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HEXO.TO - Q3 2019 Hexo Corp Earnings Call

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## PRESENTATION

### Operator

Good morning, and welcome to HEXO Corp.'s Third Quarter Fiscal 2019 Earnings Call. (Operator Instructions) Please note that this call is being recorded today, June 13, 2019, at 8:30 a.m. Eastern Time.

I would now like to turn the call over to Jennifer Smith, Director of Investor Relations at HEXO Corp.

Ms. Smith, you may proceed.

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### Jennifer Smith - HEXO Corp. - Manager of Financial Reporting & IR

Good morning, everyone, and welcome to HEXO's Third Quarter Earnings Call. We will start with the presentation by our CEO, Sebastien St-Louis, who will recap the company's third quarter results, the recently completed acquisition of Newstrike Brands Limited and our financial outlook before opening the floor to questions from financial analysts.

Before we begin, I would like to remind you that today's presentation contains forward-looking information that involves known and unknown risks and uncertainties and other factors that could cause actual events to differ materially from current expectations. These statements should not be read as assurances of future performance or results. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from those implied by such statements. A more complete discussion of the risks and uncertainties facing the company appear in the company's Annual Information Form and the company's management discussion and analysis for the 3- and 9-month periods ended April 30, 2019, which are available under the company's profile on SEDAR.

You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this presentation. The company disclaims any intention or obligation, except to the extent required by law, to update and revise any forward-looking statements as a result of new information, future events or for any other reason.



Sebastien?

**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Thank you, Jennifer. Q3 was a busy quarter. Our vision to become top 3 global cannabis company and top 2 in Canada is based on 3 pillars: operational scalability, product innovation and brand leadership. Our investments in our resources, technology, infrastructure and the specialty human capital is critical to achieving that goal. And through this quarter, we've made meaningful progress.

Under the direction of our Chief Innovation Officer, Veronique Hamel, we're continuing to expand our R&D and innovation team with top scientists, chemists, who have extensive experience in CPG companies such as Kellogg's, Church & Dwight, Coca-Cola, Philip Morris, Cambel Soups, Smucker's. That's just to name a few.

We now have 25 PhDs on staff. They are focused on developing new and innovative products for the market, best-in-class technology for our Powered by HEXO experiences.

Building on our innovative technologies, critical in building brand, we believe that brand will be the final moat, by which CPG cannabis companies are differentiated. But in the meantime, those products and that moat will be built on distribution and technology.

Having consistent, quick-on and quick-off cannabis experiences that include sleep, sport, focus, diet, sex and fun, delivered through a full range of Powered by HEXO products is what we're striving to create. Developing these experiences and partnership with Fortune 500 partners through our hub and spoke is how we're going to achieve that goal.

We've added key people to the team with extensive leadership and CPG experience, including our new COO, Donald Courtney, notable experience at Mars, Pepsi Bottling Group and also at the Head of the MedReleaf.

As well, we recently welcomed Michael Monahan as our newly appointed Chief Financial Officer. Michael's guidance will help the company drive our global strategy moving forward based out of the U.S. and he brings his wealth of experience from privately held and public companies such as Nutrisystem where he had a very successful exit.

We recently secured about 200,000 kilograms of hemp supply for CBD and non-THC cannabinoid extraction in fiscal 2020 and a closer term, we've done a secondary supply agreement of approximately 60,000 kilograms of hemp to be supplied in the next 2 quarters as we prepare for the upcoming demand in edibles and concentrates pending legalization in October in Canada.

Our hemp supply chain is a critical element to our strategy to be in 8 U.S. states in 2020 legally through traditional non-MJ channels. We're looking forward to the following months, so that we can elaborate on that strategy.

We've signed a multiyear extraction agreement with Valens to extract a minimum of 30,000 kilograms in year 1 and 50,000 kilograms in cannabis and hemp biomass in year 2. So this helps to smooth out our operating ramp up [incurs] as we expand our production to our near-term target of 150,000 kilograms and prepare for the legalization of edibles in October.

Note that our Belleville site that I'll speak about later in the call will actually be built to support the extraction using all types of extraction technologies for about 375 tons of processing capacity annually.

We were the first cannabis company to join Food & Consumer Products of Canada, which is the largest voice of the Canadian food, beverage and consumer products industry. We welcome the addition of 374 new employees, which brings our headcount to 822 employees at the end of Q3 and today, very proud to say that the team has grown to 1,100 and everyone's working very hard. I thank them very much.

We continue to expand our CSR initiatives, focused on being good corporate citizens. Our support has helped to ensure that those who depend on the services of Moisson Outaouais and the Ottawa Food Bank will continue to receive the necessary access to fresh, sustainable food using environmentally sound technology.

Our customers remain our focus. To date, we have sold over 7.5 million grams of adult-use in medical cannabis to Canadians who depend on our safe, reputable and high quality products. Adult-use grams and grams equivalent sold increased 9% to 2,700 from last quarter as we continue to expand our distribution across Canada.

Q3 2019, we produced approximately 9.8 tons of dried gram equivalent, so 9,800 kilograms and 98% increase from the previous quarter. That was due mainly to our increased yields in our 250,000 square-foot B6 greenhouse and also our first harvest of 1 million square-foot B9 greenhouse. First harvest, I remind everyone that happened 5 quarters out from us announcing that we would build that facility, one of the fastest build-outs of a large-scale, modern cannabis facility on the planet.

We're preparing for Phase II of the Canadian adult-use market with the legalization of edibles and concentrates, which is expected in October 2019. Although there is some timing risk to that date, we may see a delay from a regulatory perspective of up to 60 days, pushing us into December. We are developing gummies, a premium vape line and a line of cannabis-infused beverages with Truss, our joint venture with Molson Coors, Canada.

We remain focused on delivering net revenue in fiscal 2020 of over \$400 million and that, of course, excludes Truss beverages.

Subsequent to the end of Q3 2019, we completed the acquisition of Newstrike, providing us with the near-term increase in production to 150,000 kilograms annually, expanding our cultivation to 3 campuses, giving us resiliency and redundancy and giving us access as well to 9 provincial agreements, so now reaching over 95% of the Canadian population and increasing the HEXO family by approximately 250 employees.

