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CRON - Q4 2019 Cronos Group Inc Earnings Call

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PRESENTATION

Operator

Good evening. My name is Ryan, and I will be your conference operator today. I'd like to welcome everyone to the Cronos Group 2019 Fourth Quarter and Full Year 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. Please go ahead.

Anna Shlimak - Cronos Group Inc. - SVP of Corporate Affairs

Thank you, Ryan, and thank you for joining us today to review Cronos Group's 2019 Fourth Quarter and Full Year Financial and Business Performance.

Today, I'm joined by our Chairman, President and CEO, Mike Gorenstein; our CFO, Jerry Barbato; and Xiuming Shum, EVP, Legal and Regulatory Affairs.

Cronos Group issued a news release announcing our financial results, which are filed on our EDGAR and SEDAR profile. This information as well as our 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, including as a result of the factors described in the cautionary statement and risk factors included in the company's earnings release and regulatory filings, including the company's most recent annual report on Form 10-K, by which any forward-looking statements made during this call are qualified in their entirety. In addition, during this call, certain financial measures may be discussed that are not recognized under U.S. generally accepted accounting principles referred to by the Securities and Exchange Commission as non-GAAP measures. We believe that these non-GAAP measures such as management and planning, forecasting and evaluating business and financial performance, including allocating resources. Reconciliations of these non-GAAP measures to their closest reported GAAP measures are included in our earnings press release furnished to the SEC.

I'd also like to note that we are conducting our call today from our respective remote location. As such, there may be brief delays, cross-talk or minor technical issues during this call. We thank you in advance for your patience and understanding.

We'll now make our prepared remarks, and then we'll move to a question-and-answer session. With that, I'll pass it over to Cronos Group's CEO, Mike Gorenstein.

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

Thank you, Anna, and good afternoon, everyone. These are certainly unprecedented times, and we are doing our best to adapt to our current situation and make the most of the challenges we face. I hope everyone on the line is staying safe and healthy. And a little later, I will address the actions we are taking in response to COVID-19.

First, I want to address recent developments related to our financial reporting and internal controls as well as the remediation actions we are taking in response to our review. We completed a thorough review of our financials and controls, and we are committed to making things right and implementing the best practices of financial reporting. I want to thank our finance team and advisers who worked closely with us over the last few weeks to get this done.

As you know, the Audit Committee of the Cronos Group Board of Directors recently conducted a review of certain bulk resin purchases and sales of products through the B2B wholesale channel. Following completion of the review, and upon the recommendation of the Audit Committee and advice from our independent auditor, KPMG, Cronos determined to restate our unaudited interim financial statements for the first, second and third quarters of 2019. Accordingly, the company reduced revenue for the 3 months ended March 31, 2019, by CAD 2.5 million, and the 3 months ended September 30, 2019, by CAD 5.1 million.

We take these matters seriously, and I want to make a few things clear. We're talking about 3 transactions related to the wholesale B2B channel. This part of the business is not expected to be a core driver of our growth given the strategic initiatives we have underway. We became aware of the need for a review of these transactions as a result of our internal reporting processes and the channels for individuals to raise concerns, and we are pleased that the process worked as intended. When you look at the big picture and the path forward, these transactions do not affect our ability to execute against our strategy and create long-term shareholder value.

Now that our review is complete, we are taking comprehensive actions to improve internal policies and procedures and strengthen internal controls, including our financial reporting. We anticipate implementation of these steps to take several quarters. Let me walk through some of these actions. First, we are taking steps to segregate duties over sales and purchase transactions. As part of this, we are updating internal policies for our sales and supply chain departments, building extensive customer and vendor databases and launching revenue recognition training and education programs for employees in these groups. Second, we are enhancing our controls and procedures related to nonroutine transactions, especially wholesale B2B transactions. To that end, we will now require teams to produce accounting memorandum with key transaction details, develop business cases that outline the purpose of the transaction and request approval from either Jerry or myself. We will also enhance our certification process so that employees better understand these transactions and how these impact our financial results. And third, we are enhancing our quarterly risk assessment and controls processes to reflect changes in our business.

We are committed to making things right and implementing best practices for financial reporting. As a growing company in a rapidly evolving industry, we have taken a number of actions over the last year to enhance our internal capabilities and add resources across functions to support our strategic growth initiatives. As you know, my focus and the company's focus is on creating long-term shareholder value by developing disruptive intellectual property and building iconic brands. I encourage long-term thinking and do not tolerate or incentivize short term-ism. Our value will come from technology breakthroughs and branded sales that help build and strengthen our relationship with our consumers.

Before we discuss our results and company updates, I'd like to touch on the evolving COVID-19 situation, and how Cronos Group has made necessary changes to our business during this unprecedented time. Our top priority continues to be the health and safety of our employees, our consumers and ensuring we secure our supply chain. We've assembled a global cross-functional internal task force, led by me, that has been closely monitoring the situation daily. The company also has business continuity plans in place to support its employee base, while continuing to develop and produce reliable, high-quality products that meet the needs of our consumers.

As of today, our manufacturing facilities remain open, as governments in the region where we operate have designated our business as essential. We have implemented work-from-home policies for certain employees and a strict no travel policy, including between our sites. For our manufacturing facilities, we enhance hygiene and sanitation practices, modified schedules and maintain social distancing protocols. As circumstances vary per region and country, we're working diligently to continue to act in accordance with all applicable guidance from local, federal and international health and governmental authorities, and we are prepared to make additional operational adjustments as necessary. Despite our business continuity efforts, we may see an impact on certain parts of our business, such as operational capacity or supply chain delays. But we will remain vigilant in our evaluation of the situation as it unfolds, and we'll continue to make decisions based on what is best for our company, our employees and our customers. We know our consumers are relying on us during this time, and we're responsibly rising to the challenge.

