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Canopy Growth Corporation

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PRESENTATION

Operator

Good morning. and welcome to Canopy Growth's first quarter fiscal 2020 financial results conference call.

Canopy Growth issued, after financial markets closed on August 14, 2019, a news release announcing its financial results for the first quarter fiscal 2020, ending June 30, 2019. This news release is available on Canopy Growth's website and has been filed on SEDAR.

On the call this morning, we have Mark Zekulin, Canopy Growth's company—Canopy Growth's Chief Executive Officer, and Mike Lee, Canopy Growth's Executive Vice President and Chief Financial Officer.

At this time, all participants are in a listen-only mode.

Certain matters discussed during today's conference call or answers that may be given to questions could constitute forward-looking statements. Actual results could differ materially from those anticipated. Risk factors that could affect results are detailed in the Company's Annual Information Form and other public filings that are made available on SEDAR.

During this conference call, Canopy Growth will refer to supplemental non-GAAP measure, adjusted EBITDA. These measures do not have any standardized meaning prescribed by IFRS. Adjusted EBITDA is defined in the press release issued yesterday, as well as in this period's Management's Discussion and Analysis document that is filed on SEDAR.

Please note that all financial information is provided in Canadian dollars unless otherwise specified.

Following prepared remarks by Mr. Zekulin and Mr. Lee, the Company will conduct a question-and-answer session, during which questions will be taken from analysts. To ask a question at that time, please press *, followed by the number 1 on your telephone keypad. If you would like to withdraw your question, please press the # key.

I would now like to turn the meeting over to Mr. Zekulin. Sir, please go ahead.

Mark Zekulin — Chief Executive Officer, Canopy Growth Corporation

Thank you, Carol, and good morning, everyone. So as usual for Canopy, I'd like to begin the call with a brief summary of our objectives as a company and then speak to our execution as it relates to those objectives. I will also discuss how that execution, in turn, translates into our financial performance and hit on our broad expectations heading into the future.

I will warn now that you can expect a little bit more detail than we've historically given, for better or worse. After I speak, our CFO, Mike Lee, will provide a more detailed overview of the financial performance of our business. And finally, as mentioned, we look forward to taking any questions you may have. On that note, I will add that Rade Kovacevic, Canopy's President, is also here and will be available to participate in the Q&A session.

So what has Canopy been doing? As a first objective, we are focused on laying the foundation for dominance in an emerging global opportunity. To us, this means developing intellectual property, building brands, building international reach, and ensuring scaled production capability for current and future products. It means having a formula and level of credibility to ensure smooth and efficient expansion into new product forms, markets, and channels.

But also, as a second objective, we are fixated on the process of evolving from builders to operators over the remainder of this fiscal year, meaning that as our expansion program comes to a close

in Canada, and as new value-add products come to market in Canada, we demonstrate a sustainable, high-margin, profitable Canadian business. The ambition of our first goal impacts the speed at which we achieve our second goal. Canadian headquarters resources serve not just our Canadian operations but our global ambition. But both objectives are equally important, and both will be achieved.

With that said, I will use the remainder of my time to go over each of those in some detail.

Firstly, developing intellectual property. During Q1, Canopy filed 56 patent applications across its various R&D areas, including several related to pre-roll joint production; cannabinoid isomerization, whatever that means; vape oil and vape devices. Together with the patent assets acquired from C3, This Works, and KeyLeaf, Canopy's patent portfolio has increased to 110 patents and 270 patent applications.

So why is this important to us? Consider growing. Growing in a greenhouse to sell dried flower is great. Dried flower sales will always be a core part of any market. But growing protected, specialized genetics bred for specialized purposes, driven through efficient patented extraction technology and put into IP-protected delivery formats like beverages or vape products is even better.

Or consider market development. Selling medical cannabis in Canada, through what is essentially a special access regime, is great. The model works, and a strong brand and team like Spectrum Therapeutics can differentiate itself and make money. But selling a registered, differentiated, clinically proven medicine, produced to GMP standards and covered by insurance programs changes the money-making equation exponentially.

These things take time and money and unique expertise that only a few companies, like Canopy, have. But each person on this call has seen the speed at which this market evolves. Canopy will bring the future forward faster and better than anyone else through its investments in research, intellectual properties, and clinical programs.

Second, brands and new product formats. The program with the greatest potential to drive the overall size of the Canadian recreational cannabis market is our multiyear effort to develop unique, high-margin cannabis consumer products. To date, we have not, for competitive reasons, revealed significant information about these products. With this call, we will begin revealing some information but, of course, still only at a high level.

On vapes, our market research identified many designs and functional limitations of current devices, from battery life to device safety, all the way down to how a device does not remain in place when you put it on a flat surface. We believe that most of the products that would be brought to market would be licensed versions of products that the market was already familiar with, with limited differentiation. We have deliberately taken a different path.

Over two years ago, we started developing our strategy for vapes and how we wanted to enter this competitive market. As the world's largest cannabis company, we have the resources to develop better vape products that will offer the market something truly differentiated. We have the added benefit of being an end-to-end, vertically integrated company, and nobody will be able to replicate this integration like we have, as we develop supporting, proprietary technology.

Our technology team has come up with new ways to address many of the device design and functionality limitations that our market research has identified. Not only do our devices address these limitations, they add functionality that elevates the user experience and brings the industry into a new world of technology innovation. In an effort to protect the many innovations in our devices, we have filed many tens of patent applications covering unique features, functionalities, and device design.

In December 2019, we'll be launching over 15 new SKUs related to our vape technologies. As we get closer to unveiling the new products, we'll provide full details surrounding the different device options, cartridge formats, strain availabilities, and flavour profiles.

On beverages, we have of course spoken more openly about our belief in cannabis beverages becoming a new consumer product category. We believe that high-quality cannabis beverages that offer sophisticated taste, better bioavailability, and dose control, along with zero or low-calorie options and little or no drug interaction, will appeal not only to current cannabis consumers, but also expand the cannabis consumer category to reach a larger portion of the population. In Q3, we will be revealing more details about the multiple beverage products that we will be bringing to market later this year.

Benefitting from significant collaboration with Constellation Brands, we are excited by the market segmentation, brands, packaging, taste profiles, strengths, and formats of the cannabis beverage products that we will be bringing to market. And of course, occupying a former Hershey chocolate factory, you can expect a great lineup of bean-to-bar chocolate products.

Our existing brands will leverage these new formats as line extensions, building on the brand equity and customer affinity that we have already created. In addition, we have created format-specific brands with unique value propositions that have a clear focus on their respective formats and consumer preferences.

Moving on now.

Thirdly, let me speak to our international reach, starting with the closest opportunity, the United States.

The focus that we have had for some time in Canada is now equalled by our focus on the CBD and future THC markets in the United States. We now have over 70 staff in place in the US, including most

of our senior leadership, and our Canadian headquarters team has dedicated more and more time and resources towards this next opportunity.

On the THC side, we are very pleased that Canopy was able to close the unprecedented and historic arrangement with Acreage Holdings that will see Canopy acquire all the shares of Acreage when the production and sale of cannabis becomes federally permissible in the United States. With the arrangement now closed, Acreage is moving forward with plans to leverage our intellectual property. As Acreage communicated on their own conference call yesterday, they plan on opening Tweed and Tokyo Smoke-branded dispensaries going forward and to that end, expect to open several Tweed dispensaries this fiscal year.

Similarly, with respect to medical cannabis products, Acreage anticipates undertaking a national rollout of Spectrum Therapeutics-branded products in 2020. On the adult-use side, while continuing with their current brands, Acreage will add Tweed-branded products as a mainstream product line, rolling out in calendar 2020. With the brands will also come the know-how from Canopy to produce these products at scale.

And while Acreage does its thing, Canopy is squarely focused on CBD. Since January of this year, our team has been very active developing a range of high-quality CBD products and brands and securing the production resources necessary to bring them to market by the end of this fiscal year. Our accomplishments in these efforts are numerous.