I mentioned Belleville earlier on the call, very proud to say we are on track. We -- Phase I was online in May as planned, and we plan on having the building fully operational by the fall. That will include not only HEXO core operations in about 580,000 square feet, but also the Truss-Molson Coors joint venture, which we're expecting to have a full line of bottling and canning made available to be ready for October legalization as should regulations allow.

A 1.5 million square-foot facility will also allow future Fortune 500 partners a licensed, centrally located facility optimized for their specific manufacturing requirements. Looking forward to sharing the future on our future partners.

It was very exciting announcement this morning. We announced that HEXO was now officially internationally licensed in multiple jurisdictions with our Greece update. So we announced that HEXOMed has received its medical cannabis installation license in Europe and that's another step towards our plan of providing regulatory access to Fortune 500 companies, so that we can use their existing distribution networks in countries such as the U.K., France and all supplied from European domicile.

Financial results. Our total gross revenue was \$15.9 million for the third quarter, an increase of 11.8x over the same quarter in the prior year. As I guided last quarter, gross adult-use revenue remained flat at \$14.6 million. In comparison to the same period in 2018, it increased by almost 1,000%, which included only medical sales last year.

We expect revenues to double this quarter with realized sales from the first harvest from B9 and our 1 million square-foot facility and also as we start to shift flower outside of Québec, which we're very excited to do.

Sales volume increased 9% to 2,700 kilograms from 2,500 kilograms in Q2. While we're in dry products, accounted for about 84% of gram and gram equivalent sold during the quarter. Oils accounting for the remaining 16%.

We achieved adult-use revenues per gram of \$5.29, a 0.54 decrease over last quarter due to a shift in product mix. And 91% of our sales were done in Québec, with 9% coming from Ontario and BC, reminding everyone that we had not begun starting -- selling flower in Ontario and BC.



Cost of sales remains consistent with the prior quarter, about \$6.6 million including the cost of dry flower and the transformation costs related to oil and value-added products. The fair value adjustment on the sale of inventory was \$4.7 million, which has increased from \$572,000 in Q3 '18 due to an increase in sales, which was offset by lower fair value per gram on the adult-use market.

The fair value adjustment on biological assets was \$20 million compared with \$2.5 million in Q3 2018. This is due to an increase in the number of plants on hand, the result of bringing B6 and B9 fully online. So B9 is full of plants today. You can see that in a video that was publicized on Tuesday. I'd invite everyone on the call to go Google for that HEXO reel, you can see our staff hard at work and B9 full of plants.

We also drove higher yields this quarter on a per plant and per square foot basis, and we expect that to continue meaningfully as we ramp through our 150-ton a year production capacity.

Our gross margin before fair value adjustment on biological assets was \$6.4 million, yielding a 49% gross margin on net revenue. So holding towards the 50%, we do expect over the next 24 months as there is significant pricing compression that the flower might drag those gross margins towards the 40%. We do expect that as we introduce more and more advanced products, we'll be able to pull that gross margin back towards the 50%, but do expect some turbulence on gross margin in the short term.

Operating expenses. Our G&A increased to \$10.5 million in Q3 from \$2 million in Q3 2018. This reflected the growth in operations as we continue to strengthen our general, finance, administrative staff, an increase of \$3 million. Rental expense increased by \$790,000 related to rent on the Belleville facility. Professional, listing and legal expenses increased by \$9,000 as a result of corporate development initiatives and increased financial reporting and regulatory requirements from the TSX and the New York Stock Exchange American. And insurance increased \$1.8 million due to an increase in property, plant and equipment being covered and D&O premium increase as a result of listing on the New York Stock Exchange. G&A is expecting to trend with revenues over the remaining quarter in 2019.

On marketing and promotion, we had an increase to \$5.1 million in Q3 from \$2.1 million in Q3 2018 and this reflects the implementation of our adult-use marketing and promotion events to build brand recognition and establish HEXO in the adult-use market. We expect this to trend with revenues in the final quarter of 2019. Our long-term goal on our marketing spend is to be roughly around 5% of revenue, and we believe we're on target looking at forward revenue of \$400 million or \$20 million for the year, excluding sales and operations, of course, so just on pure marketing spend.

Our stock-based compensation increased to \$8.1 million in Q3 2019 from \$783,000 in Q3 '18. This relates to an increase in the number of options outstanding and represents our increase in headcount as a result of a significant increase in the underlying market prices of those options granted during the period.

Net loss from operations for -- of \$2.2 million in Q3 2019 compared with a \$2.7 million loss in Q3 2018 and this was offset by higher revenues and increased biological fair value adjustments as our production increases.

Net loss from operations decreased 61% over last quarter due to an increase in fair market value adjustment on biological assets based on increased scale of operations and the additional plants in our B9 greenhouse.

Other income and expense of \$0.5 million loss in Q3 2019 compared with \$682,000 in Q3 2018 was due to revaluation of financial instruments of about \$1.1 million and a fair value loss on a convertible note receivable of \$4.1 million.

Happy to turn it over to analysts on the call, looking forward to taking your questions. Thanks for being here.



## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from Rupesh Parikh of Oppenheimer.

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**Erica A Eiler** - *Oppenheimer & Co. Inc., Research Division - Equity Research Associate*

This is actually Erica Eiler on for Rupesh. So first, I wanted to touch on the \$400 million revenue target. We were just curious, the sensitivity and ability to hit this target if we do see the regulatory delays in advanced products and also maybe you could talk about some of the risks you see to potentially achieving this target.

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Erika, yes, there are 2 key risks to the \$400 million. So the first one is, of course, as you pointed out, the regulatory risk. So if we don't get the advanced products, that would put -- and I believe the risk of not getting it is negligible. I think the risk is really in delays. As I mentioned on the call, I think a delay to December -- it would be prudent to expect the delay potentially into December, but if it's further delayed, that could put upwards of \$100 million of that \$400 million at risk as that -- we're planning advanced products to be about 25% of that number.

The second risk is an execution risk, so much more in our control, relating to our Belleville facility. So to achieve that \$400 million target, we do need Belleville to be operational in the fall. And we are on track for that. But if something should happen outside of expectation, that would put that number at risk. We are confident we will deliver an operational facility in time.

