

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

APH.V - Q2 2019 Aphria Inc Earnings Call

EVENT DATE/TIME: JANUARY 11, 2019 / 2:00PM GMT



## CORPORATE PARTICIPANTS

**Carl A. Merton** *Aphria Inc. - CFO*

**Irwin D. Simon** *Aphria Inc. - Independent Chairman*

**Victor Neufeld** *Aphria Inc. - CEO & Director*

## CONFERENCE CALL PARTICIPANTS

**Graeme Kreindler** *Eight Capital, Research Division - Research Analyst*

**Martin Landry** *GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst*

**Matt Bottomley** *Canaccord Genuity Limited, Research Division - Analyst*

**Neal Gilmer** *Haywood Securities Inc., Research Division - Research Analyst of Special Situations*

**Noel John Atkinson** *Clarus Securities Inc., Research Division - VP & Research Analyst of Growth and Innovation*

**Oliver S. Rowe** *Scotiabank Global Banking and Markets, Research Division - Associate*

## PRESENTATION

### Operator

Good morning, good afternoon, and good evening. My name is Mary Alma, and I will be your conference operator today. At this time, I would like to welcome everyone to the Aphria Inc. Q2 Quarterly Investor's Call. (Operator Instructions)

Mr. Carl Merton, you may begin your conference.

---

### Carl A. Merton - Aphria Inc. - CFO

Thank you, Mary Alma, and good morning, everyone. Thank you for joining us to discuss our Q2 2019 financial results. With me on the call is Vic Neufeld, Chief Executive Officer of Aphria; and Irwin Simon, Chair of the Board, who is participating remotely.

Earlier today, we issued a news release summarizing our second quarter results. We have also filed our financial statements and MD&A for the 3- and 6-month periods on SEDAR and EDGAR. Each of these documents is also available on our website at [www.aphria.ca](http://www.aphria.ca).

Today's call is intended to give you more color about the results and to answer any questions that you may have. In discussing our financial and operating performance on this call and in responding to your questions, we may make forward-looking statements, including statements concerning Aphria's objectives, its strategies to achieve those objectives as well as statements with respect to management's beliefs, plans, estimates, intentions and similar statements concerning anticipated future results, circumstances and performances or expectations that are not historical facts.

These statements are based on our current estimates and assumptions and are subject to risks and uncertainties that could cause our actual results to differ materially from the conclusions in these forward-looking statements. The forward-looking statements in this discussion speak only as of today's date and we undertake no obligation to update or revise any of these statements.

Now, I would like to turn the call over to Vic Neufeld, Chief Executive Officer of Aphria.

---



**Victor Neufeld** - Aphria Inc. - CEO & Director

Thank you, Carl, and good morning and welcome to the Aphria analyst call. Before we get into the details regarding the quarter, I would like to touch on the executive transition that was also announced this morning. I, along with co-founder Cole Cacciavillani, today disclosed our intention to transition out of our roles at Aphria as part of an orderly succession process. The last 5 years, going from an idea and some greenhouses in Leamington, Ontario, to a global player in a major new industry have been an incredible journey for entrepreneurs like myself and Cole. But to be brutally honest, the journey has also taken a toll on health, family and personal priorities.

When the Canadian medical cannabis opened up 5 years ago, our idea was straightforward. We understood that cannabis was a natural product extension for the founder's decades of experience as greenhouse growers in Leamington.

Looking ahead to the next 5 years, Aphria has huge new opportunities driven by innovation, legalization and positive developments in the U.S. and across the globe. To realize these global opportunities, for the maximum benefit of Aphria's shareholders, customers, employees, it's clear to me and Cole that Aphria needs an equally globally minded executive leadership team to lead the company into the next chapter. As a result, Cole and I informed the board and they have agreed that we will begin the transition process and at the appropriate time we'll step down from our executive positions at Aphria.

The appointment of Irwin Simon as our new Independent Board Chair is a great addition to our leadership team that will drive continued growth and success for Aphria. Irwin is an impressive leader as well as an entrepreneur who has a passion for building teams and brands. He also understands the complexities and responsibilities of building a successful and competitive company for the benefit of shareholders. Irwin has requested that following the transition, Cole and I will continue to serve the company as special advisers to both him and the executive management team, ensuring a smooth transition of institutional experience and strategic advice.

I continue to have the greatest pride in what Aphria has achieved and its future has never looked brighter, from continued technology advancements to continued support of scientific developments to amazing adult-use brands, to globalization strategies and most of all, the hundreds of dedicated passionate Aphria team members that have joined Aphria. We are well positioned to be a dominant player. The Aphria team is second to none, and Cole and I are extremely proud of them in what they have been accomplished -- what they have accomplished in such a short time.

Before turning the subject of today's call, our Q2 operational results and our journey going forward, I want to provide a brief update on the progress of board committees relating to the short-sellers reports and the unsolicited proposal by Green Growth Brands. As we have previously announced, a special committee of the board comprised of independent directors continues to move forward with a comprehensive review of the allegations that were made relative to our recent acquisition of LATAM Holdings.

As a company and as a board, we are committed to protecting our shareholders and restoring market confidence by confirming all of the facts through an independent process. I can confirm that this special committee is making good progress, assisted by independent advisers and intends to fully address short-seller allegations.

As we wait for the special committee to finish its deliberate and thorough process, I would point out that multiple respected journalists and analysts have independently analyzed our disclosures and/or visited our Latin American subsidiaries, leading them to publicly refute the short-seller's allegations.

