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EDITED TRANSCRIPT

OGI.V - Q2 2020 OrganiGram Holdings Inc Earnings Call

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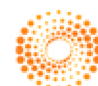

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PRESENTATION

Operator

Good morning. My name is Lisa, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Organigram Holding Inc.'s Second Quarter 2020 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded and a replay will be available on Organigram's website.

At this time, I would like to introduce Amy Schwalm, Head of Investor Relations. Ms. Schwalm, you may begin.

Amy Schwalm - *OrganiGram Holdings Inc. - VP of IR*

Thank you, operator. Joining me today are Organigram's Chief Executive Officer, Greg Engel; Chief Financial Officer, Derrick West; and our Chief Strategy Officer, Paolo De Luca. Please bear with us today as we're all doing this call remotely from our homes.

Before we begin, I'd like to remind you that today's call will include estimates and other forward-looking information from which our actual results could differ. Please review the cautionary language in today's press release regarding various factors assumptions and risks that could cause our actual results to differ. Furthermore, during this call, we will refer to certain non-IFRS financial measures. These measures do not have any standardized meaning under IFRS, and our approach in calculating these measures may differ from that of other issuers and so may not be directly comparable. Please see today's earnings report for more information about these measures.

I will now hand the call over to Greg.

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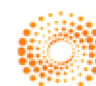

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Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Thanks, Amy. Good morning, and thank you for joining us today. This morning, we reported results from our second quarter of fiscal 2020 ended February 29, 2020.

Before I begin, I would like to welcome Derrick to his first earnings call as our Chief Financial Officer and Paolo as our Chief Strategy Officer. We'll provide some overall remarks on the quarter as well as on current developments, and then Derrick will take you through our financials in more detail. All 3 of us will be available to answer questions before we close the call by no later than 9 a.m. Eastern Time.

First of all, stepping back, I have 2 important messages I want to come through clearly this morning. First, we are pleased with our continued execution in the second quarter and with the demand for our new products in the market today, including Rec 2.0 SKUs as well as new core strains being introduced across the country. And secondly, we believe we are well positioned with our plans to manage through these uncertain -- very uncertain times for a number of reasons, which I'll go through shortly.

So turning to the quarter. Adult-use recreational revenue was up 16% sequentially driven by the launch of our first Rec 2.0 products, despite total revenue being down on lower wholesale revenue. The adult-use rec market is our core business and represents the most significant growth opportunity for us. We also continue to introduce new strains after these sold exceptionally well as limited time offers in the past. Limelight, which averages about 20% to 25% THC, was available in Alberta, B.C., Québec, Nova Scotia and New Brunswick in mid- to late February and was launched in the remainder of the provinces, including Ontario, in Q3. El Dorado, our recent addition to our hybrid category, averages about 18% to 20% THC and had distribution to all provinces in Q2, with the exception of Nova Scotia and B.C., both of which are expected to come in Q3.

We expect to continue to see wholesale market demand for our indoor grown product over the next couple of quarters, but it is not our primary focus and more of an opportunity for us in the near term. We have continued to diversify our revenue streams. During the quarter, Rec 1.0 products represented about 52% of net revenue. New 2.0 products, including chocolates and vapes, represented 13% of net revenue. Wholesale revenue from other large Canadian LPs represented 24%, with Canadian medical sales representing 10%, international sales representing 1%. The company continues to actively seek opportunities to expand its product mix and customer base.

The second quarter marked a milestone for us, the launch of our initial Rec 2.0 products. We began shipping Trailblazer Torch vape cartridges on December 17, 2019. And right before the quarter closed, we made our first shipments of Edison vape pens and Edison Bytes, our premium cannabis-infused chocolates. Powered by Feather technology, Edison vape pens are ready-to-use inhalation-activated pens that are designed to offer a simple and intuitive user experience. Feather is a cannabis vape pen company currently selling products in Colorado, and we have secured exclusivity with them in the Canadian market. Edison Bytes are premium truffles in both milk and/or chocolate formulations and available as a single chocolate containing 10 milligrams of THC each and a set of 2 truffles containing 5 milligrams of THC each. Pax Era cartridges, our third and final vape offering for the premium segment of the market, are expected to launch before the end of calendar Q2 2020.

Notably, we've secured listings in all provinces that allow edibles and vapes for our Rec 2.0 products. Along with our license renewal received this month, we also obtained licensing approval for the remainder of Phase 5 of our facility we chose as a dedicated edibles and derivative product facility. The market continued to see price compression for Rec 1.0 products, but our average net selling price held up well and remained above $5 per gram, excluding wholesale. Our cost of cultivation remained one of the lowest in the industry, which better positions us against pricing headwinds. In fact, our cost of cultivation decreased from the previous quarter to $0.53 per gram on a cash basis and to $0.75 per gram all in. Q2 gross margin before fair value changes to biological assets and inventories sold declined somewhat from Q1 as we launched a number of Rec 2.0 products for the first time. Importantly, we see opportunity to drive improved gross margin as we continue to scale and optimize Rec 2.0 product's impact.

Adjusted EBITDA was negative in Q2 primarily due to a large brand campaign for Edison that ran during the quarter and higher costs related to the launch of 2.0 products. As I've said before, prudent cost management is deeply embedded in our culture at Organigram. We've seen most of our competitors announce executive turnover and/or complex cost restructuring plans, where we've been able to stay focused on execution and have not faced these same disruptions.