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**Erica A Eiler** - *Oppenheimer & Co. Inc., Research Division - Equity Research Associate*

Okay. Great. That's very helpful. And then, I just also wanted to quickly touch on market share. Is there any update on your sense of what your market share is currently?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

We believe that we're holding pretty strong as one of the top Canadian LPs. We're not sure exactly where. Put us somewhere between top 3 and top 5 is probably a good guess, but we have some more work to do on those numbers.

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### Operator

Your next question comes from Oliver Rowe of Scotiabank.

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

When I think about Québec, which is obviously an important market for you, you're expecting 20,000 kilograms in sales to Québec in the first year of [rec]. I think we're over halfway through that year now and sales have been about 5,500 kilograms to that province. So it seems to me like it could be a bit challenging for the SQDC sales to triple over the remaining 5 months. Do you see a risk that the SQDC doesn't need that much product, but takes it anyway and that leads to significant inventory builds and maybe even impacts demand on your year 2 contract?

**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. So definitely, a risk. I think the demand is there in Québec. I think the SQDC has been doing a fantastic job. But since there were inventory supply shortages on the early days from most LPs, so HEXO was delivering on its purchase orders, but the SQDC [weren't] getting fully supplied. They slowed their store ramps. So the original plan called for about 25 stores in Québec by this day. And last quarter, we were at about 13.

Now the good news is SQDC has now gone back to 7 days of full-time selling. So that adds significant demand. They've added more stores now, so we have a brand-new store in Gatineau right next to an Ottawa population center. I do think there could be some timing risk around a few of those tons -- of those 20 tons. And of course, as you pointed out, it is a take or pay contract, but we value our relationship with SQDC more than the few million dollars in revenue we can get this quarter. So we're working very closely with them. [We've asked our] SKU mix to create more interesting products. We plan on launching a whole bunch of new products over the following couple of quarters, which we think will help that, but expect some timing risk whether it's in October, November, December time line to hit the full 20, I think, would be a reasonable assumption. We're confident we can completely offset that and more, of course, in other provinces.

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

That's helpful. And just a follow-up on Québec. I know the province recently added 6 more suppliers to the prior 6 and I believe that you're targeting 30% share in Québec. So is that at risk as they increase supply or do you think 30% is a pretty sustainable number for you, no matter how many suppliers they have?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

It's always going to be at risk. I mean people are going to be gunning for the top spots in Québec. I mean it's the second largest market in Canada and now people are finally realizing that. Thankfully, HEXO has a preferred supplier status. We have a great reputation in Québec. Our products are loved. So I think it's very feasible to defend our 30% market share but of course, we'll have to be very vigilant. We'll have to keep listening to our customers and responding to their needs.

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**Operator**

Your next question comes from Chris Carey of Bank of America. We have a question from Chris Carey.

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**Christopher Michael Carey** - *BofA Merrill Lynch, Research Division - Research Analyst*

Hi, can you hear me?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. Thank you, Chris.

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**Christopher Michael Carey** - *BofA Merrill Lynch, Research Division - Research Analyst*

So just on your expectation for the 40% gross margin in the near term. I mean how much of that is investment without getting kind of the requisite sales leverage and mix, mix being flower and oils? And really, what I'm trying to get at is, [what] you secure your capacity for longer-term margin is because clearly, expectations are for your gross margins to be a little bit higher over even the medium-term horizon. So I'm wondering if you could just talk to the near- and longer-term dynamics around the gross margin line.

**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. Absolutely. I think -- so longer term, I think 50% is definitely doable, but that will be contingent on us building a brand moat long term. I think the 50% will be reserved to the top 3 or 4 global cannabis companies that are able to create brand pull. Otherwise, cannabis companies as a whole, not just HEXO, will be pushed towards the 30%, right, in the long term.

I think in the short term, the pressure is completely different. The pressure is because as we've mentioned in Québec, new producers constantly coming online, coming to the provinces and we're talking right now about, for example, in Québec, 6 new producers online, but remember that there's 150 companies in Canada that have licensing, that want to start to sell flower. So what can happen in the next 18 months is that those companies are coming to the provinces, saying I want to get my flower listed. These companies are not sophisticated. They are small scale. They have high cost and they need to get a listing. They need to get sales revenue. So in turn, what we believe is going to happen is the province is going to say, well, we have enough flower SKUs. We have trusted partners. We don't need your flower. And then the smaller producers are going to have no other choice, but to drop their price.

In consequence, what's going to happen is that the provinces will then call their preferred suppliers, HEXO and other major licensed producers in the country, and will say, well, guys, you can get to keep your listing, but you need to be competitive with these smaller guys. What that will do is that will create a shakeup in the industry over the next 18 to 24 months. We believe there will be 80% of smaller licensed producers that will go bankrupt because they will be unable to obtain significant listings and leverage. And as such, their financing will also dry up. I think that will be an incredible painful process and that will put downward pressure on our ability to generate margin from flower in the short term. That's what brings me to 40%.

Now the good news is less competition and nobody except the majors is focused on advanced products and HEXO being at the top of the list has an advanced products company with great partners such as Molson Coors, we believe that we'll be able to introduce products that are in the 60% plus margin range, which helps to balance this out. So over time, as we shift from flower to advanced products, able to kind of stabilize in the 50% range.

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**Christopher Michael Carey** - *BofA Merrill Lynch, Research Division - Research Analyst*

And so as the market stays [along] flower over a longer period of time, how quickly do you think your own product mix will shift towards new products form? So your 84%, I think, in this quarter on flower will stay at that level for the next 6 to 9 months or do you envision being able to capitalize on these opportunities in the near term both for things like your sprays, but also obviously you have the beverage lines coming at the end of the year.

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. And the biggest question there, Chris, is going to be the regulatory risk around the legalization. So if we're live in October, which is still very possible, but at risk. So if we're live on shelves in October and HEXO is ready, so we're ready for that date. We're growing. We're ready to load in starting in September, so we're very excited with that. The Truss products are phenomenal. They taste great. They work superfast. So we think those are going to be a home run.

So if we launch in October, to your question on 6 to 9 months, absolutely, I think that's going to move the needle. I don't expect the needle to move from 84% flower to 20% flower. It's not going to be that kind of seismic shift. It's going to be a month by month. People are going to try these new products. There will be some excitement, but look for a gradual move where flower takes less and less and less of our total sales. Flower will not go away and I believe that even long term, flower will remain about 35% of the total addressable cannabis market. And we plan on maintaining that position in Canada.