With that, let's take a closer look at the progress we've made on our strategy over the last quarter to continue to build our foundation for long-term growth. First, I'll start with the progress we made in establishing and growing our brand portfolio. Our goal is to bring high quality, consistent cannabinoid products to the market, while expanding how consumers approach and shop for the category. In the fall of 2019, we added the luxury hemp-derived CBD brand, Lord Jones, to our brand portfolio, and welcome the talented and creative team to the Cronos family.

Under the Lord Jones brand, we now manufacture, market and distribute hemp-derived CBD-infused skincare and other personal care products in the U.S. market and e-commerce and retail outlets such as Sephora, SoulCycle and Neiman Marcus. During the holiday season, Lord Jones experimented with its own retail by activating 3 holiday pop-up shops at the Westfield Holiday Markets. We were able to see how a larger retail concept could work and learned about consumer habits during the holiday season. We're looking forward to bringing this brand and other skin care brands and products to more consumers in 2020.

Last quarter, we also announced the launch of PEACE+, a new hemp-derived CBD brand in the U.S. While we are very excited to bring this brand to market, we have made the decision to take a measured approach to the distribution of hemp-derived CBD tinctures product line. To that end, we decided to pause the distribution of PEACE+ hemp-derived CBD tinctures through Altria's sales and distribution network, while we collect more information and assess the evolving environment. Cronos remains committed to meeting the demands of adult consumers and will continue to evaluate other product formats and categories that we believe may be more suitable for the PEACE+ brand in the current and evolving climate.

As we move to new markets, trade channels, product formats and launch new brands, we remain fully committed to doing so in a responsible way. To set that standard and take a position of leadership, we sometimes have to make difficult decisions in the short term, but we believe this approach will position us as a market leader in the long term.

We continue to welcome open dialogue, collaboration and look forward to working with industry peers, regulators and governments to allow for reasonable regulation to prevail. We are committed to ensuring the advancement of consumer education, science, research and elevation of standards for cannabis consumer products in all of the markets we serve.

In the Canadian 2.0 market, our adult-use brands Spinach and COVE, launched new vaporizer products. COVE, our premium brand, launched an elegant vaporizer pen, while the Spinach line was inspired by sought-after strain-specific terpene profiles. Informed by consumer insight work, both hit markets in late December of last year. A lot of work went into our launch for vaporizer products, and although we use nonproprietary hardware to start within the Canadian market, we did so purposely because we know consumers are in a trial phase when a new market begins. We take a consumer-first approach to everything we do, and that is a direct reflection of the new tailored 510 vaporizer product lines for COVE and Spinach.

We worked with Cronos Device Labs to bring the best version of this product to market. Our cartridges are made with quality, stainless steel components, food grade silicone and are tamper resistant. We spent months doing our diligence with boots on the ground at our suppliers to ensure the products released in market were properly tested before launch. Our rechargeable draw batteries has contemporary intuitive designs and include mechanisms to prevent overheating, and our formulations are made with premium cannabis extract and all-natural terpene-rich flavors.

We're proud of our uncompromising approach to quality, which is at the heart of everything we do. As we continue to glean more consumer insight into the Canadian market, we look forward to developing innovative and differentiated products that meet the needs and exceed the expectations of our consumers.

Turning to distribution. In the Canadian market, in Q4, we expanded our distribution network and began selling products to cannabis control authorities in Manitoba, New Brunswick and Québec. Cronos currently sells dried flower, pre-rolls, cannabis oils and cannabis vapes through its adult-use brands, COVE and Spinach, to cannabis control authorities in Ontario, British Columbia, Alberta, Nova Scotia and Prince Edward Island, as well as to private sector retailers in Saskatchewan.

We firmly believe that the best way to create value through the supply chain is by working with contract farmers and suppliers to support our capacity needs versus building out our own cultivation for those needs. We continue to structure our supply chain with efficiency, flexibility and the best interest of our business in mind, with the goal to create a global network of co-manufacturing and contract farming with first-class operating partners. To this end, and in the fourth quarter, we continue to build out and transition certain facilities at the Peace Naturals Campus to provide for more R&D activities and the production and manufacturing of derivative products. We are pleased with the progress we are making with the redesign, and believe this is a natural evolution for our business as we look to evolve and drive efficiencies at our facilities.

We also continue to make progress at our international production and manufacturing facility in Israel as we move closer to operational readiness. For this facility, we work closely with our partners at Kibbutz Gan Shmuel and are able to leverage not only their agricultural expertise, but also their skilled labor pool and extensive infrastructure, including warehousing, utilities and much more. In December of 2019, Cronos Israel successfully passed full good agricultural practices audits for propagation and cultivation as well as GMP and good distribution practices, inspections for the manufacturing and distribution facilities. These licenses allow us to cultivate, manufacture and sell products in Israel. We are in the process of waiting for official GMP certification for the facility, which is expected to occur in phases throughout 2020 for flower, pre-rolls and oil. We look forward to working towards our GMP certifications and getting Peace Naturals products to the Israeli medical market later this year.