We have developed a broad set of CBD products that includes skincare and cosmetics, topical treatments, vape products, beverages, edibles, oils, and softgels. Our team is developing, in the context of current regulatory environments, our targeted product marketing, advertising, and branding programs for these products, and we are on track to reveal our CBD products this fiscal year.

Investors will recall that in Q1, we announced the acquisition of skincare and sleep solution company, This Works. Today, we are leveraging our investment in This Works to ready one of our new CBD product lines, a range of CBD-infused skincare and sleep solutions. Our team has been working since this past January to identify and contract a robust, scalable, and outsourced supply chain to get CBD products into the market by the end of this fiscal year.

Working with American farmers, we have thousands of acres of hemp planted in the United States. In addition, our team has already procured hemp biomass and processing capabilities for the production of CBD for our product launch. Our supply chain will be augmented, starting next fiscal year, by corporate assets, including extraction and production resources at our facility in Kirkwood, New York, as well as additional manufacturing facilities for producing vape and beverage products in select locations in the United States. We have already begun work on these facilities, though locations have not yet been announced.

To stand up a new CBD business in the United States, we have made significant pre-revenue investments in building a strong team. Our team includes cultivation management, logistics, manufacturing, processing, sales, marketing and, of course, back office support, and finance, IT, and human resources.

Over the past two quarters, we have established offices in California and Colorado and will soon be establishing offices in Illinois and New York. We are currently involved in high-level discussions with key retailers in the United States, including being constructively involved with them as we collectively navigate the regulatory process. These investments in the US CBD markets are significant. They predate any associated revenue and increase our costs both in the US and at our head office. They negatively impact our short-term performance but are an appropriate investment in the future.

Next, I would like to briefly speak about select accomplishments in our international business.

First, in Europe, you will recall that we purchased C3 late in the first quarter of this fiscal year. Our Spectrum Therapeutics team is working towards full marketing and sales integration with C3 by the end of the calendar year. Our C3 sales team have 30 experienced medical sales professionals, who by the end of this fiscal year, be fully integrated into the existing Spectrum Therapeutics business, representing the largest cannabinoid medicines company in Germany, with the highest health care provider reach of any organization in the medical cannabinoid industry.

Our team has made significant infrastructure improvements, that by the end of this month will allow for increased flow of product into European markets, including Germany, Poland, Czech Republic, and the United Kingdom. This includes significant increases in pre-pack and fulfillment capacity, to ensure rapid product flow into the pharmacy channel.

On the supply side for Europe, our state-of-the-art, 300,000-square-foot greenhouse facility in Odense, Denmark is licensed and continues to be on track to provide European supply this calendar year, pending final regulatory approval of the harvested products. This facility, certified in both good agricultural and collection practices, as well as GMP designations, is currently completing pilot harvests. Commercial-scale cultivation has begun, with initial harvests beginning early this fall.

Our teams operating in Latin America, Asia Pacific, Europe, and Africa have all shifted from market building to an emphasis on commercial sales. To that end, we have exported almost 1,000 kilograms or kilogram equivalents of dried flower, oil, and softgel products from Canada since April 1st.

To reiterate, the ramp-up of sales teams and operations across all these continents remains just at the inflection point between pre-revenue ramp-up and commercial sales, with these investments and costs reflected in our financial numbers.

Fourth and lastly, I will speak to our scaled production capacity, which naturally leads into an overview of our performance in the first quarter of this fiscal year.

At the outset, there are a number of things we are proud of that are worth noting, including the growth of our flower, oil, and softgel sales in the medical market; strong growth from dried flower sales in the Canadian recreational market; the sale of over 1.3 million pre-rolled joints, proving the value of the automated machines that we have designed in-house; and the significant increase in the quantity of cannabis harvested during the quarter, with over 70 percent of that in high-THC strains.

At the same time, as I mentioned at the start of the call, we recognize that this year is an inflection point between completion of our ambitious national ramp-up and all the investments that come with that, and the need to move into optimized, efficient, high-margin business performance. To that end, we have been focused on improving the supply of high-THC flower products, utilization of assets and operational efficiencies as we ramp up, our manufacturing throughput, and ensuring the continuity of supply of CBD-only products.

While I will discuss our progress on these items momentarily, it is worth pausing to mention some of the macro variables at play in Canada, which we are watching very closely, as I'm sure you are.

These big-picture events are increasingly relevant to our performance today and through the remainder of the fiscal year. Canopy built an ambitious sales and operation structure in order to succeed in a thriving Canadian market, and we have to ensure that overall market growth in Canada continues and accelerates.

The Company looks forward in particular to the successful launch of new cannabis formats and an acceleration in store openings across the country. Today, both Ontario and Quebec, Canada's two most populous provinces, have one store for every 595,000 and 495,000 people, respectively, versus a

saturation rate in California, for example, of one store per 10,000 people. As such, we applaud announcements by both provinces to licence further retail locations and are signaling today that we believe the sector is ready for even more stores.

Canopy will continue to examine alignment of its strategy to market dynamics, as the Canadian retail landscape unfolds, but remains confident in its Canadian plans today, the long-term potential of the Canadian market, and Canopy's positioning to succeed as that market develops.

Having said that, let me get back to our progress operationally.

Increased sales of high-velocity flower products, we have now hit an annual run rate of over 160,000 kilograms per year, while continuing to bring additional growing capacity online. We have also brought an additional two automated packaging lines online to increased throughput, with a third coming online later this month. The increased supply, and in turn sales of pre-rolled joints, we are now operating five days per week, 24 hours per day. We have three automated lines in place and operating and have moved production from a temporary setting to the recently licensed 175,000-square-foot advanced manufacturing building, bringing operational efficiencies.

To ensure that we have more than adequate supply of extraction inputs for the next generation of value-add, high-margin cannabis products, we've obtained our processing licence for our large-scale continuous extraction system in Aldergrove, estimated to be online in Q3 with extraction throughput more than capable of supporting our BC operations.

We have also retrofitted the KeyLeaf Life Sciences facility in Saskatchewan, a company with over 50 years of business experience in the extraction industry. This facility is expected to be online by early Q3 and is conveniently located near our hemp farming and outdoor cannabis operations in the province, with capacity to extract approximately 5,000 kilograms of hemp or cannabis per day.

To ensure we have consistent supply of CBD product across both medical and recreational markets, we will be able to leverage the 900 metric tons of hemp biomass we harvested from 4,000 acres last fall and extracted at the KeyLeaf Life Sciences facility this fall, with an expected yield of thousands of kilograms of pure CBD. We will also further increase hemp extraction with our planned harvest of an additional 5,000 acres of hemp this fall. We also continue to invest in the development of new intellectual property related to cannabis production, processing technologies, and plant genetics.

We are now squarely focused on driving demand for our brands and our current and future value-add products in the Canadian recreational market. This includes extensive training programs with retailers across Canada and ensuring we bring high-demand CBD SKUs to market. It also includes communicating to provinces that our supply can now exceed current demand through the existing retail platform, providing confidence to expand the number of retail locations being licensed, in order to create further market demand.

Next, I would like to discuss the readiness of our facilities and people to produce the next generation of new, value-add, consumer cannabis products.

During our last conference call, we identified a number of milestones that we were expecting to achieve on the path to commissioning our new bottling plant, and we have achieved those milestones. The licence application for the beverage manufacturing facility was submitted on time on June 28th. Processing skids, large 20,000-gallon tanks, and piping equipment began arriving in July as planned. Bottle-line systems tested for our facility have begun completing factory acceptance testing in July, with full installation and turnover to operations expected by late October.

Automated systems related to the filling and packaging of our vape products are undergoing testing during August and September, with delivery to site and installation beginning later this month.

They are on track to be turned over to operations by October. The necessary vape filling and packaging rooms have also already been licensed by Health Canada.

And lastly, a reminder that automated systems related to chocolate manufacturing are already on site and qualified, with the associated rooms already having been licensed by Health Canada.

With critical equipment on site, equipment qualification well underway, and a capable and experienced operations team in place, we remain confident that we will begin producing high-quality beverage, vape, and edible products in the third quarter of fiscal 2020.

