

## Canopy Growth Corporation First Quarter Fiscal 2020 Financial Results Conference Call

Remarks delivered by Mark Zekulin, CEO

- Thank you, operator, and good morning everyone.
- As usual, I would 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.
- After that, Mike will provide a more detailed overview of the financial performance of our business in the first quarter of fiscal 2020.
- Also, as mentioned, we look forward to taking any questions you may have. On that note, I should 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? What is Canopy about?
- As a first objective, we are focused on laying the foundation for dominance in an emerging global opportunity. 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, and the ability to make new markets materialize.
- But please make no mistake, 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. Both objectives are equally important, and both will be achieved.
- I would like to use the next several minutes to go over each of these in some detail.

### Firstly, Developing Intellectual Property:

- During Q1, Canopy filed 56 patent applications across its various research and development areas, including several related to pre-roll joint production, cannabinoid isomerization, vape oil and vape devices. Together with the patent assets acquired from the C3, This Works and KeyLeaf acquisitions, Canopy's patent portfolio has increased to 110 patents and 270 patent applications.
- So why is this important?

- Well, consider growing. Growing in a greenhouse to sell a beautiful 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 and select markets through special access regimes is great. The model works and a strong brand and team like Spectrum Therapeutics can differentiate itself. But selling a registered, differentiated, clinically proven medicine, produced to GMP standards and covered by insurance programs globally is even better.
- These things take time and money, and unique expertise that only a select few have. But each person on this call has seen the speed at which this market evolves. Canopy will bring this future forward, faster and better than anyone else through its investments in research, intellectual property, 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 for Canopy Growth is our multi-year effort to develop unique, high margin cannabis consumer products that we believe will be well received by consumers in Canada beginning in December of this year.
- To date, we have not, for competitive reasons, revealed significant information about these consumer products.
- With this conference call, we will begin the process of revealing some additional information about these products, though only at a high level so as not take away from the broader product launch plans coming later.
- On vapes, our market research insights show us just how high the demand for these new product formats can be, as well as opportunities to step change what is currently offered in the market. When we take a closer look, at California's \$680M cannabis vape market, about 87% of sales are replaceable cartridges, and the remaining 13% of sales are disposable pens. Indeed, our market research identified many design and functional limitations of current devices from battery life to device safety all the way down to how devices do not remain in place on a flat surface when not in use."
- We believed that most of the products that would be brought to market would be licensed versions of products that the market was already familiar with. Indeed, judging by the number of license agreements that have been announced, many vape products, with limited differentiation, are expected to come to market.
- 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 would 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 will 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 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, functionality and device design. The applications have been filed in the United States and jurisdictions around the world.
- In December 2019, we'll be launching over 15 new SKUs related to our new vape technologies. As we get closer to unveiling the new products, we'll provide full details surrounding the different device options, cartridge formats, strains availability, and flavour profiles.
- We have spoken more 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, zero or low calories and little or no drug interaction, will appeal to not only current cannabis consumers but will also expand the cannabis consumer category to reach a larger portion of the population that may have never tried cannabis before.
- In October 2019, we will be revealing more details about the multiple beverage products that we will be bringing to market later this year. Benefiting from significant collaboration with marketing, market analytics and beverage science groups at 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 factory that produced many confectionary products, how could we not think about producing cannabis infused edibles? As with vape and beverage products, we will be revealing more about our future edible products in October 2019.
- Our existing brands will leverage these new formats as line extensions, building on the brand equity and customer affinity we've 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.