As for the unsolicited proposal from GGB, I'd like to remind listeners that: one, there is no active offer for the company and the proposal as presented was determined to significantly undervalue the company; and two, given the hostile nature of the proposal, our Board of Directors has established an independent committee of directors to consider proposals and any formal offers received.

As we have stated, the independent committee is comprised of directors with no relationship, either directly or indirectly to Green Growth Brands. Out of respect for the independence of both board committees, we will not be taking further questions relating to short-seller reports or recent media coverage of the unsolicited proposal by GGB.

With that preamble behind me, I'd like to dive into Aphria's operational results and strategic progress in Q2 as we continue to strengthen our position as a premier supplier of medical and adult-use cannabis to the Canadian market.

It was a momentous quarter for us with the legalization of the adult-use market last October in Canada. It was also an opportunity to prove the strength of our strong team, brands, supply and distribution capabilities. In the end, strong execution in the first partial quarter of adult-use helped drive 63% quarter-over-quarter net revenue growth. We also maintained our sales to the medical market as substantial numbers of medical patients remained with us likely as a result of the product shortages at the provincial retail sales level.

Adjusted gross profit rose significantly to over \$10 million in the quarter. Adjusted gross margins declined as expected for 2 reasons. Our average selling price was lower, reflecting lower effective selling prices in the adult-use market compared to medical use. In addition, we had temporarily lower yields and higher production costs as we moved aggressively to build-out production facilities and implement new automation processes.

As we have discussed in the past, a top priority for the company is expanding production and automation to secure long-term cost and scale advantages. Our Part IV and Part V expansions of Aphria One are now complete, adding 800,000 square feet of greenhouse capacity and 150,000 feet of infrastructure space, all awaiting Health Canada approval.

In addition, we have submitted an application for cultivation license at Aphria Diamond, which represents an additional 1.3 million square feet of greenhouse growing capacity and 200,000 square feet of infrastructure. Based on this, we now expect to generate first sales from these new facilities later in the calendar year, pending Health Canada approvals.

By the end of calendar 2019, our annualized harvest should reach 255,000 kilograms with long-term improvements in cost efficiencies and quality. Last quarter, we also positioned the company for long-term growth in key global markets, announcing multiple strategic alliances, targeted investments and disciplined acquisitions.

We are excited to have just closed the previously announced acquisition of CC Pharma based in Germany, which distributes pharmaceuticals and medical cannabis to over 13,000 pharmacies in Germany. This transaction positions Aphria to be a leading player in the European medical cannabis market.

Other developments include signing letters of intent to expand our strategic operations and cultivation of cannabis in Argentina and to supply medical cannabis in Paraguay. We also expanded our partnership to introduce Rapid Dose Therapeutics' innovative QuickStrip oral strips to the German market.

We also remain very optimistic about continued progress with our acquisitions of highly strategic licenses and operations in Latin America and the Caribbean's most attractive emerging cannabis markets, including Columbia, Argentina and Jamaica.

In both the medical and adult-use markets, consumer-centric innovation remains a commitment and focus for Aphria. What is important to note as consumer demand will drive innovation is the concept of cannabis as an ingredient. Aphria is positioned to be a leader in the advanced oil extraction methods to allow for oil-fractionated distillates and crystallites. Our R&D team is most skilled in creating cannabis-infused products and have demonstrated R&D's success and soon on a commercial basis.

Aphria is well positioned to take full advantage of our massive cultivation strength, investments in automation and low-cost producer status, advanced oil extraction capabilities, recently launched adult-use brands and capabilities of bringing to market oil-infused products that consumers are expecting, including foods, confectionery, beverages and even pet care.

Lastly, a strong foundation is critical to sustaining Aphria's leadership in the global cannabis market and delivering long-term profitable growth. To that end, we finished the quarter with a strong balance sheet and sufficient capital to fund our previously announced plans internationally. We also have strength in our leadership team and as I just described, appointed a new independent Chairman to our Board of Directors as we continue to focus on driving value for our shareholders.



In conclusion, it's business as usual at Aphria. Our journey, regardless of the external noises, is based on sound and solid strength built to last.

**Carl A. Merton** - *Aphria Inc. - CFO*

Our Q2 2019 results offer investors a first look at Aphria's operations in a legalized Canadian market that serves both our traditional medical-use customers as well as new adult-use recreational customers, which until now have been serviced solely by illicit suppliers. These are very early days for all licensed producers as we adapt our cultivation, production, distribution and marketing operations to this new environment. This makes the comparability of an individual company's results between quarters challenging, and between licensed producers even more so.

We've enhanced the disclosure in this quarter's MD&A to try and help investors better understand Aphria's current financial performance by isolating factors that we believe diminish in influence as our operations normalize.

Currently, as Vic previously noted, Aphria is in the process of increasing our production capacity from 35,000 kilos per year to more than 250,000 kilos per year through expansions at Aphria One and Aphria Diamond and in addition to the expanded processing capability from our new extraction center of excellence.

Previously, our public comments indicated that we expected to record our first sale from our Part IV and Part V expansions at Aphria One and Aphria Diamond in January of this year, subject to receiving the necessary approvals of license amendments from Health Canada. As these approvals are still pending, we need to update this outlook.

While the license amendment has been submitted for Aphria One and the license application has been submitted for Aphria Diamond, these applications are still making their way through the backlog at Health Canada, where staff are working diligently to bring more legalized supply online. Once they are licensed, we expect to see the first sale of product grown in the expanded facilities within 14 -- within 12 to 14 weeks thereafter.

