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Tilray, Inc. (TLRY)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Rachel Perkins
Senior Vice President, ICR LLC

Good afternoon and thank you for joining us on Tilray's Fourth Quarter and Full Fiscal Year 2019 Earnings Conference Call. On today's call are Brendan Kennedy, Chief Executive Officer; Mark Castaneda, current Chief Financial Officer; and Michael Kruteck, incoming Chief Financial Officer.

Before we begin, please remember that during the course of this call, management may make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 as amended. These statements are based on management's current expectations and beliefs, and involve risks and uncertainties that could differ materially from actual events and those described in these forward-looking statements.

Please refer to Tilray's reports filed from time-to-time with the United States Securities and Exchange Commission and Canadian securities regulators and its press release issued today for a detailed discussion of the risks that could cause actual results to differ materially from those expressed or implied in any forward-looking statements made today.

Finally, please note on today's call, management will refer to adjusted EBITDA and adjusted net loss, which are non-GAAP financial measures. While the company believes adjusted EBITDA and adjusted net loss provide useful information for investors, presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. Please refer to today's release for a reconciliation of adjusted EBITDA to net loss, the most comparable measure prepared in accordance with GAAP.

Now, I would like to turn the call over to Brendan.

Brendan Kennedy

President, Chief Executive Officer & Director, Tilray, Inc.

Thank you, Rachel. Good afternoon, everyone, and thanks for joining us. I will begin this call with a brief recap of Tilray's 2019 performance, followed by perspectives on the state of the cannabis industry and the markets in which we operate. I will conclude with remarks on our focus for the months ahead in 2020. Then, Mark will review our fourth quarter and full 2019 financial results in detail.

2019 was a year of firsts for Tilray, but not a year without its challenges. In the face of market volatility, I'm proud of our team and how we executed to drive our business forward to position Tilray for long-term shareholder value creation. In 2019, our revenue increased 287% year-over-year to $167 million. We built a highly diversified cannabis business across three core markets, global medical, Canada adult-use and hemp. These businesses generated approximately 16%, 36% and 36% of total 2019 revenue respectively, with the remaining 12% of revenue coming from bulk product sales.

Our medical cannabis products now are available in 15 countries on 5 continents around the world. Our hemp products are available in over 17,000 retail doors and 20 countries around the world. We have a diversified asset base with facilities and offices in Canada, the United States, Europe, Australia and Latin America. We are the only cannabis company to have GMP certified cultivation facilities in two countries, Canada and Portugal.

Over the course of 2019, key milestones we achieved that position Tilray well to compete on the global stage include the following: delivering on our promises to Canadian customers, we're one of the first licensed producers in market with 2.0 cannabis products on time and with product formats and brands that have thus far been very well received; launching our joint venture with Anheuser-Busch InBev named the Fluent Beverage Company with CBD-infused beverages – beverage products in Canada; completing the acquisition of Manitoba Harvest, providing us with a hemp product platform in the United States and 19 other countries around the world; being the recipient of two Good Manufacturing Practice or GMP certifications for our Portugal facility; participating in cannabis clinical trials in the United States and around the world, furthering our commitment to cannabis research and product development; completing a merger with Privateer Holdings to allow for an orderly release of Tilray shares formerly held by Privateer over the course of the next two years; strengthening our industry-leading executive bench by attracting talent from best-in-class Fortune 500 companies to lead key functions within our business.

Turning to the broader industry and the markets in which we operate, I will share a few remarks. I have been an investor and operator in the cannabis industry for nearly a decade now, and I believe that we are still in the very early days of this industry's growth trajectory. There is a global paradigm shift occurring around the legalization and use of cannabis as both a medicine and mainstream consumer product. To capitalize on this opportunity, Tilray has strategically invested in key markets to secure raw materials supply, advance research and development, and build brands and relationships with patients and consumers.

Our global footprint today puts us in an advantageous position to enter new medical and recreational markets when we are legally permitted to do so. Over the next two to three years, I continue to believe we will see additional countries legalize medical cannabis followed by adult-use. We have invested and will continue investing prudently to drive long-term shareholder value. The focus of our business remains steadfast, to build the world's most trusted and valued cannabis and hemp company with a portfolio of best-in-class brands, supported by a multinational supply chain. I firmly believe that we have the right team, assets and balance sheet to execute on our strategy. Tilray remains well positioned to win globally.

Turning to Canada, the challenges in the Canadian market have been well-documented over the past few quarters. Primarily, the legal cannabis market has been slower than expected in taking share from the illicit market due to a lack of points of distribution and product availability. We are encouraged by recent announcements and actions taken by provincial governments to increase the pace of retail licensing. Additionally, as the industry evolves, we see issues with the consistent availability of high-quality product supply dissipating.