### **Third, 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 equaled by our focus on the CBD and future THC markets in the United States. We now have over 70 staff in place in the USA, 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 of 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 conference call yesterday, they plan on opening Tweed and Tokyo Smoke branded dispensaries going forward. And to that end, they have begun the process of redesigning dispensaries that are under construction and 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.
- For Canopy, however, it is on CBD where our focus has sat squarely.
- Since January of this year, our team has been very active developing a range of high-quality CBD products and product marketing plans and securing the production resources necessary to bring products to the US 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, therapeutic creams, vape products, beverages, edibles, oils and gel caps. Our team is developing, in the context of the current regulatory environment, 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 the first quarter 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.
- We have thousands of acres of hemp planted in the United States, largely contracted with American farmers. 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 all locations have not yet been announced.
- To stand up a new CBD business beginning 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 in 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. Our sales and marketing team will be based out of Illinois and our operations team is based out of Colorado.
- We are currently involved in high level discussions with key retailers in the United States including being constructively involved with them in the regulatory process in the United States.

- While these investments are significant, pre-date any associated revenue, and increase our costs at head office thereby negatively impacting our short-term performance, we have absolutely no intention of slowing them down because we're focused on the long term.
- 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. The C3 sales team of 30 experienced medical sales professionals will 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 healthcare 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 into Germany, Poland, the 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 1000 kilograms or kg equivalents of dried flower, oil and softgel products from Canada since April 1.
- To reiterate, the ramp up of sales teams and operations across all of these continents remain 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 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:
  - the growth of our flower, oil and softgel sales in the medical cannabis market
  - strong growth in dry flower sales in the Canadian recreational cannabis market
  - the sale of over 1.3 million pre-rolled joints, proving the value of the automated machines that we designed in house; and
  - the significant increase in the quantity of cannabis harvested during the quarter, with over 70% of that in high THC strains, to name but a few.

- 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 the investments that come with that, and the need to move into optimized, efficient, high margin business performance.
- Most notably, we have been focused on improving:
  - Supply of high THC finished goods in the flower category;
  - Our utilization of assets and operational efficiencies as we ramp up;
  - Our manufacturing throughput; and
  - Ensuring the continuity of supply of CBD only products.
- We will discuss our progress on these items momentarily, but it also worth pausing to mention some of the macro variables at play in Canada which we are watching closely.
- 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 operations 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 10,000.
- As such, we applaud announcements by both provinces to license further retail locations and are signaling today that we believe the sector is ready for more stores to come. The Company 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 the market develops.
- Having said that, let me get back to our progress operationally.
- To increase sales of high velocity flower products we have now hit an annual run rate of over 160,000 kg per year, while continuing to bring additional growing capacity online.
  - We have also brought an additional 2 automated packaging lines online to increase throughput, with a 3<sup>rd</sup> coming online later this month.
- To increase supply, and in turn sales, of pre rolled joints we:
  - Are now operating five days per week, 24 hours per day
  - Have 3 automated lines in place and operating
  - And have moved production from a temporary setting to the recently licensed 175,000 sq ft. Advanced Manufacturing Building, bringing operational efficiencies.
- To ensure we have more than adequate supply of extraction inputs for the next generation of value-add, high margin cannabis products we have 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 in late Q2, 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 products across both medical and recreational markets, we:
  - Will be able to leverage the 900 metric tonnes of hemp biomass we harvested from 4,000 acres last fall and extract it 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 also 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 limited 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 license application for the beverage manufacturing facility was submitted, on time, on June 28.
  - Processing skids, large 20,000-gallon tanks, and piping equipment began arriving in July, as planned.
  - Bottling line systems destined for our facility have begun completing Factory Acceptance Testing in July with full installation and turn over to operations expected by late October.
  - Automated systems related to the filling and packaging of our vape products are undergoing FAT testing during August and September, with delivery to site and installation beginning later this month and 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 beverages, vape and edible products in the third quarter of fiscal 2020. You can't make a return on investment without first making investments.

## 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, to acquire Acreage when a triggering event occurs and to increase our investments beyond North America, has not waived.
- Our commitment to research, and the incredible potential of the medical market has not changed.
- Building organizational scale, investing in product research & 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 dollar 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 3, 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 also 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 this search is now well under way with several exceptional candidates already identified. We expect to complete the transition process within the next several months.

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