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However, we are all facing even more challenging times today with COVID-19 global pandemic. Our priority is to protect the health and wellbeing of our employees. It was clear many facility staff were not comfortable coming into work, particularly if they weren't able to practice sufficient physical distancing even with the additional matter -- measures we put in place. It was no longer possible to continue to operate our facility in a business-as-usual approach. We know we are not alone and other LPs are also experiencing employee absences and reduced operational activity for the same reasons. As such, we developed a plan intended to help protect the health of our employees and maintain business continuity to service our medical patients and customers.

We offered temporary voluntary layoffs to facility staff and those that accepted made up the majority of those temporarily laid off. Lump sum payments equating to approximately 2 weeks' worth of work have been paid to the affected employees to help bridge the gap to government programs. In addition, we will absorb the employee pay portion of health dental and short-term disability premiums for all employees during this difficult time. The impact of these temporary layoffs will result in a onetime charge of approximately $0.6 million. We have maintained an experienced group of employees at the facility with skills flexible enough to work on various production and packaging lines as demand dictates.

There were also a select number of administrative and other employees who were temporarily laid off as a result of reduced operations and/or deemed nonessential in the short term. To be clear, we did not make these changes because we had any employees that tested positive for the virus, nor have we made these changes because New Brunswick is anywhere soft in any other parts of the country. In fact, even though New Brunswick is reported to conduct about 10% less testing than the national average to date, the province is reported to have 78% fewer confirmed cases per capita than the national average. We applaud the actions the government has taken in an effort to contain the virus in New Brunswick.

By prioritizing the health of employees and being proactive in our containment efforts, we believe this puts us in a better position in the medium to long term, while still being able to manage our operations in the near term. We continue to closely monitor the evolving situation and are prepared to make decisions in the best interest of our employees, balanced with the long-term sustainability of our business. We have no current plans to reduce medical production as we intend to continue our -- service our patients who have come to rely on our products. In fact, just last week, we expanded our distribution with our first shipment to Shoppers Drug Mart under distribution agreement we previously announced in February.

With reduced capacity, we are focusing on the most automated and efficient lines of production and packaging and are able to supplement with finished goods inventory on-hand in an effort to meet demand in the short term. A good example is our Edison Bytes chocolate truffles with our automated production and packaging equipment. Also, we recently started operating a T-Zero trimming machine since we received licensing approval for the remainder of Phase 5 in mid-March. The T-Zero does the same work as 12 T4s and requires significantly less manual labor to clean than multiple T4 machines. It also means that we have to deprioritize certain products with lower margins and are those -- and/or those reliant on more manual processes in this temporary period.

Where possible, we also shift our production mix to larger format SKUs as online purchasers tend to prefer those. We are also evaluating new brand and product launches during this time. We are no longer providing guidance as to the launch timing of our new powder beverage product and ANKR, our recreational organic dried flower product. Although there has been great interest in our powder beverage from our provincial partners, it is still estimated to comprise a smaller percentage of sales relative to vapes and chocolates. Similarly, despite having ANKR product ready to package, we need to assess priorities in light of a reduced workforce and current consumer demand. Dry flower vape pens and chocolates will be our mainstays for the foreseeable future.

Now turning to current demands. We've seen an uptick in March sell-through as well as more orders from provinces have happened. Consumers continue to have access to purchase cannabis across the country with most retail stores remaining open or offering click and collect or curbside pickup. In addition, online sales run by the provincial cannabis bodies and private retailers, where applicable, are experiencing surges in sales as purchasers adhere to stay-at-home directives. As a company, we are actively monitoring these trends, but still need more time and data to evaluate just how much is due to pantry loading versus a sustained change to purchasing habits. While it remains to be seen, there is evidence to support cannabis demand is just as inelastic as demand for alcohol. A survey of 1,005 U.S. consumers by MK and Partners found that media, alcohol and cannabis were the categories that showed the highest indications of discretionary spending as a result of the pandemic. There are factors that tend to support increased consumption even light of an economic downturn.

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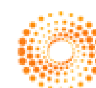

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As consumers pare back spending on higher ticket items, such as dining out and travel, cannabis is relatively less expensive and still provides a recreational experience. Stay at home and physical distancing directives offer more opportunity to consume cannabis in private settings, which is what our own market research indicates is to be expected, particularly for edibles.

I would now like to turn to our ability to supply this demand. As we announced last week, we believe we have sufficient inventory levels to supplement reduced harvest plans and enough contingency staff to keep packaging intact to meet anticipated demand in the short term. We also remain comfortable with our current inventory from external suppliers, such as vape product hardware and packaging materials and have not experienced any significant disruptions to date. We provide some detail on the breakdown of inventory in note 7 of our financial statements, so I'd ask you to please turn to that to review. Our finished good dried flower inventory is largely comprised of higher THC product and our most popular strains. Further, the majority of upcoming harvests are comprised of strains in higher demand, including Limelight and El Dorado. As we have been saying, we can contribute this to the benefit of our yearly views on retail sell-through, allowing us to shift their production mix starting last year.

With that, I will now turn the call over to Derrick.

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Thank you, Greg. Since I joined early last month, it has certainly been an eventful time in the industry and globally to say the least. In any event, I am very happy to be here and look forward to meeting many of you on the call virtually and eventually in person when it is safe to do so. I have been getting up to speed quickly, and it has helped to have had the vantage point from previously being on the company's Board and Chair of the Audit Committee.

I will begin with some comments on our financial position. As at quarter end, our remaining estimated capital spend on Phase 5 was $11 million, largely related to the installation of certain equipment in the edibles and extraction area. We expect to spend at a slower pace to balance near-term priorities with respect to COVID-19. Our remaining estimate spent on Phase 4 is quite marginal at about $2 million. We are pleased to see our capital expansion nearing completion. We believe we have built an impressive indoor facility capable of producing high quality, low cost flower as well as premium chocolates and other derivative products.