So in summary, as I hope is clear from this call, our strategy has not changed. We will continue building capacity in Canada, the United States, Europe, and beyond. Our commitment to build out our CBD platform in the United States and to acquire acreage when a triggering event occurs has not wavered. Our commitment to research and the incredible potential of the medical market has not changed. Building organizational scale, investing in product research and development, and bringing value-add consumer products and medical therapies to market remain high priorities, even though these investments have a meaningful impact on our short-term performance. This is how we will create the most shareholder value over the medium and long term in an increasingly complex and competitive global sector.

However, we are well aware that our business will, in the future, be increasingly judged by financial metrics, including achieving positive earnings in our consolidated corporate P&L.

Based on our current view of the growth of our markets, including distribution, retail, and the coming expansion of our product offerings, we expect that Canopy's net revenue will achieve a $1 billion run rate by the end of the fourth quarter of fiscal 2020. Further, Canopy is committed to its Canadian business delivering positive adjusted EBITDA on a quarterly basis within fiscal 2021. Still further, Canopy's

consolidated operations are forecast to deliver positive adjusted EBITDA on a quarterly basis within fiscal 2022.

Finally, we are aligned with Constellation Brands in the expectation that our consolidated operations will begin to deliver positive net income in the medium term; that is, within three to five years.

And last of all, before Mike continues with a more detailed discussion of our Q1 performance, I would like to provide an update on the Company's current leadership transition.

As you all know, on July 3rd, we announced a leadership change that saw Bruce Linton leave the Company, myself move from my role as President and Co-CEO to sole CEO, and Rade Kovacevic become President.

Additionally, we announced that I have made the decision to leave Canopy once a suitable CEO is found, one that can embody all of the vision and ambition that Canopy has, while bringing fresh energy and experience to drive this incredible company to the next level. I can confirm that the Company has retained recruiter Heidrick & Struggles, and that the search is now well underway, with several exceptional candidates already identified. We expect to complete the transition process within the next several months.

This concludes my long remarks, and I will pass the call over to Mike to review our first quarter fiscal year 2020 financial results. Mike, please go ahead.

Mike Lee — Executive Vice President and Acting Chief Financial Officer, Canopy Growth Corporation

Great. Thanks, Mark. Good morning, everyone. I will begin my remarks with a brief review of our top-line performance.

During the first quarter of fiscal ‘20, we generated net revenue of 90.5 million on net cannabis revenue of 71.7 million. This includes sales of 10,549 kilogram or kilogram equivalents, which is up 13 percent versus Q4 of fiscal ‘19, or up 291 percent versus Q1 of fiscal ‘19.

Looking at revenue by channel.

Gross revenue in the Canadian rec market totalled 61 million, including 50.4 million in product wholesale to the provinces and 10.6 million of revenue from our retail stores. Our gross revenue for the rec channel includes an $8 million provision for returns that I will speak about in more detail in a few minutes.

Gross revenue from our global medical channel reached 23.6 million, including 13.1 million of gross revenue from our Canadian medical channel and 10.5 million from our international medical channel. As you will likely recall, we recently acquired C3, which accounted for 8.8 million of our international medical channel sales.

Looking at our medical channel trends. The Canadian medical business rebounded in Q1 with growth of 13 percent, driven by increased supply that Mark highlighted earlier. With continued improvements to our export process and higher inventory levels available for export, we expect international medical to grow in coming quarters.

We also had other revenues of 18.8 million, which includes revenue from Storz & Bickel, This Works, as well as revenue from our clinics and merchandise sales.

And now a quick look at volume sales. I would like to highlight the following:

During the quarter, we sold 9,060 kilogram and kilogram equivalents into the rec channel, which is up 14 percent versus Q4. Of this, 7,673 kilograms were dried cannabis, which is an increase of 94 percent

versus Q4 of F’19, and we also sold 1.3 million pre-rolled joints, which represented 16 percent or 9.7 million of total rec cannabis revenue.

In the global medical channel, we sold 1,489 kilogram and kilogram equivalents, of which 46 percent was softgels and oils, and this is up from 17 percent in the first quarter of fiscal ‘19.

Now back to the revenue provision that I discussed earlier. Being a short nine months into this new adult-use market, we, along with our provincial and territorial agency partners, have been working to improve the overall supply chain for the rec market. We’re working hard to streamline business processes, with a focus on improving fill rates and reducing out-of-stocks, while also improving inventory turnover, especially as the sector grows.

And working with the agency partners, we build forecasts into our production plans which consider a number of factors, including the pace of new store openings. And, being an operator of physical retail stores ourselves, we understand that the pace of store openings is affected by a variety of factors, most notably the time required to complete the retail permitting process and licensing requirements.

In our detailed review of wholesale inventories at the end of Q1, we concluded that there was a modest surplus of oils and softgels in certain locations, and as such, we concluded that an $8 million provision for returns was necessary. This charge has been reflected in reported gross revenue for oils and softgel caps in the rec market. Taking all of this into account, net revenues for the first quarter of fiscal ‘20 are largely in line with Q4 fiscal ’19. And with our latest harvest of over 40,900 kilograms, we expect to return to growth in the next quarter.

Now I’d like to turn my attention to gross margin. As a reminder, the cost of sales includes the impact of operating costs of cannabis cultivation subsidiaries not fully utilized, including specific zones of

our Aldergrove, Mirabel, and Niagara greenhouses, as well as costs associated with developing vape, edible, and beverage products for which markets will be available later this calendar year.

Gross margin in the first quarter of fiscal '20, before the IFRS fair value impacts, was $13.2 million or 15 percent of net revenue. Comparatively, gross margin in the first quarter of fiscal '19 was $11.1 million or 43 percent of net revenue. The lower gross margin percentage in the first quarter of fiscal '20 was primarily attributed to $16.2 million of operating expenses for facilities not yet cultivating or processing cannabis, producing cannabis-related products, or facilities that had underutilized capacity.

In my remarks during our prior call, I highlighted that start-up costs related to our advanced manufacturing building and new bottling plant would continue to serve as a modest headwind in coming months. In the first quarter, we incurred expenses of approximately $1 million related to the commissioning of our advanced manufacturing building.

Excluding these costs associated with underutilized assets and nonrecurring expenses, the gross margin before the fair value impacts and cost of sales and other inventory charges was $29.4 million or 32 percent of net revenue.

With utilization increasing in these facilities, we expect our operating costs to normalize in the next several months, as we work through seed to sale, and we expect gross margins to surpass 40 percent by the end of the fiscal year.

Let me briefly speak about operating expenses. Sales and marketing expenses were 45.1 million in the quarter, reflecting increased staffing as we build out our network of Tweed and Tokyo Smoke-branded retail stores in Canada, increased staffing in our sales and marketing functions to support both our domestic and international markets, and investments aimed at driving brand awareness and educating consumers through various marketing, trade marketing, and promotional campaigns. But we are also

making investments ahead of revenue to prepare for the second phase of recreational cannabis, as well as CBD products in the United States, both of which are expected to launch later this year.

Research and development expenses grew to 8.5 million in the quarter, reflecting our investments in vape, plant genetics, applied technology, as well as the cannabis-based medical therapy clinical research. And we expect our R&D investments to expand further with our recent acquisition of Beckley Research and the associated clinical trials that are underway.

G&A expenses grew to 62.3 million as we have built out our global team, back-office functions, information technology, human resources, and legal.

Investments in acquisition-related activities totalled 13.2 million in the quarter and included investments related to implementing the plan of arrangement with Acreage Holdings and closing acquisitions of C3 and This Works.

Share-based compensation was 87.3 million and was down 5.8 million from Q4, due to reduced expenses on acquisition milestones.

Moving beyond operating expenses, I would like to spend a few minutes on other income and expense. We noted, in the Subsequent Event note in our fourth quarter and fiscal year 2019 press release, associated with the approval of certain modifications to the investor rights agreement with Constellation Brands, as well as terms of existing warrants, that Canopy Growth would record a material, noncash charge during the first quarter of fiscal '20.