We are building an inventory of mother and vegetative plants to allow us to immediately commence cultivation once the approvals are received. This will allow us to bring the expanded facility up to optimal capacity within 6 months of receiving Health Canada's approval. Once they are in full crop rotation, these expanded facilities are expected to reinforce Aphria's positioning as an industry-leading, large-scale, low-cost producer of high-quality cannabis.

Health Canada knows that bringing expanded production capacity online will have a meaningful impact on alleviating supply shortages that consumers have been experiencing since the legal market opened last October.

We have the greenhouse space, the cultivation expertise, the automation technology and the raw materials to help solve this supply imbalance. We just need the greenlight to go.

In the interim, however, the scaling of these facilities will cause distortions in our financial results. And where this is happening, we call this out in our MD&A, so investors can be better informed.

My comments this morning will distinguish between results that are attributable to our Canadian cannabis operations, which we previously referred to as ACMPR operations and results attributable to international operations, including Aphria International and LATAM. The organization charts on Page 4 and Page 9 of the MD&A help to illustrate the composition of these segments.

Let me begin with an overview of some key milestones for our Canadian operations during the quarter. After investing SG&A dollars to develop brands in advance of the implementation of the Cannabis Act and enhancing our commercial packaging requirements to meet demands of the market, we introduced 5 adult-use brands to the Canadian market, fulfilling orders to 10 provinces and 1 territory.

As Vic described, we completed Part IV and Part V expansions at Aphria One as well as the retrofit of Aphria Diamond. We filed final license amendment for Aphria One and the final initial license application for Aphria Diamond.



In our export business, we successfully made multiple international shipments. We also invested in and signed a licensing/supply agreement with Rapid Dose Therapeutics for the development of a quick dose, dissolvable, strip delivery system in Canada and Germany.

Our international operations also made significant progress. We added to our comprehensive German strategy, addressing each facet of the business, namely demand, supply and distribution, including acquiring CC Pharma, as Vic described, and we announced earlier this week.

In Europe and Lesotho, we continued construction of EU GMP oil processing facilities. We advanced the early stages of our European CBD strategy. We also engaged in preliminary activities in 4 other European countries.

In Latin America and the Caribbean, we closed the acquisition of LATAM Holdings. Subsequently, we purchased additional adjacent land in Columbia. We generated over \$1 million in sales in Argentina since the acquisition. We completed the next harvest at the cultivation site and also continued the build-out of herb houses in Jamaica.

In Australia, we had a monumental quarter for Althea Group Holdings. The company received its manufacturer's license for cannabis from the Office of Drug Control, Australia and successfully launched its industry-leading patient and physician education platform, Althea Concierge. The company also successfully completed its IPO on the Australian Stock exchange in September.

Moving to our financial results. As expected, revenue significantly increased in Q2 over the previous period as sales to the adult-use recreational market had their first impact on our reported results following the legalization of this market at the midpoint of the period on October 17. Net revenue, after the payment of excise taxes, increased by 63% in Q2 to \$21.7 million versus \$13.3 million in the previous 3-month period. Included in revenue in the quarter was \$2.2 million attributable to noncannabis sales in Canada and international markets, including \$1.1 million of revenue attributable to ABP S.A. pharmaceutical sales in Argentina since our acquisition on September 27.

The company sold 3.4 million gram equivalents of cannabis in Q2, up 92% over the previous period, when 1.8 million gram equivalents were sold. The domestic adult-use recreational market accounted for 1.9 million gram equivalents or 57% of the volume sold during the period. The domestic medical market accounted for 1.5 million gram equivalents or 43% of the volume. Also as expected, because of the significant increase in volume sold to the adult-use wholesale market at a lower average selling price in Q2, the company's reported average selling price per gram, including excise tax, declined to 6.5 -- sorry, to \$6.54 in Q2 from \$7.12 in the previous quarter. The company's average selling price for the 1.9 million gram equivalents sold to the adult-use market in Q2 was \$6.32 per gram including excise tax versus \$7.51 per gram also including excise tax, for the remaining 1.5 million gram equivalents sold to the medical and wholesale markets.

Production costs, which include both the cost to produce cannabis and other noncannabis-related cost of sales increased in Q2 to \$10 million from \$4.4 million in the previous quarter. The increased production costs partly reflect preparations for the ramping up of production upon obtaining Health Canada approval at the company's expanded and highly automated facilities at Aphria One. These preparations included allocating additional space at Part III of Aphria One to mother and vegetative plants required for the Part IV and Part V expansions. They also included adapting production to a new growing method to produce the plant uniformity and size required for the automated industrial-scale harvesting being incorporated in the expanded facilities. When fully operational, this new growing method is expected to result in similar yields per square foot from a number of -- a larger number of smaller plants with the added benefit of increased potency. However, in the interim, this resulted in a temporary reduction in yields from Aphria One Part III during the quarter.

The preparations for production ramping also contributed to an increase in the adjusted all-in cost of sales of dried cannabis in Q2 to \$8.9 million or \$2.60 per gram versus \$3.3 million or \$1.83 per gram in the previous quarter. These all-in costs include packaging costs, which increased to \$0.55 per gram of dried cannabis in Q2 versus \$0.24 per gram of dried cannabis in the previous period. The increased packaging costs per gram are attributable to the higher packaging costs incurred in both the material and labor costs associated with packaging for the adult-use market versus the medical-use market. As a result, packaging costs per gram are expected to increase in the near term as the company's product mix continues to shift in favor of the adult-use segment. However, these higher packaging costs are expected to be partially offset by efficiency gains attributable to increased automation in future quarters.