When we reflect on 2019, I think one of the spaces we've made exciting progress on is our intellectual property initiatives and our commitment to investing in cutting-edge breakthrough technology that we think will have the potential to disrupt our industry as well as others. We are pleased with the progress we are making and our research collaboration with Ginkgo, which will allow us to produce cultured cannabinoids at commercial scale. Ginkgo has filed certain patent applications pertaining to the fermentation of cannabinoids to protect intellectual property developed as part of the research progressing under our partnership. Under the partnership, Cronos Group is the exclusive licensee of the intellectual property covered by the patent applications for the target cannabinoids.

In November, we welcome the employees of Cronos Fermentation, which include a team of engineers, scientists, production and quality assurance personnel previously employed by Apotex Fermentation. We believe that Cronos fermentation will allow us to accelerate our breakthrough technology initiatives by optimizing the cannabinoid fermentation manufacturing process in advance of a commercial scale rollout. We have commenced work on developing scale up and downstream processes at Cronos Fermentation, while in parallel, Ginkgo develops microorganisms for producing cultured cannabinoids. As Cronos develops the processes and parameters, these learnings will be applied to the strains that will be utilized for commercial production in cultured cannabinoids.

Cronos Fermentation has received the R&D license, and is waiting the receipt of our production licenses, which is required for the commercialization of cannabinoids at the facility. In short, we are very pleased with our progress and look forward to bringing this disruptive technology to market when available.

I'd like to close my remarks by reflecting on the incredible year we had. We often don't think about all that we were able to achieve and the sheer speed of our growth in just a short amount of time, but it's important to remember everything that was accomplished to bring us to where we are today.

Here are some of the key accomplishments of 2019. We closed a USD 1.8 billion investment from Altria, and began tapping in to Altria's expertise in manufacturing, product development and much more. We look forward to continuing to work with Altria as we build the cannabinoid industry together. We opened an R&D-focused initiative, Cronos Device Labs, which houses a talented research and product development team with significant vaporizer experience that is leading the charge to develop next-generation vaporizer products.

We hired a Chief Innovation Officer, Dr. Todd Abraham, who brings over 35 years of R&D and consumer products experience to cannabinoid research and innovation. We acquired a pharmaceutical fermentation facility to advance our research with Ginkgo, and eventually manufacture cultured cannabinoid at commercial scale for the Canadian market. And we entered the U.S. market by acquiring a premium hemp-derived CBD brand, Lord Jones, and welcome their talented team to the Cronos family.

Overall, we believe that we are positioning the company for long-term success by investing in innovation, R&D and brands. Our strategy is focused on sustainable growth, and we believe what we are building 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 Filomena Barbato - Cronos Group Inc. - CFO

Thanks, Mike, and hello, everyone. I will provide specific details on our results for the fourth quarter and full year 2019. All the figures that I will review today can be found in the 10-K filed with the SEC. But first, I want to reiterate some of the key points Mike provided earlier regarding the restatement. This is a matter that the Board of Directors and the entire management team at Cronos Group takes very seriously.

We completed a thorough review of our financials and internal controls. I'm grateful to our finance team and advisers who worked incredibly hard to complete the review in a timely manner. We are taking comprehensive action to improve internal policies and procedures and strengthen internal controls, including financial reporting and are committed to best practices. This includes implementing the following steps: first, we are ensuring there is segregation of duties over sales and purchase transactions; second, we are enhancing our controls and procedures related to nonroutine transactions, especially wholesale sales and purchases; and third, we are enhancing our quarterly risk assessment and controls processes to reflect changes in our business. We have said consistently over the last year that one of our biggest priorities is attracting and retaining the right talent in the right areas, which will help us prepare for our future growth initiatives, and we will continue to do so to fortify our infrastructure. Our top priority is to enhance our internal controls and financial reporting practices. These efforts are already underway, and I am confident we will be even stronger as a result of this undertaking.

Before discussing our financial performance, I'd like to make a few comments about our transition to U.S. GAAP reporting, our filings, including our press release, and then, generally, how we view the business. As I mentioned in my remarks last quarter, Cronos started filing domestic SEC reports as of January 1, 2020, and our financial results are now reported in U.S. GAAP with the U.S. dollar as a reporting currency. Historical financial information is included in our 10-K filing, which is currently available on EDGAR and SEDAR. Regarding the conversion to U.S. GAAP, the most significant change from IFRS is related to biological asset accounting, which does not exist under U.S. GAAP. Under U.S. GAAP, agricultural products are valued on the balance sheet at the lower of cost or net realizable value as opposed to IFRS, which accounts for these products at fair value less estimated selling costs.

We've also updated our financial disclosures and reporting structure to reflect how we are managing the business. Going forward, we will discuss our business with 2 segments: U.S. and Rest of World. Lastly, we are now using operating income to evaluate performance and allocate resources across our business segments.

Operating income is a metric used across many industries, including CPG and consumer staples. Some of you may know this metric by other names, including income from operations or operating profit. I'd like to spend a moment explaining this measure and why we find it useful in understanding our business performance. Operating income or loss is defined as net revenue less cost of sales and operating expenses. At the segment level, operating income excludes corporate expenses, which do not directly impact the underlying performance of the segment. We believe operating income provides us the clearest view of the segment's core business performance as compared with other metrics, because it does not exclude depreciation or amortization of revenue-generating assets.

These revenue-generating assets have a real economic cost, and measuring the business performance through EBITDA, which excludes these items, would present results that are not reflective of our underlying business performance. Our asset-light strategy demands that our segment managers be ever vigilant and financially disciplined regarding their capital expenditures. By measuring and discussing our performance in terms of operating income, we believe that we are holding our segment managers accountable for their investments and accurately reflecting the merits of our asset-light strategy. We review these results on an adjusted basis, which excludes certain income and expense special items, which may be highly variable, unusual or infrequent, and can distort underlying business trends and results.