As I highlighted during our previous conference call, and as previously addressed in the management information circular related to the Acreage deal, we and Constellation Brands agreed to a modification to the investor rights agreement with Constellation Brands. And the new investor rights

agreement has two modifications related to the exercise price of their warrants, as well as the expiration date of their warrants, both of which are subject to fair value adjustments.

The fair value adjustments, the accounting of which is detailed in Note 25 of the consolidated financial statements and recorded through the consolidated statement of operations, resulted in a noncash charge of $1.2 billion. Going forward, the revised tranche A and B warrants will be accounted for as equity instruments and will not result in subsequent remeasurement in the P&L. In addition, the tranche C warrants will be classified as a derivative liability, for which the fair value will be nil, given that they are based on a five-day, volume-weighted average price, or the VWAP.

The remaining expense and gain items included in net total other expenses, the majority of which are noncash, are further highlighted in our MD&A for the three months ended June 30, 2019.

The Acreage arrangement provides Canopy with the option to acquire 100 percent of the shares of Acreage, with a requirement to do so once US cannabis production and sale is federally permissible in the United States. In exchange for this option, Canopy has made an up-front payment to Acreage shareholders that totalled US$300 million, which will be recognized as a financial asset on Canopy's balance sheet.

Subsequent changes in the fair value of this option will be recognized through our consolidated statement of operations and will be disclosed in our quarterly reporting. The fair value accounting of the Acreage option, which will add a noncash expense or gain into other expenses, will introduce some volatility into our statement of operations.

Now let's briefly review adjusted EBITDA, our supplemental non-IFRS measure, for the first quarter of 2020. Adjusted EBITDA is defined as earnings from operations as reported, before interest, tax, depreciation, and amortization, and is further adjusted for noncash items such as stock-based

compensation expense, as well as accounting for biological assets and inventories and acquisition costs. And we believe adjusted EBITDA is a useful financial metric to help investors understand the operating performance of our business before the impacts of investments and acquisitions and income taxes and noncash fair value measures.

Our adjusted EBITDA for the quarter amounted to a loss of $92 million as compared to a loss of 22.5 million in the comparative period last year.

From the beginning, our company has had different aspirations. We have long believed that success in this industry should not be judged by selling dried cannabis flower to existing cannabis consumers in Canada. Instead, we believe the true opportunity and, ultimately, the path to generate the greatest sustainable return on investment over the long term will be driven by our company becoming a global consumer-and-medical-products company with a product offering that expands the cannabis category beyond traditional consumers, to also include consumers that have not yet tried cannabis for the first time. And to accomplish this, the scope of our activities and investments will continue to be greater.

We have invested in the development of infrastructure to produce what we believe will be a new, category-defining cannabis beverage. As Mark highlighted earlier, we have invested in a range of new feature-and-function-rich vape products. We're standing up a new CBD business to start in the US. We're investing in scientific research and clinical trials that we believe will pave the way for cannabis-based medical therapies to enter the market. We're investing in development of medical markets around the world. And we, of course, have our core operations that generates revenue for us today in Canada and Europe.

So as we continue to mature as an organization, it's important that we distinguish the financial performance of our core operations from that of these other activities. Hence, we've recently expanded

our adjusted EBITDA reporting to include a breakout of the existing unchanged metrics into the three subcategories as follows:

Number one, adjusted EBITDA related to corporate operations and corporate overhead, and this will include our Canadian and European results.

Adjusted EBITDA related to nonoperating or underutilized facilities, which contains the cost that we often cite in our explanation and reconciliation of reported gross margin to normalized gross margin.

And adjusted EBITDA related to strategic investments and business development, which includes global research and development and global spending beyond Canada and Europe.

The breakout of these measures are captured in our press release and our MD&A. And for Q1, our adjusted EBITDA on core operations and corporate overhead was a loss of 57.8 million. Our adjusted EBITDA nonoperating and underutilized facilities was a loss of 16.2 million. And our adjusted EBITDA on strategic investments and business development was a loss of 18 million, totalling the 92 million cited previously.

Taking a look at our overall net loss on a reported basis, which includes all fair value adjustments for biological asset accounting, as well as the noncash $1.2 billion fair value adjustment related to the extinguishment of warrants discussed above, was 1.3 billion or $3.70 per share.

I'd like to now turn to the balance sheet. At June 30, 2019, we had cash and cash equivalents available and marketing securities on hand totalling 3.1 billion, representing a decrease of 1.4 billion from March 31, 2019. The primary use of cash during the quarter was for the C3 and This Works acquisitions, totalling approximately 430 million; the premium paid for the Acreage call option, which was 395 million in Canadian dollars; and capital spending for infrastructure, which was 212 million. And the balance was related to ongoing debt servicing and funding for operational losses.

Finally, I would like to provide an update on the priorities that I covered during our last call. One of my key priorities for the Company is to strengthen our financial reporting and controls, and this includes everything from mitigating our material weakness on end-user computing, that is covered in our MD&A, to reengineering our financial close and reporting processes so that we can better support the business with reporting and analytics, while also speeding up our external reporting process in anticipation that we will someday be an accelerated SEC filer. I'm happy to report that all of these projects are underway, that we're fully resourced, and our project plans are in place, and we expect to make tremendous progress in coming months.

I also mentioned my desire to revisit our ERP strategy, and this work is also underway. I will provide a much more detailed update on Q2 earnings call.

On our Q2 earnings call, I will also share more about the outcome of our upcoming foreign private issuer test, which will help to solidify our plans for conversion to US GAAP at the end of FY'20.

For now, this concludes my review of Canopy's financials for the first quarter of 2020 and would like to field questions from analysts on the call.

Q&A

Operator

As a reminder, to ask a question, please press *, then the number 1 on your telephone keypad. To withdraw your question, please press the # key. To ensure an efficient call that gets to the questions of as many analysts as possible, analysts are requested to limit to one question and, should it be necessary, one follow-up question. In the event analysts have additional questions, they are welcome to reenter the question queue.

Our first question this morning comes from Andrew Carter from Stifel. Please go ahead.

Andrew Carter — Stifel

Hey. Thanks. Morning. So I guess the first thing I wanted to ask is, the building brands has been a long-term focus for the Company that you've reiterated, and you've obviously outlined some pretty compelling products for the next generation. But wanted to ask about kind of where you stand today. And you've spent a lot of money on retail infrastructure, obviously. You participate in campaigns where you can. But really, is there any differentiation for what your brand stands for? And outside compelling products, there's still quite a bit of marketing restrictions. What's going to change in the second wave of the market?

Mark Zekulin

Yeah. Excellent question. Thank you. So as I mentioned, we do have Rade Kovacevic here, our President. So he's the only guy who hasn't had a chance to talk, so we'll let him field this one.

Rade Kovacevic — President, Canopy Growth Corporation

Hi. Thank you so much for the question. I think what I would say is, we're really proud that many of the brands we brought to the recreational sector, we started building five years ago, so we have lots of times to explain the propositions to consumers, to build that brand affinity, and so forth.

I think in addition to that, through the retail strategy we've had, we've had the opportunity in the early days of recreational legalization for consumers to interact directly with the brands and have sort of a hands-on feel for them. We've been able to leverage that in terms of sort of the good, better, and best pricing scheme, to ensure that each of these brands sort of has a clear place to live. They've been mapped out well in terms of different consumer segmentation. And I think, as Mark spoke to, the goal

would be to take the intellectual property, align it with the brands, and then leverage what we've built in the current market as we move to sort of Cannabis 2.0.

Andrew Carter

Got it. And then, just kind of a second kind of question about Cannabis 2.0. Have you been able, really, to share any of your innovation details with some of your retail partners or customers? And kind of help us understand how receptive they are to kind of understanding this new category. And this speaks particularly to the beverages where you've made a lot of investment or made investment. Is the infrastructure out there going to be there to support that form and maybe push it above what we see here in the US?

Rade Kovacevic

Yeah. For sure. So I think a few points on that. I'd say, we started discussing innovation segments with the cannabis boards about six months ago. So we had our innovation team go around, do a road show, and help the boards understand the formats that were coming, sort of with a consumer-first mind-set on our side, in terms of why would the demand exist, how are these products disruptive, and so forth.

