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PRESENTATION

Operator

Good morning. My name is Suzanne, and I will be your conference operator today. At this time, I would like to welcome everyone to the Aphria Q2 Quarterly Investors Call. (Operator Instructions)

Katie Turner, you may begin your conference.

Katie M. Turner - *ICR, LLC - MD*

Thanks, Suzanne. Good morning, everyone. We appreciate you joining us to discuss Aphria Inc.'s financial results for the second quarter ended November 30, 2019. On today's call are Irwin Simon and Carl Merton.

By now, everyone should have access to the earnings release, financial statements, MD&A and investor presentation, which are available on the Investor's section of Aphria's website at www.aphriainc.com. The financial statements have been filed with SEDAR and EDGAR.

Before we begin, please remember that during the course of this call, management may make forward-looking statements. These statements are based on management's current expectations and beliefs and involve known and unknown risks and uncertainties, which may prove to be incorrect, and actual results could differ materially from those described in these forward-looking statements.

Please note that in the text of Aphria's earnings press release and financial filings issued today are a discussion of the risks and uncertainties associated with such forward-looking statements.

And now I'd like to turn the call over to Irwin Simon.

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

Thank you, Katie. Good morning, everyone. We appreciate you joining us today to discuss our second quarter financial results.



Our team has accomplished a lot on all fronts. Boy, what a difference a year makes, from enhancing our global team to our brand-building activities, new facilities, grow production capabilities, to investing in new systems technology as well as evolving our corporate governance. I enjoy working closely with our team, and it's great to remove the Interim title. Together, we all appreciate the hard work and dedication that has propelled us forward and will continue our future success is on horizon.

But let's focus on Q2. A few key quarterly highlights include: adult-use cannabis net revenue increased 46%, and we nearly doubled our consolidated adjusted EBITDA as compared to the first quarter. Net cannabis revenue increased 9%, and we nearly tripled cannabis operations' adjusted EBITDA from the prior quarter.

We ended the quarter with one of the strongest cash positions in the industry, a strong balance sheet, \$498 million of cash and cash equivalent to fuel our future growth in Canada, Germany and South America. As I like to say, cash is king, and we're proving it. We believe that as the cannabis industry continues to evolve globally, our balance sheet and financial flexibility will continue to further and differentiate us. We remain focused on the highest-return priorities for growth. Our second quarter results demonstrate our emphasis on sustainable and profitable growth.

At Aphria, our entire team of more than 1,200 employees is intensely focused on growing our brands' profitability, our strong cash position for growth and focusing on our core assets that we believe will create the most value as we invest in them to grow. This also includes the potential monetization of noncore assets, which will help to further streamline our business and reduce CapEx over time.

Our mission is clear: to be a premier global cannabis company, with our medical and adult-use cannabis brands. We are building brands that we believe resonate with consumers today and well into the future, which I'll focus on in more detail in a minute. We created robust initiatives and clear goals for execution across function and emphasizing our core capabilities and further developing areas of our business to position us for sustainable growth.

The level of accountability that we've enacted upon that delivers results even as transitional market dynamics impact the cannabis industry from time to time. We believe, as dynamics improve for everyone in the industry, that Aphria will continue to stand out as that leading cannabis company.

Aphria has a strong foundation, compelling business fundamentals and capabilities, with streamlined operations process, upgrades and investments in technology that play the key role in our development with recent rollout of our new ERP systems and greater automation in our facilities.

In Leamington, we are consistently working on generating higher yields at a lower cost and a low-cost producer. At Aphria One, our team has planted more than 600,000 plants. During Q2, Aphria Diamond, our premier greenhouse featuring 1.3 million square feet of production, received its license from Health Canada. Since then, I'm proud to tell you Aphria Diamond is now 100% planted, and we expect the first full crop rotation in early February, with the first shipments of wholesale dried bud soon to follow. We look forward to sales from Aphria Diamond commencing in Q4.

We are excited about the tremendous growth opportunities we now have as a result of expanding our total annual domestic production capacity in Canada as well as our strong medical- and adult-use brand sales and our GMP export and white label opportunities. We are pleased to have received confirmation of compliance with the requirements of the EU GMP from Malta Medicines Authority, from the company's subsidiary, Avanti Rx Analytics. This license will allow Aphria to ship bulk and finished dried flower as well as bulk finished cannabis oil for medicinal use in permitted jurisdictions throughout the EU.

At Aphria, we strive to be better in all that we do as an industry leader. We recently finalized long-term multidisciplinary research partnership with the University of Saskatchewan and the Cannabinoid Research Initiative of Saskatchewan to investigate novel and proprietary cannabinoid drug formulations. And we're pleased to see positive early results from the Hospital of Garrahan's Argentinian trial with our Aphria medical oil, showing significant outcomes for the treatment of refractory epilepsy.