We've included a section in our press release that provides information and details on the special items for this quarter and year-end comparisons period for 2018. Also, we've included reconciliation tables in our press release and 10-K that bridge the reported GAAP operating loss to the adjusted operating loss for each of our segments.

Turning to Q4 results. I will focus most of my comments on the fourth quarter's performance versus that of the fourth quarter of 2018, which is a slight change from the sequential discussion in prior quarters. The company reported net revenue of $7.3 million in the fourth quarter, a 71% increase from prior year. Revenue growth for the quarter was driven primarily by distribution of vaporizer products in Canada and the inclusion of financial results for the Redwood acquisition. In the Rest of World segment, reported net revenue for the fourth quarter of 2019 was $4.6 million, an increase of 8% from the fourth quarter of 2018. This is primarily driven by the continued expansion of growth in the adult-use business in Canada and the introduction of vaporizer products in the fourth quarter of 2019.

Gross margins for the Rest of the World segment were negative in the fourth quarter, a decrease from the fourth quarter of 2018, primarily driven by inventory write-downs in 2019. We incurred an inventory write-down of approximately $24 million in the fourth quarter, made up of a one-time charge of $1.9 million related to the repurposing of certain facilities at the Peace Naturals Campus; and a $22.1 million write-down on cannabis, oil and flower. If we were to adjust for the effects of the inventory write-down, gross profit for Q4 would have been $2.2 million, representing gross margins of 48%. We do, however, anticipate inventory write-downs in the short-term due to pricing pressures in the marketplace, and while the company executes its operational repurposing of the Peace Naturals Campus.

Operating expenses in the Rest of World segment totaled $37.3 million in the fourth quarter of 2019, representing an increase of 247% from the fourth quarter of 2018. This increase is primarily driven by higher sales and marketing costs associated with agency and market research fees connected to the adult-use market. G&A growth was driven by an increase in headcount as well as various professional and consulting fees. The repurposing cost at the Peace Naturals Campus accounts for $5.3 million of the growth, and R&D expenses increased mainly due to the costs associated with Ginkgo. The Rest of World segment reported an adjusted operating loss of $51.8 million in the fourth quarter of 2019. The loss increased significantly from the fourth quarter of 2018, primarily due to inventory write-downs and higher operating costs, partially offset by an increase in net revenue.

In the fourth quarter, the U.S. segment reported net revenue of $2.7 million, as Redwood continues to expand the distribution of Lord Jones products in retail and through e-commerce channels. Gross margin for the segment was strong at 53%, driven by lower Jones position in the super premium/luxury CBD category. The segment reported an adjusted operating loss of $1.8 million in the fourth quarter of 2019. This loss was primarily driven by higher marketing costs associated with the continued expansion of Lord Jones products and upcoming new product and brand launches.

Overall, Cronos reported an increase in net income from the prior year, 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 10-K.

In the fourth quarter, the company recorded a non-cash gain of $118.8 million related to the change in fair value of these financial derivative liabilities. 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 $1.5 billion in cash and short-term investments, essentially unchanged from the third quarter. Capital expenditures for the full year were $39 million. This spending includes investments in our Peace Naturals campus, Cronos Fermentation, our Israeli facility and device technology innovation at Cronos Device Labs. We remain focused on deploying capital in a disciplined manner, and only in ways that align with our strategic priorities.

I'd also like to provide an update on the redesign at our Peace Naturals Campus that we announced last quarter. We optimized our Peace Naturals Campus for alternative uses such as R&D facilities and derivative product manufacturing. Since our last earnings call, we have removed rooms from cultivation in a number of the buildings at the Peace Naturals Campus and began the transition of space for R&D and derivative manufacturing. During the fourth quarter, we recorded a total pretax onetime charge of $7.2 million related to the repurposing efforts at the Peace Naturals Campus, with $1.9 million associated with an inventory write-down and $5.3 million of operating expenses, primarily related to impairment costs.

Overall, we are pleased with the strategic progress the business made in 2019. It was a year of transition and significant investment toward achieving our long-term goals. We expect to continue to invest behind our strategic initiatives in both the U.S. and Rest of World segments. We know that it won't be easy, but I'm optimistic about our plans for 2020 and beyond to achieve long-term leadership in the cannabis space.

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

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

Thank you, Jerry. Cannabis is a young industry with a lot of potential opportunities in front of it. For the last few years, capital has been cheap, assets have been expensive, and the available product format as well as distribution was limited.

2019 was really the first year of widespread industry adversity. In 2020, that trend has continued, adding macroeconomic headwinds around the world that require adjustments to the way people interact with one another and do business. Now in our industry today, capital is more expensive and assets are cheaper, even though distribution is beginning to open up and new product formats are becoming available for sale. Our long-term thesis on cannabis has not changed, and we believe, with our strong balance sheet, investments in disruptive intellectual property and the flexibility provided by our asset-light model, we are well positioned to be opportunistic and aggressively seize on opportunities in the near, medium and long term.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we do have our first question coming in from the line of John Zamparo from CIBC.

John Zamparo - CIBC Capital Markets, Research Division - Associate

I wanted to touch on business disruption at Lord Jones, presumably SoulCycle and Sephora locations across the U.S. are closed. But it seems like there may be some restrictions on the Lord Jones' website. So just wondering, will that be in place as long as the shelter-in-place rules are in effect in California? And just can you talk broadly about how large the DTC business is at Lord Jones versus brick-and-mortar stores?