The market has been volatile over the past 12 months, but I remain extremely bullish on the long-term opportunity in Canada. Putting this into context, we are less than 1.5 years in the federal legalization in Canada and 2.5 months into the legalization of cannabis 2.0 products. Yet, retail sales last year were CAD 1.2 billion and are expected to grow to over CAD 4.5 billion by 2021. That is nearly 300% growth by the end of 2021. And in 2021, market estimates still point to the illicit market being bigger than the legal market. While I expect continued near-term market volatility, you can see why I continue to remain bullish on the medium to long-term prospects for our industry.

In Canada, we have built a broad product portfolio of trusted brands for our Phase 2 adult-use products, as previously mentioned. We were one of the only licensed producers in Canada ready to ship the first day of legalization in December, and we have been able to successfully restock retailer shelves, whereas some of our competitors have not. In total, our brands are in 11 provinces and territories today with Phase 2 products in 7 regions where authorization allows.

As we see regulation shift in certain provinces such as Alberta and Quebec, we are well positioned to serve those markets. Our expanded adult-use portfolio under High Park currently includes the following: Chowie Wowie milk chocolates with THC and CBD varieties; Canaca, pure cannabis all-in-one vape pens and cartridges; Marley Natural, pure CO2 extracted cannabis vape cartridges; Everie, CBD-infused tea and sparkling beverages through our joint venture with Anheuser-Busch InBev and Labatt Breweries of Canada.

Looking internationally, particularly in Europe, we have made great strides in building our business. In late December, Tilray Portugal received its second GMP certification in accordance with European Union standards for our manufacturing facility in Cantanhede, Portugal. This is our second GMP certification for Tilray Portugal, which allows us to formulate, manufacture and export GMP-certified finished medical cannabis products, including dried flower and oils, from Portugal to Germany and other European and international markets with legal medical cannabis regulations.

Last May, we received our first GMP certification in Portugal to manufacture and export GMP-certified dried cannabis as an active substance for medical products. And last week, we had a 2.5-day inspection in Portugal for a third and final GMP certification for oil extraction, which we expect to receive in the first half of 2020. Since receiving these GMP certifications, we have successfully exported medical cannabis to Germany and Israel from Portugal and from Germany to Switzerland.

We expect to increase our exports from our European Union Campus in Portugal, which will be our international hub for operations with indoor, outdoor and greenhouse cultivation sites, as well as research labs, processing, packaging and distribution sites for medical products. Our processing capacity is greater than our cultivation capacity. So, we have ample runway to grow, scale and finish and prepare finished goods with raw materials from third parties in addition to our own cultivation capacity.

Our footprint is 2.7 million square feet in Portugal, including 2.4 million square feet of outdoor growth space and 300,000 square feet for our greenhouse and processing facility. In 2020, we expect to increase our greenhouse and processing capacity in Portugal by 340%. In the fourth quarter, Tilray Portugal also partnered with the University of Coimbra to develop a first-of-its-kind strategic partnership to research cannabis-derived medical products. The industry is lacking data, and we believe clinical research will help foster mainstream acceptance within the medical community and among governments in international markets.

In the United States, we remain focused on building a portfolio of consumer-centric CBD brands in states where we're legally permitted to do so. Manitoba Harvest is a core US asset with hemp products at over 14,000 US retail doors today. We are closely monitoring the FDA's guidance around CBD and await further clarity before we make further investments in this market. During the fourth quarter, we also imported medical cannabis into the United States from Canada for a new clinical trial conducted by Columbia University evaluating the efficacy of medical cannabis as a treatment for TIPN or taxane-induced peripheral neuropathy, which affects 67% of women undergoing breast cancer treatment.

Since we closed our fourth quarter, I would like to comment on changes to our executive team and broader employee base. In January, we strengthened our executive leadership team with two new hires: Jon Levin as Chief Operating Officer, who was formerly with Revlon; Michael Kruteck as incoming Chief Financial Officer, who was formerly with Molson Coors and Pharmaca. As announced in January, our current CFO, Mark Castaneda, will be transitioning to a strategic business development role within Tilray and will be closely involved in Michael's transition. We're happy to continue having Mark's expertise as we navigate this ever-changing industry.

Additionally, last December, we brought on former Mattel and General Mills executive, Katy Dickson, as President of Manitoba Harvest. While we continue to make key hires, the rapid shift in investor focus to profitability also led us to restructure our broader organization to better align with the competitive landscape and meet our 2020 goals. Each of our operating businesses has been reviewed in order to increase efficiencies, reduce duplication and costs with a focus on return on our invested capital. As a result, in February 2020, we eliminated approximately 10% of our global head count. While these decisions are never easy, Tilray has been successful in being one of the leading cannabis companies because of our ability to pivot and react when needed.