We ended the quarter with $41 million in cash in short-term investments. As of today, there is $30 million undrawn on our term loan and a $25 million revolver available to be drawn against specified receivables. As at quarter end, working capital declined to $97 million from $152 million at fiscal 2019 year-end. This was largely due to an IFRS requirement to classify the long-term portion of the term loan to current liabilities because we were in violation of our fixed charge coverage ratio covenant. We obtained a waiver from our lenders that waives compliance until May 30, 2020. We are currently negotiating an amendment to the credit facility agreement in an effort to provide flexibility as a result of the impact of COVID-19.

We reported approximately $85 million in current and long-term debt as at quarter end, which primarily represents the carrying value of the term loan in our credit facility with BMO and a syndicate of lenders. In December of 2019, we announced an at-the-market offering, or ATM program, which allowed us to issue $55 million or its U.S. dollar equivalent of common shares from treasury. We issued approximately 16.2 million common shares pursuant to the ATM program in Q2 for gross proceeds of approximately $55 million at a weighted average price of $3.39 per common share. Although the price per share I just quoted was in Canadian dollars, approximately 2/3 of the shares issued were on the NASDAQ Exchange with the remaining on the TSX. Net proceeds were $52.9 million after agents' commissions, regulatory and legal and professional fees. We have used and intend to continue to use the net proceeds to fund capital projects for general corporate purposes and to repay indebtedness. The ATM program was completed before quarter end.

Moving to our quarterly results. Q2 net revenue of $23.2 million compared to $26.9 million in the prior year quarter. The decline from 2019 was largely due to: a decrease in adult-use recreational sales volumes as a result of the timing of the large pipeline fill orders in Q2 2019, which was to fulfill supply shortages in Alberta and Ontario following the legalization of adult-use recreational cannabis; a lower average net selling price from increased competition; a provision for returns and price adjustments largely related to cannabis oil, which has seen less-than-anticipated demand

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in the industry, another slow-moving product. This decline was partially offset by the launch of our initial Rec 2.0 products and continued wholesale revenue in Q2 2020.

Q2 2020 net revenue of $23.2 million compared to Q1 2020 net revenue of $25.2 million. Adult-use recreational sales were up approximately $2.1 million or 16%, offset by a decrease in wholesale revenue. Q2 2020 net revenue of $23.2 million was largely comprised of $15 million in sales to the adult-use recreation market, $2.4 million in sales to the medical market and $5.6 million and $0.2 million in wholesale and international sales, respectively. This compared to Q1 2020's net revenue of $25.2 million, which was largely comprised of $12.9 million in sales to adult-use recreation market, $2.7 million in sales to the medical market and $9.2 million and $0.3 million in wholesale and international sales, respectively. As Greg mentioned, Q2 cash and all-in cost of cultivation were $0.53 and $0.75 per gram, respectively, and decreased from $0.61 and $0.87 per gram in Q1 2020 as more economies of scale were realized with increased cultivation capacity and as our yield per plant increased from 150 grams in Q1 to 155 grams in Q2 2020.

Q2 2020 cost of sales of $15.8 million compared to Q2 2019 cost of sales of $10.8 million. Higher cost of sales in Q2 of '20 was primarily due to: more staffing for increased cultivation and post-harvest capacity without the benefit of full economies of scale; inventory provisions and write-offs primarily related to legacy packaging; and thirdly, higher costs associated with the launch of Rec 2.0 products as the company scales and optimizes production and packaging. Q2 gross margin before fair value changes to biological assets and inventories sold was $7.4 million or 32% of net revenue. As we have said in the past, we focus on gross margin before fair value change to biological assets and inventories as one of the key measures to assume underlying performance and generally find this to be what the investment community tends to track. The Q2 IFRS gross margin was $11.3 million, largely due to a net noncash fair value gain on biological assets and inventories sold of $3.9 million versus a net noncash fair value loss of $8.1 million in Q2 2019.

Q2 2020's SG&A, excluding share-based compensation, was $14 million compared to $5.7 million in Q2 2009 (sic) [2019] as the company increased staffing and sales and marketing efforts, including a significant brand marketing campaign and higher costs related to the launch of our new Rec 2.0 products. We reported negative adjusted EBITDA of $1.1 million in Q2 versus positive adjusted EBITDA in Q1 due to the combination of higher cost of sales and higher SG&A as just described. Our Q2 net loss was $6.8 million or $0.041 per share on a diluted basis compared to our Q2 2019 net loss of $6.4 million or $0.049 per share largely due to higher SG&A in Q2 2020.

I will now turn the call back to Greg for closing remarks.

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Thanks, Derrick. To wrap up our formal remarks, I'd like to summarize why we believe we are well positioned during this temporary period and beyond.

First of all, we believe we have developed brand loyalty and there's strong demand for our Rec 2.0 products, and we are rolling out new higher THC popular strains across the country; secondly, we have forged excellent partnerships and have strong relationships with suppliers, regulators and our provincial and private retail customers; third, we maintain a lean cost structure and a relentless focus on prudent discretionary spending; fourth, we have further strengthened our executive team with the addition of another experienced finance executive and a Chief Strategy Officer, who is intimately familiar with the business; fifth, we can supplement reduced production capacity with existing inventory as well as leverage our investments in automation to meet demand in the short term; and lastly, we remain committed to focusing on disciplined capital allocation to generate sustainable value for our shareholders.