Second to that, in the past, I would say, one to two months across probably the majority of cannabis boards at this point, we've submitted actual SKU listings with pricing and so forth and had those in-person conversations with the cannabis boards. And I think, overall, across the market, there is excitement about the Cannabis 2.0 products, the ability to convert further cannabis consumers from the black market to the legal market, to grow the overall size of the cannabis market, and increase sales.

On specifically new formats, I think one of the advantages that the cannabis boards being full of people that used to be alcohol boards is they're fairly comfortable with the beverage sector. So to your question, yes, we have worked through on the logistics, shelf-spacing considerations, and things of that

nature with beverages. I would say we have a strong trademark in educational plan in terms of helping consumers understand.

And I think the big difference we see with our beverages compared to the US market is really looking at our beverages as all the IP work we've done and scientific development work, to ensure that our beverages are analogous to alcohol in terms of on-site (sic) [onset] time, duration, and so forth. And I think it's a very different approach than has been taken, US recreational market, where it's been very focused on sort of a high-dose, high-strength, single-use, as opposed to an occasion-based approach to beverages.

So from the outset, we think it'll be stronger than the US. We have a moderate approach with a moderate building of inventory going in, so that we're able to react to levels of demand and so forth.

Andrew Carter

Thanks. I'll pass it on.

Operator

Our next question comes from Tamy Chen from BMO Capital Markets. Please go ahead.

Tamy Chen — BMO Capital Markets

Yeah. Thanks. My first question is, could you just comment on your revenue performance in the quarter in the rec channel? We've seen some—we've seen some of your peers increase share, while yours has been largely flat. Like what would you attribute it to? Is it not the right mix of products? And your rec average selling price was also down, even backing out the return provision, so just wondering what factors played a part in all of this.

Mark Zekulin

Yeah. Thanks, Tamy. So Mark here. The way I see it is Canopy had incredible success coming out of the gate in October. Not perfect, of course, but between our ability to get our scaled facilities running, our logistics, our distribution, our sales, we really got out to a great start that allowed us to achieve a very good market share. And in this sector, there's not enough data to pinpoint exactly what market share is, but I would confidently say it's between one-fourth to one-third of the market as Canopy market share. So we're incredibly pleased with that.

What's happened now, over the last eight months or so, is a couple things. Firstly, obviously, our competitors have now began to ramp up their own supply, which means they are able to increase revenue from a lower base, but to have that revenue increase and taking some market share back.

And the second thing, frankly, is that we've gone through a process of doing some retrofits and some changes to our facilities that were brought online, to make sure that they have the right yield, the right output over the long term. So I think what we've seen is, in my view, we are still within that one-fourth to one-third market share. It's probably—whereas we were at the top of that band, we're now towards the lower end of that band, but I feel pretty good.

And I'd say, in terms of narrative, if you gave me the choice between having a 10-share boon to 15 to 20, or having a 35 moving to 30 or 25, I would still take the 25 ending point. And as we look forward, obviously, with the harvest that we just had, with the value-add products coming online, with the scale and the systems, we certainly expect to maintain and increase our market share. And as the market grows, certainly that means to increase our revenues.

Hopefully that hits on point one.

I think, Mike, do you want to speak to point two on pricing?

Mike Lee

Sure. Yeah. So, Tamy, on your question about ASP and pricing, what I'll say is, overall, our pricing is up about 1 percent total company global sales, Q1 versus Q4. When you look at the Canadian medical channel, our average price is up around 8 percent versus Q4. When you look at recreation, recreation average price versus Q4 was down about 13 percent, entirely driven by mix between bud and our softgels and oils, so. And Q4, we had about a 50/50 mix between bud and softgels and oils, whereas in Q1, our mix was heavily weighted toward bud and less weighted on oils and softgels. And oils and softgels, being average higher price, had a negative mix impact. So we would expect that to normalize going forward.

Tamy Chen

Okay. Thanks. And just my follow-up is, on the return provision you took in the quarter, appreciate the colour you gave earlier. Just wondering, did the inventory review—was that spurred by provinces thinking about optimizing their inventory that they've got? And did any of discussions, if it involved the provinces, did that also involve how the provinces are thinking about even flower SKUs that they've got at their warehouses?

Rade Kovacevic

Hi, Tamy. Rade here. So what I would say is, for us, working with all the provinces, business planning is an ongoing thing. We meet on a routine basis, either weekly or monthly, depending on the province. And so, as the market evolves, as retail stores get launched, we're constantly reviewing various SKUs, inventory levels at provinces, and rates of sale between those various SKUs.

So I think, for us, it's more part of an ongoing conversation as opposed to something new, and looking at where the market's at, how many stores are planned in what period, and us being proactive and cautious to ensure that we have the provision in place. I think it's more from a normalizing of rate of sale across SKUs, as opposed to initial forecasts, as opposed to a cause for concern going forward.

Tamy Chen

Okay. Thank you.

Operator

Our next question comes from Vivien Azer from Cowan and Company. Please go ahead.

Vivien Azer — Cowan and Company

Hi. Good morning.

Mike Lee

Good morning.

Vivien Azer

Just a—good morning—just a housekeeping item and then my real question. Mike, you enumerated the sequential change in pricing for both medical and adult-use in Canada, but the real eyepopper is the 61.38 from international. Can you explain what that is? That looks like an anomaly.

Mike Lee

Yeah. It's entirely driven by the C3 acquisition during the quarter. And, as you know, these are pharma-grade products that have a much higher price point than our existing softgel-oil-cannabis business.

Vivien Azer

So is that a good number to think about going forward?

Mike Lee

Yeah. Yeah. And certainly—and maybe Rade can jump in on expansion plans. But for C3, we can talk a little bit about what our expansion plans are going forward. I would also say that the mix is going to

continue to evolve as the supply situation for our international markets improves. So it's going to be entirely driven by mix.

So, Rade, why don't you cover the C3 expenses?

Rade Kovacevic

Yeah. So I think, to that point, we're looking at how to leverage C3 across various international markets. And to Mike's point, it's a high-quality pharmaceutical product, and so the lead time to expansion is longer than a medical cannabis flower and so forth. So I think, in the short term, you'll see that mix start to lean more towards cannabis flower, as our various regions come online. Sales export process with Health Canada has improved significantly in the past quarter. And so we see growth there, which will average the price towards where flower sales are, and then more in the medium to long term, working with the team at C3 through their integration in terms of leveraging those high-quality pharmaceutical products globally to other regions.

Vivien Azer

Terrific. And then my real question, Mike, is on gross margin. So I think, kind of first impressions last night, based on the conversations I was having, the sequential deterioration in your reported gross margin was quite disappointing. I think I'm actually even more surprised by your commentary on the call. Last quarter, your adjusted gross margin, excluding costs associated with underutilized assets and nonrecurring expenses, was 41 percent, and this quarter, it's 32 percent. How is it possible that you guys grew your kilograms harvested by over 300 percent, and your underlying adjusted gross margin deteriorated that much, sequentially? Thanks.

Mike Lee

Yeah. Sure. So the—going back to the starting point of the normalized 32 percent that I talked about on the call, there's about 6 points of negative sales mix in the quarter, due to more dried cannabis sales and less gel caps and oils during the quarter. That was a full 6 points of headwind. In addition to that, we had an increase in royalty payments related to Houseplant's that were a further headwind on margin. So when we normalize for that and get back to a normal softgels and oil mix, the normalized margin would be much closer to that 40 percent that we keep talking about in terms of Q4 target. But admittedly, we're also counting on productivity gains to get to that 40 percent margin as well.

Vivien Azer

Okay. Thank you very much.

Mike Lee

Mm-hmm.

Operator

Our next question comes from Chris Carey from Bank of America. Please go ahead.

Chris Carey — Bank of America

Hi. Good morning.

Mike Lee

Morning.