For the balance of 2020, we anticipate optimizing our current assets and market footprint. Along the way, we will evaluate opportunities to make disciplined strategic investments or enter into partnerships only where warranted. We anticipate some of the following: continuing to restock our Phase 2.0 products across Canada where regulations allow; exporting Tilray medical products to new countries and expanding our medical cannabis product offerings in the international markets we currently serve; completing the build-out of our facility in Portugal and obtaining our final GMP certification there; entering into strategic partnerships that enable us to further accelerate our growth; growing our global medical, Canada adult-use and hemp product market share and aggressively driving cost efficiencies; and finally, becoming EBITDA positive in Q4 of 2020.

With that, I would like to turn the call over to Mark.

Mark Castaneda

Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

Thanks, Brendan. Good afternoon to those of you joining us on today's call and webcast. It is a pleasure to be speaking with you today. This will be my last earnings call as Chief Financial Officer, and I'd like to welcome Michael Kruteck, who'll be taking over after we file our Annual Report on Form 10-K. I have been working with

Michael since he joined in January, and I'm confident it will be a smooth transition. I'm excited to move into my new role of strategic business development to focus on strategic initiatives for Tilray.

Turning to our results, please note that all the financial information we discuss today is prepared in accordance with US GAAP and US dollars, unless otherwise indicated. On balance, Q4 was a challenging quarter for the industry. As Brendan articulated, the lack of points of distribution, among other things, has kept the illicit market robust in Canada and has moderated the rate of growth in legal markets. However, against that backdrop of broader industry challenges, I'm encouraged by the fundamental performance of our key businesses relative to our peers.

Specifically, we put up strong sequential quarterly growth numbers over Q3 in our adult-use business, which included an uptick in average selling prices. Similarly, we experienced sequential quarterly growth in our hemp products business. Given the state of the industry, we also determined it's prudent at this point to de-risk our balance sheet by taking non-cash impairment charges related to the uncertainty in the US CBD market, as well as non-cash inventory valuation adjustments addressing significant industry-wide supply of cannabis extracts and extract feedstock. Finally, we've raised $60 million in debt to provide a capital cushion as we focus on our path to profitability.

Drilling in on Q4 results in more detail, Q4 revenue grew more than threefold to approximately $47 million or CAD 61 million compared to the fourth quarter of last year. Revenue in hemp products grew 17.5% sequentially from the prior quarter. Adult-use grew 7.4% from Q3 and 34% after adjusting for returns of pricing reserves taken during the quarter. Our international medical business was $4 million in the quarter compared to $5.7 million in Q3. However, Q3 included a $3 million wholesale shipment. Excluding the wholesale shipment, international medical increased 48% from Q3 and 280% from the prior year. Our Canadian medical business was up 27% from the prior year and down slightly from the prior quarter in 2019.

Finally, as we previously forecasted, our bulk sales decreased 44% from the prior year and 60% from Q3, as demand for extract products and feedstock has dissipated in Canada. Going a little deeper on our adult-use, sales represented 36% of revenue in the fourth quarter and increased sequentially from 31% of revenue mix in Q3. With additional retail distribution and new form factors becoming available, we expect adult-use to be a driver of continued revenue growth. Our average selling price excluding excise taxes for adult-use was $3.19 or CAD 4.16 for Q4, an increase from Q3 of $2.98 or CAD 3.96, as Q3 had significant mix of lower-priced product selling. We expect that ASPs will increase as the mix of 2.0 products increases throughout 2020.

Moving on to operational metrics, excluding hemp products, total kilograms sold excluding bulk increased sevenfold to 15,035 (sic) [15,039] (00:19:56) kilograms from 2,053 kilograms in the prior year's fourth quarter. The overall average net selling price per gram excluding bulk sales was $8.78 or CAD 11.43, compared to $7.52 or CAD 9.79 in the prior year's fourth quarter. The increase was due to a shift in product and channel mix. Gross margin for Q4, excluding non-cash inventory reserves and returns, was [ph] 29% – 29.5% (00:20:34) compared to 31% in the third quarter and 20% in the fourth quarter of 2018. Our GAAP gross margin, including non-cash reserves, was a negative 120%.

As previously described, inventory reserves are primarily related to extract – extract feedstock and supplier risk on prepayments. Over the past several years, we have generated sufficient extracted product. We do expect demand for extract products to increase significantly due to Canadian Phase 2 products being available, as well as the roll-out of additional retail locations. However, we have been conservative in our forecasted demand due to a slow conversion of the illicit to the legal market. We expect gross margin to increase sequentially going forward as we gain greater scale and benefit from the positive product and channel mix, particularly in the second half of the year with international medical and 2.0 products in Canada.

Moving on to expenses, total operating expenses increased by $135 million compared to the prior year, which included $112 million non-cash impairment charges, primarily related to our ABG agreement. Due to delayed clarity of the FDA regarding CBD products in the US, we thought it was prudent to reserve against the fair value of this intangible asset. We also expect to reserve an additional $37 million in Q1 of 2020 related to an amendment to our ABG agreement, which allows us the benefits of triggering the last tranche of the agreement without having to issue approximately $83 million in stock cash.

