Client Id: 77

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CRON - Q3 2019 Cronos Group Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 12, 2019 / 1:30PM GMT

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PRESENTATION

Operator

Good morning. My name is Jay, and I'll be your conference operator for today. I would like to welcome everyone to the Cronos Group Third Quarter 2019 Earnings Conference Call. Today's call is being recorded.

At this time, I would like to turn the call over to Anna Shlimak, Investor Relations. Ma'am, please go ahead.

Anna Shlimak - Cronos Group Inc. - Head of IR & Communications

Thank you, Jay, and thank you for joining us today to review Cronos Group's Third Quarter 2019 financial and business performance. I'm joined by our Chairman, President and CEO, Mike Gorenstein; and our CFO, Jerry Barbato.

Earlier this morning, Cronos Group issued a news release announcing our financial results, which are filed on SEDAR and EDGAR profile. This information as well as the prepared remarks will also be posted on our website under Investor Relations.

Before I turn the call over to Mike, I'd like to remind you that our discussion during this conference call will include forward-looking statements that are based on assumptions that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Management can give no assurance that any forward-looking statement will prove to be correct.

Forward-looking statements during this call speak only as of the original date of this call, and we undertake no obligation to update or revise any of these statements, except as required by applicable law. Management refers you to the cautionary statement and risk factors included in the company's most recent MD&A and annual information form, by which any forward-looking statements made during this call are qualified in their entirety.

We will now make prepared remarks, and then we'll move to a question-and-answer session.

With that, I'll turn the call over to Mike.

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Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Thank you, Anna, and good morning, everyone. In the third quarter of 2019, we continue to strengthen Cronos Group's foundation for long-term growth and success by staying focused on our core strategic initiatives.

I'd like to begin by sharing our developments in both product and brand launches and what you can expect to see from us in the future. In the third quarter, we made significant progress in expanding our brand portfolio to include additional brands that resonate with adult consumers. We closed the acquisition of Redwood in the third quarter and are very excited to have such a talented and creative team join the Cronos family. Redwood manufacturers, markets and distributes hemp-derived CBD-infused skincare and other personal care products. These products are sold online and through premium retail and hospitality partner channels under the Lord Jones brand.

During the third quarter, Lord Jones introduced several new CBD products to the U.S. market. We launched the Lord Jones Heavy Duty Chill Balm, a nourishing balm that melts on contact, leaving skin with a velveteen finish and the Lord Jones CBD formula bath salts, which are small-batch bath salts made from pink Himalayan salt, arnica, magnesium-rich Epsom salts, calendula petals, and a unique blend of terpenes and essential oils to help support body relaxation.

Lord Jones collaborated with Tamara Mellon, Co-Founder of luxury shoe brand, Jimmy Choo and eponymous luxury footwear brand, Tamara Mellon, to develop a hemp-derived CBD formula Stiletto Cream for foot application before and after wearing shoes. These new personal care products are part of the broader product portfolio that can be found in over 800 premium stores, including retail brands such as Sephora, SoulCycle, Neiman Marcus and other boutiques in the U.S. as well as direct-to-consumer to the Lord Jones website.

We look forward to continuing to support Lord Jones best-in-class hemp-derived CBD products in innovation pipeline. Our goal with Lord Jones is to preserve the integrity of the brand, while providing additional resources to capitalize on the significant demand for hemp-derived CBD products.

Today, we are also very excited to introduce a new hemp-derived CBD brand, launching in the U.S. market, PEACE+. PEACE+ was developed with positivity in mind and the brand philosophy is about more than just making better high-quality hemp-derived CBD products. The brand ethos stems from the belief that well-being can lead to a better world, full of positivity and possibility. This belief extends beyond the products and into everything the brand seeks to do and stand for. The PEACE+ motto is Add To Life™, and we're excited to share this brand with a new group of consumers in the U.S. This quarter, PEACE+ intends to begin selling hemp-derived CBD tincture products through a test market of approximately 1,000 retail stores in the U.S.

Redwood will manage the launch, leveraging Altria's sales and distribution network to access the convenience store retail channel in order to gain consumer insights and product feedback prior to expanding distribution more broadly. We're very excited to be able to bring this brand to an established traditional retail channel that has been underserved with respect to quality, hemp-derived CBD products.

As we move to new geographies, trade channels, product formats and launch new brands, we remain fully committed to leadership in the industry with responsibility. As always, we welcome open dialogue and look forward to working with industry peers, regulators and governments to allow for reasonable regulation to prevail and ensure the advancement of consumer education, science, research and elevation of standards for cannabis consumer products, both domestically and internationally.

Turning to distribution. In the Canadian market, we recently added the province of Alberta to our domestic distribution network for adult-use products. Cronos currently sells dried flower, pre-rolls and cannabis oils through its adult-use brands, COVE and Spinach to cannabis control authorities in Ontario, British Columbia, Nova Scotia and Prince Edward Island, as well as to private sector retailers in Saskatchewan. While these six provinces together represent approximately 70% of the Canadian population, the infrastructure for the adult-use cannabis market is still in its infancy and is slowly being developed. The number of retail stores as well as warehousing and logistics needs are in the process of catching up to meet the demand of consumers. As a result, we are still not able to fully reach the long-term total addressable market represented by this population.

On the international front, Cronos Australia has recently completed the previously announced IPO, raising $20 million. Cronos now holds an approximately 31% ownership stake of Cronos Australia. As we mentioned on the previous call, Cronos Australia will also adopt our asset-light

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model and expects to import and distribute PEACE NATURALS branded products to the Australian medicinal cannabis market, while also developing its own branded products.

The Cronos Australia IPO enables Cronos Group to continue to participate in Cronos Australia's growth as it works to become the market leader for medicinal cannabis in the Asia Pacific region. We also feel this IPO demonstrates a way that we can unlock the value of hidden assets on our balance sheet.

Cronos Group has always maintained an asset-light approach to production capacity. And you've often heard us say, our business model is not to be the farmer. We believe that there will be value created across many verticals in the cannabis industry. However, we see sustainable long-term value in the areas of research and development and marketing innovative branded products. We firmly believe that the best way to create value to the supply chain is by working with contract farmers and suppliers to support our capacity needs versus full vertical integration. We have structured our supply chain with efficiency and flexibility in mind by creating a global network of co-manufacturing joint ventures with first-class operating partners to meet the company's needs. But as supply comes online, we are also procuring cannabis and cannabis-derived products from third-party producers to supplement our production and drive supply chain efficiencies in both Canada and in the U.S. for hemp-derived CBD.

As the new product categories come online, regulations changed domestically and new markets opened internationally, we expect to see our mix of wholly owned assets transitioned to being used for fermentation, manufacturing and packaging for branded products. Certain facilities at Peace Naturals will be partially repurposed from cultivation to provide for more R&D activities, production and manufacturing of derivative products and will allow for increased vault and warehousing space. This is a natural evolution as our business progresses, and there are times we have to update our facilities to ensure we are achieving our goals. We also continue to make progress at our international production and manufacturing facility in Israel as we move closer to operational readiness. Construction of Cronos Israel's greenhouse was completed in the first half of 2019, while its manufacturing facility was completed in the third quarter of 2019. Management is now beginning the GMP certification process for the facility, which is expected to occur in phases throughout 2020 in relation to the manufacturing processes for bottled flower, pre-rolls and oil.

As we continue to diversify our supply chain, we are also pleased to have closed the acquisition of Cronos Fermentation. This advanced facility is expected to provide the fermentation and manufacturing capabilities we need to capitalize on the progress underway with Ginkgo Bioworks. Cronos Fermentation facilities include fully equipped laboratories covering microbiology, organic and analytical chemistry, quality control and method development as well as two large-scale fermentation production areas. Earlier this month, we were pleased to welcome to Cronos from Apotex Fermentation, an experienced team that includes engineers, scientists and production and quality assurance personnel to support the breakthrough research and development and commercial production planned at this facility. We continue to be pleased with our Ginkgo partnership. We are making good progress and are on track to bring this disruptive technology to market. And we feel that Cronos Fermentation will allow us to accelerate that progress by optimizing the cannabinoid fermentation manufacturing process and advance of a commercial scale rollout and ensuring that we have the industrial fermentation infrastructure licensed and ready to go.

I'd like to close my remarks by discussing our highest priorities, which is expanding the business and aligning our organizations to execute on innovative strategies to drive shareholder value. Last month, we put into place a realignment of our organizational structure at the senior leadership level and added a new member to our Board of Directors. As we continue to enter new markets and product categories, it is critical that we manage the company in a way that meets the evolving business needs. We announced a new General Manager position, accountable for territory specific sales and operations for the Canadian and European market. Jeff Jacobson, the former Head of Sales and Business Development, who has been with the company in Peace Naturals since 2013, will be taken on this role and will now be responsible for operations, sales and manufacturing in Canada and Europe. JJ's cross-functional knowledge will help us scale in the Canadian and European markets.

In the U.S., Rob Rosenheck, co-founder of Redwood and the Lord Jones brand will remain CEO of Redwood and will also assume responsibility for Cronos Group's operations, marketing and brand strategy in the U.S. hemp-derived CBD space, including Lord Jones, PEACE+ and the pipeline of brands and products under development at Redwood.

With this shift in resources and responsibility, David Hsu, Chief Operating Officer; and William Hilson, Chief Commercial Officer, will be transitioning from the company at the end of the year. On behalf of myself and the entire Cronos Group team, we extend our deepest gratitude to David and Billy for their service and contributions to the Company. They played a pivotal role in the creation and growth of the company, and we wouldn't

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be where we are today without their hard work and dedication. This realignment will foster new ideas, focus our business priorities and influence how we examine and find efficiencies across our organization.