We have compelling brands for patients and consumers across broad demographics. Today, Aphria has 5 quality brands, including Solei, RIFF, Good Supply, Broken Coast and, as I just mentioned, Aphria, our medical brand.

We are increasingly connecting with consumers for our medical- and adult-use brand positioning and innovation to drive growth. This is demonstrated by the following key brand highlights for the quarter. Our 4 adult-use brands combined held the #1 position in the oil and capsule categories, with Soleil representing the #1 brand in the oil and capsule categories in Ontario, Nova Scotia and Prince Edward Island, the only provinces sharing sufficient data to determine.

For the month of November, Aphria's adult-use brands combined held the #1 sales position for pre-rolled, oil and capsules and the #3 sales position for flower as compared to other licensed producer. Aphria's brands represent 13.8% market share in Ontario for November. That's excluding capsules. This is 2/3 greater than the next largest LP.

As the cannabis industry continuously evolves globally, we're also evolving at a rapid pace to ensure Aphria stays ahead by leveraging our core capabilities.

Aphria's success will continue to be driven by our differentiation portfolio of brands and products aimed at delighting distinct consumer segments. We believe the quality of our brands remain unmatched in this industry. Our entry into new product markets will be done in strategic and thoughtful manners, where the best opportunities exist, differentiating us as we address patients and consumer needs at the forefront. This includes vapes, as I previously mentioned. We will have 34 new vape SKUs, many of which are already in stores today, including Solei, Gather, Unplug, Balance, RIFF Super Lemon Haze, Jean Guy and GDP Sour Kush, Good Supply, Blue Dream, Pineapple Express. And we look forward to launching our edibles, teas, beverage and topicals in the very near future.

Internationally, we are very pleased with our progress. Aphria remains the only licensed producer in Germany. We're permissioned to growing all 3 strains of medical cannabis approved by the German authority. We remain confident that not only the first harvest in Germany happened before the end of this fiscal year but that our CO2 extraction capabilities will be ready in January 2021.

We are also pleased to report our import and wholesale license for Germany has been received. In Colombia, Aphria partnered with Federation Medical Colombia, to host the first academic medical Congress in Bogota, Colombia. The event welcomed more than 200 doctors from the country who participated in a full day of educational lectures by experts in the fields. Speakers share insights on the current state of cannabis in Colombia, the government's efforts in regulating the space and patient case studies from our -- from Canada.

In the U.S., we are focused on building strategic partnerships and alliances for growth, with an emphasis on industries that aren't necessarily attached to but rather complement cannabis until medical cannabis is fully legalized. We believe Aphria can generate strong growth in the U.S. over time.

Over time, we continue to believe Aphria will be a consumer packaged goods company. With that comes plenty of options for us in the U.S. and around the world. Aphria is increasingly well positioned with the right team in the right global markets, with the right strategic initiatives, production capabilities and capital to support our growth in fiscal 2020 and well into the future.

We have a strong foundation in Canada, where we expect momentum to accelerate in terms of both sales and profitability in the second half of fiscal 2020. This strong foundation helps us leverage key learnings, implement on market-specific bases in Germany and Latin America, as I said, including Colombia, Argentina, Paraguay and Jamaica as well as other international markets.

Together, the team at Aphria has the entrepreneurial, nimble culture that is grounded in capabilities and accountabilities. We believe the opportunities for long-term shareholder value creation are very strong.

I'd like to thank my leadership team, my Board and our associates around the world for all their help getting us to where we are today and their continued dedication to moving Aphria forward.

With that, I'd like to turn the call now over to Carl, to take you through our Q2 financials. Thank you.



Carl A. Merton - Aphria Inc. - CFO

Thank you, Irwin, and good morning. Please note, all financial references are in Canadian dollars unless I mention otherwise.

Given recent industry events, I want to highlight 4 key items from our results. These quarterly results include: no impairments on subsidiaries; no inventory write-downs; no provisions for future sales returns; and no sales returns on either adult-use or medical cannabis.

As Irwin discussed, in the second quarter, we continued to execute on our growth initiatives and prioritized profitability as we continue to position our business for long-term growth and success. We are pleased with our financial results, particularly our cannabis revenue growth, sequential positive adjusted EBITDA and our ability to maintain a strong balance sheet and cash position while recognizing the need to hasten the evolution of CC Pharma's business model, most importantly, as it relates to sales levels. This demonstrates the strength of our team and the strategic initiatives we are working on together to execute every day at Aphria.