Excluding amortization and packaging costs, the cash cost to produce dried cannabis per gram was \$1.76 in Q2 versus \$1.30 in the previous period. The allocation of additional production space at Aphria One in preparation for Part IV and Part V expansion and the temporary yield reduction contributed \$0.20 and \$0.48 respectively to both the increased all-in cost of sales of dried cannabis per gram and the cash cost to produce dried cannabis per gram in Q2 over the previous period.

Adjusted gross profit, which excludes the noncash fair value adjustments required by IFRS, increased to \$10.1 million in Q2 from \$8.5 million in the previous quarter. Adjusted gross margin was 46.9% of revenue in Q2 versus 63.6% of net revenue in the previous period, reflecting both the reduced average selling price per gram as we transition to a wholesale model for the adult-use market, the impact of the temporary increase in production costs and decrease in yields as previously mentioned.

As it relates to SG&A costs, the company experienced improved operating leverage in Q2 with SG&A costs increasing to \$27.5 million, but decreasing to 127% of net revenue during the period versus slightly lower SG&A costs of \$24.1 million, representing 181% of net revenue in the previous period. The increase in SG&A costs in the quarter were almost entirely related to increased brand development, advertising and promotion associated with the introduction of our adult-use brands prior to the Cannabis Act's effective date and the commission costs associated with our distribution agreement with Great North Distributors, the Canadian subsidiary of Southern Glazer's.

As in the previous period, net operating items had a significant impact on net income, adding \$84.2 million to the bottom line in Q2 versus a contribution of \$35.5 million in the previous period. For example, during the period, the company reported a gain from equity investees of \$46.9 million and a gain on long-term investments of \$30.5 million, which were primarily related to the divestiture of our investments in Hiku Brands and Liberty Health Sciences. In the previous period, the company reported a \$9.9 million gain on the sale of equity investees and a gain on long-term investments of \$22.7 million. Including these nonoperating items, the company reported net income of \$54.8 million or \$0.22 per share in Q2 versus reported income of \$21.2 million or \$0.09 per share in the previous period.

Adjusted EBITDA neutralizes the impact of those nonoperating items as well as income taxes, amortization and share-based compensation among other items. The adjusted EBITDA loss for the period was \$9.5 million, comprised of adjusted EBITDA loss from Canadian cannabis operations, formerly called ACMPR operations, of \$6.1 million and adjusted EBITDA loss from Aphria International of \$3.4 million.

In the previous quarter, the company reported adjusted EBITDA loss of \$3.4 million comprised of adjusted EBITDA loss from ACMPR operations of \$0.8 million and adjusted EBITDA loss from Aphria International of \$3.2 million (sic) [\$3.1 million]. The increase in the adjusted EBITDA loss is primarily attributable to the previously mentioned planned decrease in product yield as well as higher labor costs across the entire company to support the company's growth to industrial-scale production volumes.

Moving to liquidity. As at November 30, 2018, the company had near cash of \$184.8 million available for deployment in its Canadian operations and international activities. During the quarter, the company invested \$4.9 million on maintenance CapEx and \$50.7 million on growth CapEx.

Mary Alma, that concludes our formal remarks. Vic and I would now be pleased to respond to analyst questions.

---

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from Oliver Rowe with Scotiabank.

---

**Oliver S. Rowe** - Scotiabank Global Banking and Markets, Research Division - Associate

So there's a disconnect between the underlying cost of obtaining international licenses and the cost to acquire companies with international licenses. Could you reconcile that delta for us and about how you think about license-based acquisitions and why that delta exists?





---

**Victor Neufeld** - *Aphria Inc. - CEO & Director*

Yes. Oliver, when we look at penetration of other markets outside of Canada, we look at the population, we look at their departments or ministries of health. We look at what chronic conditions are in need of alternate medical assistance called cannabis, specifically CBD oil. So if I could just use as, by way of an example, Argentina. It was very simple for us. Population, all of the metrics fit our metrics of looking and investigating into a market. Epileptic seizure control, we had an ideal product called our Rideau oil, high CBD. That was a great transition away from Charlotte's Web, where a lot of Argentinians were flying to the U.S. to acquire that product and bringing it back illegally. We met with the Ministry of Health, the Ministry of Agricultural, all of the right metrics and what we've learned and what they wanted to proceed with was opportunistic for Aphria to move forward in a more meaningful way in terms of penetrating. In that particular country though, the license was not an in-country cultivation. They have made progress since then. But at the time, it was an import license, almost a permit through a pharma distributor, which eventually what we acquired was ABP. So Oliver, there is -- from time to time, it will be a hard number to understand when you acquire licenses, it's not the immediacy rather what is the long-term win and does it fit the Aphria definition of medical cannabis and Argentina was the example I cite.

---

**Carl A. Merton** - *Aphria Inc. - CFO*

So I think if I could just add to that answer. I think one of the other important things once you get past the fact situations, if you step back a little bit to a more general view of the question. The big difference between going to a country yourself and starting the process up and acquire -- and building that license versus acquiring it is the risk and the capital costs associated with it. When you're doing, like Vic said, and moving into a country that hasn't formally adopted this process yet and you're dealing with GR and IR expenses to build awareness in the country, when you're going out and acquiring land and taking the time to build that license from scratch, there is a significant amount of risk and expenses that would end up sitting on your income statement. And acquiring those licenses after it's already been developed removes a lot of that risk from the equation.