In addition, we welcomed a new board member from Altria, Jody Begley, who currently serves as a Senior Vice President of Tobacco Products for Altria Group, in which he oversees Altria's core tobacco businesses as well as their engineering, quality and product development.

Mr. Begley replaces one of Altria's previous director designees, K.C. Crosthwaite. Overall, we believe that we are positioning the Company for long-term success by investing in innovation and responsibility and, ultimately, in our business. Our strategy is focused on long-term sustainable growth, and we believe that we are building will continue to resonate with consumers and will generate long-term shareholder value.

With that, I'll turn it over to Jerry to provide a discussion on this quarter's financial results.

Jerry Barbato - Cronos Group Inc. - CFO

Thanks, Mike, and good morning, everyone. Both our press release and MD&A includes comparisons of our financials for the same period in 2018. As we shared last quarter, we believe the best way to evaluate our business and the industry is the comparison on a sequential quarter basis as comparisons to the prior year do not reflect the current operating or regulatory environment. I will focus the majority of my comments discussing the third quarter's performance versus that of the second quarter of 2019.

Turning to Q3 results. The company reported net revenue of $12.7 million in the third quarter, a 24% increase from the second quarter. Revenue for the quarter was driven primarily by opportunistic sales into the wholesale channel and the inclusion of financial results for the Redwood acquisition. We remained focused on an efficient inventory management while ensuring we can meet demand in the future for the products available today and the derivative products coming online shortly. As the market evolves and cultivation capacity across the industry grows, the wholesale channel will be utilized opportunistically by Cronos. We saw an opportunity to sell products that would not be used for our own commercial use into the wholesale channel before prices compress further.

The wholesale revenue decreased the overall ASPs for the quarter. Although our net ASPs in non-U. S. markets was 42% lower quarter-over-quarter at $3.75 grams sold, we still maintain a healthy total gross margin before fair value adjustments of 41%. This is due to lower cost of goods sold for wholesale sales and this channel doesn't require post-processing and packaging, nor does that incur excise taxes.

Turning to operating performance metrics. In Canada, kilograms of cannabis sold increased 98% to 3,142 kilograms in the third quarter of 2019 from the second quarter, primarily due to wholesale shipments. Operating expenses for the third quarter of 2019 totaled $34.8 million, representing an increase of 32% from the second quarter. This increase is primarily driven by higher R&D expenses, higher professional fees for services in connection with various strategic initiatives and higher G&A expenses tied to increased headcount and marketing spending in preparation for the upcoming Canadian derivative and U.S. product launches.

The company reported an adjusted EBITDA loss of $23.9 million in the third quarter of 2019. The loss increased by 35% from the second quarter. This increase is primarily due to higher operating costs associated with sales, marketing and R&D, partially offset by an increase in net revenue. We will continue to invest in infrastructure, people and capabilities to support future growth. The company reported an increase in net income from the third quarter, primarily due to the change in fair value of the financial derivative liability associated with Altria's investment, which is described in more detail in the MD&A and the financial statements.

In the third quarter, Cronos Group recorded a noncash gain of $835 million related to the change in fair value of these financial derivative liabilities compared to a noncash gain of $264 million in the second quarter. Cronos continues to expect there may be significant reported earnings volatility, primarily driven by the fair value quarterly adjustments related to the movement of Cronos Group's stock price.

Turning to the balance sheet. The company ended the quarter with approximately $2 billion in cash and short-term investments, a decrease of approximately $332 million primarily driven by the acquisitions of Redwood and the Cronos Fermentation facility. During the quarter, Cronos also

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announced that it had entered into a credit agreement with GrowCo for $100 million term loan credit facility to fund the construction of the previously announced custom build greenhouse and for general operating purposes.

GrowCo has drawn down $27.5 million against the term loan as of September 30. We remain focused on having a disciplined and balanced manner in how we deploy capital, one which makes sense for our business and is aligned with our strategic priorities.

Capital expenditures for the first 9 months of the year were $50.7 million. This spending includes investments in our Peace Naturals campus, Cronos Fermentation, our Israeli facility and device technology innovation at Cronos Device Labs.

I'd like to provide an update on our capacity disclosures. As Mike mentioned, we remained focused on an asset-light strategy. We will continue to balance our own cultivation capacity with buying cannabis and cannabis derived products from third parties. Historically, we have disclosed all potential capacity at our facilities in our MD&A. Starting with the third quarter and going forward, we've removed the capacity table with our own facilities, the ability to source from third parties and the on-ramp of GrowCo and Cronos is real for the future, our current disclosures more accurately reflect how our business is evolving and how we are running the business by balancing our sourcing needs with our own production. We are constantly evaluating the best use of our own assets and facilities.

As you saw also announced this morning, we are optimizing our Peace Naturals campus for alternative uses like additional R&D facilities and derivative product manufacturing. At this time, we estimate the pretax onetime charge of these updates to be no more than $15 million, primarily related to asset write downs.

I'd like to wrap up by continuing the discussion from last quarter about my priorities as CFO. First, as I mentioned on the last call, we need to have an ERP system that can support a global business in an ever-changing industry. We have selected the vendor who we believe can best provide us the right solution and are actively working on the full scope and business requirements before implementing the upgraded Tier 1 ERP system. I will provide updates on the status of this implementation as we continue to progress.

Second, I continue to remain focused on improving our financial reporting process. Effective December 31, 2019, Cronos will become a domestic issuer with the SEC and will no longer qualify as a foreign private issuer. As a result, we will report our fourth quarter and full year 2019 results in U.S. GAAP, with the U.S. dollar as the reporting currency. We are currently working through the process of migrating to U.S. GAAP reporting. While our segments may change over time, we currently anticipate having two reportable business segments, the United States and Rest of World.

When we file our results next quarter, we will also provide historical financial information in U.S. GAAP for comparative purposes. My focus is on continuing to develop a robust and flexible financial reporting process that gives us the ability to incorporate future changes in the business.

Overall, while we are generally pleased with our progress in the third quarter and the first nine months of the year, we realized that we have a significant body of work to do in order to achieve our long-term goals and strategies.

With that, I'll turn it over to Mike for closing remarks before Q&A.

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Thank you, Jerry. For those that have been following Cronos for a long time, you'll know that our plan has always been to learn from Canada, to develop intellectual property, to build an elite team, fuel iconic brands and to create a turnkey solution that we can deploy in other markets like the U.S. when they are available to us. We know the cannabis market is real, and we believe the opportunity is huge. But no one in the industry can force the market to be opened immediately at full run rate without using existing channels.

Unlike the U.S. hemp-derived CBD market, where we can distribute through established infrastructure, in Canada, we're developing all new distribution channels, and we can't move faster when the channel is open. We're marketing new products to consumers in new ways, and it will take time for existing consumers to switch from the illegal market and for new consumers to adopt new products. So, we continue to invest in researching consumer needs globally and developing products that meet those needs, and we believe as strongly as ever, that now is the time to

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continue to allocate capital to R&D and brand development. We want to continue to be a first mover in innovation, which we believe will position us for long-term success.

We are excited and energized by this next phase of the industry and of our business. One thing that we know won't change about this industry is that it will continue to take disciplined, strategy and flexibility to succeed and create value in the long term. We believe the opportunities are large and are excited by the prospects of entering the Canadian derivative market and the U.S. hemp-derived CBD market in a meaningful way.

With that, let's now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Michael Lavery of Piper Jaffray.

Michael Scott Lavery - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

You talked about your asset-light model, again, as you have, of course, can you give us a sense – you also mentioned you had some wholesale purchases in the quarter. Maybe just give a sense of the magnitude of those? And then as you look ahead, what stage are you in the transition to where you would expect or want to be in terms of really taking advantage of lower cost inputs as a buyer, growing relatively little and getting a margin benefit from that. Can you just give a sense of what timing might be? And when to expect a turning point on the margin side?

Jerry Barbato - Cronos Group Inc. - CFO

Sure. Most sales went through wholesale in the quarter, which resulted in our lower ASP. And as the market evolves and cultivation capacity across the industry grows, the wholesale channel will be utilized opportunistically to better align our inventory stream with the adult-use consumer demand. And I think, over time, with new form factors in Canada, and sales from hemp-derived CBD products in the U.S., we believe this will result in a sales mix weighted more towards adult-use sales and less towards these opportunistic sales through the wholesale channel.

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

And I think what you will see is, as there's more and more supply of inputs, flower-based or otherwise, crude oil and we see more stores, and we're allowed to launch derivative products – the cost of getting those inputs, is going to continue to come down, as more and more supply comes online. And so, I don't think we're quite where we want to be. And certainly, on a transition where we want to move from being the ones that are producing that to being the ones that are sourcing that. And between being able to produce ingredients through Cronos Fermentation and Cronos GrowCo, we expect within our supply chain, as well as third parties that, over the next year, things will transition pretty rapidly towards margin improvement and also, I think we're not just looking for cost to come down, but again vape pens and other derivative products in Canada to be available to us.

We're already seeing in the U.S. in the hemp-derived CBD side that the price for ingredients is certainly coming down. And there's still work we can do to optimize that. But I think the market will run its course and continue to make those inputs become more and more cost-effective for us.