Our commitment to give back to both people and the planet continues. Aphria launched its cannabis education program, Aphria Educates, in the quarter, mandated to educate Canadian adults on responsible use of all cannabis products legally available now and in the future. Aphria Educates kicked off with a 2-city panel tour in Toronto and Vancouver. Throughout the year, Aphria will continue to provide both education and understanding, where it makes sense to Canadians, helping them to better understand the ever-evolving cannabis landscape.

Our sustainability benchmarking is underway, and we are on track towards our commitment to report on our CSR and sustainability initiatives and practices after the end of this fiscal year.

And finally, Plant Positivity, our social impact platform that champions plants and the incredible power they have in overall well-being, as well as looking to improve access to green spaces for communities. We have a number of exciting programs launching soon and look forward to expanding Plant Positivity in more cities across Canada this year.

Our financial results demonstrate our ability to continue to gain share, both in provinces reporting share figures and in provinces that have chosen not to share these figures. They demonstrate our continued focus on leveraging our cultivation experience into lower costs per gram and our focus on being and remaining adjusted EBITDA positive, both internally financed future growth initiatives and in the future being in a position to provide an annual return to our shareholders through dividends.

Net revenue increased 457% over the prior year period to \$120.6 million. Compared to the prior quarter, cannabis revenue increased 9% to \$33.7 million from \$30.8 million. Adult-use net revenue increased 46% to \$29 million.

Distribution revenue, which was below our expectations for the quarter, decreased from \$95.3 million to \$86.4 million. The lower distribution revenue is associated with the change in the German government's medical reimbursement model, as I discussed last quarter, and normal business seasonality in CC Pharma. Going forward, we expect to see more normalized rates of growth in distribution revenue. Distribution revenue remains the key metric for our international team for the remainder of the year.

Our team in Germany are preparing the business for importation of EU GMP-certified cannabis from Canada. Facility additions are well on their way, and they already have pharmacies reaching out for preorders. In addition, the team continues to complete weekly practitioner-initiated training of pharmacists and doctors on all topics cannabis related.

We remain on track to harvest Germany's first domestically grown medical cannabis by the end of calendar 2020 from our new cultivation facility in New Minster. The entire Aphria team in Germany is focused on positioning Aphria with the most comprehensive license in the country as a dominating force in the German cannabis market.

In Colombia, we are excited about the early results from Hospital Garrahan's Epileptic Seizure Control Study. Early results suggest a reduction in seizures for 80% of the participants, with 10% of the participants realizing a 100% decrease in seizures. On the heels of this positive result, we are seeing preregistrations in Argentina for access to the new compassionate use laws.

Here in Canada, we'd like to extend our congratulations to our partner, Tetra Bio-Pharma, for receiving a favorable letter of advice from the FDA for QIXLEEF, a botanical drug for chronic pain, whose active ingredient is supplied by Aphria. This allows Tetra to explore pain indications beyond cancer, such as arthritic, neuropathic, chronic back pain, migraine and fibromyalgia, with the potential to compete against first-line pain medications, such as acetaminophen and NSAIDs, and possibly even second- and third-line medications like Lyrica, Cymbalta and opioids.

The company sold 7,062 kilogram equivalents of cannabis, up 18% compared to 5,969 kilogram equivalents in the last quarter. Adult-use cannabis accounted for 5,567 kilogram equivalents, and medical cannabis accounted for 1,237 kilogram equivalents.

Further, dried flower represented 3,950 kilogram equivalents of this total, with the remainder coming from cannabis derivatives. The average selling price of adult-use cannabis before the excise tax decreased to \$5.22 per gram compared to \$6.02 per gram last quarter, primarily as a result of a shift in sales mix.

The average selling price of medical cannabis, exclusive of wholesale and before the excise tax, increased to \$8.16 per gram compared to \$7.56 last quarter, primarily related to a higher percentage of total medical sales coming from Broken Coast this quarter.

During the quarter, our cash cost per gram decreased from \$1.43 to \$1.11. Our all-in cost per gram decreased from \$2.52 a gram to \$1.98 a gram. We continue to work to lower these amounts and await the impact of Aphria Diamond's expected lower cost per gram on our consolidated results.

Adjusted cannabis gross profit increased to \$19.1 million from \$15.3 million as a combined result of increased sales, reduced wholesale sales and a reduction in cost. Adjusted cannabis gross margin was 56.6% compared to 49.8%. The increase was primarily due to no wholesale sales to other licensed producers during the quarter as well as reduced cultivation costs in the quarter.

Adjusted distribution gross profit decreased slightly to \$11 million from \$12.2 million. Adjusted distribution gross margin decreased slightly to 12.7% compared to 12.8%.

