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MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Corey, and I will be your conference operator today. I would like to welcome everyone to Cronos Group's 2022 Fourth Quarter and Full-Year Earnings Conference Call. Today's call is being recorded. After the speakers' presentation, there will be a question-and-answer session.

At this time, I would like to turn the call over to Shayne Laidlaw, Investor Relations. Please go ahead.

Shayne Laidlaw

Thank you, Corey, and thank you for joining us today to review Cronos's 2022 fourth quarter and full-year financial and business performance. Today, I am joined by our Chairman, President and CEO, Mike Gorenstein; and our CFO, James Holm. Cronos issued a news release announcing our financial results this morning, which is filed on our EDGAR and SEDAR profiles. 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, let me remind you that we may make forward-looking statements and refer to non-GAAP financial measures during this call. These forward-looking statements are based on management's current expectations and assumptions that are subject to risk and uncertainties that could cause actual results to differ materially from those projected in the forward- looking statements.

Factors that could cause actual results to differ materially from expectations are detailed in our earnings materials and our SEC filings that are available on our website, by which any forward-looking statements made during this call are qualified in their entirety. Information about non-GAAP financial measures, including reconciliations to US GAAP, can also be found in the earnings materials that are available on our website. We will now make prepared remarks, and then, we will move into a question-and-answer session.

With that, I'll pass it over to Cronos Group's Chairman, President and CEO, Mike Gorenstein.

Michael Ryan Gorenstein

Thank you, Shayne, and good morning, everyone. I want to start our call today by reflecting on the transformative steps we took in 2022 to put our business on a better footing in preparation for the future growth of the global cannabis industry. In 2022, we embarked on a strategic realignment of our business centered on three key objectives. First, we centralized our functions to improve strategic alignment. Second, we optimized our global supply chain to reduce complexity and drive enhanced innovation capabilities. And lastly, we implemented a cost reduction target to reduce operating expenses by $20 million to $25 million, which we overachieved.

The realignment of our business was centered on our core objective, to create a portfolio of borderless products and brands across adult use product formats. Last year, we spent a lot of time getting our product mix right for each market we operated in. This involved strengthening our borderless product portfolio, including edibles, vapes and infused pre-rolls, and exciting new flower genetics that launched in Canada and Israel. We also decided to exit the CBD beauty category in the US in favor of focusing on adult use product formats.

Core to our strategic initiatives and continuous improvement efforts are getting cannabinoid products in market that elevate the consumer experience and leverage a nimbler supply chain. We are building a blueprint in Canada for what we think will win in other markets. Our focus is on borderless product innovation, meaning we're creating product lines and brands that we know from our experience will win when introduced to new markets.

We've managed to do all this while cutting our costs significantly and re-establishing our mindset to ensure growth with attention to ROI and borderless innovation. Our slimmer cost structure enables us to fund the product initiatives help grown Cronos strategically.

As we look ahead this year, we know there's more we can do to cut costs while maintaining our innovation and growth engines. We remain keenly focused on cutting costs throughout our business to ensure Cronos is poised for long-term growth. As part of our plan to optimize our supply chain, in early 2022, we announced plans to begin winding down operations at our Peace Naturals Campus, including the shuttering of cultivation and moving certain activities to contract manufacturers. As you all know, we participate in an industry that is constantly evolving, so it's important to stay agile. We continue to transition towards a more flexible footprint, ensuring we have the capabilities to execute in current and future market opportunities.

To that end, we've decided to maintain select components of our operations at the Peace Naturals Campus, specifically we plan to continue distribution and warehousing, certain R&D activities and manufacturing our most proprietary innovative products. We expect this decision to provide us the space and security for continued growth.

Through this realignment, our goal has always been to position Cronos successfully to assemble our portfolio of best-in-class borderless products, fueled by proprietary innovation, while preserving financial flexibility. The decision to remain at the Peace Naturals Campus allows us to make selective strategic investments in our R&D and brand pipeline as we innovate and evolve with consumer preferences.

In Canada, we continue to execute our plan to create a robust portfolio of borderless products, highlighted by several important product launches and the continued success of the products already in market. All of the following Canadian market share information I will be referencing is provided by Hifyre.

In January 2023, our award-winning gummies under the Spinach brand umbrella became the number one gummy in Canada with 15.9% market share in the edibles category. When focusing on just gummies, Spinach has a 20.9% market share. We're thrilled that our gummies have become a highlight of so many adult consumers' lives. I would like to thank them for showing brand loyalty and enthusiasm for our products.

SOURZ by Spinach is a borderless product and the flavor, the combinations and sales have made us confident that we have a winning product that can appeal to consumers in any market. In December, we launched the SPINACH FEELZ CBC gummy in select markets, and have continued to expand distribution in the first quarter of 2023. This is the first CBC gummy product in Canada and the first product of any kind to feature a 3:1 ratio of CBC to THC. We're incredibly excited about the potential of CBC and have big plans for it in 2023. