're leaving on the table that's a hard one to answer, we certainly know that in our conversations with the OCS, they certainly see it as a very large number. Their retailers are looking for products and that's something we can supply.

So, every quarter we started to see improve deals, we started to build some extra supplies this past quarter and that should help us fulfill more orders over the next quarter as you know there are sort of delay between when you plant a new harvest, but we should continue to see improvements over the next couple of quarters but I see the big unlock coming in once 4C expansion is complete and we will have production out of those grow rooms by the end of our fiscal year.

Unidentified speaker

Question – Unidentified speaker: Thanks, and congrats on the quarter.

Answer – Unidentified speaker: Thank you.

Operator

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

Unidentified speaker

Question – Unidentified speaker: Good morning. Thanks for taking my question. Maybe just starting off with some of your products continuing on SHRED, is it possible to quantify the price increases that you've made in Q1, how much more do you expect to increase it by in Q2 and as you bring SHRED into new markets, are you thinking about having a standardized national price on SHRED or could there be even further upside on price.

Answer – Unidentified speaker: So thank you Andrew. So here with regards to SHRED, we know that currently we're selling in the most price-compressed market which is in Ontario, the biggest bulk of our volume, and that's just based on their margin model.

And so we do believe that as we rolled out to other markets there is margin upside as we have some markets that have better for prices and we could get better margins on our SHRED. In terms of the price increase, while we were able to get the pricing through in Alberta a little bit earlier in the quarter, we were only able to get the Ontario pricing through by the end of October. So, we do think that there is good upside in the next quarter as we see the full impact of the price increase in Ontario.

Unidentified speaker

Question – Unidentified speaker: Is it possible to quantify the price increases?

Answer – Unidentified speaker: Derrick, do you want to take that?

Answer – Unidentified speaker: Yeah, I'm not sure if it's a quantification and we were -- we partially benefited in the quarter as noted just on the timing and -- but from here it would be in the 5% range effective in terms of the impact to the top-line sales just based on a transitional implementation on the timing during our Q1 reporting period.

Unidentified speaker

Question – Unidentified speaker: Thanks for the color and maybe transitioning to your R&D expenses that you had that nice outlook of accelerated profitability. Could you clarify, I believe that's excluding R&D expenses and when thinking about R&D expenses I believe the last time we spoke about it you were talking about maybe CAD 30 million over three years, has that outlook changed at all? Could you maybe talk about the cadence and any other color you can provide on the level of R&D expenses to take into account your profitability outlook?

Answer – Unidentified speaker: Yeah, I would say that our R&D expenses to date have been modest just in terms of the timing of the programs that are within the Center of Excellence for their employees have been hired that are doing the work from in terms of the Center of Excellence and we of course have our own innovation in R&D team over and above the Center of Excellence. But I would indicate that the total program spend is the same as it was originally budgeted, and originally forecasted and that it was pitch more or less that the timing on some of the spend on the programs is being pushed out a few months but the aggregate of the spend would be similar. So it's, we can get a bit lumpy but we would see that it would start to increase from the run rate that you have seen in Q4 and Q1 of this year in terms of the total R&D spend for the company.

Unidentified speaker

Question – Unidentified speaker: Thanks. I'll get back in the queue.

Operator

Your next question comes from the line of Rahul Sarugaser of Raymond James.

Unidentified speaker

Question – Unidentified speaker: Good morning Beena, Derrick, thanks so much for taking our questions. I know you talked a little bit about gross margin already, but I wondered if you can build that little bit about -- into the interplay between capacity and gross margins. We saw historically that the company was an extraordinarily efficient in the early days of legalization when operating at capacity and Derrick, I think you referred to being close to capacity if not fully at capacity right now. How should we be thinking about the sort of upper end or the rate limiting stuff in terms of capacity and gross margins now?

And then how do we see that with the expansion and do you potentially see sort of a deep in margins as you transition to that expansion?