In exchange for this amendment of our agreement, we will not receive the annual guaranteed minimum cash payments. We also reviewed our goodwill in our cannabis business for impairment and there were no impairments taken. Additionally, we incurred a non-recurring tax charge of approximately $8 million, which is included in our G&A expenses in the quarter.

Next, I'd like to explain the gain on acquisition-related costs. Because we are in the early stages of this industry, there's a lot of uncertainty regarding forward revenue forecast, which is why we structure our acquisitions with a large mix of earn-outs and other performance-based metrics. Based on actual results, our Natura and Manitoba Harvest acquisitions did not achieve their full earn-outs. So, in accordance with GAAP, we adjusted our earn-out liability down, which created a gain in acquisition-related activities of $29.1 million during the quarter. This gain reflects savings of additional purchase price that would have otherwise been paid.

The net loss for the quarter was $219.1 million or $2.14 per share, compared to a loss of $31 million or $0.33 per share in the fourth quarter of 2018. As previously described, we incurred non-cash charges of $180 million comprised of $112 million for impairment and $68 million for inventory reserves. We reported adjusted EBITDA loss of $35 million compared to a loss of $13.3 million in the fourth quarter of last year. The increase in adjusted EBITDA was primarily due to operating expenses increasing faster than our gross profit contribution, as well as some non-recurring charges.

We expect our operating expenses to decrease materially in 2020 as a result of cost reduction actions taken in February of 2020 and continuous review of our cost structure that remains ongoing. Turning to the balance sheet, we ended the quarter with cash and cash equivalents of approximately $97 million and closed a $60 million senior credit facility on February 28, 2020 with a two-year term. We continue to believe we have sufficient capital and access to capital to execute on our growth plans until we achieve positive EBITDA, which we expect in Q4 of 2020.

In reviewing the cash flow for 2020, we expect our cash requirements for operating cash flow of $35 million to $45 million, plus cash interest and principal payments of approximately $40 million and CapEx of between $25 million and $35 million for a total of between $100 million and [ph] $115 million (00:25:02). We expect the cash flow to be positive in 2021. We expect there will be a use of working capital in the first half of the year, which then provides a benefit in the second half of the year as we draw down inventory. Another change in the balance sheet during the quarter include the new lease accounting pronouncement, which added about $30 million to both assets and liabilities for the quarter.

Long-term, we continue to expect to capture a sizable share of the global cannabis market with anticipated gross margin opportunity at 50% range and adjusted EBITDA margins of 25% to 30%. As new markets are added, we will invest to develop those markets, which may have short-term impacts on margins, but also provide for greater long-term revenue upside. In summary, we continue to believe we have a long runway for growth with multiple paths for shareholder value creation.

Brendan, Michael and I are now available to take your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Chris Carey with Bank of America. Your line is open.

Christopher M. Carey
Analyst, Bank of America Merrill Lynch
Q

Hi. Good evening.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.
A

Hey, Chris.

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.
A

Hi, Chris.

Christopher M. Carey
Analyst, Bank of America Merrill Lynch
Q

Hi. So, clearly, there was a material step-up in OpEx this quarter, and you had just noted, Mark, that you expect that to – I think you put it decrease materially in 2020. And so, I guess in the context of expectations for OpEx to come down, it sounds like you're still kind of implying that you can get to over 40s gross margin in 2020, though it feels like we're kind of far away from that place today. But can you help me bridge the gap between what you just did on the quarter and how you think you can still get to Q4 2020 EBITDA by year-end? Is that over 40% gross margin correct? How do we think about OpEx coming down? And then, I suppose revenue assumptions are just a plug there. So, I realize that's kind of a standard modeling question, but I think it's important enough to start out with that. And then, I just have one follow-up.

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.
A

Yeah, Chris. So, first, your point is there – on the Q4 G&A, we had a couple of non-recurring items of charges in there of about $8 million to $10 million – really closer to $10 million. And what – the biggest piece of that was – $8 million was tied to some tax cost – tied to some RSUs or some equity [ph] issuances (00:28:03) for some cross-border. It was a pretty unique situation, but it was an $8 million charge during the quarter for that specifically. And then, there was another $1.5 million regarding some legal fees tied really to some acquisition-type transactions.

So, those would not be recurring. So, first, you got to cut off roughly $9 million when you look at the kind of run rate. And then, we had some changes in our G&A as we announced, as Brendan mentioned, of 10% on the head count side. We expect G&A to get into the $40 million to $45 million range, closer to $40 million by the end of the year, which is actually – when you look at total SG&A for 2019, it averaged $37.5 million. I know that the last quarter was higher because of some one-time costs. But we actually will see a little bit of an increase from 2019 kind of on average for the quarter in the $40 million to $45 million range.