I think for us to get there, if you look to Colorado historicals, it could take about 5 years. So if you take us from 84% flower now and kind of straight lining down to 35% in 5 years, I think that's a reasonable guess, taking into account certain regulatory risks. So if I don't get my advanced products before December, for example, then I think expect flower to remain in the 80% plus range for 6 to 9 months.



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**Christopher Michael Carey** - *BofA Merrill Lynch, Research Division - Research Analyst*

Okay. If I can squeeze in 1 more, I appreciate it. How quickly can you enter into the U.S. and just any flavor on that launch?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

We're very excited about the U.S. So I've committed to be in the U.S. in 2020. I think we can do multiple states. So the number I've mentioned is 8. I think we can do those states legally with Powered by HEXO, non-THC-based experiences, so that'd be focused sport and sleep to start. We think we can enter with our Fortune 500 partners and our hub and spoke strategy. We think we can lever their existing distribution and go through traditional non-marijuana channels. So I think this is going to be a key advantage for us as we use our hemp supply and the farm bill and our extraction technology to clean outdoor field hemp. I think we can use all of that in our formulation technology and our Powered by HEXO team to gain -- to essentially leapfrog the multistate operators. So instead of being limited to say 60 individual retail stores, our strategy is to go with non-THC experiences at first through traditional retail where we could get a listing in a traditional retailer like Walgreens or CVS, thereby getting 1,000-plus stores at once. So that's -- watch for that in 2020. And of course, if we're able to do that a bit faster, you'll see it in the news right away.

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**Operator**

Your next question comes from Brett Hundley of Seaport Global.

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**Brett Michael Hundley** - *Seaport Global Securities LLC, Research Division - Research Analyst*

Sebastian, thank you for all this detail around near-term revenue and margin. It's really helpful. If I can go a step further and think about your specific route to the new 2.0 market, as we get beyond fiscal Q4 and maybe look at the early part of fiscal '20, what parameters might you put in place for us thinking about revenue performance in Q1 into Q2 as you potentially short the flower market and get product ready for the 2.0 market?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. So we haven't provided guidance spread on specific ramp for the \$400 million, but you can expect that it'll be an incremental step function, so try to -- I think if your model is the linear model, it will get pretty close if -- and that's probably a good place to start.

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**Brett Michael Hundley** - *Seaport Global Securities LLC, Research Division - Research Analyst*

Okay. I appreciate that. And then, I wanted to go back to a comment you just made on entering the U.S. because I think what you're saying does make some sense insofar as competing well with the MSOs if in fact you're able to get product into traditional markets, traditional channels rather and leverage some of these hub and spoke partners. And it gets back to a question that I wanted to ask you broadly just about hub and spoke trends. We personally were hoping to see more in the way of strategic tie up at this point in time. And it's at least my understanding that may be big CPG and big pharma are looking a little bit away from marijuana and maybe towards hemp and biosynthesis insofar as getting cannabis into their branded products sooner rather than later. And I'm clearly here focusing more on the U.S. market. Can you just talk a little bit about your own discussions with hub and spoke partners? And what you think they're looking for at this point in time and whether or not that's changed relative to 6 or 9 months ago? I'd really appreciate it.

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. I think you're absolutely bang on that hemp is a key part of the strategy, so one thing that hasn't changed for the Fortune 500s. I mean we're talking to over 60 of them right now in the funnel, obviously, talking to more than that, about 60 in various stages of discussion. So we remain on track for our plan at kind of 1 a year over the next 5 years to round out our wheel.

The hemp strategy is key because if you want to operate legally in the U.S. and of course not pseudo-legally on a state-by-state basis, but legally at all levels of government with FDA and DEA, no contest, you need to source from hemp. And so that's why HEXO has put in place these hemp relationships. That's why we already now have 260 tons of hemp biomass secured under contract. That's why we've invested heavily in specific extraction technology to be able to clean outdoor field hemp.

I think one of the things that the Fortune 500 companies and you've seen this from a few of them, some of them are taking a strategy of saying we don't need the marijuana companies. We don't need LPs. We're going to go with our own and then they take a hemp strategy. And then they come up with a product that perhaps doesn't taste as great as what they would normally have, but doesn't have the right actives, that doesn't work fast enough and, quite frankly, becomes a subpar offering. Now just going with a pure hemp product, like if you're going with the hemp oil, much easier alternative that going with a complex formulation, something that we're trying to achieve with Powered by HEXO.

So I think the discussions are still very lively. We're still very excited about delivering kind of 1 a year spoke partner. In the meantime, Truss, our existing spoke partner, is performing very well. We're developing that business plan and the drinks are going to be absolutely dynamite we believe in traditional retail channels. So working our way at that.

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**Brett Michael Hundley** - *Seaport Global Securities LLC, Research Division - Research Analyst*

That's really helpful. Just lastly for me. Do you guys have a target for reaching profitability on the EBITDA line? We can all do the math, given your commentary over the near term, but have you disclosed any target as far as profitability on that line?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

No. We haven't guided, but I do -- I'm happy to share with you that in 2020, we're going to make some money. I mean, obviously, \$400 million, that's the kind of margin we're throwing off, it would be a little foolish not to. So we're going to do that, but this -- we're in growth mode. So the reason I don't want to guide EBITDA is because I'm ramping up my R&D team and nobody is investing in marijuana today for the EBITDA I'm going to generate next year. If we were all investing in marijuana for that reason, none of these companies should be worth what they're worth.

What we're building are global branded companies. What we're building is a sustainable moat around not only that brand, but the technology and these Powered by HEXO experiences. And that takes significant investments. With these top PhD scientists we've hired, I mean this team of 25, obviously, there's significant cost to that, but I don't want to stop there. 25 is not enough. We plan on having 100 PhDs on staff. We believe that, that will actually create a human capital moat as well beyond just pure technology in IP. There's not 1,000 of these top food scientists on the planet and HEXO was continuously attracting top talent. So we believe that over time, that erects the technology moat over the next 3 years and then that gives you one more reason to go back to the Fortune 500s and say, well, our technology is fundamentally better. You can do it on your own and spend hundreds of millions of dollars to try to develop a product that will be subpar or you can solve it immediately, global supply chain, already solved in the U.S. in 8 states, in the U.K., in France and then we also saw the technology piece. So I think that, yes, absolutely, able to be profitable next year, but the number will be modulating, given our investments back into R&D.