I'd like to expressly thank the regulators as well as government authorities for including cannabis in stimulus packages and in subsidies in this challenging period. I would also like to thank our customers, patients, investors for their support. And last but not least, the entire Organigram team and our Board of Directors.

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

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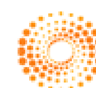

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Tamy Chen from BMO Capital Markets.

Tamy Chen - *BMO Capital Markets Equity Research - Analyst*

First question is, just wanted to understand, is it, at this point, your intention to rehire back the temporary laid-off workers after the COVID-19 developments go past us? Or do you intend to wait and see how quickly, for example, stores open in Ontario for bringing back those workers?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. It's Greg here, Amy -- Tamy. That's a good question. So certainly, the intent and the way we structured this as a temporary layoff. So this was structured in that manner that we can bring and plan to bring employees back. But I think the time frame and the cadence of how we bring employees back is going to be dependent on kind of the growth of the market back into play. So it is our intention to bring them back, and that's why we've structured it this way.

Tamy Chen - *BMO Capital Markets Equity Research - Analyst*

Okay. And my second question is -- so I noticed your Rec 1.0 sales were flat to slightly down sequentially. But I believe in Ontario, the provinces, I think, almost doubled their store count over this sort of period into March. So I would have thought you would have experienced some shelf filling during this period and increased your Rec 1.0 sales sequentially. So just any color there would be helpful.

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Sure. In Q2, we were still drawing down on inventory that we had placed in Ontario in Q1 and as well as a move to kind of the more high velocity strains, as we said, Limelight and Eldorado and insuring we moved inventory there. So it was a bit of a combination of both, so we did have sufficient inventory. So certainly for the majority of Q2, Ontario revenue was still ticking through inventory from Q1.

Operator

Our next question comes from the line of Andrew Partheniou from Stifel GMP.

Andrew Partheniou - *Stifel Nicolaus Canada Inc., Research Division - Analyst*

I'm just curious, how does your cost profile now change with the workforce reduction and especially also the licensing of Phase 5?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. So I'll start off and maybe ask Derrick to add some color. I mean, so we've had a workforce induction. I think we're still assessing our capabilities and exploring what impact that's going to have. As we've indicated, both in our press release related to the temporary layoffs as well as the current information in this press releases, we are moving as much as possible to automated lines and system. And so to make a comment, I think we can't give guidance yet in terms of what impact that will have, but it is a shift to as much automated systems and higher SKU -- higher large-format SKUs as well, where possible, on flower.

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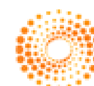

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Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Derrick here. I would just add that our largest cost is our labor cost. And so we have -- we will achieve obviously the savings from the layoffs in terms of our labor cost. And we -- obviously, that will reduce our total production an ounce, but we do believe that we're going to get some balance as it relates to the SKUs that we'll be focusing on, the product lines we're focusing on. But again, we're not in a position at this time to provide any future guidance on exact amounts.

Andrew Partheniou - *Stifel Nicolaus Canada Inc., Research Division - Analyst*

Okay. And -- well are you able to provide maybe some kind of a distribution between savings on SG&A versus COGS?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Well, we're not at this point, I apologize. So we just -- again, we're still working through kind of -- as we -- we've only now been running 2 weeks with kind of the reduced structure, so we're not able to give guidance at this point.

Operator

Our next question comes from the line of Rupesh Parikh from Oppenheimer.

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

So I wanted to ask a little bit more about gross margins. So as we look out to the balance of the year, how should we think about the gross margin? Should we expect sequential improvement versus what we saw in Q2?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Maybe I'll turn that over to Derrick to answer. Yes.

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Yes. I just -- I don't want to comment too much about future margins, but I can comment that for the margin that we have, the adjusted gross margin of 32%, that was after we did allowances for packaging material on certain product lines, and the impact of that was $1.3 million or 5.5%. So there -- while there's always going to be these types of adjustments, it would probably be a larger-than-normal adjustment that happened in one quarter. And without that adjustment, the margin would have been, on a pro forma basis, 37.5%. And -- but I'm not going to, at this point, provide any kind of future guidance in terms of our margins.

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Great. And then I guess one follow-up question, just on pricing. So I know there's some pricing pressures within the marketplace right now. Just wanted more color in terms of what you guys are seeing in -- if there's any forward commentary in terms of how you're thinking about the pricing pressures going forward.

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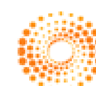

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. Maybe -- so thanks, Rupesh. It's Greg here, I'll answer again. So I think where we've seen -- I mean, we've still maintained an average selling price of product that we're selling into the rec market above $5. And I think we are seeing pricing pressures, and we have always made the assumption that the pricing pressure would come because of large SKUs that were coming into market, and we are seeing that. And I think it's important to understand that some of this competition is being driven out of short-term needs from companies who have had to move product.

And when you look at the price they're selling at versus what their production costs are, I'm not sure they're actually even making money on some of these products, so not a sustainable pricing strategy beyond the near term. I think where we have an advantage, we are looking at larger SKU formats that are our average cost of cultivation and all-in costs are quite low compared to many of our competitors. So we've got the best of both worlds. I guess when you look at it, we're producing high quality product as well as at a very low cost. So I think that's where we're seeing most of the pricing pressure is really on the large SKU formats on the lower end.

Operator

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

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

I was wondering if you could comment on what the ordering patterns from the provinces are looking like, given the current environment that we're in. I know historically, we went from larger ordering patterns to smaller, more frequent orders. Now that we're in a situation where it looks like there's spikes in demand followed by a commensurate sort of decline in demand, just wondering if the ordering pattern behavior from the provinces has changed at all and how you're responding to that.