SG&A costs increased approximately \$7.8 million compared to the prior quarter. The increase in SG&A was primarily related to a \$2.6 million increase in share-based compensation and a \$4.4 million increase in selling, marketing and promotion costs primarily associated with variable costs tied to sales.

We reported a net loss of \$7.9 million or a loss of \$0.03 per share compared to net income of \$16.4 million or \$0.07 per share in the prior quarter and net income of \$54.8 million or \$0.22 per share in Q2 last year.

In an industry full of cash burns and heavy adjusted EBITDA losses, our focus remains on generating positive EBITDA. For the quarter, we are pleased to continue our trend and report a third consecutive quarter of positive adjusted EBITDA. The consolidated adjusted EBITDA in the second quarter almost doubled to \$1.9 million based on adjusted EBITDA from cannabis operations up \$3.4 million and adjusted EBITDA from distribution operations up \$2.1 million but were partially offset by an adjusted EBITDA loss from businesses under development of \$3.5 million.

Most notably, adjusted EBITDA from cannabis operations almost tripled, and the adjusted EBITDA loss from business under development decreased by almost 20% in the quarter. The increase in adjusted EBITDA is primarily attributable to increased sales in the company's cannabis business.

Moving to liquidity. We continue to possess an industry-enviable balance sheet, including a strong cash position, an appropriate capital structure for our industry and a cap table with minimal potential dilution. As of November 30, 2019, the company had cash of \$497.7 million to fund planned Canadian and international growth. This amount is more than sufficient to fund previously announced CapEx, working capital and strategic investments.

Out of the almost \$5 billion -- \$500 million in cash, we anticipate utilizing \$45 million to complete German CapEx initiatives, \$50 million to complete Colombian CapEx initiatives, \$10 million to complete the installation of butane and other extraction capabilities in Canada and between \$50 million and \$60 million to fund the working capital increases associated with Aphria Diamond's ramp-up, leaving between \$300 million and \$350 million,

plus the cash generated from future operations, all of which is available for future strategic initiatives, more than sufficient to take advantage of any attractive but distressed asset sales in Canada, U.S. expansion or other income statement-accretive opportunities.

In the second quarter, the company increased its cash position by approximately \$30 million. Cash outflows in the quarter included approximately \$36 million for investments in working capital, \$27 million in CapEx and a \$4 million OpEx burn.

Last quarter, we commented that our anticipated CapEx would be \$20 million to \$25 million, which is consistent with what we reported for Q2. And we expected investments in working capital to be \$15 million to \$20 million, the incremental investment in working capital in the quarter related to higher inventory as we transitioned to Cannabis 2.0.

Offsetting these items was our \$80 million debt financing, \$16 million related to the divestiture of noncore investments, \$4 million related to warrant and option exercises and \$2.5 million in borrowings on Germany's line of credit.

Turning to our outlook for fiscal 2020, with a little over 4 months left in our fiscal year. While we firmly believed in our original guidance, certain market dynamics have evolved relative to our initial expectations, particularly in the last 30 days. While there were a number of positive industry events in the quarter that speak to growth opportunities, those opportunities will only present themselves after the end of our fiscal year, including the change in the Province of Ontario's retail rollout and the expected normalizing of store counts against Ontario's population; resolution of Alberta's temporary ban on vapes; and recent initiatives within the FDA to advance cannabis to first-, second- and third-line therapies.

Despite these positives, 3 key items more directly impact Aphria in the second half of its fiscal year, including a continued delay in opening the 40 expected retail locations awarded by Ontario in their lottery late last summer; the temporary banning of vape products in the Province of Alberta, while it studies the impact of vape products, with resolution on the temporary ban not expected until very late in April; the additional cost associated with using third-party purchased cannabis to meet current market demands for our brands as opposed to the internal cultivation costs if receipt of Aphria Diamond's license had not been delayed; and a delay in the growth of CC Pharma's distribution business from recent changes to the German government's medical reimbursement model.

As such, we now expect fiscal year 2020 net revenue of approximately \$575 million to \$625 million, with distribution revenue representing slightly more than half of the total net revenue, a decrease of approximately \$75 million; an adjusted EBITDA of approximately \$35 million to \$42 million, a figure expected to lead the Canadian cannabis industry. We look forward to generating an acceleration in our revenue and profit growth in the second half of the fiscal year and continue to believe the Canadian international cannabis industry outlook remains robust.

In summary, at Aphria, we have differentiated brands, product innovation, greenhouse space, cultivation expertise, extraction capacity and automation technology to position us for success. As we gain scale, we will gain efficiencies through our team's focus on further building our international distribution for our medical- and adult-use cannabis.