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Michael Scott Lavery - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

That's helpful. And then just a follow-up on Alberta from the revenue side, you're launching there. That's obviously where all the stores are. Can you give us a sense of what we should expect maybe from a top line trajectory, both some sense of the opportunity, but also how not to get expectations too high on what that might do?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Yes, I think as you've heard us say in the last few quarters, we don't know it's appropriate for guidance at this time. There's a lot of shifts that are difficult to predict. And we have an idea of where things end long term, but considering we're about a month away from the first derivative product launch, how things will play out over the next few months is difficult to really assess. So, I think I'll hold off on further comment on specifically what numbers will be. But overall, we're excited for the new opportunity.

Operator

Next question comes from the line of John Zamparo of CIBC Capital Markets.

John Zamparo - CIBC Capital Markets, Research Division - Associate

I wanted to ask about the PEACE+ [test] and Lord Jones. Can you talk about what the margin profile is on these products versus your existing portfolio? And I'm not sure if you can share exact details, but any directional commentary on how Lord Jones has been growing or perhaps seasonality would be helpful.

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Sure. I think comparing the products, we have a quite a wide range, so it would be really difficult to speak to specifics. I think you'll see among the different SKUs there, they're so different in the different price points that it's, I think, hard to generalize. But I would say that Lord Jones is generally a premium, ultra-premium brand, it's going to be higher margin and lower volume than the rest of our product portfolio. But we do see just given the environment, the ability to communicate consumer benefits, to build a community with our consumers in a way that is much less constrained than in Canada. We do have stronger opportunities – PEACE+, we're in the process of launching, so we're excited for that, and excited for you to be able to see where we're coming out with.

John Zamparo - CIBC Capital Markets, Research Division - Associate

Okay. That's helpful. And then my follow-up is on Europe. You've now got an executive with oversight in Europe. And Mike, you've spoken about the attractiveness of that market. Can you talk about your expectations for the region? Is it material in 2020? Or do you look further out in other particular countries that you find attractive?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Yes. Europe, I think what we're seeing – and again, this goes back to my comment on guidance and why we're being hesitant to provide guidance at this point. A lot of it is certainly driven by regulations. But we are seeing that with respect to the cannabinoids and product mix that -- the trend seems to be towards opening up for nonintoxicating cannabinoids, similar to what we're seeing in the U.S. and still there's a lot of restrictions and things that may slow down the more medicinal regulated THC side. So, we would expect that meaningful growth is likely to be more from nonintoxicating and intoxicating.

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Operator

Next question comes from the line of Andrew Carter of Stifel.

William Andrew Carter - Stifel, Nicolaus & Company, Incorporated, Research Division - Associate VP

First question, the $0.90 million in sales for Lord Jones that came in the quarter. Can you give us an indication of kind of how representative that is of the business to stay in terms of its distribution channels, what we should expect from the contribution of that to really meaningfully step-up in the fourth quarter? Or is it more of a step-up in 2020?

Jerry Barbato - Cronos Group Inc. - CFO

Yes. So that's -- the Redwood acquisition took place September 5. So, it's a partial month, and I wouldn't read too much into the partial month of revenue. I don't think it has a fair assessment of what the run rate will be going forward.

William Andrew Carter - Stifel, Nicolaus & Company, Incorporated, Research Division - Associate VP

Okay. Just kind of a second question, kind of thinking -- you mentioned the new products. So, I kind of wanted to understand where you stand today in terms of new products submitted to Health Canada? Is your expectation to get those products as soon as possible, December? Or will we see more, a wait into kind of the calendar first quarter?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Yes. Our focus is getting vape pens out in the market as soon as possible. So something that we have submitted and again, we're hoping for December, but because of the timing, it's tough to predict whether it's end of December, beginning of January. But our focus is really rolling that out to start and then phasing in other derivative products. We certainly have IP product formulations around topicals and edibles. But specifically with edibles, what we haven't been able to see is: how are the packaging rules, specifically around single-serve versus multi-packs, going to resonate with consumers? We have formulations that have been tried and tested and very successful with consumers and markets where you can sell multipacks. But we want to make sure that before we launch that we have a little bit of market data on how best to satisfy consumer needs.

Operator

Next question comes from the line of Chris Carey of Bank of America.

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

So on the last call, you said that your U.S. CBD sales could be bigger than Canadian cannabis in 2020? And I guess, just taking the Lord Jones run rate and fully appreciating that you said that's not really typical -- going to be that instructive on the go forward. But we still haven't seen guidance from FDA. You had a peer report last week that was calling out increased competition. But clearly, especially in the context of going U.S. GAAP and reporting segments on U.S. versus rest of the world, it's pretty clear what your intentions are. And so, I wonder if you can just maybe address the puts, takes on how 2020's mix might look? And it's not really looking for guidance at all, but just kind of reading the tea leaves on some of the developments you've seen over the past few months? And how that might form out as things shape up over the next year?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Sure. I'd say we're certainly only a few months into our entrance into the CBD market. But just one illustrative example, when we're thinking about a test market and just starting off with the brand that we're announcing today, PEACE+, and we're comparing that to Canada. In Canada, there's a

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total of 24 stores in Ontario and for the CBD brand launch, our test market is 1,000 stores. So I think being able to leverage the Altria distribution is a huge advantage and our ability to scale, when we talk about increased competition, we're – we believe in the opportunity is very strongly, we are eyes wide open that we are not going to go into any environment right now where there isn't competition. That really just shows that it's a fragmented market. There's opportunity and market leaders have not yet commanded dominating share. So we're very excited. We think we have an advantage on the distribution side. And we think that between Lord Jones, PEACE+ and the other brands that you'll be hearing about in the near future that we can have meaningful contribution.