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**Operator**

Our next question comes from Graeme Kreindler of Eight Capital.

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

Just first off, as a matter of housekeeping, you mentioned in the press release this morning about revenues doubling in the next quarter. I just want to confirm that the doubling there would not include anything on the Newstrike side of things. That would be strictly from the number reported on the HEXO side this quarter.



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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

So the doubling of revenue would -- will include the Newstrike numbers, which are expected to be consolidated in the next quarter, yes.

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

Okay. Understood. I wanted to just elaborate a little bit on the U.S. strategy and understanding that you have supply agreement signed for 2020 to source the biomass there. But when you think about that strategy, how capital intensive does that get for you? We've seen some other of your peers looking to invest a significant amount of capital on the processing manufacturing side. So how does HEXO look at the U.S. opportunity and how capital light or capital intensive would that be?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. So the -- well, the U.S., I mean, at a very broad level, right? When I look at our worldwide plan, when I talk about becoming a top 3 global cannabis player, if I look at what it took to become a top 3 Canadian player, that was about \$400 million, right, deployed ultimately down between CapEx and operations. And I was pretty efficiently deployed.

So if I looked at Europe that's 5x the size of the Canadian market, that would be \$400 million x5 gets you to \$2 billion in investment required for Europe. The U.S. is about 10x the size, so you're looking at \$4 billion, so you're looking at total capital deployment of above \$6 billion. Now that's not all going to come from treasury in the form of capital raises. I think there's significant M&A opportunity in the U.S. And so the exact mix of what's going to be done through M&A out of that \$6 billion and what's going to be done through capital -- future capital raises is yet to be determined. So whether that's 40-60 or 50-50, we're not sure yet.

We believe that, that level of investment fundamentally long term will be required in the U.S. And then, of course, that will breakdown between your capital, your R&D and then your marketing spend as we get the traditional channels and we lever the ability to build brands in the U.S., which is very exciting because that's going to unlock our potential. And as you see in that marketing video we put out on our B9 greenhouse on Tuesday, the HEXO marketing team is doing a great job in putting some exciting material out there.

So that gives you a high level idea of [where] kind of in the next 5 to 10 years a \$6 billion requirement to become a top 3 global player. And of course, HEXO will continue to manage its capital responsibly, continuing to rely on our great finance team and calculating our IRR and making sure we return a good return on capital and continuing to penetrate in new markets.

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

Okay. Understood. Just to follow-up, with respect to the entrants into the U.S. market, is that something where you would lead in with the HEXO brand or would this be leading in through the Truss JV?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

So leading in with a Truss suite of products, so we're really excited for Truss to come out and we have a conference call with Brett later next week and we're excited to be able to start to plan that rollout. Obviously, a lot of questions around what the brands are going to be. They're very exciting. We're touching over 85% of consumer occasions and the marketing team at Truss has done an absolutely dynamite my job, but I'll let him take that thunder.

The exciting piece is that we're going to have Powered by HEXO marks on every single product going out. So the idea, of course, is to build a long-term brand around Powered by HEXO, think Intel Inside, think of draw where someone can walk into a store, know that Powered by HEXO sleep has worked very well in the [brief] format, but then know that if they need to go take a plane in the next morning, they can also find a face

cream by a trusted cosmetics brand that has Powered by HEXO sleep as well. So that's our long-term build on the HEXO brand itself. And of course, in Canada, we'll continue to have HEXO as core products.

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

Got it. And finally, with respect to the 8 states, is there any additional color you can provide at this time in terms of which markets are at the top of the priority list?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

We're keeping that as a bit of a competitive advantage. Figuring out all the regulatory work around how to operate legally in the U.S. is a key strategic advantage. Our regulatory team is absolutely phenomenal under the direction of our General Counsel of Roch Vaillancourt. He has built an amazing legal team, which I really think that if you look 10 years out, those are going to be the 2 core functions at HEXO is going to be R&D and innovation and our legal and regulatory team. So we're really making great inroads there.

So I'm not disclosing a whole bunch of colors -- a color on where we're going to be. But what I can tell you is we will be legal at all levels of government, and we will have no contest from both DEA and FDA.

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**Operator**

Your next question comes from Matt Bottomley of Canaccord Genuity.

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

Just wanted to touch back on something Graeme mentioned with respect to what we're expecting for next quarter on that top line. So maybe it has to do with the dynamics of the production ramp-up versus getting everything packaged and labeled [and excise tax] into the wholesale channels. But considering you're producing close to 10,000 kilograms as of this reported quarter versus sales 3,000, I would have anticipated that, that double next quarter would be facilitated just from the HEXO side of things independent of Newstrike. So can you just comment on the dynamics of how that shapes out?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. Happy to, Matt. Thanks for the question. So it all boils back down to the infrastructure. So I think last quarter, I mentioned that we'd be flat this quarter. We'll double in Q4. And I pointed that the key reason for that is that our infrastructure to package what we were growing was still ramping up, right, so and -- now that infrastructure, this particular quarter, has caught up and that's what leading to the double. So your insight is right. The infrastructure that's allowing us to package everything is really from the HEXO side, leading to that double. Obviously, we're going to grow much more, right? Our yields continue to go up every day. We're going to add the Newstrike yields, which is going to be great. But fundamentally, to truly unlock our infrastructure requirements, I need my Belleville facility. So I need the facility that's going to have processing capacity for 375 tons per year and that kicks in in the fall. So that's why we're going to double and not much more immediately as we pointed out because we're catching up our infrastructure in 2 phases. Phase I now complete and Belleville in the fall.

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

Great. That's helpful. Makes sense. And then just on the guidance, again, I know this was for 2020, touched on a little bit already, but you gave some good color there that about 25% relates to derivative products. And obviously, there's some timing there that isn't in your control based on what the government puts out.