And so, yes, we do expect gross margin to move from where we're at today. There were some clean-up items in the quarter. We were on trend to increase a couple hundred basis points – 200 basis points to 300 basis points per quarter. We'll see some stronger increases this year, and the visibility we have on that is the throughput in our existing facilities are going to increase substantially with no increase in space. So, we'll be able to absorb more of those fixed costs. Secondly, we will be ramping up our Portugal facility. So, we do expect gross margins closer to the 40% to 45% range, and as you said, the revenue is kind of that last plug.

Christopher M. Carey
Analyst, Bank of America Merrill Lynch

Q

Okay. That's very helpful. Thanks for that. And then, I guess just one other on you had – Brendan, I think it was you that had said that you could look at optimizing some of your footprint. And I don't know if that was kind of regarding OpEx or whether there was something a bit more strategic there. And if I could, I guess the way that I think about this is, you're all in the industry producing so much of this flower and there's going to be a volume gain there, and certainly, it's a notable part of categories long-term. But there's not a lot of evidence that it matters to brands. And so, if there's all this extract out there and 2.0 is really where all this is going, is that comment a function of you looking at how much capacity you have and the expansion plans that you had before and thinking maybe you don't need to do that in Canada? Or did I misread that, and if I did, if you could just talk about broadly 2.0 trajectory from here? Thank you.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

Yeah. In terms of optimizing our footprint, it's doubtful that we would invest additional CapEx in building out additional capacity inside of Canada, certainly cultivation capacity. We have been investing in our facilities for cannabis Phase 2.0 products, and what you'll see quarter-by-quarter throughout this year is the facilities that we operate will become more efficient. If you think about what we experienced in Canada six years ago, what we experienced in Canada a year-and-a-half ago with the launch of adult-use and really in Q4 with the launch of 2.0 products, we're just making a whole bunch of stuff that we've never made before, and the first time you make, it's never – you're never the most efficient.

It's like turning on one of our cultivation facilities, yield goes up with each harvest. And so, the first time you make a chocolate bar or the first time you – the first time we made a beverage in candid, it's not as efficient as the 10th time or the 100th time you operate that particular facility. So, we'll get – we'll optimize our footprint, optimize our yield, optimize our unit costs throughout the course of this year. In terms of Phase 2.0 products, the second part of your question, alongside our partners at Fluent Beverage Company, High Park was the only [indiscernible] (00:32:47) only licensed producer to ship edibles, vapes and beverages on day one of Phase 2 legalization, and as of the week of February 28, Fluent Beverage has shipped the first and only sparkling beverage in the market. And so, those Fluent Beverage products of sparkling beverages are in, I believe, six provinces today.

Christopher M. Carey
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks. I'll get back in.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

Yeah. And except for – one final point there, Chris. Except for the canned beverages, we had reorders on all of the Phase 2 products, and the reason Fluent hasn't had them on beverages yet is that they're too new.

Operator: Thank you. And our next question comes from Michael Lavery with Piper Sandler. Your line is open.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Thank you. I just want to try to understand pricing dynamics a little bit better, and the bulk sale disclosure is helpful. But I think if I'm looking at all of this right, sequentially your bulk sales went down – I think you had your kilograms up, but revenues fell even with a little bit of 2.0 products catching tail-end of the year. Can you just help us understand what some of the drivers are and how to think about the total company price/mix view? And is there pricing pressure? Is it mix-driven? What were some of the key moving parts we should be focused on?

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

Yeah. Michael, I think most of that will be mix-driven. So, when you look at the bulk, the bulk came down pretty dramatically in Q4 versus Q3, and we expect it to be again somewhat nonexistent in 2020. So, that does take some of the pressure off from the overall average pricing. Actually, in the beginning part of the year, we actually made some pretty good margin on bulk, just because there was less product available. But as far as the 2.0 products, we did ship in December. It was the last couple of weeks of December. So, the impact to Q4 was negligible. So, it was relatively small dollars, a few shipments here and there, but you'll see more of an impact going forward from an ASP standpoint. So, mix will matter. So, adult-use 2.0 and international medical markets, we expect those two to be the fastest-growing segments, which have a positive impact in ASPs going forward.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

So, I guess I still don't see what the real drag is. Is somehow bulk sales falling a headwind to pricing? I would think that's low price per gram. Am I wrong?

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

No, you are correct. So, the headwind is on the flower side. So, flower pricing, especially when we talked about our lower priced flower offerings that we put in the market last quarter, those are lower priced and those are meant to compete with the illicit market and those are going to be at lower ASPs. Like I said, as mix changes going forward with more 2.0 and more medical, you'll see overall ASPs come up.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

And just one last one on this. The premium higher THC flower is not necessarily synonymous, but it seems to be for the consumer a lot of times, is where you have the pricing power. Did that shrink meaningfully as of – how much were you able to supply that and just how big did your value segment grow, just to get a sense of how they are proportionally and the level of mix drag we should expect going forward?