---

**Oliver S. Rowe** - *Scotiabank Global Banking and Markets, Research Division - Associate*

So switching to Canada, how confident are you in that new end of calendar 2019 as the new date for full capacity and will that -- will the license delays impact your ability to utilize the extraction facility and by extension, impact putting new formats into the recreational market later this year?

---

**Victor Neufeld** - *Aphria Inc. - CEO & Director*

So Oliver, as a placeholder, Health Canada is greatly backlogged. They are working as best they can. They've been great partners. But at the same time, there are many, many license applications, license amendments sitting on their desks. So this is not a slam against Health Canada. It's just we were not -- we as an entire industry were not fully prepared for the onslaught. And it's just not license for cultivation, it's for processing and it's for many other things that under the old ACMPR are required. We are expecting -- I'm not going to give a date, but we are expecting in a timely fashion approval for Part IV. And as Carl said, it's probably a 14-week lag time from seed-to-sale, ready for shipment. We have great pent-up demand. We are impatiently waiting, but we are waiting. So to answer your question, we are confident that Health Canada will eventually move our file through the system. I know the growers are building the mothers, the stock plant that's necessary to begin the journey of cuttings, wedge, flowering and oil extraction into whether it's an infused product between now and October 17, we'll know more. But we are confident that by the end of 2019, our run rate will be north at/or exceeding 255,000 kilos annualized.

---

**Oliver S. Rowe** - *Scotiabank Global Banking and Markets, Research Division - Associate*

Great. Last one for me. So I understand your Broken Coast expansion is under review. What happened to the initial expansion plan? How is that operation doing in general? I mean, the market wants more Broken Coast products, so will you be able to give it to them?





**Carl A. Merton** - Aphria Inc. - CFO

So when we bought Broken Coast, the original expansion plans were tied to the original property and Broken Coast is effectively land locked. And in order to build the expansion, they were looking to build, they were basically building a skyscraper, and we just -- after reviewing those plans, we determined it was not an appropriate commercial way to grow cannabis and the process within the facility. So we are looking for an appropriate piece of land to then resume those expansions.

---

**Operator**

Your next question comes from the line of Noel Atkinson with Clarus Securities.

---

**Noel John Atkinson** - Clarus Securities Inc., Research Division - VP & Research Analyst of Growth and Innovation

First, I was wondering if you could comment at all about the purchase order trends for you folks during the November quarter? And how your ability to supply their demands migrated or improved during the quarter and if there's anything you can talk about since the end of the quarter, that would be helpful as well.

---

**Victor Neufeld** - Aphria Inc. - CEO & Director

So the answer is twofold, Noel. And thanks for the question. On the medical platform front, we continue to onboard consistently as we have for a long time there. Whether it is true medical script patients coming or those that may want to migrate to the rec world one day, the medical platform continues to hit. And we are first and foremost making sure that those patients in need with the specific genetics are being attended to. On the recreational side, on the adult-use, like it has been expressed many a time in the media, the entire industry has not met the expectations of provincial regulators. We were very well positioned with every province. We continue to have some very good relationships in whether it's brick-and-mortar on certain stores and certain provinces or online. Our failure as an industry is being worked on. I don't want to reinvent and go back and talk about supply chain issues in late summer and early fall, but many of those have now been worked out. We as an industry are slowly getting to the point where we can be the best partners that every provincial regulator wants us to be. It continues to have great support by consumers, whether it is our Solei, it's our RIFF, it's our Good Supply, it's Broken Coast. We just need a little more time to get our yields to where they're supposed to be. And in turn, what we've described many a time, in its Part IV full automation, so that we can be the best partners. And at that point in time, we'll then address what happens to the pricing of rec brand to products on the shelves.

---

**Noel John Atkinson** - Clarus Securities Inc., Research Division - VP & Research Analyst of Growth and Innovation

Can you give us a sense of the amount of dried cannabis to harvest that you achieved in the quarter?

---

**Carl A. Merton** - Aphria Inc. - CFO

We'll get that for you off-line, Noel.

---

**Noel John Atkinson** - Clarus Securities Inc., Research Division - VP & Research Analyst of Growth and Innovation

Okay, cool. And then -- okay. So switching to CC Pharma, congratulations on the acquisition there. Can we expect the core operations to sustain the 2018 run rate for revenue and adjusted EBITDA?



**Carl A. Merton** - *Aphria Inc. - CFO*

We -- that's our belief, yes. That market continues to move forward. The business has been very careful about how it -- how much product it buys. That business is largely a turns-based business and has taken appropriate steps to both maximize revenue and EBITDA over the long term.

**Noel John Atkinson** - *Clarus Securities Inc., Research Division - VP & Research Analyst of Growth and Innovation*

Okay. And then there was a bit of a difference in terms of the amount of cash paid at closing. It was about EUR 5.6 million less than the initial announcement -- press release. So what was the difference there?

**Carl A. Merton** - *Aphria Inc. - CFO*

The deal was cash free, debt free and we agreed to leave \$5 million (sic) [EUR 5 million] of debt inside the organization. Sorry, I said dollars, I meant euros.

**Operator**

Your next question comes from Neal Gilmer with Haywood Securities.