We are pleased with our financial results this quarter, and we continue to execute on our strategic priorities to be a stronger, more profitable company. Aphria has a long runway of growth ahead, and we are confident in our ability to create long-term shareholder value.

That concludes our formal remarks. Irwin and I are now available for your questions. Suzanne, back to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Owen Bennett of Jefferies.



Owen Michael Bennett - Jefferies LLC, Research Division - Equity Analyst

Just a couple of questions, please. First of all, so you gave a number of factors leading to the sales downgrade. Could you maybe just put some actual numbers on these versus initial expectations? And actually, which of these were most impactful?

And then secondly, could you just give a bit more comment around the shift in sales mix impacting the average price in rec in the quarter?

Carl A. Merton - Aphria Inc. - CFO

Thanks, Owen. So just in terms of the guidance, we laid out that -- we had laid out an order in the discussion. And so I think biggest item was the impact of the change in the store counts or the lack of change in store counts in Ontario; those 40 additional stores that were supposed to be opened sometime in the late fall and now don't look like they're going to get opened until March, maybe late April. That certainly had the biggest impact. The Province of Alberta's temporary ban was next in order of priority. And then the last piece related more to the purchased cannabis in the quarter due to the delay in Aphria Diamond's license previously.

With respect to sales mix in the quarter, we saw a greater increase in the brand mix itself. And so we see higher prices per gram in Soleil and RIFF and slightly lower prices in Good Supply. And there was a little bit more volume on Good Supply in the quarter.

Operator

And your next question comes from the line of Aaron Gray of Alliance Global Partners.

Aaron Gray;Alliance Global Partners;Analyst

Irwin, congrats on the official title.

Irwin D. Simon - Aphria Inc. - Interim CEO & Chairman

Thank you.

Aaron Gray;Alliance Global Partners;Analyst

So I just wanted to dive a little bit more into the average price per gram. So I can appreciate in terms of how it kind of declined sequentially given the increased volume for Good Supply. But how do we expect that kind of going forward as you're going to have more mix from vape coming online and then with beverages and edibles in the very near future?

And then also, you made a comment on Aphria Diamond, where I believe you referenced the wholesale market from sales coming from them in the fourth quarter. So should we expect kind of a lower price per gram there too to kind of have an impact? So just high level how to think about that line item kind of going forward over the next couple of quarters.

Carl A. Merton - Aphria Inc. - CFO

So I'll just -- I'll take the question on the Aphria Diamond and the wholesale piece first, just because I think there might have been just a misunderstanding in terms of that comment.

Aphria Diamond's sole customer is Aphria. And so all of the product coming from Aphria Diamond moves on a wholesale basis to Aphria. And then Aphria takes that product, does all of the packaging, branding, product format conversion and then it sells it into the market. So no, we are not

expecting a change in sales mix, price mix, average selling price just as a result of Aphria Diamond coming online. Any changes that happen within that would really be driven by a decision to lower prices, which is not a position we have taken. We continue to remain and see very strong sell-through of our brands. And it's really more just about that, that the mix of which brand is selling more in the quarter, which brand has more orders, when do shipments go out. And in the current quarter, we just -- we ended up shipping more Good Supply than we did the other 2 brands -- or actually, the other 3 brands. Sorry, I'm forgetting Broken Coast.

Aaron Gray;Alliance Global Partners;Analyst

Okay. All right. And just one more quickly then. Just in terms of what drove the increase sequentially in sales and marketing. I believe you said it was the increase associated with variable cost tied to sales. So is -- should we expect that to be the new clip kind of going forward? Has that come back down? Just any color on that would be helpful.

Irwin D. Simon - Aphria Inc. - Interim CEO & Chairman

It should be the new norm. As we roll out new products, we continuously invest in our brands and continuously get new distribution out there. And as more and more retail stores open in Ontario and more and more new products, whether it's our vapes, edibles and that, we'll continue to spend dollars to grow those brands and products.

And it's working, which is key because that's why our share increased in Ontario. And if you combine all our brands together, you'll see where our share is increasing. The other thing is we continue to invest with our partners. Great North and Southern Glazer's has boots on the ground to get our distribution and to get our displays within the stores. So we'll continue to invest at those levels.

Operator

And our next question comes from the line of Graeme Kreindler of Eight Capital.

Graeme Kreindler - Eight Capital, Research Division - Principal

My first question was with respect to CC Pharma and the distribution revenue. Two quarters ago, the question came up about seasonality in that revenue. And it was discussed that there isn't seasonality in that revenue. Now I see that's one of the factors in there, in addition to the change in the reimbursement structure in Germany. So I was just wondering what's changed from the previous discussion there. And how big are those impacts on seasonality? What points of the year might we see some of those impacts as it goes on?