Answer – Unidentified speaker: Yeah. Firstly, I would not see any dip to our margins as we proceed to the expansion. The costs that are getting added up the operational costs that are getting added are not at the same dollar per dollar pro rata as the extra capacity it's going to generate. Just by example, when we say we're at 55,000 annualized capacity say that's for the month of January, but for our Q1 reporting period, it was approximately 45,000. So, just in terms of volume output today and where we can get to we will be going from 45,000 from Q1 effectively to 75,000, an increase of 30,000 which is significant.

And our cost structure and where there is that fixed cost component sort of tying back to a reply I gave on Tammy Chan's question earlier is that most of the costs from here are going to be variable in nature and as a consequence, our cost of production per unit is going to go down as we increase every room that we increase and we've already seen that as we've increased the number of rooms available in Q1 than as compared to Q4 and Q4 with Q3 we've had these significant increases to our adjusted gross margin again going from a negative to a positive 18%. So, we do think that there is a mathematical reason that this should not continue as we get to full capacity of 75,000.

Unidentified speaker

Question – Unidentified speaker: Great, that's very helpful, and then just switching gears a little bit, we saw OrganiGram continue to support its investment in Hyacinth and we understand that Hyacinth is starting to meet some important milestones particularly in terms of the production of, fermentation and production of CBDA. Could you maybe give us a sense for when we might start to see the incorporation of Hyasynth-produced molecule into Organigram's products then hitting shelf particularly given that we see a couple of your or at least one of your major competitors hit shelves with fermentation-derived cannabinoids.

Answer – Unidentified speaker: Right. So, thank you for that question. So, at this point we're very pleased with the IP that's come from Hyasynth and it's why we've furthered our investment. We are looking at having contract manufacturer organization instead of agreements in place to help on the scale up by around Q3 of 2022 that's calendar year 2022 and expect production sort of material revenue coming out of their facility or that agreement by the end of calendar 2023. So, it's still a little ways way before we have scaled rare cannabinoids out of that production, but we're very excited about what we've seen in terms of their technology and IP.

We think we have a simplified approach that is easier to scale up than some of our competitors, and we believe that while we're talking about revenue only coming out by significant material revenue coming out by the end of calendar 2023, we do believe that the opportunities in terms of use of these products will take that time between now and then to work on some of the innovation and work with BAT and our product development collaboration to see where the greatest opportunities are in bringing in these products. So, we'll use that time to do the right research, to do the right consumer work and make sure that we're ready to go once that product is scaled.

Unidentified speaker

Question – Unidentified speaker: Great, that's very helpful. Thanks again for taking our questions.

Operator

Your next question comes from the line of Adam Buckham of Scotiabank.

Unidentified speaker

Question – Unidentified speaker: Good morning. Thanks for taking my questions and congrats on the quarter. Beena, you provided some great color on the demand for SHRED, I want to focus more on the sort of flower revitalization project that's been undertaken over the past year and a half. Are you able to provide some high level details on the contribution for sort of premium flower to overall sales versus let's say last quarter or versus last Spring, and really I'm just trying to get an idea about demand that you're seeing for those sort of new products that you've launched?

Answer – Unidentified speaker: Right. So -- So, a couple of points on that question. So, we have seen from a of flower standpoint we have seen the growth obviously in our SHRED demand but also in our Big Bag o' Buds so that's our 20-gram format, unique strains and again we have limited distribution as we work through our capacity challenges. But we're seeing some growth in that format as well. Our Edison brand, we've seen it's been sustained market share on our Edison brand. We expect to see some growth on our Edison flower in the back half of this year as we start introducing some of our newer genetics behind that brand. Higher THC, higher terpene offerings on Edison which is consistent with the consumer demand for more premium brands.

So that is coming in the interim, we continue to focus on building out our portfolio behind Edison with our vapes, we have some live resin vapes under packs that will be coming out to market. We have our Edison JOLTS, which I talked about briefly in the script. That really was a great intro into sort of high potency lozenge category and we're seeing additional SKUs coming out in that space because of the demand.

So we'll margin up outside the flower through some of our derivatives. We launched our Monjour offering which is CBD infused soft chews.