And I just would point again to – on our side, being able to leverage existing infrastructure. We don't need to go and build out the retail stores or wait for them to be built for us to get CBD products on shelves. So I think we have just a little bit more clarity. It's less of a comment of what that means for Canada, say, in two years or three years. It's just when you can see the stores open, and you know the demand is there and that you can address it, it's easier for us to be comfortable with showing where contribution comes from.

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

Okay. That makes sense. And then just on a follow-up. So you've got $2 billion in cash, right, which at current cash burn is like 41 quarters, I think, by my math, which I think makes a lot of sense actually to be measured on cash, especially given the capital raising environment right now. But just as we go forward here, how do you think about deploying that cash? Obviously – and I come back to changing reporting segments to U.S. and Rest of World. So again, it's quite clear what your intentions are. Is this the type of approach where you perhaps stay patient on any potential change to U.S. law? Or is this just a function of not having the types of investments right now that you think are the most interesting for the long term, and it makes more sense to hold off? Just how are you thinking about broader deployment and the sorts of geographies or assets that you might be interested in?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Sure. I think, first, when you think about some of the markets we're in today, it's not simply financial modeling, it's a little bit of game theory that comes into it. And so, when we look out at how things develop and the timing. And when you talk about cash burn and being able to wait for the market to come open, I think having the capital, being able to be patient, wait for things develop and watching what happens is something that we looked at, whereas, say, a year ago, everyone was focused on speed, I think the focus is going to quickly shift to survival, and we want to be in an advantageous position to be able to capture that market when it comes online.

As far as thinking of the global picture and what's available to us. There's been a lot of capital that's poured into cultivation and ingredient supply. But it's interesting when you look at most of how capital is deployed and allocated in CPG, typically, you would think about researching and addressing different consumer needs. And we actually think that there has been an under allocation of capital there and then towards research and development against those consumer needs. And that's right now where we see the opportunities, making sure that when there's retail infrastructure opened and when there are laws that allow us to be in the markets where there's the biggest business opportunity, how are we making sure that we've got the best internal landscape and product portfolio. And as part of that mapping exercise, also what the best targets are to be able to go and execute against that and really be able to translate, what we look now is an addressable market that we can't address in the short-term, something that we capture and are able to start generating durable margins and long-term shareholder value.

Operator

Next question comes from the line of Tamy Chen of BMO Capital Markets.

Tamy Chen - BMO Capital Markets Equity Research - Analyst

My first question is on the Canadian business this past quarter. You mentioned that most of the sales came from the LP-to-LP market or the wholesale channel. So I'm just wondering, what does that say about your ability to sell more in the red channel? You mentioned this was opportunistic, but

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it seems like you were alluding to that you may not have the right mix of products that maybe the promises or consumers are looking for. So is this big LP-to-LP sale you had this quarter, really a onetime thing? Or is this something that until you align your mix that's better with consumer demand, it will be more gradual for you to push further into the right channel?

Jerry Barbato - Cronos Group Inc. - CFO

Yes. So I think the adult-use cannabis market here in Canada, still in its infancy, and that means consumer preferences are evolving rapidly as new consumers enter the legal market and new products become available, and we are aligning our production as well as our third-party pool that we've collected to make sure that we are matching consumer demand, but what's in our inventory. Additionally, as we continue to roll out this third-party strategy, we're going to make sure that we're adapting quickly to consumer demands. That being said, we believe that the launch of derivative products is where the brand equity will be built with consumers based on quality, product differentiation and the ability for brands to match their brand ethos to the derivative products that they sell.

Unfortunately, the current restrictions on marketing and branding for flower products don't really allow for this and contribute to an environment where it's difficult to build the brand off of flower alone.

That being said, though, we believe that the marketing activities that we have executed are creating brand equity so that once we have the right strings in the marketplace and these derivative products then you'll see positive reaction from adult consumers.