Carl A. Merton - Aphria Inc. - CFO

Thanks, Graeme. So we see some elements of seasonality really in this quarter tied around the preorders leading up to the December period. The -- in past years, that seasonality wasn't as pronounced as it was this year. But by far, the bigger of the 2 items at CC Pharma is the continued evolution of that business as it scales properly for the change in the reimbursement model. We believe that the impact on revenues has hit its trough as this -- so to speak, at this point and that future quarters, we will see growth in that number as the business finishes that evolution.

Irwin D. Simon - Aphria Inc. - Interim CEO & Chairman

And I think it's important to understand, too. I mean there's a lot connected with CC Pharma in regards to the government there and some of the regulations. So that's -- it's not so much seasonality. It's just how the government mandates some of this distribution. So it's not so much seasonality.

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

Got it. Okay. And then just as a follow-up. With respect to the comments made in the prepared remarks on the call saying that Diamond will have its first shipment out in February. As that relates to revenue growth and the cadence of that revenue growth and tying into the guidance here, is it fair to assume that the fiscal Q4 will have quite a step up from the fiscal Q3? Just trying to assess the magnitude of how large that first shipment could actually be.

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

Yes. That's fair.

Operator

And your next question comes from the line of Brett Hundley of Seaport Capital.

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

Carl, something caught my ear on the potential monetization of noncore assets. I think it was in Irwin's commentary. But can we just revisit that? And maybe have you put some type of quantitative factors around that comment? Or at the very least, is that comment related to new management potentially looking to reverse some M&A decisions made by prior management? Can you just color that a little bit for us?

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

So I think first off, like noncore investments, you need to concentrate on long-term investments, convertible notes receivable, promissory notes sections of our financial statements. So promissory notes was kind of Note 14. Long-term investments is Note 13. And the convertible notes receivable is Note 11. I wouldn't say it is a change as it relates to M&A. That's -- those 2 things are very, very different, okay?

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

All right. And then, Irwin, if I can just ask you something on your U.S. focus and your potential evolution there or market entrants there. So consumer CBD in the U.S. just seems increasingly uncertain with recent commentary from both the FDA and the USDA. There was even a recent article in the Journal kind of painting a picture that mainstream CPG companies are potentially stepping back from their CBD development, whether that's true or not.

As you guys evaluate your place in the U.S. market, you talked about some complementary areas that you're looking at, and I can appreciate that. But given the backdrop here, is your position something that may have to increasingly wait in the U.S.? Or are your opportunities still front, center and available?

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

Thank You. So question good. And I think, listen, Aphria, from the beginning, always had a position. We're not going to jump into the U.S. with a lot of out unknown out there. And last year, when the Acreage-Canopy deal happened, I came back and said it was like buying a lottery ticket. So we're not going to go out there and jump into an unknown situation.

But having a 25-year experience in the consumer packaged goods business and if something in the consumer area that would complement Aphria and complement CBD or THC when it did become legalized is something that we are looking at, that would have strong sales, strong growth and strong EBITDA contribution that would fit within -- well with Aphria. And there's nothing wrong with diversifying from cannabis but to diversify

into consumer packaged goods products. What I said in my remarks, I want Aphria to be a global consumer packaged goods business that has a connection with the cannabis industry.

Operator

And our next question comes from the line of John Zamparo of CIBC.

John Zamparo - CIBC Capital Markets, Research Division - Associate

I wanted to ask about the Alberta vaping ban or temporary ban. You mentioned you expect it to last through April. What conversations have you had with the province? And what's the province looking for in order to move forward?

Carl A. Merton - Aphria Inc. - CFO

At this point, I think they're just -- they're continuing to collect information. They've been a little bit tight-lipped on the full details of it. But they just want -- they want to take the right steps for their consumers. And we just -- based on those conversations, we feel that that's an April decision, not something that's going to happen in the next 2, 3 weeks.

John Zamparo - CIBC Capital Markets, Research Division - Associate

Okay. That's helpful. On the 2.0 products and pricing, I don't expect you can share specific numbers. But just directionally, do you expect these to be beneficial to price per gram or gram equivalent in gross margin given your numbers are already ahead of some competitors on those metrics? And will we notice it more in Q3? Or is it more likely to be felt in Q4?

Carl A. Merton - Aphria Inc. - CFO

I think you'll start to see it in Q3.

John Zamparo - CIBC Capital Markets, Research Division - Associate

Okay. And directionally versus your existing product set, can you make any...

Carl A. Merton - Aphria Inc. - CFO

Oh, sorry. Directionally versus our existing product, yes, it will represent upticks.