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

Sure, thanks. That's a great question. Recently, our business has been declared as essential. So those -- from a supply chain perspective, we're still able to keep things open. Of course, it's something that we need to monitor, how potentially things roll out and how they develop. But as of right now, we're able to continue getting product made and shipped.

As far as DTC versus retail, these really are unprecedented times, and it's pretty early to be able to actually conclude anything from the data we're seeing. Obviously, with retail and a lot of categories being closed off, we're seeing what we think is some shift from retail to DTC as people are self-quarantined. But also, it's probably too early to be able to determine whether any sales trends are pantry loading versus sustained changes in the way the consumers are making purchases. So I think it's something that we'll continue to monitor. But we do expect, as long as the nationwide trends that we've seen continue, that there's more likely to be a shift to online purchasing versus brick-and-mortar.

John Zamparo - CIBC Capital Markets, Research Division - Associate

Okay. And then my follow-up is on PEACE+. Can you talk about the regulatory environment for CBD right now? Have you seen any encouraging signs on that front? It seems like the FDA was pretty cautious in its statement in December. But have you had any conversations with the FDA that's led you to any conclusions on what the final outcome might be here, whether it's maximum potency or preference to allow certain products? Just any commentary there would be great.

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

Sure. Look, I think, U.S. CBD and the FDA stance is something we continue to monitor. And as with any regulatory environment, we welcome open dialogue, collaboration and look forward to working with our industry peers, regulators and governments to make sure that we're providing for a reasonable regulation to prevail. I think that a lot of -- some of the trends that we were focused on as far as which way regulations have been going, recent events with COVID has certainly changed, I think, where the focus from a lot of government organizations are. So many developments there can be changed depending on how COVID's dealt with and where regulators feel they need to shift their attention.

Operator

At this time, we do have another question on the line. This is from the line of Tamy Chen from BMO Capital Markets.

Tamy Chen - BMO Capital Markets Equity Research - Analyst

First question is just wanted to understand, with respect to revenues, just how do you think about when will it begin to grow meaningfully? It seems like things in the U.S. may still be some time away given the regulation. So specifically in Canada, I'm just trying to understand what the challenges may be. It doesn't seem like there's a supply issue anymore, so just wanted to get a better sense of when we should think about revenues will really start to pick up there.

Jerry Filomena Barbato - Cronos Group Inc. - CFO

Yes, with new form factors in Canada and sales from U.S. hemp-derived CBD products in the U.S., we believe that this will result in a sales mix weighted more towards adult-use sales and less towards opportunistic sales that we had in Canada. And as we launched 2.0 products in our base launch in late 2019, we believe will help accelerate growth in Canada.

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

Yes. I think when we're looking specific to Canada, obviously, store growth and 2.0 are big impacts. But also, I think what impact COVID may or may not have is going to be important. In Ontario, we've seen new cannabis dispensaries continue to open even during the, call it, the COVID era. But while cannabis dispensaries have been deemed an essential business in Ontario, we don't really have visibility in how the pace of future store growth might be affected by other potential delays, like from trades or macroeconomic headwinds. But also, I think that's counterbalanced by increase in recent online sales. I think that you've seen Ontario discuss, again, though, I think we still need more time and data to be able to evaluate just how much is due to pantry loading versus sustained changes in purchasing habits, and how consumers will be shopping as they self-quarantine.

Overall, though, when we think about the position that we're in and the macroeconomic environment, the way that we look at it is there's distribution points continuing to open up. We expect competition will consolidate, and we think that provides more opportunities for us to be aggressive in growing the business.

Tamy Chen - BMO Capital Markets Equity Research - Analyst

Got it. Okay. And my follow-up is with respect to Ginkgo. So Mike, I just wanted to confirm one of the comments you made earlier. So at this point, has Ginkgo largely done the formulation work? Are you just waiting for the facility to receive its production license and then you can move into the commercialization part? Or is the R&D formulation, there's still more work to be done there?

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

Sure. So the formulation work is work that we do with Cronos. The work that Ginkgo is doing is giving us strains that are able to ferment cannabinoids. The work of how we combine those cannabinoids, what type of consumer products we put them into, it's something that's specific to what we're doing in-house at Cronos. And of course, the difference would be just rare cannabinoids, being able to get those in any type of commercial quantity from cultivation extraction is difficult. But the THC and CBD, for example, it's the same cannabinoid we formulate with that we would be getting from supply today.

Essentially, the separation between what's done at Cronos Fermentation versus Ginkgo, you could think of that as comparable to setting up a cultivation facility and then putting in the processes of how you grow the product, how you harvest and how you ultimately cure. And at Cronos Fermentation, we're going through those processes, while the genetics, which is -- if we think about cultivation, the genetics are being developed the same way you would breed a new plant strain. Ginkgo was essentially breeding and designing those strains that we will cultivate or ferment at Cronos Fermentation. Is that helpful?

Operator

Our last caller seems to have fallen off the line, but we do have another question on the line from the line of Andrew Carter from Stifel.

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

I just wanted to ask and you mentioned it kind of starting to accelerate meaningfully in Canada, obviously, you mentioned that kind of the challenges were unveiled in 2019. And now we have kind of an accelerated shakeout will -- if you will. How, kind of, are you thinking about Canada now versus how you thought about it historically in your portfolio? Is there an opportunity to invest more in this market now? Is it acquisitions? Just any help in how you're looking at the landscape right now.

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

Sure. So I think, certainly, trends, as far as the way that things are setting up with having less access to capital across the space and having, at least in the last few months and near term, limited opportunities for distribution, albeit increasing. We do expect, certainly, consolidation will hit. I think M&A, we haven't really changed our view that what we're looking for is ultimately something on the brand side or something on the intellectual property side that's ultimately scalable.

How consumers end up building a relationship with different brands would ultimately dictate in Canada, specifically, whether or not we were looking for growth organically or through acquisition. But we do expect that the competitiveness for organic growth is something that will become easier as a lot of the capital reserves have been depleted with competitors with marketing.

So ultimately, opportunities that we may have looked at in the past, if we were to revisit them today would certainly look more accretive. But it really comes down to does it help us with our relationship with the consumer to make an acquisition, and would it be more accretive to look at it through organic growth versus acquisitions?

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

Okay. And then second question, just kind of on your vaporizer business that you've launched. You've obviously jumped out to a pretty nice start given your supply chain lead. I wanted to ask, you obviously mentioned COVID-19 disruption and a lot of questions on kind of the Chinese supplies issues. So first question in there, can you kind of give us an idea on these device sales, how accretive they are to your gross margin overall in the profitability of your business?

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

I think we could separate that in 2 categories. I think the actual -- the device, meaning the battery and then the cartridge, which has the actual cannabis oil in it. So I think we look at the batteries really as more of a marketing opportunity, not something that's supposed to drive gross margin. But we do think that the cartridges, especially given pressure in the flower side over the long term, we expect that that's going to be accretive, especially if we continue with the progress of Ginkgo and being able to take that technology and put it into vaporizer products, we think would change the way that we look at our business.

Jerry Filomena Barbato - Cronos Group Inc. - CFO

And while we have healthy margins on our vapes today, we decided to outsource the manufacturing to CMOs, really to make sure that we get the product format, the product type right before bringing it in-house so we can dial it in and improve margins over time, as well as the market continues to fluctuate in terms of pricing. And so we'll see how that plays out over the course of 2020.

Operator

And there are more questions on the line. The next question is the line of Rahul Sarugaser from Raymond James.

Rahul Sarugaser - Raymond James Ltd., Research Division - MD and Equity Analyst of Healthcare, Biotechnology & Cannabis

So my first question, really, with respect to the PEACE+ brand. Did the launch into the first 1,000 stores get started at all? And now that the product line is on hold, when do you expect to relaunch it?

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

Sure. It did not. I mean there are certainly steps in the process that we took. But ultimately, we decided to pause and reassess the landscape. I think when a different product might be launched is something that will depend on how we view the landscape and, ultimately, what gives us the opportunity to meet consumer needs.

But when we think of things right now, retail -- launching a new brand in retail, given the environment with COVID is something that we're going to have to think through as far as timing. And when we start seeing a return to normalcy is when we would start thinking about taking a product and putting it into a new retail location. But I think supporting a new brand on shelf in the kind of social distancing world we're in, it's something that would be pretty difficult.

Rahul Sarugaser - Raymond James Ltd., Research Division - MD and Equity Analyst of Healthcare, Biotechnology & Cannabis

Great. That's really helpful. And then my second question is when do you expect the tech transfer of the first couple of strains developed by Ginkgo to hop in over to the Winnipeg facility? And do you have any visibility on when you anticipate commercial production of those first couple of cannabinoids to happen?

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

Sure. I think it's something that we'll be able to give more color on as time goes on. What I can say is that we're still very confident in the timeline that we gave when we announced the deal, being September of next year.

Operator

And there are more questions on line. This next question comes from the line of Chris Carey from Bank of America.

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

So maybe big picture. We're a little over a year from the close of the Altria transaction. And I guess I'm struggling a little bit just to understand where Cronos is going in the near to medium term. Lord Jones was a big price tag, but it's obviously a small contribution now, maybe that improves over time, but certainly not yet. The U.S. CBD launch is getting delayed potentially indefinitely. It sounds like there's a repivot back to Canada, though it's not that there never was a focus there, but certainly, it seems like more of an emphasis, given that's going to be a market for you in the near term.

And so I guess I'm trying to understand where all this work that we've been talking about starts to get commercialized. Or 2020 is another year where Cronos watches the cash balance, while many others don't, focuses on long term and becomes this very long-term-type story. Or if there's some of this work that maybe comes to fruition sooner? So maybe if we could just talk about kind of where things are going in the near to medium term, would be helpful for me.

Jerry Filomena Barbato - Cronos Group Inc. - CFO

Sure. So I'll take the first part of that in relation to our Redwood acquisition. So we're very excited about the future potential for Redwood, and we anticipate significant growth across our new U.S. platform. And we believe that the U.S. provides significant opportunity for Redwood to deliver value to Cronos.

We selected Redwood as our U.S. platform, not only to the strength of Lord Jones but, more importantly, the talented team that Rob and Cindy, the co-founders, have assembled. And while I won't share our plans for competitive reasons, we believe that through the combination of the Redwood team and Cronos' existing resources that the acquisition of Redwood will deliver significant returns to shareholders over the medium to long term.

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

Thanks, Jerry. And yes, as far as medium and long term, I'll take that part. I don't think our view has changed that similar to other consumer categories, ultimately, differentiation and a product is what's going to lead to long-term value. And there are ways that we look at doing the research, ultimately, things that we find from consumer insight, research, inform what we do in product development. And that certainly takes time.

But we don't want to rush products to market unless we feel that we have winning product. But we do see that technology breakthrough is ultimately what's going to lead to us being able to generate long-term value. So there are a number of initiatives we have that, once we think the product is ready and we think that we can meet consumer expectations, I think that's the first step. And certainly, financial results will follow that.