Tamy Chen - BMO Capital Markets Equity Research - Analyst

Got it. Okay. And my follow-up is on the U.S. aspect as well. Just taking a step back, just wanted to better understand, given how, as you mentioned, competitive and fragmented. And also, the regulations are so ambiguous right now in the U.S. CBD market. I hear you on the ability to leverage Altria's distribution. But could you speak to other parts that you believe will help you stand out in this market, whether it's product development, M&A, brand strategy. Just trying to understand, if you go into the c-store channel as a test market. What specifically are you testing for? Is it all of the above that I just mentioned, so should we still think of 2020 as a very gradual trajectory and basically a test year for CBD before you learn more and you really further develop your CBD strategy past 2020?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Sure. I think for PEACE+, it's something that we plan to expand gradually throughout the year as we get market learnings and see expansion opportunities. But what we're really testing for and hoping to learn are all the facts of the value equation for, specifically here for the tincture category, the consumer preference, the consumer insights, pricing, merchandising, insights from the retail partners, flavors. And it's important for us to get that in the 1,000 stores because as we look at expanding, when you go from 1,000 to 10,000 to 50,000 to 100,000, we want to make sure that we understand just the logistics around what type of volumes or which SKUs are going to be moving because there's a lot -- certainly, that will be plan there. But we think -- yes, that product development that generally brand and brand management, it's going to be very, very important. Like any other consumer category, there is something simple about what we need to do is find out what consumers want. And when we have a good idea of what consumers want, deliver it to them.

I think that there's -- with the different brands, you'll see a lot of different channels that we target that aren't just specific to Altria distribution, Lord Jones is the only CBD brand that you can go in a Sephora in-store and purchase, being able to go to places like SoulCycle or The Standard Hotel that are really about brand building. And I think that differentiates Lord Jones and the products that you'll see that it's very unique, like the bath salt and Tamara Mellon, Stiletto Cream and some of the other products we mentioned, we think that's ultimately what the market looks like in the future - differentiated products for differentiated segments.

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Operator

Next question comes from the line of Matt Bottomley of Canaccord Genuity.

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

Just wanted to touch again briefly on your strategy for the 2.0 implementation. Are you thinking of launching it sort of at a more muted province by province level similar to what we saw in sort of the dry bud and oils in cannabis. I guess, we'll call it 1.0? Or are you planning on attacking a broader, I guess, breadth of markets right out of the gate in Canada?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Yes. One of the things that we've been doing is trying to just make sure that we internally have a logistics and understand how to work with the provinces. So now that we've opened relationships with provinces, we don't see going and reverting back. It makes sense for us to continue expanding among the provinces, but once we've opened a relationship with provinces our focus is really on satisfying those channels and being able to deliver products.

So I'd say the way that we approached it with 1.0 in terms of not wanting to go to all ten provinces at once and have so many SKUs, it was difficult to manage. We're thinking of it as starting specifically with a focus on vapes and then expanding different types of products and layering those in. So it's still the same idea of making sure that we can stay disciplined and focused. But we see proliferating that in a little faster than what we did with 1.0.

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

Great. And just a second question, just switching to the CBD side of things. Just obviously, including the Lord Jones hemp-derived sales that hits your books. How many markets or regions are those in? And can you give any color on what the distribution points are today?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

So specific to Lord Jones, roughly 800 stores. And I think about those stores, I think, a little bit differently than the C-stores. Those are channels like Sephora, SoulCycle, Neiman Marcus, a lot of luxury boutique stores. A lot of the sales also, there's a D2C, direct from the website. And I think online will continue to be a place where we see more margin, there will certainly be scale coming from the wholesale channel, meaning into retail stores. But that mix will continue to expand. And then with PEACE +, we're seeing that in more of a mainstream market. So convenience stores, grocery stores, specialty shops and that carry CBD products, channels more like that.

Operator

Next question comes from the line of Graeme Kreindler of Eight Capital.

Graeme Kreindler - Eight Capital, Research Division - Principal

I wanted to follow-up with respect to the comments on the asset-light model. And understanding that you're removing the disclosures of capacity at the various assets. As it relates to GrowCo given what we've seen in the supply and demand dynamics. And you mentioned earlier that you think inputs are ultimately going to get cheaper on the wholesale market. Has there been any discussion or view to right size that GrowCo facility because it was -- the expected capacity from last disclosed was expected to be quite substantial?

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Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Sure. When we've had discussions – and maybe I'll go back to originally the whole concept behind GrowCo, with the belief that there would be a drop in prices and some form of commoditization on inputs, we looked across Canada and said, what's the comp for a plant you grow that there's going to be price compression and you can be successful. And we looked at lettuce, tomatoes, cucumbers, strawberries, and what you find is there is two or three groups that really dominate all of Canada – In any of those agricultural ventures – and the Mucci's are one of those groups.

It was our favorite group and our first pick. And rather than simply sitting back and waiting, when we recruited them, and we knew they would move into cannabis at some point. And so it's not simply about supply demand, I think driving some of the efficiencies are going to be necessary for us to be able to compete in the market and being able to have a close relationship and being able to make sure that the right products are being produced is important.