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

Yeah. So, the value segment has been a larger part of the mix in Q3 and in Q4, which drove down the overall ASPs. What we've done with our higher THC percentage product or higher quality products has really been going to the medical markets. And the medical markets – and that's all coming from Nanaimo or from our facility in Canada. As our facility ramps up now in Portugal, you'll see more of that shift that will allow us to keep some of that product – the higher value product here in Canada as well. So, yes, the greenhouse product is a bigger percentage of our volume and a bigger percentage of our overall adult-use revenue, and that's primarily – will change as the 2.0 starts to kick in.

Michael S. Lavery
Analyst, Piper Sandler & Co.

Q

Okay. Thank you very much.

Operator: Thank you. Our next question comes from Rupesh Parikh with Oppenheimer. Your line is open.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Good afternoon. Thanks for taking my question. So, I was hoping to, I guess, dive a little bit deeper into how you guys are thinking about the Canadian and international medical markets for this year. Any more color you can provide on the top line in terms of how you guys see that, the growth ramping in both of those segments throughout the year?

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

So, on the Canadian medical, we actually saw it decrease this year versus last year. That decrease was primarily due to supply concerns really in the first half of the year. As you could see, in Q3, we kind of got our footings back and then Q4 slightly turned back down just for some – again having to allocate product to different markets. In 2020, we do expect to see strong growth in that market, growth back to about the $4 million level per quarter in revenue, so north of every quarter of this year for Canada medical. For international medical, we expect to see significant growth in the second half of the year and a slower ramp in the first half of the year. So, second half of the year, we do expect to see some significant growth.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

And then, one follow-up question. So, clearly, on the CBD front of the US, there's been some challenges given some of the delays from the FDA. How are you guys, I guess, going forward just approaching US CBD at this point? Is it just slowing down investments or just any more color there in terms of how you guys are approaching that?

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

It's definitely slowing down investments until we have some sort of clarity from the FDA. Until the FDA provides us with some sort of clarity, we'll continue to invest in Manitoba Harvest from a hemp foods perspective and continue to meet with the various retailers to discuss the Manitoba Harvest CBD products and portfolio. But most of the retailers, certainly from an ingestible perspective, are still sitting on the sidelines.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Vivien Azer with Cowen. Your line is open.

Steven Schneiderman
Vice President, Cowen & Co. LLC

Q

Hi. This is Steve Schneiderman pinching in for Vivien tonight. Brendan, you mentioned off the top [ph] you guys wanted a few LPs to be (00:40:15) ready to go right away both in vapor and in edibles. But can you just kind of provide an update on your 2.0 supply chain and how long do you think it's going to take before we start seeing equilibrium in this respective market, in particular for edibles given the out-of-stocks that we are seeing in the market today?

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

Yeah. I think it's going to take longer than most people thought. Frankly, we were positively surprised by demand. We were expecting something similar to October 2018 when there were so many LPs entering the market with so many different products, and that really just hasn't happened this time. And so, we're racing at this point to increase our supply of vape, edible and beverage products. And so, we're expanding our manufacturing lines and increasing our shifts, so that we can get more of those products to market. We were surprised not only by the demand, but the lack of – really the lack of competition. It seems like a lot of the LPs just decided to sit on the sidelines.

Steven Schneiderman
Vice President, Cowen & Co. LLC

Q

Okay. All right, that's helpful.

[indiscernible] (00:41:54)

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

It's a good problem, but it's still a problem.

Steven Schneiderman
Vice President, Cowen & Co. LLC

Q

Agreed. In terms of the value dry flower, do you have a sense of how – of what your share is in that market or how you are competing? And just teasing out some of Mark's commentary about batches impact on ASPs, what portion of your dry flower volumes come from either the batch or the value segment?

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

So, as far as market share, it really varies by province, and there's a couple of provinces where we're in the top couple of points or the top couple of areas. As far as the mix of overall product, it's one of the largest pieces of our mix today. Again, I expect that to change because of the 2.0 products. Now, 2.0 in Q4 was, like I said, effectively one shipment to the provinces – to several provinces, but the dollars for one week's or two weeks' worth of sales are pretty small in Q4. You'll see that increase in Q1. So, the mix of the value segment of products will come down as those other segments go up.

Steven Schneiderman
Vice President, Cowen & Co. LLC

Q

Okay. Well understood. And last one for me, what expectations are you currently baking in for store openings in Ontario with the province indicating they're going to approve 20 store authorizations beginning in April, how much are you baking into your plan?

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

So, our plan – I think there's around 800 stores today in total. I think Ontario has in, what, 45-ish and I think Quebec is pretty similar. We expect the full – at the end of the year to be just over 1,000 locations with Ontario probably doubling where they're at today, but we don't – we're not planning a significant increase in locations. Just from an execution standpoint, we just want to be conservative.