And again a larger format CBD offering, there is not very many in the marketplace. Good margin for us, a great offering for consumers an opportunity to build out pack distribution.

So I think there is going to be margin improvement as we continue to build out our portfolio, and then as I said earlier, I think with Edison it's just a matter of some of the new products gaining some traction. And we did see that with our Edison Pinners which were our pre-rolls this past quarter. So, I hope that answers that question.

Unidentified speaker

Question – Unidentified speaker: Yeah, no it certainly does, thanks for the color. So, second I just wanted to kind of touch on Israel again. And I'm just wondering if your partner Canndoc has shared any sort of commentary on what they expect for forward to kind of dynamics in the market, it seems basically right now, that Israel will eat sort of anything Canadians put on the table but of course there are many LPs looking to get into that market given the tractor demand and end margins right so, is there anything you can share on that front in terms of what you would expect on a forward basis. I know you said sort of sequential one order every quarter, but anything on that front would be helpful?

Answer – Unidentified speaker: Right, so I think what became clear in our discussions with Canndoc is what they are looking – what is really gaining the best premium prices in the Israeli market is Canadian indoor grown flowers.

So what I think provides us with a unique opportunity is that we're one of the largest indoor grown facility supplying that marketplace. They've said that as soon as they put product out there with our brand and identified as Canadian indoor grown it just flies off the shelf.

So we were seen as premium quality product in that marketplace. So while I think there will be some competition from Israeli grown cannabis, certainly think that we feel pretty strongly about our performance in the market and Canndoc is very pleased with the products and they were certainly told us how quickly that some of our new strains that we introduced sold out in the marketplace. So I'm feeling good about that relationship and continuing to build from there.

Unidentified speaker

Question – Unidentified speaker: Great, thanks for the color. And congrats on the quarter again.

Answer – Unidentified speaker: Thank you.

Operator

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

Unidentified speaker

Question – Unidentified speaker: Good morning, couple of questions. First question just has to do with the illicit market maybe what you could do is walk us through where you see the pricing in that market particularly in the larger provinces. And the price differential between your SHRED, Big Bag o' Buds product and the type of differential that you need to maintain in terms of pricing like how far on price side can you take before you are not able to take share from the illicit market, just want to start with that?

Answer – Unidentified speaker: Right, okay. So thank you for that question. I think we've actually crossed that market in terms of pricing with the illicit market, if you look at price per gram you know we've seen overall in the market where the price per gram in the legal market and some of the value offerings has actually fallen below the price per gram in the illicit market.

Now it's hard to say whether that's another playing field. You have differences in obviously strains and THC but I feel like the increase in our demand on SHRED has sort of indicated that we're there. We're getting that crossover from the illicit market into legal market and we're at the right price there that we continue to see and I believe it's come across that right now, the legal market is now 53% of sales versus 47% in the illicit market.

I mean there is still a long way to go, to get more of that illicit market over but in terms of price per gram on flower I think we've kind of crossed over. And I think that gave us the opportunity to take a little bit of pricing on SHRED, obviously the market dynamics are a little bit different depending on the province you're in. But generally speaking that I think we've already hit that mark.

Unidentified speaker

Question – Unidentified speaker: Okay, that's fair. Second question, I wanted to ask was about, we see that you're selling into Israel, but there are going to be a couple of other markets that open up in Europe in the next sort of while. Perhaps in the next 12 months to 24 months what's your thinking or the company's thinking for international expansion outside of Canada and what you're doing in Israel?

Answer – Unidentified speaker: Right, so first of all, we also have a partnership with Cannatrek out in Australia. We had shipped them a while ago when we had reengaged with them and are looking to expand our export shipments to Australia as well. So, that in addition to Israel are current businesses that we'll certainly look at fulfilling in this fiscal year.

In terms of other markets certainly we're all watching Germany and trying to understand legalization there. And other available markets in Europe. What we're doing in the short-term we're evaluating how to get some EU GMP or GMP status in our Moncton facility. How to build out some capacity to be able to take advantage of that market as well. The facilities are designed to get to EU GMP that's our derivatives facility in Winnipeg as well as our Moncton facility.