**Neal Gilmer** - *Haywood Securities Inc., Research Division - Research Analyst of Special Situations*

Carl, maybe I'll start with you. We just heard a bunch of numbers there in your prepared remarks, and I know some of them are in the MD&A. But just maybe on the cost of production, can you sort of give us a sense of -- there's a number of moving factors, I understand that, but are we -- are you expecting the cost of per gram sort of to continue to increase because of those packaging costs you mentioned sort of in the next quarter and then start to taper off as you start to see the benefits of Part IV, obviously, assuming Health Canada is approved by then?

**Carl A. Merton** - *Aphria Inc. - CFO*

Short answer is yes. The longer answer is that the packaging costs for rec are higher than they are for the medical -- for a medical stream. And so as adult use increases, those packaging costs will increase as a result of that total equation. It's not going to be hugely material because we basically had about 9 to 10 weeks of adult-use sales in the 13 weeks of the quarter. But we -- I do anticipate that, that number is going to go up slightly. And then as Part IV and Part V are approved by Health Canada and the packaging equipment and the packaging lines that are associated with that are approved, we'll be able to leverage that back down below the level where we're at today in the quarters that follow after that. But we do anticipate with the current requirements in the Cannabis Act that are requiring us to put so much information on the label that we will have to continue to have larger amounts of packaging than are necessary in the medical -- on the medical side.

**Neal Gilmer** - *Haywood Securities Inc., Research Division - Research Analyst of Special Situations*

Okay. That's helpful. And I believe in the MD&As, you stated that you sort of expect these costs to sort of be a little bit elevated for a period of about 9 months and then you'll basically be realizing the full benefits, so we're looking at, sort of, I guess, by the end of this year that we'll see. Is it fair to assume that we'll see the cost of production decline down towards levels where you achieved previously when you were just dealing with the medical market?



**Carl A. Merton** - *Aphria Inc. - CFO*

Yes. I mean -- so you're talking specifically about the all-in cost to produce and the cash cost to produce. Yes, we see those going down over the first-- in the first 6 months, you're getting full crop rotation into the facilities and then 1 quarter after that to really tweak the operations and that's where we believe you'll really see those -- the full benefit of what we're capable with the scale that we've built.

**Neal Gilmer** - *Haywood Securities Inc., Research Division - Research Analyst of Special Situations*

Okay. That's helpful. Is it possible for you to just sort of give us an idea on sort of CapEx that is remaining, say, in fiscal 2019. Obviously, we went through what you spent on CapEx and maintenance CapEx in Q2. And what are we looking for as far as cash outflows over the balance of the 2 quarters in this fiscal year?

**Carl A. Merton** - *Aphria Inc. - CFO*

So the commitment notes inside the financial statements provide the outstanding PO number, which is \$81.5 (sic) [\$81,515]. We anticipate all of that will go out in the current calendar year.

**Neal Gilmer** - *Haywood Securities Inc., Research Division - Research Analyst of Special Situations*

Okay. And then even in the couple of quarters -- pardon me?

**Carl A. Merton** - *Aphria Inc. - CFO*

[

That was calendar, not fiscal.

**Neal Gilmer** - *Haywood Securities Inc., Research Division - Research Analyst of Special Situations*

Okay. Okay. I think there's a couple of calls ago, you basically sort of walked us through going from positive EBITDA transitioning into negative EBITDA for the first, I think, it was few quarters as you ramp up into this adult-use market. Do you have -- are you in a position where you can comment on visibility with respect to when you think that that swings back into the positive column over the next couple of quarters?

**Carl A. Merton** - *Aphria Inc. - CFO*

So when we said it previously, we were doing it on the basis of our assumed license receipt and that first sale would happen in January and we gave ourselves one -- the end of the first full quarter after we had first sale as to be the quarter that we would revert to -- revert back to positive EBITDA. That premise still stands. It's just the unknown of when we receive Health Canada's license. And so when we receive our licenses from Health Canada, we will press release them, so that everyone knows and understands. And we've given effectively guidance this quarter in terms of how long it will take us to incur those first sales, how long it will take us to get full crop rotation and then how much to see the EBITDA numbers move back in line with where -- what our previous results were. If you look at the EBITDA loss today, it's largely driven by not only the change in yield, but more importantly the investments we have made in people to help us produce at industrial scale levels and we needed those people in advance of actually producing at those levels, so that we're ready as soon as those license receipts come in.

**Operator**

Your next question comes from Martin Landry with GMP Securities.

---

**Martin Landry** - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

My first question is on the licensing delays. I don't want to beat this up to death, but I just want to understand, is it a -- did you get an answer from Health Canada asking to fix some issues? Or is it just the fact that they haven't come to visit your site yet?

---

**Carl A. Merton** - Aphria Inc. - CFO

They haven't come to visit the site for the license amendments yet.

---

**Martin Landry** - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

Okay. Okay. And has there been any progress made in the last weeks that could point signs that the file's accelerating?

---

**Carl A. Merton** - Aphria Inc. - CFO

I don't -- I'm not aware of any questions that we've been asked that would point to that. I'm not sure really what sign you would get from that in the first place, but...

---

**Martin Landry** - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

Okay. Okay. And second question would be to the new Chairman, Mr. Simon. Wondering if you could discuss your decision to join Aphria. More color on what motivated your decision would be helpful.

---

**Irwin D. Simon** - Aphria Inc. - Independent Chairman

Can you hear me? Hello?

---

**Martin Landry** - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

Yes, we can.

---

**Victor Neufeld** - Aphria Inc. - CEO & Director

Yes.