Steven Schneiderman
Vice President, Cowen & Co. LLC

Q

[ph] Helpful (00:44:04).

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

Obviously, if we get to 1,100 or 1,250 stores by the end of the year, that will be positive. But we've been burned before by active store retail openings, and so we're taking a little bit of a conservative view at this point.

Operator: Thank you. Our next question comes from Aaron Grey with Alliance Global. Your line is open.

Aaron Grey
Analyst, Alliance Global Partners

Q

Hi, and thanks for the question. So, first one, I just want to jump back in terms of the question that was asked earlier on bulk. Can you just talk about the volume increase during the quarter? It looks like it was up about 40%. I just want to know exactly how much of that was driven by bulk, because it looks like that was a good amount of the volume increase, and then how best to think about the run rate for volume going forward? I know it's a little bit difficult with 2.0 product coming online, but any color there would be helpful. Thanks.

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

Yeah. You're exactly right. The bulk drove a lot of the volume, but not the dollars, right. And bulk is in different types of products. And so, this bulk, we effectively sold lots of byproduct which had lots of weight, but not a lot of dollars to it. We expect that to have less of an impact going forward, especially into 2020.

Aaron Grey
Analyst, Alliance Global Partners

Q

Okay, great. Thanks. And then, just one other question that's been asked a couple of different ways, and I want to kind of put it all together. Just as we touch on your expectation to hit EBITDA positive by 4Q 2020 and specifically on your top line expectations, just what would you expect the mix to be between Canadian adult-use, medical, international and Manitoba? I know there is a lot of variables there, but how best do you think about the drivers of where you are today and where you expect to be in 4Q in order to hit that target?

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

Yeah. So, I think if you look at the – just in general overall doubling of where Q4 was for 2019, doubling that for 2020, and the key drivers of that growth are going to be more on the cannabis side. So, like the adult-use, we expect to more than double. Canadian medical, we expect to actually increase less than double, slightly less. International medical, we expect to grow significantly more than double, and bulk effectively going away. So, you'll see that international medical and adult-use were going to be the main drivers for next year. On the hemp side, we expect to see some growth in hemp. One growth area is just having a full year's worth. We only had 10 months' worth of activity. But as far as the overall growth, it's going to be – just base growth is going to be around 10% plus [indiscernible] (00:47:08) for the full-year. So, hopefully, that gives you a little bit more color.

Aaron Grey
Analyst, Alliance Global Partners

Q

All right, great. Thanks. That's helpful. I'll jump back in the queue.

Operator: Thank you. Our next question comes from Tamy Chen with BMO Capital Markets. Your line is open.

Tamy Chen
Analyst, BMO Capital Markets (Canada)

Q

Yeah. Thanks. I just had one question. I don't think we have a cash flow statement right now. So, I think you ended the quarter with just under $100 million, which is similar to the end of Q3. So, I just wanted to kind of understand the – obviously, we can see where the cash burn is, but just where the sources came from, particularly the ATM. I'm wondering, how much did you raise on that during the fourth quarter? Thanks.

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

Yeah. So, we've raised about $70 million in the fourth quarter.

Tamy Chen
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thank you. That was all for me.

Operator: Thank you. Our next question comes from Graeme Kreindler with Eight Capital. Your line is open.

Graeme Kreindler
Analyst, Eight Capital

Q

Hi. Good afternoon and thanks for taking my questions here. I wanted to ask about the inventory price adjustments. And I know there was some commentary regarding what it related to earlier in the call. But I was wondering, the price adjustments taken this quarter, do you see that as pretty complete at this point or are you still taking ongoing assessments of the inventory balances and we could potentially see some other sizable adjustments in the future, given the shorter term outlook in terms of what you're expecting on the market dynamics? Thank you.

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.

A

Yeah. When we look at price adjustments and reserves for returns, I think if you look at us versus some of the others, it's relatively on the smaller side. This quarter was around $4 million, and most of that has just been reserves for potential reserves based on what the inventories are out at the provinces. So, we have done some price discounting and it's been mostly on the oil-type products or tincture-type products. As opposed to taking returns, we've discounted the products that would sell through and not take a return. And some of the returns we're receiving from some of the products, relatively small dollars compared to again what we've seen in the industry.

Graeme Kreindler
Analyst, Eight Capital

Q

Okay. Thanks. And then, I just wanted to shift gears, with respect to the international medical revenue, and I understood the variance there, you mentioned you had a bulk sale in the previous quarter. A lot going on in the assets in Portugal right now. But as we think about that ramp and the expectation of more than doubling that medical revenue, I'm just trying to balance the discussions in terms of the amount of demand that various companies are expecting in the international market versus when are we going to see continued proof of that demand increasing quarter-over-quarter, expecting pretty sizable gains on that revenue line. At what point of the year would you expect in 2020 when we can really start to see that acceleration? Thank you.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

Yeah. We expect to see that acceleration really in earnest in the second half of the year. Actually, if we had more supply or high-quality supply, we'd be able to sell it. Every time we send flower to Germany, it sells on a couple of days. So, it's been more of a supply problem than a demand problem for us. So, that's been the challenge. So, we just need some – we need more high-quality supply, which we expect to produce – have more capacity come in from Portugal.