Can you give any other sort of slicing of that number with respect to just the domestic contribution in Canada between Québec and other markets? Obviously, it's about 90% plus now just in Québec on a trailing basis. So of that \$400 million, how much of that would be just Canada and then what would sort of the gappost be between Québec and ex Quebec?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. Well, you can work back to our 5-year contract with the province of Québec. Year 2, 35-ton commitment there. So that gives you a good sense of where that should round out. Expect that Ontario will be pretty close as a large market. Alberta, certainly doing a great job with their rollout. So we're excited to be in market there and -- so it's fundamentally all going to wash out to kind of population base with HEXO being overweight in Québec. So that gives you a good sense, but we're still working through the exact numbers before we share those.

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

No. That's understood. And then just on the Québec side of things. So given that there was 6 more LPs entering that market, I know initially when you announced the 5-year deal and I understand there's assumptions that go into this number, but sort of that headline, \$1 billion 5-year contract, did that contemplate other entrants coming into the market and would you still classify at that quantum over a 5-year period?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

I think -- I still think the potential of that contract is absolutely to hit \$1 billion in 5 years, yes.

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

Okay. Great. And I'll slip one more. And apologies. I know Brett was talking about the hemp side of things in the U.S. because I was pulled out of my office for a second, but can you comment if you would anticipate an execution strategy in the U.S. similar to what you're doing on the beverages with Truss where maybe you partner with cosmeceutical, nutraceutical. I know [healthcare] is becoming more and more topical right now into entities outside of HEXO is part of that rollout or you're expecting it to be completely in the economics of your current entity?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

No. We're absolutely planning on using our Fortune 500 partners. So in Canada, HEXO has all the distribution. We are listed now in 9 provinces, touch 95% of the population. So we actually provide the marijuana distribution to our partners like Truss and Molson and our other spoke partners, so when we add cosmetics, when we add health and wellness, when we add edibles, when we add vape.

So in the other markets, we're going to rely on their distribution. So we're actually getting their international distribution. So in the U.S., obviously, Molson very strong with a top 4 position in beverages, top 2 in the U.K. But as we add more spoke partners, that gives us all of that more opportunity. So as we're focused on the technology and supply chain piece, those partners are bringing a deep understanding of consumer occasion, the international distribution piece and of course, the base product, which is very important because there's really 2 parts to creating an awesome cannabis product. It has to work and it has to work better than the rest. And so HEXO has got that covered, but I do think one risk that most cannabis companies are ignoring is that it will be very difficult for a cannabis company to make a better chocolate than Nestlé, to make a better face cream than L'Oreal and a better beer than a Molson. So that's why I think our strategy fundamentally leads to better products, which will lead to better success in the market.

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**Operator**

Your next question comes from Robert Fagan of GMP.



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**Robert Fagan** - *GMP Securities L.P., Research Division - Equity Research Analyst of Healthcare*

Just wanted to ask about the ramp up of capacity at B9. Obviously, we saw in the video how it seems to be already quite filled up with plants. And just wondering if you can give us kind of a cadence of how much of the overall capacity that facility is already ramped up and what's left to ramp up?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. Absolutely. Rob, so we're -- the facility is full. So as you've seen in the video, there's plants in the entire -- the entire 1 million feet is full of plants. So with the first harvest out of greenhouse, there's always dialing in and you'll see -- if you look at our historical numbers for B6, so our 250,000 square foot greenhouse, that will give you a really good idea of how we're dialing the environmental and the new greenhouse. How we start to improve yields quarter-over-quarter. I think to get to our 150 ton ramp, reasonable to see us early 2020 to be at that number on a run rate basis. And so that will really reflect incremental yield improvements, but the facility is full and now it's just a question of -- you should see meaningful improvement every quarter.

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**Robert Fagan** - *GMP Securities L.P., Research Division - Equity Research Analyst of Healthcare*

Great. That's quite impressive. Is there any potential delays from beginning sales from that facility around licensing in any kind of way? Does that create any type of hurdle to actually get sales generation from that facility?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Rob, we have our sales license. We just didn't think it was a big deal. It's kind of order of operations these days. So now we're selling from that facility. As I said earlier, we've begun and so -- no. That facility is fully licensed, so no worries there.

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**Robert Fagan** - *GMP Securities L.P., Research Division - Equity Research Analyst of Healthcare*

Excellent. Just shifting to extraction now. In light of your agreement with Valens and in the context of Belleville, hoping to be able to accommodate 375 tons of input material for extraction. How do you see the kind of margin evolution from your Cannabis 2.0 products as a result of perhaps a shift in capacity from third-party to your own for the production of those products? And then, if you can just give us maybe a bit of insight on how you intend to go about extraction operations in the U.S. with that hemp biomass being secured?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. I think from a long-term strategy perspective, if we get a third-party extractor that can match or beat, a, our capacity, two, our quality, three, our technology, we conceptually will be happy to work through a third-party operator, which is why we're working with Valens and they've been great so far. From -- remember that 10 years out, if HEXO were to look like a team of lawyers and a team of scientists and a great brand, Powered by HEXO, in hundreds of different Fortune 500 products, that's what we're striving for.

In the meantime, we have to make sure that we can deliver certain products and that means having enough capacity for HEXO scale, which is shooting to be a top 3 global player. And quite frankly, there's nobody else whether that's the extractors, other LPs that have shot for the level of scale that we're putting in. We are preparing for the possibility that we could shoot not just for a 20% share in Canada, but actually grow that. So we are preparing ourselves. And let's say, we were to say this is a 1,000 ton market, with 375 tons of potential processing power and 150 tons of grow, the idea is we're already starting to prepare to have less grow in the supply chain, so 150 tons moves through our manufacturing and extraction and formulation stage, which has 375 tons, supplemented by hemp in the short term, in the medium term perhaps supplemented by

other forward contracts with other licensed producers, our imports from overseas and then moving on eventually to the final phase where we're simply an IP and technology company.

During that whole journey, as I mentioned, in the very short term, we'll see some margin compression especially as our sales on flower come in, but that margin should start to dilate back up. The nice thing is as we scale up, our costs are coming down significantly. And I think a testament to the team has been this quarter as you see our revenue per gram of course has dipped, but we've managed to hold our gross margin relatively stable. So we're recovering the costs. Unfortunately, I do think that in the face of lowering costs, you will have continued selling pressure, so it will be difficult to translate those costs to additional gross margin until those advanced products come online.