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. I think certainly, we saw, as kind of stay-at-home orders started to come into place, a pretty significant shift in [kind] of demand, and provincial retailers and private retailers were looking to stock up in advance at or with the demand they were seeing. I think one of the challenges that we have seen for those with -- that operate large warehouses like Ontario and Alberta is that they had staffing reductions within those facilities as well. So even though they wanted significant amounts of products, they ended up having to take them over a more pushed out period of time.

So while the demand -- there was a sudden kind of increase in demand, and we still see very strong online sales, and we are still seeing strong cannabis sales, it has been pushed out even more. So the demand was there, but they're -- getting the shipments in was kind of spaced out a little more. So in many ways, it's actually easier to manage for companies like ourselves and others to get sequential product in. We continue to see strong demand, especially for, as I commented, our leading strains and our Rec 2.0 products. So...

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

Okay. And as a follow-up, with respect to the wholesale market, I was wondering if there's been any increase in demand there, given -- I would assume, there's a number of operators who are working on a reduced staffing level, which could impact our harvest. And given -- looking at some of the breakdown of the inventory that's disclosed on the balance sheet there, is there potential for any more opportunistic sales moving forward on the wholesale channel?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

So I guess the comment I would give on that, Graeme, is we've had additional inbounds. We've expanded who we sell to. So I mean, we do have one additional company that we have been selling wholesale to than previous quarter, and we've had additional inbounds as well. So the answer's

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yes, there's demand there. And I think again, having that inventory and having quality inventory, which we've commented in the past, is a big differentiator. So -- but I can't necessarily -- until you completed an agreement and until you've made a sale, there's inbound interest, but I can't say more than that.

Operator

Our next question comes from the line of Chris Carey from Bank of America.

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

So I guess maybe just one question on the cash flow, then I have a follow-up. But I guess this quarter, cash burn represents about 1/4 of the cash on hand. And then I guess when you add the term loan and the credit facility, which is another $55 million, you have about 2 quarters of liquidity relevant to the cash burn this quarter. So I wonder if you can help me just understand the cadence of cash flow expectations from here. And I appreciate that CapEx is likely to step down. Perhaps you can provide some visibility there and maybe how operating cash flow -- so just big picture there, how this cash used versus cash sourced is likely to move over the next several quarters?

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Yes. Derrick here...

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes, go ahead, Derrick. I was going to refer to you, please.

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Okay. Yes. So for the first 6 months, a large amount of the reduction in our cash position has related to the CapEx spend. Yes, there is a working capital or cash from operations [deficiency] of $25 million to the end of February as a consequence of our working capital build that did occur, mostly as a consequence of inventory and bio asset build. But I would indicate that as at the end of the second quarter, our cash was at $41 million. We are not required to continue on an aggressive CapEx program. To complete 4C, we're talking about $2 million more that could be spent over the next period, and $11 million as it relates to Phase 5, as it relates to equipment for edible extraction, but that's not equipment that we'd be looking to put in place right away because we would even be able to bring the professionals in to assist -- to load up the equipment and make it certified because of the COVID-19 impact and social distancing.

So we have a modest spend going forward of approximately $13 million, and that $13 million spend is going to be done, and it's going to be slowed down dramatically from what we spent in the past. So when you consider that and the fact that we have $41 million in cash at the end of the second quarter, that we do have $25 million remaining on a term loan for the credit facility. And while there's no guarantee that we'll be successful in amending the credit facility, we do believe that we will be successful, we just can't guarantee at this time. So the combination of that does provide sufficient liquidity and cash that will take us past -- that will take us into the future. And we always have -- whenever the company has been in a situation where it's wanted to access other sources of capital, it's always done so when it's required, but we don't believe it's required at this time.

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Maybe just to clarify, Derrick, you were referring to what we had remaining on the long-term debt. So we have $25 million as a revolver, and we have $30 million on the debt itself remaining. So...

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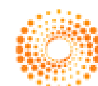

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Christopher Michael Carey - *BofA Merrill Lynch, Research Division - Research Analyst*

Right. Right. Okay. All right. That's helpful. And then I guess as a follow-up, it just feels -- and I think Tamy mentioned it as well, it just feels like the adult-use business, after kind of storming out of the gates last year, and I fully appreciate that, that was a pipeline fill, but it does feel like it just has struggled to really regain that position in the market that it had before. And I appreciate the comments on provinces like Ontario are starting to work down the inventory that they have. But it doesn't sound to me from the answer to the prior question that you're at the point where your inventory levels in the channel have now reached kind of a clean level and that you can start to refill at an area where maybe you start to retake some market share.

And so I wonder, just a high level question, if you think it's an unfair assessment that the business has stalled a little bit and maybe how you might see things starting to develop over the next couple of quarters? And then if I could just sneak one in here. I mean do you think that the industry can even grow in your upcoming quarter with so many stores going click and collect? Or is the click and collect and online demand such that the category, the industry at large, can still grow?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. So maybe I'll take part of that question, Chris, and then I'll turn things over to Paulo. So I think when -- first of all, to answer the second part of your question, I mean, there's significant -- the majority of stores across the country with this -- and if you include Ontario, are still open. PI only has 4 stores. They've closed their stores. And they're doing -- click and collect -- or sorry, online. And then in Ontario, they made a decision to close the stores as you're aware of. And then within a couple days, reverted back to click and collect and local, and they are going to have local orders. So the demand's there.