Graeme Kreindler
Analyst, Eight Capital

Q

Okay. That's it for me. Thank you.

Operator: Thank you. Our next question comes from Andrew Carter with Stifel. Your line is open.

W. Andrew Carter
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Thanks. So, I wanted to kind of drill in a little bit on the cannabis 2.0 products. We're obviously seeing a lot of out-of-stocks. So, first question is, are you seeing more of a normalized ordering pattern versus what you saw kind of in the 1.0 market and kind of give us an idea of where your supply chain is at this point? Are those products incremental to gross margin or do you still have some fixed cost absorption to go? That would be helpful. Thanks.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

A

Maybe I'll start and Mark will finish. We saw a different ordering pattern in December than we did a year-ago October. A year-ago October, all of the provinces were placing very large orders to build out their supply chain and keep product in their distribution centers. This time around, there were much smaller orders. But what happened was we had reorders essentially as soon as our initial product showed up into those distribution centers. So, it's almost as if they were testing to see who could actually make this stuff and who would actually ship it. And so, the orders for those 2.0 products, they're just – they're coming faster than what we saw a year-and-a-half ago. And so, it's – and it's not normalized. It's nowhere close to being normalized, because as soon as we ship the 2.0 products to the provinces and put them on the shelves, they disappear within a number of – a matter of days. And so, it's a good thing, but we're trying to increase our manufacturing capacity rapidly, so that we can ensure that we capture market share and capture shelf space.

Mark Castaneda
Chief Financial Officer, Secretary & Treasurer, Tilray, Inc.
A

And from a costing standpoint, we've put our plan in place and kind of built some inventory. We thought we'd be in great shape to have – we're building to 300% or 400% of our plan. But it sold out a lot faster and the reorders came a lot faster. So, we were probably more conservative this time around, as well as the provinces being more conservative versus the first time. And from a cost absorption standpoint, we're really inefficient today just because now we're trying to scramble to catch up and just push as much through as possible. We're putting new lines in – or an additional line in – I think in our chocolate side, and we'll get more efficient as those start to stabilize and we're not just rushing everything up.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.
A

And now that we know what demand is and we're seeing orders and reorders and increasing our capacity, we will further automate those different manufacturing lines. We took a conservative approach in terms of the equipment we ordered, the packaging that we ordered. And so, you'll see more efficiencies throughout our supply chain, which will drive down our COGS.

W. Andrew Carter
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thanks. I'll pass it on.

Operator: Thank you. And our next question comes from Scott Fortune with ROTH Capital Partners. Your line is open.

Scott Fortune
Analyst, ROTH Capital Partners LLC
Q

Good afternoon. Thanks for taking the questions. Most of the questions have been answered. But real quick, are you seeing any hardware issues on the vape side coming from the coronavirus and China suppliers? Or how is your supply side of things from the 2.0 side of things?

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.
A

Yeah. That's one of the areas where there is some impact, and it's really on the branded hardware. One of the things we did that turned out to be smart, but maybe not intentional was we ordered significant inventory of the vape hardware that was unbranded, so that we could put whatever brands were doing well, we could put that branding on the hardware. And so, we do have some inventory that's unbranded that we can now brand in our facilities, and that gives us a little bit of a pressure relief valve as we're waiting for additional hardware to come to us from various international sources.

Scott Fortune
Analyst, ROTH Capital Partners LLC

Q

Okay. That's it for me. Thanks.

Operator: Thank you. And I'm showing no further questions at this time. I'd like to turn the call back to Brendan Kennedy for any closing remarks.

Brendan Kennedy
President, Chief Executive Officer & Director, Tilray, Inc.

Thanks. I can't complete this call without saying a few words about Mark Castaneda. Back in March of 2018, we recruited Mark out of 18 days of retirement to be our CFO. In July of 2018, Mark completed his fourth IPO when he helped make Tilray the first cannabis company to complete an IPO on a major US stock exchange. Over the past 20 years, I estimate that Mark has participated in between 70 to 80 calls – 70 to 80 quarterly earnings calls.

Mark, I've enjoyed making history with you and look forward to continuing to work with you in your new strategic development role and thank you for your hard work and dedication to Tilray. I want to thank our dedicated employees and team members for all of their hard work improving patient and consumer lives through the power of cannabis and hemp. We appreciate everyone's questions and participation on today's call. Have a great evening. Thank you.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.