Chris Carey

So I guess, just like take a step back, right? Just given kind of the quarter which we expected to be underwhelming and—but the market's reaction. And I think there are a number of reasons to suggest here that Canopy's at trough on sales and margins, right, and that you should see pretty significant

improvement ahead. But on the other end, clearly, the market needs some confidence on this front, especially around gross margins, right? And so I think it's important to kind of lay this out, right?

So you alluded to something in the prior question around gaining share early in Canada and that that required you to kind of—you acquired the facilities in British Columbia. You really ramped production in facilities that weren't purpose-built for cannabis, and that gave you this huge lead, and you were like 2X kilos sold versus all competitors, right? But as you started to perhaps see some issues in those facilities, you started to close them down and retrofit. And we saw harvest has decelerated. Gross margins have come in. And I guess, I'm just wondering, were the challenges you saw in those facilities significant? And has the retrofits really been driving a lot of the harvest which has decelerated and the margins which have decelerated?

And then, are we now at the point where those retrofits are coming to an end, and that the sales leverage should really start to be taking off on the margin front? Because I think if you just have a year of historical perspective on how the cultivation versus kilos sold played out, some of the gross margin pressure and sales stagnation could make some sense. So just some perspective on that, I think would be really helpful in the context of everything. Thanks.

Rade Kovacevic

Yeah. Yeah. So Rade here. So I think a few things to take a step back and think about. When we brought those facilities online, we brought almost 3 million square feet of production capacity online all at once to ramp up product for the start of recreational legalization, which is what allowed us to take a strong position from the outset. So we're very happy with that decision.

I think there are basic things that we needed to improve, that we knew were the case in the greenhouses, but we didn't want to miss that opportunity for initial inventory creation and sales in the

first quarter of legalization, to get that strong market share, get our brand solidified, and customer affinity built. And so, when we took them offline, we did planned upgrades that we knew were in place.

And what we've seen over Q1, both in terms of the overall increase in harvest, our ability through our planning process to have 70 percent of the strains be high THC, and a significant increase in the percent of product that is high-quality flower coming to market, where demand currently is quite strong, is that we were able to execute on that plan as we had hoped. And so we're quite happy with the situation we're leading into legalization. We have strong supply, strong market share, and that we've been able to bring these properly online now to the capacities we wanted, where we can now look at fine-tuning and finding efficiencies, both to reduce our COGS and increase overall yields.

And so I think the margin you're seeing play out is just the nature of scaling. These products have four- to six-month lead time. If you start the time you have to grow the mother plants, to get to market, and so there's a large amount of labour as you bring these sites online. But I think the harvests in Q1—and you'll see going forward—speak to that being a strong success and positioning us very well to dominate the flower market and particularly, given the flexibility to take these kilograms and determine flower versus new products based on rates of demand. So I think it sets us up for a very good position and as Mike alluded to before, puts us in a place where we have this margin build as we go into Q4.

Mike Lee

And if I could further add just for perspective, having just finished Q1 harvest with the lion's share of this work completed, we generated a harvest of 40,900 kilograms. In retrospect, in all of FY'19, our harvest was 47,000 kg. So in one quarter, we've produced a large, large percentage of what was produced all of last year. So that's just a critical, critical thing for investors to understand.

Mark Zekulin

Yeah. And, Chris, we'll give it the three-fold answer. I mean, just to build on another example that we spoke about earlier, right; pre-rolled joints as an example.

Chris Carey

Right.

Mark Zekulin

In Smiths Falls, in order to get pre-rolled joints to market, we shut down growing rooms, right, and we changed those rooms into a facility that could, on a semi-manual, semiautomated basis, create pre-rolled joints.

And now, with the infrastructure completed here in Smiths Falls, that production gets moved to a new place, a new licence plate, where it'll be automated, where it will be in its proper home. And the old part of the facility will go back to being a grow operation. So these are the natural things that we did in an early market to make sure that we got product online and served our customer needs. But that'll lead to inefficiencies, and that will slowly get fixed as the rest of Smiths Falls comes properly online.

Chris Carey

Yeah. Okay. See that's—this is—that's kind of helpful perspective, right. And then, I guess, as my follow-up, right, the 41,000 kilos harvested this quarter, I think, by my model, you're probably now at a position where you have almost 90,000 kilos just ready to go. You have $90 million of finished goods, $250 million of work in progress. And so I'm trying to understand why this sort of foundation shouldn't be the start of kind of a real acceleration in quarter-over-quarter sales from here. And then maybe just comment on the size of your inventory right now? And why that shouldn't maybe give you the uplift in the fiscal Q2? Thank you.

Rade Kovacevic

Yeah. So Rade here. So I think the important thing to look at the market—and Mark spoke to it earlier—about retail stores per capita in Canada compared to saturation points you see in Colorado in the United States. And so the two big movers we see are retail rollouts in Ontario and Quebec, both of which provinces, with us applauding them, have aggressive rollout plans for additional retail over the rest of our fiscal year. And so what the provinces have been saying is, they need the flower to come online to be able to do this, and that's what our Q1 harvest of 40,000 kilos represents.

The next part post-harvest is how quickly we can get it to market. And so I think, to your question, a good example is in the first 10 days of August, which I'll note include a long weekend, our quality assurance team released for sale 3.5 tons of flower products and over 2.1 million pre-rolled joints. So it gives you an idea of us being able to now take those harvests in Q1, get them through our manufacturing, finished good, and quality assurance processes, and have them approved for sale and ready to go. And I give that to you as a snapshot of the product moving through the system.

I think what we now are being able to go to provinces and tell them, down to the finished good SKU level to give them confidence, is we have the flower to be able to meet existing demand based on number of retail stores, and for them to be able to confidently roll out more retail stores as they go forward.

So I think the lag in the system is that rollout and, understandably, the provinces have been waiting to hear that the flower's online for them to be able to do that. So what you'll see is us building inventory, that gives provinces now comfort that they can roll out more and more stores, and Alberta's a great example of a province that's already begun that process. And then that will allow them to drive further demand through further points of distribution, which in turn allows us to further drive sales.

I think the other great part for us is it allows us to have finished good inventories that, as we move into scaling new products for Cannabis 2.0, that those products are in finished-good form and available while we focus on building new inventories to be able to sell in in December of those new Cannabis 2.0 products.

Chris Carey

Okay. Thanks.

Operator

Our next question comes from Graeme Kreindler from Eight Capital. Please go ahead.

Graeme Kreindler — Eight Capital

Hi. Good morning, and thanks for taking my question here. Just to follow up on the discussion there on the harvest figure and the overall inventory. I was just wondering if you could give any colour just to get a bit more specific on—I understood that the future landscape of retail is not going to look like what it is now. But by all accounts, I think what you harvested this quarter could really sufficiently supply Canada in its existing format right now.

So is there any view to hold back a large portion of that inventory and get it ready for the extractable products? As well, is there any thought about potentially adjusting prices in order to climb back up in the market share position? It was pretty flat quarter over quarter on the ASP, so just wondering if you could provide some colour on those thoughts there? Thank you.

Rade Kovacevic

Yeah. For sure. So I would say, in terms of holdback, there isn't a desire just to hold back product. It's more about allocating the flower inputs to the right product, based on rate of sale and so forth, and building appropriate levels of finished good inventory to give our customers, the provinces, comfort that

finished goods are ready and on demand as they scale, while not overcommitting to a certain channel, so that we are fairly agile and able to respond to demands.

On the pricing question, we've seen great growth in our TWDs, which is our value brands, across markets. And I think, quite happy with the strategy of, we initially focused our flower inventories on our better and best brands—Tweed, Leafs By Snoop, DNA Genetics, Tokyo Smoke, Van der Pop, all those brands. And so we wanted to make sure there was continuity of those products on the shelf to build customer affinity. We didn't focus on value flower from the outset. Now as these harvests come online, we're in a place where we can continue to support SKUs being in stock on our better and best brands which, long term, is what allows us differentiation and affinity, while really starting to drive the value side of the market as well.