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

Okay. And Mike, I've asked you this before, how you would envision the breakdown of revenue between the U.S. and, I guess, it's Rest of World, but more or less Canada, in 2020. And I think previously, the U.S. was seen as slightly bigger, but it seems to me now that perhaps it's switched again, where the Canadian business is going to be bigger. And I wonder if you can confirm if that's the case in your projections and maybe offer some insight on how things develop from here.

It's just the type of thing where the vape rollout gets commercialized quicker, where wholesale pricing has obviously collapsed, and now you can really deploy the strategy of procuring a subordinated raw material to sell under your own branded products on the flower side. So maybe help understand how the geographic split looks like, and also what the cadence is going to look like over the course of 2020.

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

Sure. Yes. So I think my previous expectations of the U.S. outpacing rest of world, the key to that is going to be being able to access brick-and-mortar stores. And while I think in October, we've seen some shift from brick-and-mortar sales to online, I think it will be difficult as long as we're in the current environment to still outpace what we're seeing in the Rest of the World. But ultimately, the opportunity we still think, given the size of the market, over time, can be better. But cadence is really going to depend on the overall environment of being able to take different types of CBD products and put them on shelf.

As far as Canada, I think a few things have changed. A lot of it is based off of where the competitive set will be, what products we are able to bring forward. And we think that there's likely going to be some challenges, not just across our sector, but across the -- all sectors, given what's happening with COVID. But given the way we structure ourselves, we think that we should emerge from the COVID crisis, whenever that timing is, in a position of strength to be able to be a little bit more aggressive and continue to invest behind growth opportunities. I think specific timing is -- it's really difficult to predict because of the way that COVID could impact when those opportunities offer new growth and bringing existing products into the market would be.

Operator

And you do have more questions on the line. This is -- next question comes from the line of Vivien Azer from Cowen.

Vivien Nicole Azer - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

So I just wanted to dig in a little bit more on the inventory write-down. This is, obviously, a phenomenon that we've seen in place in the broader landscape for many months now. And so I was just hoping to get a clearer understanding of how you guys are thinking about the price compression in the marketplace. Because it seems to me that, at least from a retail standpoint, like that's really only starting to hit the market, certainly kind of calendar 1Q, given the timing of the announcements, the value price introductions in the marketplace.

So when you took the inventory write-down, is the price deflation a backward look, a forward look? And any kind of color you can offer on like what underpins the rate of price deflation that informs the inventory write-down would be helpful.

Jerry Filomena Barbato - Cronos Group Inc. - CFO

Sure. So we're comfortable that our balance sheet reflects the most accurate valuation of the inventory as of the end of the year. And the write-down was driven by downward pressure on market prices. And these prices have fallen below the cost of producing that inventory, most notably on dried cannabis. The value of future write-downs is a bit uncertain, therefore, we're not disclosing the number currently.

And in line with U.S. GAAP standard, we review our inventory balances quarterly to ensure that it reflects the lower of cost or net realizable value. And I think what we're seeing in the marketplace is, as you pointed out, a trend lower both in the dried flower as well as the oil and resins.

Vivien Nicole Azer - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Okay, that's helpful. So just to summarize then, if that was your kind of view of the marketplace as of December 31, it would be fair to assume that if there has been more price deflation in the marketplace in calendar 1Q, which wraps tomorrow, then that could potentially result in further inventory write down?

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

Correct.

Vivien Nicole Azer - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Okay. And then a quick follow-up for me. It just seems like -- it was months ago that I was at CAGNY with the Altria team. In fact, that was only 4-plus weeks ago. But one of the questions that I posed to Howard Willard during the breakout was Altria's appetite to further distribution, the PEACE+ CBD offering in the U.S. I recognize, Mike, of course, it sounds very sound that you wouldn't want to do a large-scale rollout now, given what we know today about COVID-19. The unfortunate reality is that that wasn't really a big consideration 4 to 5 weeks ago. So I am curious if you could offer whether there have been any discussions with Altria about expanding the distribution. That's my follow-up.

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

Sure. Yes, we remain in active discussion, and I think we're both very committed to the partnership. I think ultimately, a lot of the discussions in the thinking comes from making sure that we can find the right product formats for the current environment. And given all the changes, just making sure that we're taking a responsible and long-term view as to what the product format is and, ultimately, how that's received by all of our stakeholders before launching and expanding distribution.

Operator

And our next question on the line comes from the line of Matt Bottomley from Canaccord Genuity.

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

Just wanted to follow-up from a couple of questions ago on sort of taking a step back on more of a macro level strategy for Cronos. Obviously, you guys are 1 of 2 companies in the Canadian sector that has a defensible balance sheet in these troubling times with increased uncertainty. But again, sort of $7 million of revenue in the quarter, certainly lagging a lot of your peers, certainly in the Canadian sector. And Mike, I appreciate the viewpoint of having a longer-term view versus shorter-term view. But maybe if we could just dig a little bit deeper with respect to where your capital allocation is going to go, and how investors should judge Cronos sort of in the next 4 quarters or so, given the fact that with all the things you have going on between Ginkgo and Israel, the hemp in the U.S., obviously, everything that's happening in Canadian -- in the Canadian market, the top line still is very modest.

So should we be expecting this to be a continued trend as you allocate capital towards the longer-term initiatives, although there's more unknowns and risks there? Or is there anything we can look at in the next couple of quarters that that can be definitive things to assess performance for Cronos in the more near-term than long?