And I think the comment I made earlier, which is interesting, is that, again, consumers and the population in general has limited opportunities for spend. We've seen and we look at -- I mentioned some of the survey data from earlier. We've seen in the past, for example, if you go back, there was a major ice storm in Canada back in the late '90s on the East Coast. And in Québec, alcohol sales for the month of February where the power was out for 3 weeks was the highest it had been for the last couple of years at that point. So with limited available for spending kind of their entertainment dollars, I think certainly demand for cannabis continues to be strong.

Back to your first question, I think when you look at -- I think, look, there was a lot of excitement to Rec 2.0 products, and that has brought an expanded consumer base into the legal market. I think one of the challenges has still been on the 2.0 products is product availability as we saw when 1.0 launched. And secondly, is that the provinces, in some cases, didn't expect the demand to be as high as possible. So they were -- they wanted to keep their inventory levels down and then make decisions on reorders.

For one of the large provinces, for example, we had reorders happen on our Trailblazer vape pens before it had even hit the store shelves because the fill demand from the stores was very, very high. So I think the -- there has been a lot of excitement and brought new consumers in through the 2.0 products. And maybe I'll let Paulo add a little bit. I know he's -- this is one of the areas he focuses on.

Paolo De Luca - *OrganiGram Holdings Inc. - Chief Strategy Officer*

Can you guys hear me, okay?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes.

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Paolo De Luca - *OrganiGram Holdings Inc. - Chief Strategy Officer*

Perfect. Chris. So look, this quarter that we're in is obviously kind of a once-in-a-lifetime quarter in terms of the uncertainty around COVID. And we're just learning right now what's happening in terms of consumer behavior, both kind of in the pantry loading that we saw last month when people were worried that the stores would close down and subsequently -- that hasn't been the case for the most part, as Greg alluded to. And we do have a little bit of a different world right now where you have click and collect in the province, for example, like Ontario are online ordering. So we're monitoring that. We're trying to see what's happening there.

But we do see some positive anecdotes, for example, people are actually shifting to the legal market now because they don't want to interact with their black market dealer, and they don't want to meet the person physically. They don't want to exchange cash, which is a concern for people in terms of the virus spreading. So that's all to be determined, and we're going to obviously respond in whichever way we think is best to take advantage of the opportunity that may present itself as a result of that.

And in terms of just the logistics of the entire market, we are dependent, obviously, on the consumer behavior. We're dependent on the ability of the provinces to have the logistics in place and not to have disruptions there in terms of their ability to stock at the distribution centers and so forth. Our view is that this quarter is -- it's difficult to forecast to be -- there could be opportunities for us to do well in certain products and take advantage of opportunities, but we just don't know. It's a very unknown quarter.

Where we are focused was longer term on our core strengths, which is to become a leader in the chocolate segment and to become a leader, obviously, with some of our new strains like Limelight and El Dorado, which we've mentioned in the past. I think one of the things to look at in the way that the rec market has developed over the last, call it, 6 to 9 months, we've seen some of our competitors adopt pretty aggressive pricing strategies and move to larger SKU formats. There's nothing proprietary in what they've done in those segments. And in fact, we are actually in the best position to take advantage of some of those opportunities. So if we need to toggle our SKU mix and our product offering to participate in that market, we can do so, and we're going to do so cautiously and with a lot of thought. But right now, we really are focused this quarter on our best-performing products and to use our reduced workforce in a manner which can drive the most revenue for the least amount of cost.

Operator

Our next question comes from the line of John Zamparo from CIBC.

John Zamparo - *CIBC Capital Markets, Research Division - Associate*

I want to go back to the questions about sell-through. Greg, maybe you could talk about your market share in the quarter versus the prior quarter, particularly in larger provinces. Were there any notable changes among your different categories? And how about your 2.0 products versus 1.0?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

So I guess we don't typically share market share information in part because some of the agreements with the provinces prohibit you from doing that. So some of the data you see out there is actually a bit of a breach of some of the agreements. I mean there is public information on a few of them, and I know many of the analysts are kind of accessing -- or media's accessing some to publish. But I think 2 comments I would make is I think in -- certainly with our 2.0 products launch, our vape portfolio, starting with Trailblazer and then adding in the Feather pen, has had a strong position.

There was one company certainly that has went with a price strategy on vapes, and they have a very -- they would -- in Ontario, for example, they would be the leader. And one of the other key comments I would make on vapes is we have seen challenges from other companies, right, with leakage and with product returns, and that's not an issue we faced. And I think it's important to contemplate that, that we've really focused on very high quality suppliers. We've vetted our suppliers. We know that there's not performance issues or leakage issues or heavy metal leaching, and those are critical for us.

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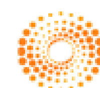

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On our chocolates, still early days. We only shipped at the end of the quarter, our first couple of shipments. And in this quarter, we've been getting significantly more product out. But I mean, there were provinces like Ontario that went a few weeks without our chocolates available. So demand's been there. And I think we are seeing a shift, as we alluded to, and we've allowed our production, capability and capacity -- we've really shifted our production to our core strains. And we -- it was one of the advantages of being a leader last year in kind of -- in the first couple of quarters as we got information about what those core strains are.

So our Rio Bravo and our La Strada are strong strains for us. But then subsequently, we did these onetime offers with Limelight and El Dorado, and we've had really strong response to them. So we've got additional strains that we're going to do onetime offers with as well that are high THC, we believe will be somewhat unique in the market. And again, the ability to shift again to those products, I think it's going to continue to provide assistance for us.