And so it wasn't an area we chose to focus on to start. I'm very confident that that was the right play, and what I'll say so in a year from now as well. But it's a category where we haven't played in a big way, and it's a place where, now with the scale we have and the cost of goods sold we'll be able to drive down, where we can play quite aggressively and pick up additional market share from a Canopy Growth perspective.

Graeme Kreindler

Okay. Thank you. And just to follow up, with respect to the 8 million charge against sales, is that a onetime event? Or is that something we could expect to have coming in the future quarters here? Thanks.

Mike Lee

Yeah. Mike here. So it's normal for CPG companies to have an ongoing revenue provision for estimated ongoing returns. I would remind you that the supply agreements with the provinces allow for

returns at any point in the future. But I would say that now that this is established and we have processes in place where the information from the wholesale-level inventories is now becoming more available, more frequently, I would say that this is something that I wouldn't expect to move the P&L in the future.

Graeme Kreindler

Okay. Thank you for that. Appreciate it.

Mike Lee

Yep.

Operator

Our next question comes from Matt Bottomley from Canaccord Genuity. Please go ahead.

Matt Bottomley — Canaccord Genuity

Yeah. Thanks for taking the question. Just wanted to go back to the sales mix, particularly on the recreational side of things. Can you just give us a little more colour as to why the oil and gel capsules this quarter went essentially to zero? I think you were in 30 million or 35 million last quarter. Was that a decision in terms of allocation? Or was there any—was there any issues with production in getting those types of products out the door? It didn't seem to be a problem on the medical side, so just more colour would be helpful.

Mike Lee

Yeah. Thanks, Matt. Yeah. No, it is not related to our production flow here. It's simply related to the product mix that we see demand for and ensuring that we allocate products appropriately to that mix. So certainly, as you say, our oils and softgel products, yeah, remain exceptionally popular and an increasing share of our Canadian medical base, and an increasing share of our global exports to medical markets.

So I think that's—it's just an indication of properly seeding the market with what customers are buying at the till. And again, I think it's also important to reference that at-the-till part, because we still see softgels increasing in demand at the till, at the retail store with customers purchasing, right? So it's just a matter of ensuring that education continues, people understand that product increasingly better, and we continue that philosophy.

Matt Bottomley

Great. And my follow-up's just again on the provision. Has there been any communications from any wholesalers themselves, that returns are more likely than not? Or is this just your own analysis you guys have done in making that determination?

Mike Lee

Yeah. I think it's—as Rade alluded to before—it's normal course of business, right? We are always having these conversations. It's sort of like, when somebody asks us, do you have any conversations going on with Health Canada? We always have conversations going on with Health Canada through the regular process. So it's the same thing. We're always talking. We're always looking at the mix of what they have, the mix of what we're preparing, the mix of what customers are buying. And for us, through those conversations, we decided it was a prudent time to take that provision as we look forward.

Matt Bottomley

Thank you.

Operator

Our next question comes from John Zamparo from CIBC. Please go ahead.

John Zamparo — CIBC Capital Markets

Thanks. Good morning. I want to ask about the revenue as well. You mentioned the lack of retail distribution points versus Colorado, which is fair, but we've seen much of the rest of the sector advance revenues in Q2 versus Q1 on a calendar basis. So I'm just trying to reconcile that with your B2B and B2C, which are down sequentially. So can you help us understand that? And maybe talk about the ordering process of the provinces? I understand there's some lumpiness there, but just some commentary on that would be helpful.

Mike Lee

Yeah. Absolutely. Thanks, John. I think it's fair to say that—and it sort of goes back to the answer I gave before—we've had a great start, and our goal is to maintain that share as the market continues to grow. And as our competitors have brought on increased supply, I think there's some natural expectation that they will increase their share, but I think it's starting, frankly, from a lower base.

So certainly, our intention is, as we've talked about the product mix and the high-THC products coming online, and our ability to push even more out going forward—we're very confident in our ability to grow shares going forward. But as you say, there is an element of, the pie has to continue to get bigger, and I think we're seeing the provinces start to do that.

John Zamparo

Okay. Thanks. And then a follow-up on a question from earlier. You mentioned you were decommissioning some assets for retrofitting, but you still hit a record production level in the quarter. I mean, does that—should we interpret that as stockpiling for Q4? And do you have the ability to shift your product mix in the back half of, or the remainder of this year? Thanks.

Rade Kovacevic

Hi. Rade here. So I think you slightly misunderstood. What we were referencing was that in sort of mid-Q3 and into Q4 of last year, we had retrofitted our large greenhouses in British Columbia and some work in Mirabel as well. Those came back online in sort of early, mid-Q4, and then those are the harvests you're seeing resulting in Q1. So it's not that anything's been taken offline now. That was a historical retrofit, and now the facilities are fully online and producing. And glad to say I was out in Vancouver two days ago touring the facilities, and they're doing great.

Mike Lee

Yeah, John. And I don't see—it is a bit of a fluid process, right? I mean, if you just imagine a large facility like that, you'll grow a crop, you'll take it down, you'll clean, and you'll put up a new crop. Right? And so it might be a case that we don't fill the area for an extra couple weeks because we are—fill in the blank—updating the irrigation line, or the lighting system, or the HVAC, or whatever it is. So it's not so much an on-and-off sort of thing. It's a continual improvement, but we think we're there now.

John Zamparo

Okay. Thank you.

Operator

Our next question comes from Doug Miehm from RBC Capital Markets. Please go ahead.

Doug Miehm — RBC Capital Markets

Yeah. I just wanted to circle back to the pricing issue, with respect to the product that was returned. Correct me if I'm wrong, but I think the majority of it was gel caps. And in the event we move ahead over the next little while, and you have a little bit more share of gel caps—but it appears that these were products that were having difficulty being sold, but you can correct me if I'm wrong. Why would you

expect margins to jump back so dramatically to previous levels when those levels of gel caps and oils were probably too high to begin with?

Mark Zekulin

Yeah. Thank you. So I think—so just to clarify, it's not that there actually have been returns. The provision reflects our assessment of the overall inventory levels, versus rate of sale and the precautionary step to account for that now because we think it will—it has the probability of coming in the future. So it's not that they have actually been returned yet.

So I think, speaking probably more importantly, to your point about the rate of confidence, even in, let's say, the most ambitious product mix forecast for the existing SKUs, right—flower and pre-rolled joints on the one hand, and oils and softgels—oils and softgels were always going to be a smaller part of that mix, right? So I think what actually gives the greatest confidence is thinking ahead to when what we call Cannabis 2.0 comes online, you have a whole range of products, from vapes, to beverages, and chocolates. Those are the ones we've talked about but of course, there are others, even, right?

And I think, with those products online, I think you're nearly certain to see what looks like flower sitting at, let's say, a 90 percent share today, falling to something closer to 60 percent, which is consistent with what you see in other markets. So that opens up a big range and even bigger range than we see today of value-add, higher-margin products. And that can of course include softgels or oils or sprays, but it can also include all of those other products that will come online.

Doug Miehm

Okay. So we'll see some benefit, but in the next quarter or two, but honestly, you're going to feel the real impact of that in your fiscal Q4.

My follow-up question has to do with, you're a very well-connected company in the Canadian and international markets. But what do you think the rollout of new retail stores in Ontario is going to be over the next two years, given how important it is to your plan here? And I'll leave it there. Thanks.

Mark Zekulin

Yeah. Thank you. I mean, I think you hit it on the head. Ontario is a major market, is an important market. It's obviously the market where we're based. I think the government, if we think back, after the change of government, their position was that they wanted an open, full market. Right? I mean, that anybody who wanted to apply to run a retail store could do so. And as we've talked about, there's this chicken-and-egg game of is there enough supply to justify the stores, and then how these things—how these things turn. But at the end of the day, every indication I have is the government remains committed to an open, private cannabis market. So we would expect—as you say, two years out, we would expect a fully open, as we say, saturated retail market in Ontario.

Doug Miehm

Thanks.

Operator

Our next question comes from Michael Lavery from Piper Jaffray. Please go ahead.