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**Robert Fagan** - *GMP Securities L.P., Research Division - Equity Research Analyst of Healthcare*

Okay. Great. Last quick one, if you could maybe -- I don't know if you can give us an idea of the mix in terms of new products in Canada. You mentioned gummies, vape and beverages. Can you give us an order of magnitude of the split there? What would be the biggest drivers?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

So our top priority is our beverage launch followed by our vape launch and then gummies is one that we think, from an edibles perspective, will be very interesting. So they're in that order. I think steady state in the future. As I mentioned on the call that at steady state, this market will be about 35% flower, 65% advanced products. Of the advanced products, we think that beverage and vape could easily be 1/3 each with other categories such as edibles, which -- gummies is the largest part of the edible segment, which would be less. That would start to give you a bit of an idea on how we see the world.

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**Operator**

Your next question comes from David Kideckel of AltaCorp Capital.

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**David M. Kideckel** - *AltaCorp Capital Inc., Research Division - MD & Senior Equity Research Analyst of Healthcare and Life Sciences*

I just wanted to go back to the U.S. and with Truss JV in particular. So when we're talking about in the press release and we talked about this morning so far, when you're looking to enter into 8 states in 2020, just to clarify for housekeeping here, does this only -- and you also mentioned, Sebastian, that you want to lead into the U.S. with Truss, but do these initial 8 states, is this only going to be including the Truss products?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

No. So it will be including Truss. Well -- and specifically, I should clarify. So Truss is a Canadian joint venture, so it's Canadian only. So most likely, the exact form of entity -- we haven't revealed exactly how we're doing this with MCBC yet. So MCBC and HEXO will be doing a joint release at some point in the future to explain exactly how -- under which brands. Of course, Truss and all the work that's been done will be leveraged on the marketing side. So that's 1 piece.

The other piece is we're going to have our other spoke partners, so -- I've said 1 a year, so you could assume that in 2020, we have 2 at this point. Late 2020, maybe 3. And yes, the idea is to enter the U.S. using our spoke partners, not to go direct with HEXO core products in the short term.





**David M. Kideckel** - *AltaCorp Capital Inc., Research Division - MD & Senior Equity Research Analyst of Healthcare and Life Sciences*

Okay. That's helpful. And to clarify as well, you mentioned that the Truss beverages are great and so there's a lot of progress that has been made. So can we assume that the development in the R&D, all the innovation behind the actual beverages, are those nailed down now or are they still being tweaked?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

So 1.0 is nailed down and 1.0 is amazing. It's better than anything that's in the U.S. today. Hands down. But I think 1.0 has a lot of room to grow. What I'm excited about is the future, right? I'm excited about a 2-minute onset. I'm excited about a 45-minute onset. I'm excited about (inaudible) experiences, a sparkling water where we reduce your appetite using the ingredients in cannabis, but are nonpsychoactive. These are all things the R&D teams are working on, and I think that's going to provide for a really exciting road map for the next 5 years. Today, our starting lineup is best-in-class. It's better than anything that exists on the planet that I've seen. And so I'm tremendously excited about that.

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**David M. Kideckel** - *AltaCorp Capital Inc., Research Division - MD & Senior Equity Research Analyst of Healthcare and Life Sciences*

Okay. So just to confirm then, so the Truss product -- the beverages are ready to go subject to, I guess, number one, Canadian -- the derivative legalization and then also with your eventual and near-term strategy in the U.S.?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. We have technology. We have a level of technology and product quality right now that puts us in our own class. I expect that at launch, it will probably be -- we'll see how we're performing against the other top LP. Obviously, Canopy with their Constellation partnership I'm sure are coming out something pretty impressive as well, but I haven't seen anything else in the industry right now that compares to what we have today.

So what we have from a technology perspective today is absolutely phenomenal. The team has done a great job. And now the question is going to be the ramp up in infrastructure and that ramp up in infrastructure is dependent on our Belleville facility rollout and the Truss rollout within that Belleville facility, which we are on schedule to deliver for the fall, but that is the risk to that full rollout. And obviously, for the 2020 plan in the U.S., there's some infrastructure in U.S., which is why we formed HEXO USA, our corp in Delaware to have that corporate structure to start acquiring assets and doing infrastructure build-out in the U.S.

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**David M. Kideckel** - *AltaCorp Capital Inc., Research Division - MD & Senior Equity Research Analyst of Healthcare and Life Sciences*

Okay. Great. Another question. I have a couple of more here, quick ones. I know, Sebastian, you mentioned sort of capital deployment over time around the \$6 billion mark, which could include both M&A and capital raises. Is there any -- just to tweak this down a little bit. Over the next, say, 12 months or 6 to 12 months, can you provide any CapEx guidance for HEXO?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

We're not going to provide the CapEx guidance just yet, but -- so thanks for asking. We'll see what we can do over the following quarters in terms of thinking about that. But I want to make sure we nail down our numbers. And again, we don't give up exactly the how -- of how we're entering the U.S. just yet. I'd rather do it and then tell you guys about it, if that's all right.

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**David M. Kideckel** - *AltaCorp Capital Inc., Research Division - MD & Senior Equity Research Analyst of Healthcare and Life Sciences*

Understood. That's great. My last question, Sebastian. Actually, I think it was brought up by another analyst before in passing around biosynthetics. I'm just wondering in all of your discussions with Fortune 500 partners, I mean it's apparent I think from a lot of our due diligence that a lot of the



Fortune 500 partners, especially when considering cannabis, they really pride their final product with consistency, purity and potentially low costs as well. So on that note, with biosynthetics, can you maybe -- is there any color you can give to your discussions with the Fortune 500s around any sort of biosynthetic discussion that's of relevance for them and how that could impact your strategy if you decide to move into the area of biosynthetics as well.

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. I think biosynthetics certainly have a lot to offer, but they also have a lot to prove. And so from our perspective, we're waiting to see who will emerge as the biosynthetic winners before making significant investments in that space. And to us, the winners are not only the ones that will solve scale, but also the ones that will solve intellectual property, especially when it comes to rare cannabinoids that would be relevant to a specific Powered by HEXO experience.