---

**Irwin D. Simon** - Aphria Inc. - Independent Chairman

Okay. Number one, I have always been interested in the cannabis world. As I said earlier, this reminds me of an industry -- of a natural organic industry that I got into and started in 25 years ago and was fortunate enough to build a \$3.5 billion company around brands and products on a global basis.

I spent the last 2 days in Leamington at Aphria. I was blown away by the facilities, what has been built there and I have traveled all around the world, have seen a lot of operations, improved personal care and other businesses. And I got to tell you, I've never seen an operation that has been built around Aphria. So I see the opportunity to build on the rec side, the medical side, ingredient side and brand. And what they have been building and buying around the world and building a global basis, I think it's one of the hottest categories in the industry, so that's why I decided to join.



**Martin Landry** - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

Okay. And is there a project or something that you want to tackle early on?

**Irwin D. Simon** - Aphria Inc. - Independent Chairman

I would say this here. There is no business out there, there's one project. There is many projects. And my philosophy in life is juggle 13 balls, there's 3 or 4 red balls that never drop and make sure you're juggling all the other balls. So there is no one project, there's multiple projects.

**Operator**

Your next question comes from Matt Bottomley with Canaccord.

**Matt Bottomley** - Canaccord Genuity Limited, Research Division - Analyst

Just wanted to touchback on the revenue line again. Maybe just looking at more on the medical side of things. What are you seeing industry wide when it comes to -- I understand there's continued patient registrations. But in terms of actual throughput sales, it looks like a lot of license producers including yourself have had a sequential flat or declining line when it comes to the medical side of things. Any guidance you can give on that part of the revenue stream as we head into 2019 here.

**Victor Neufeld** - Aphria Inc. - CEO & Director

Yes. Thanks, Matt, for the call -- question. Listen, on the medical side, we had envisioned, we expected some cannibalization erosion post October 17. We haven't seen any significant shifting on that basis. So I think there's still a lot of existing and new patients onboarding for a number of reasons, probably their frustrations of not finding their product in the rec world, Ontario being half of the marketplace with no brick-and-mortar. So the convenience of maintaining their license-producer affiliation continues. What we, as a number of other licensed producers have undertaken, because of the tax status, the \$1 per gram excise that even though we tried to lobby hard against it was not successful. The pocketbook of a patient cannot be ignored. So we obligated that we would now take that \$1 per gram as a hit from gross to net sales as well as a number of other licensed producers. So on a revenue basis, where we were on average \$8.5 a gram, on a net basis now we're at \$7.50. So I'm not saying that's price erosion, Matt. It's simply listening to our patients, really considering their motivations of purchasing for their medical reasons and being the best licensed producer partner we can. We have no visibility -- I would also say, today we have no concerns, where there will be a significant migration away from the medical platform. It is here for the last 4 years and change. It will continue to be here.

**Matt Bottomley** - Canaccord Genuity Limited, Research Division - Analyst

Okay. Maybe just shifting to the recreational side of things. I know you touched on it briefly already on the call, but the 1,900 kilograms that you sold to the rec market, is it fair to say that if you prorate that just for roughly the 2 to 3 months that the rec market was online with maybe some incremental quarter-over-quarter growth, is that the best way to look at what The Street and investors should anticipate for your recreational volumes over the next quarter or so?

**Carl A. Merton** - Aphria Inc. - CFO

It's not a bad start, Matt. I think one of the important things that has to be looked at is that in the initial orders from the control boards, there has been a heavy, heavy focus on flower. And our anticipation is that over time that will move more and more to oil and to concentrates. Now there's a number of changes that have to happen for that to occur, but we've also gotten into a situation where there is product shortages. And so the

control boards have -- are relooking at that decision. And as they relook at that decision and have an increased willingness to stock more oil products, you would see sequential growth on top of that.

---

**Victor Neufeld** - Aphria Inc. - CEO & Director

Yes. If I could add -- again, addressing this issue weekly with Jakob, our President, it is very apparent to us that what the objectives were on October 17 and where the industry did not meet its end of the bargain with provincial regulators is supplying not just quantity, but the right SKU listings, the right genetics, Indica, Sativa, balanced THC, CBDs. I'm going to suggest to you that as we continue to move forward with our expansion and growing our genetic base, I think we have over 10 new genetics waiting in mothers for Health Canada approval. This is what consumers are demanding and in turn this is what the provincial regulators are looking to licensed producers to supply. We will be there. The demand has not gone away. They stay underground. It is a huge volcano ready to erupt once Aphria and hopefully a few other licensed producers can really come to the table with sustainable, consistent, quality genetics that the consumer is demanding. Now, between now and October, we know that Health Canada has asked for input, what are the ongoing product extensions? Will vape pens come to the table? Will certain infused foods come to the table? That is when this market really takes the underground consumer and brings them aboveground, and that's what we're all working toward. At Aphria, as I've already shared, we are well down the path. We have got it nailed when it comes to R&D. We are now working on our commercial activities to make sure that cannabis as an ingredient will be there. We are very well positioned.

---

**Matt Bottomley** - Canaccord Genuity Limited, Research Division - Analyst

Great, appreciate that. Just last question for me. I know you guys already said and I expect you to comment on the short report on the call. I'm just wondering if there's any anticipation, just goalpost whether it's days, weeks or months, where you're anticipating the results from the independent committee's review?