John Zamparo - CIBC Capital Markets, Research Division - Associate

Okay. That's useful. And if I could sneak in one more about inventory. I guess a 2-part question. You've got a meaningful amount of inventory. I think it was about 10,000 kilos of dried flower in hand. So just walk us through why, I guess, you feel the need to buy from third parties?

And then the second part of that, given the stagnant number of stores in Ontario, does that make you rethink the production strategy at Diamond once it is online? And do you feel you have too much inventory on hand? Or is there a risk you'll have too much inventory on hand for the medium term?



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

So if you look at our inventory, I think that one of the things you'll see is there's a bit of a concentration on oils, and we are actively working on managing all the inventory imbalances but that one in particular. Some of our balances on salable flower were lower, and that was where the customer demand was in the quarter. It's a little bit specific to strains and potencies and things like that. And so we supplemented our production capabilities where there was demand that we just didn't have the right specific inventory.

Operator

And our next question comes from Matt Bottomley of Canaccord.

Matt Bottomley - *Canaccord Genuity Corp., Research Division - Analyst*

Just 2 questions, one on the domestic cannabis sales and then just some more clarification on the international distribution. Just first, I'm wondering if you can provide any commentary on what your expectations are in the next 6 months or so, given the significant increase in dried cannabis flower inventory balances at wholesalers. So I think you had a pretty solid pricing relative to some of your peers at about \$5.20 and change this quarter. What magnitude could we potentially expect a price erosion, particularly on the dried flower? I understand that the cannabis 2.0 will likely more than offset this, but I'm just trying to get my arms around how significant commoditization might be in the next couple of quarters here, industry-wide.

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

So I think that any level of price compression is really going to be tied to brands themselves. And people who haven't invested properly in their brands and who haven't developed their brands and don't have sell-through are going to experience far more price compression than the people who have thoroughly invested and thoroughly researched and developed good, strong brands.

We continue to see very strong sell-through of all of our brands, very positive reviews online related to the brands. I don't foresee the same concerns with price compression that I think a number of our competitors do.

Matt Bottomley - *Canaccord Genuity Corp., Research Division - Analyst*

Okay. Great. And then just staying on the...

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

(inaudible)

Matt Bottomley - *Canaccord Genuity Corp., Research Division - Analyst*

Yes. And just sort of staying on the -- just the cannabis or the domestic sales, can you give any sort of goal posting or how you feel the initial launch has gone of the 2.0 product? I understand we're in very, very nascent stages but just I know that retail is muted, and you gave some of the factors in your press release and prepared remarks as to why guidance has come down, but just a general first, sort of, 3 or 4 weeks of cannabis 2.0 from a logistical standpoint how that's been going.



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

Well, I think you've seen -- the big difference for cannabis 2.0 versus 1.0 is the different ordering patterns that the control boards have gone through. In cannabis 1.0, it was more about, I'll take whatever anyone's got. In cannabis 2.0, it's been a more muted, initial purchases by the control boards. They're trying things out. They're trying brands. They're trying to manage inventory levels, inventory levels inside of the control boards, inventory levels at stores. And so the idea is lower purchases, higher frequency just changing the cadence of orders. And there's been some -- I've read some articles where some places are accordingly out of stock and are doing more frequent reorders. So it's just being handled differently this quarter -- this time.

Matt Bottomley - *Canaccord Genuity Corp., Research Division - Analyst*

Great. And just last question for me on the international side. Just want to make sure I understand the sort of ramp in that segment considering your revised guidance. So at about 50% of your revised guidance, that puts your international revenues at about \$290 million. So you've already done about \$180 million in the first 6 months. So that delta of about \$100 million, how is that going to come into the results over the next 2 quarters? Is it going to be a gradual decline? Because I imagine we're going to see more substantial decreases in that segment given your new guidance.

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

No. I would suggest that you're going to see revenues that, more or less, mirror what they did this quarter in our international distribution business for each of the remaining quarters.

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

They'll continue to be the same.

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

Yes.

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

The guidance is slightly more than half.

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

Yes.

Operator

(Operator Instructions) Our next question comes from the line of Pablo Zuanic of Cantor Fitzgerald.

Pablo Ernesto Zuanic - *Cantor Fitzgerald & Co., Research Division - Research Analyst*

Look, I just want to follow up on the guidance question. I mean obviously, based on the share price this morning, the market doesn't like the guidance. But I have to say personally, I like it. And what I want is clarity here. Based on the numbers you've given, we're looking at cannabis sales for the second half about \$160 million to \$110 million versus \$65 million in the first half. I mean those are rough numbers, right? That's a meaningful

step up in growth of 150% to 220% growth. Yes, you have confidence on those numbers, but can you just maybe give more granularity, like, what do you think what happens with the base business? What happens with 2.0? I mean just so we can have more confidence on that big ramp-up in sales that you have given here. Any color would help, whether medical flat, 2.0, what percentage of that, how Diamond helps and then just the base underlying business.