John Zamparo - *CIBC Capital Markets, Research Division - Associate*

Okay. That's helpful, particularly on the LTOs, it seems like that's kind of an untapped part of this market. My follow-up is going back to the balance sheet and cash burn. What do you expect in terms of investments in working capital over the next couple of quarters? And generally, maybe we're fast forwarding to next 12 months, what do you view as a normalized maintenance CapEx number?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. I mean first -- I mean, it's important to kind of maybe answer the first part of it, like from a cash flow perspective, I mean, we ended the quarter with $41 million. As Derrick outlined earlier, we have limited CapEx remaining to spend and the $2 million on 4C to get it up to fully functional. Not all of the growers is operating, but it's -- it likes occupying the space. And then $11 million on Phase 5, which, as noted, the spend on that will be delayed because of some of the OEMs and working with them to get kind of equipment certified to be operating in. So we've got -- we're really at the end of our CapEx spend, which is one of the most important things. So I think it's -- we feel we have a strong balance sheet at this point in the market relative to peers as personally with having $30 million of undrawn debt capacity with BMO and the syndicate. I mean there's still no guarantee we can draw that $30 million, but we're certainly working closely with them to be able to do that. But Derrick, I don't know if you want to add any commentary?

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Yes, thanks, Greg. I just want to add that specifically as it relates to the working capital, even in our receivables, we have government HST refunds from the prior CapEx spend that we've already done that's being realized during the third quarter. And also with working capital, our inventory and bio assets are already fairly significant on our balance sheet, and we would not -- where we have done the reduction to our workforce, and we are emphasizing the focus on moving the inventory that's there and producing near-term saleable product. We are not anticipating there to be a cash strain as it relates to further investment into our working capital, just as a general comment based upon the reductions to the staff and production levels combined with the -- some of the near-term realization on the working capital.

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

And John, maybe just to add to the earlier question, part of your question about maintenance CapEx. So we don't have a general rule of thumb because this is primarily a new facility that's been really built over the last couple of years. We expect it to be low single-digit percentages against the total CapEx, right? We're -- the majority of the equipment is new. And other than kind of standard maintenance, I mean we're not in replacement mode. I think even on our irrigation systems in the last 2 years, we've had to replace one pump, and we have redundancies [than ever]. So again, I think just based on the age of it, you typically might see a maintenance CapEx that's in the 4% to 5%, but we -- significantly less than that based on what we're seeing to date and based on the age of the equipment.

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One thing I didn't comment on earlier, and I think it was in the kind of prepared remarks that we made, but we have not tapped into any government opportunities. And I'd say one of the things that -- now that with weight subsidies and that being offered, and the cannabis industry being included in that, and that was a big win for our association. And I know Cameron Bishop, who is our VP of Government Relations, worked really closely with government on that. I think there's also opportunities for us and for the cannabis industry, both federally and even provincially, to look for some assistance during this period if needed, and I think that's got to be taken into consideration as well. I mean there are significant funds available, and I think there's definitely an opportunity to access some of those.

Operator

Our next question comes from the line of Matt Bottomley from Canaccord Genuity.

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

Just wondering if you could provide just a little more color on the nature of the fixed charge covenant. And is the plan right now, like, just to negotiate with the lender? Or is there anything that's remedial in the interim that can be done independently?

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Yes. Derrick here. It's just standard cash flow covenant in the sense that you need a certain amount of EBITDA to cover the future debt service on the term loan, on the $85 million. And we did not meet our Q2 covenant, just looking at the trailing 12 months as a consequence of the EBITDA metric, not achieving the standard that had been set. There were reasons for that as we've already outlined in our presentation of the information during the call. I would indicate that we've already been -- have been in discussions with the lender.

And since it came to our attention that this was going to be an issue for our Q2 filing, and they very quickly moved forward and obtained the approval of all the lenders in the syndicate to provide the covenant waiver and -- for us in a very timely way, and that was part of our disclosures. Going forward, we're still midway through on these negotiations. They've provided the forgiveness, which is until we file our Q3 -- until our Q3 balance sheet, so until the May 31 period. And as mentioned, we're in discussions with them now. And while I cannot provide any guarantees, based on our working assumption, we don't believe this will be an issue based on the discussions we've had with them to date.

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

Great. That's helpful. And there's been a lot of good color on this call as well with respect to some of the assumptions and inputs here on various parts of your income statement. The follow-up I had is more on the SG&A part. So I know you touched on this briefly already, but just with respect to paring back with only your operational planting and existing facilities, but also with some of the pare backs as it relates to COVID, what's the best way for us to look at that SG&A line?

Obviously, there was a ramp-up this quarter in relation to the launch of 2.0 and all the things you've been doing with your vape pens, et cetera. Maybe the next 6 months, what's the best way to look at this from a volatility standpoint, given that it seems your existing operations now are right around that breakeven on adjusted EBITDA? So just looking for what might make it plus or minus on that breakeven in the next couple of quarters with respect to your SG&A plans.

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. I guess I alluded to this earlier, Matt, is that it's still early and challenging to give a prediction. I mean yes, we've had temporary reduction in our workforce. And certainly, there are savings associated with that. It does impact our operational efficiency, which is why we've moved to the most automated systems and lines and focused on those as a way to best utilize the staff and personnel we have. And I think that, that is a way for us to optimize both the inventory we already have in existence, and then going forward, continue to get out products that give us really the greatest

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return for the amount of labor hours that we have available, and that's how we're mapping it. But as I said earlier, we're only a couple of weeks into this adaptive workforce.