We don't have the certification yet, but it's something that we'll look at over the course of the next 12 months as we consider those export markets in Europe that become another opportunity for us.

Unidentified speaker

Question – Unidentified speaker: Okay, thanks very much.

Answer – Unidentified speaker: Thank you.

Operator

Your next question comes from the line of Andrew Bond of Jefferies.

Unidentified speaker

Question – Unidentified speaker: Good morning. Andrew Bond on the line for Owen Bennett, thank you for taking our questions, I understand it's late in the call so I'll keep it to one. Just around US strategy for Federal legalization, understanding the timing remains uncertain, we've seen several different approaches in transaction types from other LPs like optionality agreements and structured agreements for the MSOs as well CPG oriented brand place. Obviously, Organigram has shown great traction based on market share data so just curious what specifically you're thinking about as you develop an approach to the eventual US THC market? Thank you.

Answer – Unidentified speaker: Great, well thank you. So, we have been looking at the US market and obviously it's something that we -- I apologize, hold on for a second, sorry about that. So, we have looked at the US market and you know I don't believe necessarily that the options that some of our competitors have done is the right approach you know we know how significantly this market has changed over the course of two years and you know I'm not sure if you put in an option now, you know you're going to be getting in two years time given there is rapidly changing market dynamics. We as a company will continue to look at the market and track regulation changes to make sure that we understand when the opportunities really develop in the US for us.

We'll explore CBD offerings in the US and other adjacencies so those are things that we'll look at but we're going to do it when it's the right move for us, the short-term goal in the last six months has been to build out the foundation in our Canadian marketplace. We added EIC which got us into Gummies market very quickly. We have just added Laurentian, which bolsters our presence in Quebec and gets us both into craft flower and into concentrates in a bigger way with the Tremblant hash.

So, I think that was our priority. As we continue to look and as we have built out our base in Canada we will start to look. And I am not sure if the US is the first market, we will look outside of the US but we will look at expanding internationally as we see the right opportunities come for us.

Unidentified speaker

Question – Unidentified speaker: Great, thanks for that color. Congrats on the quarter.

Answer – Unidentified speaker: Thank you.

Operator

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

Unidentified speaker

Question – Unidentified speaker: Hi, good morning and thank you for taking my question, I keep to one. In terms of your market share, so you guys have a good momentum growing there but you know the markets are very competitive for demand, so just with going forward do you just expect to continue to gain share in the market, are there any target that you guys have in mind in terms of how much share you can take organically or you know you just expect that market share curve to kind of flatline until the market consolidates? Thanks.

Answer – Unidentified speaker: Thanks for the question. I think what we've said so far is obviously we're not taking full advantage of our SHRED offering because of our capacity constraints. So, we do believe as we build out our capacity there is more upside to gain on our SHRED as well as our Big Bag o' Buds so our 28-gram format. As we build out our capacity we do believe there is more market share to grab from those offerings, and we do have a derivatives business that we continue to build out. So, we have more offerings coming in our gummy lineup, we have yet to really see the full benefit of our new launch behind our Monjour brand. We have some new innovation on pre-rolls more dual pack coming out, and more vapes coming out which we are underdeveloped in the vape category but we have some new vapes coming out both under our SHRED brand and our Edison brand.

So, I think that the answer is we do think that there are opportunities to gain market share, and I'll also say that while Quebec is a challenging market to take a good read on because of the limited data coming out of that marketplace. We certainly believe we'll have a larger market share simply through the benefit of the acquisition of Laurentian.

Unidentified speaker

Question – Unidentified speaker: Great, thank you very much.

Operator

This concludes today's Q&A session. I will now turn the call back to Beena.

Thank you, everyone for listening this morning and thank you for some great questions. We're very excited about the momentum we have on the business and I look forward to updating you again soon. Thanks for joining the call.

Operator

Thank you for participating in today's call. You may now disconnect.