And then the second question is related to the -- go on. Yes. I'll stop there.

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

So Pablo, nice to hear from you. I'll go with my piece first. And then I'll let Carl chime in here. But why are we confident in what happened out there? There's a lot of things that were not in our control, as Carl took you through. But I think with Cannabis 2.0 and rollout of the vape product line, we will hopefully roll out some edibles in the latter part of the fourth quarter and continuously, additional stores opening up in Ontario and the rest of the country. Our GMP certification, which we have received over the last couple of days, which we'll be able to ship to the EU. And just the big thing is having supply here. And with Aphria Diamond coming on and we'll be able to start shipping product in mid-February, that we now have supply.

So there is a real good plan in place. It's a real good integrated plan from a growth standpoint, from a process standpoint, from our marketing standpoint as we built their brands. And last, but not least is a whole rollout with our sales team and with Great North who helps us do this. And as you saw in our last quarter, in Ontario, with 25 stores and more stores opening up, we grew our share to over 13%. So that's why we feel good. And as this industry is in its infancy stages, there's lots to change. But I got to tell you, we've really got a good measured account of how we will achieve this guidance in the back half.

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

The only thing I would really add to that, Pablo, is that our sales growth, to date, has been more limited by our internal supply than by demand from individual consumers within our brands. As I said earlier, our brands continue to just demonstrate very, very strong sell-through and significant levels of demand. And so we remain confident that with that additional demand, our ability to pick up additional share with the expected retail rollouts in Alberta and B.C. and some of the other provinces as it relates to this year and then going past this year, Ontario, it all puts us in a position where we're extremely confident in that guidance.

Pablo Ernesto Zuanic - *Cantor Fitzgerald & Co., Research Division - Research Analyst*

That's good. And then just ask a follow-up. So more from a market perspective, if you can talk about underlying trends, I mean, the September and October stats and data show flat sales sequentially month-on-month up to double-digit growth from the prior month. What happened in November, December? Do you have a sense of that? There's chatter in the market that there's explosive growth in the very, very low end of the market. And I wonder whether that's incremental, just bring in people from the illicit market, so that's not a problem, or whether it's really cannibalizing the other products. Just give more color in terms of what you see happening in the underlying market from a 1.0 perspective.

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

Well, from a market standpoint and from a timing standpoint, as I say, we continuously see great demand out there. And I think there's a lot of anticipation and buildup in regards to Cannabis 2.0 and rolling out our vapes, and we're one of the first ones to get out with them. And I come back and say is, this year, not much has changed from the share that we talked about in November. So it's robust.

Listen, I think what happens is there is price out there, and price always does matter. But one of the biggest things that we're seeing, Pablo, is this year, the consumer wants brands and quality. And that is the big thing. And ultimately, where is the consumer coming from? It's them coming from the illicit market and coming in to buying products that they know they've gone through quality, regulation and that. And that's what we



feel very, very good about. And there's lots of plans in place at Aphria, how we continuously move consumers over from the illicit market into the regulated market.

Operator

And there are no further questions in the queue at this time. I'll turn the call back to the presenters.

Irwin D. Simon - *Aphria Inc. - Interim CEO & Chairman*

Thank you very much, everybody. Again, a lot is happening at Aphria, as you can see. We're in an industry that's changing daily. And I was part of the natural organic food industry for 25 years and saw lots of change there. Very similar. I'm down at ICR meeting a lot of investors today, and it's exciting to talk about Aphria.

And as I sit back and look at Aphria from a rec standpoint, from a medical standpoint, as we sit back and look at our GMP certifications that we can sell into the EU, as we sit and look at many multiple products and multiple things that we can do, what I will tell you, cannabis is something that's going to be around a long, long time in many, many, many multiple facets; Aphria, today, having both Aphria One and Aphria Diamond, having that supply, having that quality and having that regulation.

And yes, we're talking about rec only being legalized in Canada today, but there's a lot we're learning from that, that will help us roll out products around the world. As I said, we have a very interesting and we're looking at multiple opportunities for the U.S., just not around CBD, around other products that will complement cannabis. And that's something that we'll be focused on.

So we have our brands. We have our people. We have our strategy. We have a strong balance sheet that will allow us to do this. And last but not least, we look to go back and how do we return back to shareholders.

So with that, everybody have a great day, and thank you very much for your time.

Operator

And this concludes today's conference call. You may now disconnect.

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