I think the one thing we are planning, again, is because, again, as I commented, we have flexibility based on our production cost is to bring a larger SKU product into the marketplace, and that's been in the plan for a significant amount of time. It would have been on the market already had we not hit some of the challenges around COVID-19. But -- so I guess I'm not fully answering your question here because it's very challenging for us to predict. I mean in many ways, we've taken savings, and we've also looked at where our spends are and relative to, for example, marketing programs. And we're focusing very much more on kind of digital programs as online increases and less on some of the other programs we've done historically. So it wasn't just temporary layoffs for health and safety. We also, in conjunction with that, looked at our production output and what we could actually get out to market, although we do have significant inventory. So...

Operator

And our next question comes from the line of Doug Miehm from RBC Capital Markets.

Douglas Miehm - *RBC Capital Markets, Research Division - Analyst*

I just wanted to follow-up with respect to something you just said a minute or 2 ago, and that is, there's no guarantee that we can draw down on that $30 million. Did I hear that correctly?

Derrick W. West - *OrganiGram Holdings Inc. - CFO*

Well, there's no guarantee because it's a future event. I'm just stating a factual comment. We are in discussions with them. However, we have had very positive discussions with our lender group as led by BMO, and they responded very quickly when we -- to provide the covenant waiver letter when we had asked for it. And they have indicated the willingness to hear from us on what the renegotiated credit facility would look like. And clearly, as we do this renegotiation, we're going to bear in mind what we believe the EBITDA would be on a go-forward basis based upon the COVID-19 impact to our business, to the industry, and that will be factored in. But I -- just indicating the obvious that until we've done the renegotiation, I cannot guarantee it. But we're -- it's reasonable for us to assume that there's not going to be an issue based on all the indications they've provided to us.

Douglas Miehm - *RBC Capital Markets, Research Division - Analyst*

Okay. Perfect. And then when you think about the amount of product that you've -- or harvested in this latest quarter at almost 14,000 kilos, I believe you sold about 4,000 of that, just over 4,000. Is the remainder going for extraction? And maybe you could tell us what your extraction, not capabilities, but the deals you have with your partners, are those fixed in stone? Do you have to continue to extract a large part of what you're harvesting? And what could be the impact of the costs there?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. So it's a good question, Doug. Greg here. So the -- so our agreement with Valens, who's our contract extraction facility, doesn't have any minimums or requirements. So we have used them and have plans to continue to use them in the future for hemp. But at some point in the future, we will move all of our extraction in-house when the Phase 5 extraction is fully operational and certified. For the time being, we've got months worth of -- many months worth of extract concentrate built up. So we're simply just storing the extractable material before we -- and we don't need to send it to balance because it certainly will be more cost effective to extract it in-house.

But -- so to answer the question, I can't give you an exact number on the inventory that we had available at the end of the quarter in terms of what will go. But I mean, part of our -- what supported our decision-making around doing temporary layoffs for health and safety reasons was we knew

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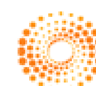

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we had sufficient dried flower inventory that we could package and get out into the market, and we could reduce kind of our cultivation footprint temporarily because we had that inventory. And a lot of that is in high-THC and high volume demand strains, Limelight's and Rio Bravo and El Dorado and La Strada. So we're in a good position in terms of converting a significant portion or parts of that inventory into sellable product.

Operator

And we have time for one more question today from the line of David Kideckel from AltaCorp Capital.

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

Congratulations on the quarter. I just wanted to circle back on one of the points that Graeme made regarding wholesale revenue. Just not even necessarily specific to Organigram but as the industry as a whole, I'm just wondering, given your remarks, Greg, about consumer loyalty and branding in the sector and how they are loyal to Organigram, for your products, in particular, what are your thoughts about different LPs selling to different LPs through the wholesale revenue metric? And if a consumer is actually purchasing a product from Organigram that it's actually coming from a different LP or vice versa, how relevant do you think that is for general branding and consumer loyalty across the board?

Gregory Engel - *OrganiGram Holdings Inc. - CEO & Director*

Yes. No, thanks for the question, David. So I think when we look back, and we had not historically before Q1 sold product wholesale, and we looked at it very opportunistically. We started to get information back in Q2 of last year regarding which of our strains were in higher demand and which ones weren't. But as you know, it takes many, many months to change your production cycle. So we ended up still having production of some of the lower selling SKUs, right, in terms of those flowers and what was available. So we had been getting inbounds from companies that were not satisfied with the product that was available for wholesale out in the market. So we made a decision to take those products, sell them to another LP.

And as to the couple of the comments that were made earlier about -- that Matt made as well, about kind of onetime offers, we do see that still there can -- there's consumers the same way that if people -- if you're a wine drinker, if you're a beer drinker, there's your kind of wines that you buy consistently, but everybody will try different ones. And I think they're -- in the cannabis space, there's a lot of kind of interest in demand in onetime or what's new. So it's a combination of brand loyalty, but also testing what's new. So there have been some opportunities where companies can take product that was not in high demand under our brand. They've taken it and put it out, and it comes out as a new product under their brand.

And I think that's where some of those product's been used. And that is why, as I said earlier, our plan to kind of introduce new genetics, cycle them through under onetime offers to see what the demand and response is. And if it's really strong, like on our Limelight, to increase it into, move it into a core offering. So that's how wholesale really has been structured and government is that it's going to other LPs, and they're putting their own brand, but it goes in as kind of a bit of a new product. So...

Operator

And ladies and gentlemen, this will conclude today's call. We thank you for your participation. You may now disconnect.

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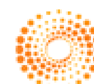

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