---

**Victor Neufeld** - Aphria Inc. - CEO & Director

Again, not getting in the way and not standing in the way and being very supportive of the special committee, it's taken longer than many of us, I'm sure every caller attending this analyst call. It is what it is. There is a lot of work, very thorough. There is a lot of false, misleading allegations that need to be addressed properly with third-party corroboration. There will be findings. If I had to guess, which I don't want to, it's not days, but it will take a bit longer than that.

---

**Operator**

Your next question comes from Graeme Kreindler with Eight Capital.

---

**Graeme Kreindler** - Eight Capital, Research Division - Research Analyst

Just a questions here, on the average selling price, understanding why it will come down with adult use, but is there potential for it to possibly creep up in subsequent quarters, considering that we're in an undersupplied market on the rec side?

---

**Victor Neufeld** - Aphria Inc. - CEO & Director

I think every province has their own objectives. I know one province in specific has a target retail price point to flood their underground economy. They are looking to the industry. They are looking to Aphria as a leader to one day come to the table and really hit their sweet spot when it comes to the retail price per gram and we are not there yet. So our average blended across all of the SKUs is still a bit above \$5 a gram. That's high. They have commented several times back to the entire industry, we need you to be better partners when it comes to the pricing. We have our own

objectives in mind. Now moving forward, if vape pens and other infused products become available to consumers, there is a huge pent-up demand underground. I've heard numbers like \$1 billion underground annually just in vape pens.

When you start moving up the chain of disruptable products and moving into areas where consumers are driving the bus, regulators are listening, licensed producers are listening and Health Canada, hopefully, one day will allow us to move towards that end of the pendulum. That now brings premium positioning and premium pricing and better margins. So the journey today, as Health Canada's approved form of product sales, you are looking at that same \$5 per gram today -- a year from today with the execution of capacity growth as press released by many licensed producers, if they do cross the finish line and you're going to see a significant supply come to the table, yes, that's where price compression could perhaps be brought to the table. That's good for the consumers, that's good for the provincial regulators and those licensed producers that come to that sort of understanding with regulators will own the shelf.

---

**Graeme Kreindler** - *Eight Capital, Research Division - Research Analyst*

Okay. Great. And just another question here. With respect to succession plan, I just don't understand the structure of how that's going to work. Is there a committee being formed that's going to look at possible candidates? Have you already started looking at any candidates? Just to get some more clarity on that side.

---

**Irwin D. Simon** - *Aphria Inc. - Independent Chairman*

Vic, you up. You want me get to that?

---

**Victor Neufeld** - *Aphria Inc. - CEO & Director*

Yes. Irwin, let me just kind of layout the land and I'll let you take over. This decision that was part of our press release, it was Cole and I having a lot of back and forth understandings of what is best for this company. We have brought in a team. We have developed a solid management team led by Jakob. I can go down the whole list of talented leaders. It was just time for us to move aside. This has nothing to do with the short-seller's report, the review, the valuation of assets. It was a matter of -- it was time. And I'm speaking for Cole too. But it has -- we are leaving eventually. Once Irwin and I sit down and start to navigate what are the strengths, what are the parameters? Who, what, where, when. None of that has been discussed. There are no preconceived ideas in an internal and external search, all of that will happen in time. But what we cannot lose sight of is managing our business today and tomorrow. I think as you heard in my beginning remarks, there are so many opportunities for a dynamic, committed passionate team to move forward. So with that, I'll hand the phone call over to Irwin.

---

**Irwin D. Simon** - *Aphria Inc. - Independent Chairman*

Just on that, as we said, there will be a transition. There has been no committee put in place first. We will work with Vic, Cole. We have an excellent President on hand today, Jakob. And we will evaluate the strategic planning going forward and the succession plan. So right now, it's business as usual and continuity with Vic, Cole and Jakob.

---

**Operator**

There are no further questions at this time. I will now turn the call back over to Irwin Simon, Chair of the Board, for closing remarks.

---

**Irwin D. Simon** - *Aphria Inc. - Independent Chairman*

Thank you very much for today's call, my first call. And with that, I want to -- as I said before, I spent the last 2 days at the facility and I was very, very impressed of what has been built and what is there. And I'm very impressed with the team that is in place. I'm very impressed with the strategy.



And I have never seen an opportunity in an industry that is growing like the cannabis industry around the world to execute and what the DNA of Aphria is to execute upon. I have been an entrepreneur myself, running a public company for 25.5 years. I will bring a lot of those experience to Aphria, building around good fundamentals, good corporate governance, good processes and having a real strategic plan that we will execute upon.

Vic and Cole have talked about decisions. When I met with Vic a few weeks ago, he talked to me about his decision. And they are consummate entrepreneurs, and the Aphria dream would not have become a reality without them. And I must tell you, it is really a great outcome of the dream and what they've put in place. During this transition period, we're going to work hard to benefit from their mentorship. I'm going to work hard to learn a lot from them and their experience in this industry. I wish to clarify that the announcement, as I said before, of the transition of Cole and Vic was planned. In one of my first conversations with Vic, he brought that up. It has nothing to do with the work that the special committee is doing. During the phase, as I said, I will look to rely on Vic and Jakob and Cole to bring into focus the strategic plan to build around rec, medical, ingredients and brands and the licenses that we own around the world to date -- the licenses that we own around the world. The Aphria team will move forward quickly. And I must tell you, there is an incredible team in place behind Vic, Cole and John.

With that, I want to thank you for your time this morning.

---

#### Operator

This concludes today's conference call. You may now disconnect.

---

#### DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.