So those are really the ones that are going to keep our attention. We have great relationships with quite a few of the biosynthetics companies. We're keeping an eye on them. We're tracking their progress. And I think from the Fortune 500 perspective, they are leveraging our maturity in market and our understanding of all that kind of sort it out. The Fortune 500s today, from my perspective, are not taking bets on technology to come. They need to solve the market access now and that's something that HEXO is doing today from plants. In the future, of course -- I've talked about the HEXO team being lawyers and scientists. That could very well mean that our supply chain is sourced from greenhouses in Canada for the flower, hemp fields in the U.S. for 80% of our cannabinoids and then a few biosynthetic providers for rare, specific cannabinoids as cost depends, but I don't plan on marrying myself now to a cost structure. I think we can pivot in the future depending on which solution becomes best. And I think that the reason a Fortune 500 would need a HEXO as a partner is because to figure all this out in a relatively effective way takes a lot of energy and expertise, which they simply don't have on their team. So that's why our Powered by HEXO partnership model has resonated very well with Molson and is resonating very well with a number of companies in our funnel.

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**Operator**

Your next question comes from John Chu of Desjardins Capital Markets.

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**John Chu** - *Desjardins Securities Inc., Research Division - Analyst*

Just a couple of quick questions. On the U.S. strategy, the \$400 million in revenue guidance for 2020, does that include any revenue generated from the U.S.? And then secondly, just...

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

No. It doesn't, John. And let me clarify, so the \$400 million guidance is for fiscal ending July. When I say 2020 U.S., I'm talking to December calendar. So there's some offset, but the nuance to consider as well is that our current spoke partner, Truss, so with Molson and depending on how the future ones will be structured, the revenue itself does not consolidate up to HEXO. We're going to see our 42.5% share of the net income or loss. So you will see it post bottom line. So obviously, show up on our financials, but you wouldn't see the revenue. And so that's the primary reason that it's not in the guidance.

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**John Chu** - *Desjardins Securities Inc., Research Division - Analyst*

Right. Okay. And then, to what extent does FDA approval on the CBD side come into play in terms of your entry into the U.S.?



**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. We're watching the FDA very closely because how they will decide to treat overall CBD treatment relative to pharmaceutical, nutraceutical, et cetera, will obviously have an impact on how we're operating, but we're currently following a path where we believe we'll have no contest from FDA. So very confident at this point in our strategy.

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**John Chu** - *Desjardins Securities Inc., Research Division - Analyst*

Okay. And then just lastly, you mentioned -- in terms of shipping flower to Ontario, BC and other provinces, are you able to ship that officially right now? And what's the update on Alberta? That's a pretty big market, and it doesn't seem you're having much exposure there at this point in time.

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. So when you look at the -- you look at our throughput, of course, Québec remains -- has remained a huge market, but that has not been demand constrained. That has been supply constrained to date. As we double this quarter and as we go, of course, and we start to ramp from there into our \$400 million next year, as I mentioned, the infrastructure blot goes away largely by fall.

So you have more and more capacity to supply into these markets. And we want to make sure that we are not only a preferred supplier in Québec, but that we're a top supplier in all other provinces. So we want to make sure when we go into these provinces that we respect our commitments, we make sure that whatever is on the shelf is always available and that we really provide a great customer experience. So not so much demand cap and that's why you haven't seen anything in Alberta yet, but expect to see more and more things in other provinces as the months go by.

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**Operator**

Your next question is from John Zamparo of CIBC.

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**Krishna Ruthnum** - *CIBC Capital Markets, Research Division - Associate*

This is actually Krishna Ruthnum on for John. My first question is on pricing. And my apologies, I missed part of the prepared remarks that there's a meaningful decline quarter-over-quarter in your pricing. Just wanted to understand whether that was simply due to lower oil sales, a greater focus on Québec or maybe what you alluded to earlier, which was constraints on the packaging side?

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**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Yes. I think a little bit on oil, but it's really -- we're starting -- so earlier in the call -- I'm not sure you caught the point, but I was talking about how we're going to into a period of price compression around flower as you have these 150 smaller LPs that buy from market share and they really have very little ability to go to market, right? So we're already seeing that price compression in the market begin. So that has started. And I think that it's prudent that we all expect that to continue for a certain period of time. And I think that is then prudent to have a bet on companies like HEXO that both have the scale and operational expertise and cost control to survive their margins in that price compression. So as you've seen, despite the price compression, we've held our margins. So I'm not too worried about it, but the smaller producers over time will not be able to because they won't have the economy of scale.

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**Krishna Ruthnum** - *CIBC Capital Markets, Research Division - Associate*

Okay. I also had another question just around the 260 tons of hemp supply that you announced. Are there any terms or is there any additional color that you can give us just sort of around that supply?

**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

So we're not disclosing the terms, but you can kind of look at how we operate. We always operate from kind of a fundable supply globally approved supply chain perspective. So when we look at our cost per milligram, we track everything and then there's -- so there's 2 things to look at. Where do you need the supply to come from and how is that supply relevant to specific jurisdiction? So in the U.S., you need hemp to participate. But then, 2, whether it's biosynthesis, hemp or marijuana, we are continuously evaluating our cost per milligram of all cannabinoids and formulation and flower and then searching the most cost effective alternative. So you can assume that our hemp transformation will be at a good price.

**Krishna Ruthnum** - *CIBC Capital Markets, Research Division - Associate*

Okay. And one last question just on your guidance for Q4. Just given where we are in the quarter, just wondering if you can give us some comments on the trend to date as well as your -- the pace and sort of your confidence of reaching that target?

**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

We're going to reach the target. I mean, I'd ask you and I continuously welcome challenges. I think that the analyst community is doing a phenomenal job in our space. I welcome more transparency in our space. I welcome a broader discussion for investors. If you ever hear me say something and not deliver, you have to call me out. And in reverse, I would tell you today, nobody has ever called me out on anything because HEXO has always delivered what we said we would. We're delivering a double this quarter.

**Operator**

(Operator Instructions) There are no further questions at this time. Please proceed.

**Sebastien G. St-Louis** - *HEXO Corp. - Co-Founder, President, CEO & Director*

Thank you very much, everybody, for your time and the great questions. Look forward to speaking with you during the following months and, of course, at our next earnings call.

**Operator**

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.

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