Michael Lavery — Piper Jaffray

Good morning. I just wanted to get at the outlook a little bit better, and two pieces maybe specifically. When you look at 4Q and talk about a 1 billion run rate, obviously something around 250 million, how do you think, in rough terms, that breaks down? And specifically, just trying to understand how much contribution from something like US CBD or second-wave products—what's some of the components of how we should think about getting to that number?

And then a little further out, when you look at the EBITDA positive guidance for ’22, how should we think about how that compares to cash flow? Would that be net cash flow positive from operations as well?

Mark Zekulin

Yeah. Thank you. So on the $1 billion run rate, it’s a great question. Our goal remains to hit that $1 billion run rate in that quarter. We certainly believe it is attainable. We do depend on the Canadian market, still. Right? So as we’ve talked about, we are in full press to get revenues online across the world and in particular in the US, and I highlighted all the things we’re doing to make that happen and to hopefully have a major contribution towards that.

But still, at the end of the day, I think it’s probably fair to say the lion’s share of that will rely on the Canadian market. There are macro factors that we’ve talked about, about new products, formats coming online that will contribute towards that, about new store openings and the rate that allows that pie to get bigger to achieve that. Certainly from an execution point of view, we are not concerned in our ability to hit that, as long as the macro environment allows for it.

Michael Lavery

And so I guess just to follow up a couple of things. I mean, any specific colour at all on how much US contribution, if any, you’re counting on, even though you said sales by the end of the year? Is that just a trickle? Or is that a meaningful piece of it? And what’s the right way to think about that?

Mark Zekulin

Yeah. I think it’s a little early for me to try to quantify that. Obviously, as we look into the US, we are thinking big. Right? But there are still a number of questions in terms of retailer lineup and those types of things. So I think it’d be premature. Obviously, there’s the FDA and the rules that they set out. So I think

we're confident we will be there. And obviously, the team is working very hard to make those meaningful. But it would be premature for me to try to quantify that.

Mike, did you want to hit on the 2022?

Mike Lee

On cash flow? Yeah. So, Mike, I think your question really is about free cash flow. So cash flow from operations, certainly, we would expect to be in line with overall EBITDA, meaning aside from normal inventory fluctuations and all of that, it should correlate pretty tightly.

So then the question then becomes, what's your capital investment at that point in the business? I would expect that by FY'22, a lion's share of our infrastructure build, and Canada's behind us, a good chunk of the US is behind us, and then depending on federal permissibility and all of that, I think, depending on when that happens, that could be a binary event that changes the entire equation. But assuming that doesn't happen, I would expect that we would start to approach, at a minimum, breakeven operating cash flow, and then depending on CapEx, could be slightly positive, slightly negative.

Michael Lavery

Okay. Thank you very much.

Operator

Our next question comes from Owen Bennett from Jefferies. Please go ahead.

Owen Bennett — Jefferies

Morning, guys. Hope all well. I mean, I just had a question around the quality of the sales outlook, I guess particularly around flower. So I mean, if you're being cynical, you could say share support to date has been driven by essentially stuff in the channel. And by that, I mean initially, I mean, you guys concede

you were the leaders because you were the ones with the supply. But now others are coming online, you are seeing share pressure.

So I just wanted to kind of gauge, what's the risk around this new flower that's coming online? You said you'll see support because you'll be able to push it out as the retail stores need supply. But, I mean, how confident are you, once you've kind of filled the channel, in terms of that sticking kind of longer term over the next few quarters? I mean, is there a risk there, similar to what you've seen with the softgels and the oils now, where you're going to have to put in provisions for returns on some of this flower?

Mark Zekulin

Thanks, Owen. No. We remain very confident. I think we have—part of our effort to push product out early and obtain market share wasn't strictly for the purpose of obtaining market share. It was for getting our brands out there and building that affinity that Rade was talking about, right, so that—and even with those brands, supply limitations meant certain inconsistency that would undermine that effort.

But overall, there's been a huge push to make sure our brands are there, and they're reliable. And in some cases, we've divided brands into certain regions to ensure that continuity, to build that customer loyalty for each brand. So we feel good about that, and I think the next step for us is to really make sure we now push a little bit further down into the TWD lineup, to make sure that while we maintain that affinity and drive for the Tweed brand, the DNA brand, the Leafs By Snoop, the Houseplant, all of those. We also really now push TWD to build that dominance in what we would call the good level.

Owen Bennett

Okay. Cool. All right. Thank you.

Operator

Our next question comes from Brett Hundley from Seaport Global. Please go ahead.

Brett Hundley — Seaport Global

Hey. Good morning, and thank you for taking the question. So I hate to beat a dead horse here, but I just wanted to go back to the nature of discussions with regulators by province, particularly in Ontario and Quebec. When they talk about store footprint and buildout, how mindful would you say they are of actually trying to keep pace, real time, with oncoming supply across the industry? And are there any other major concerns that they relate when discussing their speed at which they bring new stores to market? Just because they really are moving—Ontario in particular really is moving slowly compared to other provinces and a number of US states out there.

Rade Kovacevic

Yeah. So I would say, they're very astute and aware of the supply situation. I think Ontario and Quebec as provinces regulating retail—in the case of Quebec, operating retail—they're looking for supply to come on to meet demands across the product mix. And so our harvests of flower product in Q1 has allowed us to go to them with confidence. But what they want to see is results and those harvests existing, and that's in a place we are today. So we're now able to have those conversations and give them confidence that, one, both provinces, in terms of any planned rollouts they have, that we have the flower to support those rollouts; and, two, for them to start looking at, are there future waves? And when do those waves come of additional rollouts?

And I think, in both of those provinces, you're starting to see, based on StatsCan data, the percent of overall retail sales across Canada starting to more appropriately reflect the populations in those provinces. An example I'd give you is Ontario has significantly increased the percent of retail sales from a national perspective and is now at 30 percent. Right? So there's a ways to go; it's 40 percent of the population. It skews high in terms of disposable income, but that's with only 25 stores.

You move up to 50 stores and more points of distribution and more communities in Ontario that are able to access retail cannabis sales, and I think you will see strong growth there, and I would say the same for Quebec. And again, going back to what Mark spoke about, Alberta is in a place now where they're at about one store for every 30,000 people. Based on what we expect in Ontario and Quebec, they'll be at about one store for every 185,000 people by the end of our fiscal year.

So there are significant rollouts planned. There are significant improvements in terms of point distribution and turned sales. They've taking a measured approach, waiting for proof that flower supply's online. And we think we're at a place now where we are quite happily having those discussions and offering our support and quite pleased with the plans they have.

Brett Hundley

I appreciate that answer. And it's got me thinking, just as a follow-up here, maybe as we think about not only you guys, but the broader industry, and that dance that occurs with these regulatory bodies, and store footprints opening across a number of these important provinces in the months and quarters ahead. But for you guys in particular, do you have—well, let me ask it this way: what is your view on willing financial partners, to work with them on maybe taking some ownership and some type of sale leaseback transactions with regards with your production facilities going forward?

Mark Zekulin

Yeah. Thank you. So we have in fact spoken about that before. It is something that we continue to examine. I would say, for us, we do still have a lot of cash on the books and a plan to make sure that we use that prudently and are cash flow positive. So I think it's something we look at, and as we'd look at any sort of financing instrument. But we're not in a hurry. We'll wait for the right opportunity.

Brett Hundley

Thank you.

Operator

I'll turn the call back to the presenters for some closing remarks.

Mark Zekulin

Okay. Well, thank you, everybody, for joining, for the questions. I hope it comes across that we remain very excited for the future. We're excited for what's happening in Canada, excited for what's happening in the US and globally, and to continue to get that balance of making the right investments for the future, while focusing on the effectiveness and efficiency of our operations.

So thank you very much, and I look forward, I'm sure, to talking to many of you during the course of the day. Thank you.

Operator

This concludes Canopy Growth's first quarter fiscal 2020 financial results conference call. A replay of this conference call will be available until September 15, 2019, and can be accessed following the instructions provided in the Company's press release issued earlier today.

Thank you for attending today's call, and enjoy the rest of your day. Good-bye.