But at this point, we've seen, I think, almost every year, the Mucci have built another greenhouse and we haven't seen the addressable tomato market or strawberry market or cucumber market grow, but it's about driving efficiency. And certainly, while it's competitive, we've seen that they have consistently had the ability to succeed and thrive in hyper-competitive commodity agricultural markets.

Graeme Kreindler - Eight Capital, Research Division - Principal

Okay. And then as a follow-up, with respect to the higher proportion of wholesale in the quarter. I understand that sell-in has largely been challenged during the period in the market. But I was wondering what -- is there any read-through there with respect to -- or any color you can provide with respect to Cronos' brands at retail? What the demand is like, what products have been popular given the higher proportion of allocating product into wholesale this quarter?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

I don't know that there's much readthrough there. And I think one thing when we talked about being opportunistic – I think the ability to see sort of what was coming in terms of changes in prices, certainly drove us to be a little bit more proactive there. The -- when you look at aided awareness, and there's a lot of third-party studies you can look at for aided awareness, that gives you a good idea of how brands are doing. I think that is something that readthrough is very positive for our brands. But ultimately, because of the way the system works and the timing it takes to align SKUs, there certainly, is an element of production planning that without being able to work directly with the retailer and quickly adapt to SKUs, when we find out which our SKUs are in demand, and when we launched with listings that were early on, we were essentially producing based off of listings and some SKUs are more popular than others. I don't think it was necessarily based off of brand. We're still really in a point in the industry where when you go into a store; I think consumers are picking based off of a strain or SKU rather than brands. So, when some SKUs move faster, some SKUs just had much more depth in, based off of the way that we planned our production, it made sense for us to, I think turn over some of the inventory and then be able to reallocate production to other SKUs that would say there was more demand than we had supply for.

And one of the ways I think that we can make sure we address this is by going forward, having everything roll to a GM accountable for the territory. We have production planning/operations and demand planning and sales all rolling into the same function. And I think that's something that will help smooth that going forward. And I also think with derivative products, the ability to pivot your manufacturing to meet shifting demand – it's a much faster cycle than with cultivation.

Operator

(Operator Instructions) Next question comes from the line of Shayne Laidlaw of Hedgeye Risk Management.

Shayne Laidlaw

Just turning back to the PEACE+ brand. I was hoping to get a little bit more color on kind of what the brand positioning will be? Is this something that's going to say something to the effect of powered by Lord Jones? Or is it going to be a completely separate brand on its own?

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Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Yes. It's a completely separate brand. And certainly, I think there is a halo effect that we expect to get from Lord Jones, but it's got its own positioning, its own formulations, and it's really targeted to a specific channel. So, we think the consumers are different than Lord Jones, but consumers are increasingly more aware, not just of the brand, but of the companies behind it and what other brands might be produced. So, we do think that there's a lot of benefits that we get from having those under the same platform. But you'll see them look quite different, and the website is up, so you'll be able to take a look and understand what we're positioning. And I think, probably get some read-throughs on what that will look like and what we're preparing for in terms of expanding in other product formats.

Shayne Laidlaw

Okay. And then just turning to the repurposing of a portion of the Peace Naturals facility. How much of this was driven by kind of a change in philosophy by Cronos to be more heavily focused on derivative products, R&D and more of a global view versus a reaction to the competitive cultivation environment and kind of the below par rollout of some of the retail locations in some provinces?

Michael Gorenstein - Cronos Group Inc. - Chairman, President & CEO

Yes. I would – certainly, this was not a change in philosophy. I think this was more of a recognition of timing and how things are pacing. One of the reasons we liked having an indoor facility is the first large facility we've built is the ability to have optionality and being able to pivot from cultivation to downstream manufacturing. I think that when we look forward and the fact that right now, there is, due to the number of retail stores, we think that there's a headwind in terms of oversupply. It makes sense for us to really take this as a perfect opportunity to begin converting from more in-house manufacturing for derivative products. It's really been always our philosophy. We just -- I think in terms of timing, we're going to wait a little bit until we had GrowCo or fermentation fully up and always thought, once we were able to get lower cost and more consistent inputs that is something that we would do. And I think that it's certainly been choppy on, we believed at one point, oversupply would come earlier, then it seemed to come later. And I think now that it's here, we're executing against the plans that we've had.

Shayne Laidlaw

And if I could just squeeze one more in there. I saw that you estimated the cost to be no more than $15 million. Is there any way you could share kind of what percentage of the cultivation space will be converted?

Jerry Barbato - Cronos Group Inc. - CFO

Yes. We're still working through that. So, based on preliminary work that we've completed to date and in the spirit of transparency, the company currently estimates that it's a pretax one-time charge to be no more than $15 million, and we have a team working diligently to identify all the assets that will be subject to the write-down. So, we'll provide additional color in the fourth quarter and full year results.

Operator

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

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