Jerry Filomena Barbato - Cronos Group Inc. - CFO

Yes. We don't give forward-looking guidance on our revenue projections. And as far as the capital allocation, I would say we continue to monitor our capital allocation to determine the appropriate level for reinvestment in our business, as well as external growth opportunities. And we believe we've been very active in deploying that capital in a relatively short period of time, considering that the Altria investment closed last March.

We've acquired Redwood Holdings. We acquired Cronos Fermentation. We've launched derivative products, including vaporizers. And we have a credit facility out for our GrowCo joint venture. So we remain focused on scaling the business for the future success, and we'll continue to evaluate external growth opportunities to deploy that capital.

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

And -- thanks, Jerry. I think one of the things that we certainly balance between external growth opportunities is also evaluating organic growth opportunities. And vaporizers is a category we really believe in and leaning into as we continue to get more information and data on how some other formats in Canada have been received, and we can sort of learn from what products have been put out in the market.

We're leveraging some of our IP that we got from Redwood, and we'll look at other things that we have in development, but I don't think we're talking about years before we're able to start getting other product formats out and lean into them. But we do see that, even over the next few months, the opportunity that we have to really grow revenue better than they were in the past. But ultimately, we're still making sure that we take a long-term view, and we're doing things that are accretive. So we feel the cost of revenue of entering any specific opportunity isn't something that generates long-term value. It's something that we'll pass on. But again, given where the cost of capital for most industry participants has shifted to, and looking at the pricing of different assets, we think that picture is starting to change and presents an opportunity for us to move over the near to medium term.

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

Got it. And just a quick follow-up, very anecdotal, but I've noticed since Cannabis 2.0 is launched on a number of the provincial websites, the Cronos, whether it's COVE or Spinach or others, I've noticed those products have been a lot more relevant on those websites. And it's obviously -- no one really knows, by reviewing websites, how much depth of supply goes behind each and every SKU. But is there anything for us to read into for your next quarter that there's been an uptick in overall penetration into this Cannabis 2.0?

Obviously, everyone's starting from a base of 0 in the prior quarter, but it's just something I've noticed on a number of the provincial websites since Cannabis 1.0 that the Cronos-branded products do seem more prevalent compared to what we saw just the dried bud before it launched.

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

Sure. I think what you're seeing there is just that our focus has really been a lot on the derivative products and I think that even looking at distribution in which provinces that we've entered, we want to make sure that we can support our products in the different provinces. And so we've expanded distribution and making sure that we have the amount of supply necessary and the right product mix is something we prioritize for vaporizers.

One of the reasons that we picked having just one 2.0 product format in market is to make sure that we're able to service it properly. So I think, again, looking at opportunities for us, we are placing a priority on making sure that there's more organic growth this year now that we think the adult-use market is opening up with more retail stores and with more product formats.

Operator

We do have one last question on the line. This last question comes from the line of Michael Lavery from Piper Sandler.

Michael Scott Lavery - Piper Sandler & Co., Research Division - Director & Senior Research Analyst

You touched on some positives in the quarter, including obviously the bigger -- much bigger sales from Lord Jones and the launch in 3 new provinces, obviously, Alberta being a very developed one. And then it sounds like some -- at least early and initial vaporizer sales as well, but maybe can you just help us with a postmortem on what then still really drove, even after the adjustment in 3Q, a pretty significant decline? And then maybe with that, help us understand what has or hasn't changed as we look and try to model ahead.

Jerry Filomena Barbato - Cronos Group Inc. - CFO

Yes. So after the restatement, we had some growth in Q4 versus Q3. And as I said before, we're not giving forward-looking guidance in terms of revenue. I think there's a lot of things at play, especially with COVID-19, and people going to brick-and-mortar. And I think we'll be able to get a better sense as the environment changes and to see how many stores actually open up, especially in Ontario, where they've done, I guess, you can say a fair job at beginning to open more stores. The question still remains, will they be able to get to their intended number and satisfy the market?

Michael Scott Lavery - Piper Sandler & Co., Research Division - Director & Senior Research Analyst

And maybe just to make sure I'm not confusing the numbers, with the restatement in U.S. dollars, what was your 3Q revenue number?

Jerry Filomena Barbato - Cronos Group Inc. - CFO

Well, we took a $3.8 million write-down, or a change in U.S. dollars in Q3. So the total change in the net revenue figure was $5.7 million.

Michael Scott Lavery - Piper Sandler & Co., Research Division - Director & Senior Research Analyst

Because -- okay. So I guess I still just want to understand maybe where most of the pressure is from. Is it share -- market share or pricing pressure? Is it a combination of both?

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

I think there's a few things, Q4, as far as sort of how things landed versus our expectations, I think that we certainly had a focus on the 2.0 launch. And given the -- leaning in the vaporizers, I'll just give you an example, Alberta being a very developed province, something that has certainly changed, but we expected that to be a big growth driver for us.

And then temporarily, vaporizers were not a product format that was accepted, that certainly changed. But a lot of it was, I think, timing of 2.0 launch, how different things, different provinces were accepting different product formats. Certainly, the -- there is probably a peak level of congestion that we've been experiencing for certain types of flower. But we do expect that's something that will begin to clear up, although it's -- the exact timing is difficult to pinpoint. Just from trends we've been seeing and where we naturally would follow to -- we expect congestion to clear up with more store openings and less competition.

Operator

And at this time there is no one else in queue. Again, there are no other...

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

If there are no more questions, I hope everyone stays healthy and safe, and talk soon.

Operator

This does conclude our conference. You may all now disconnect.
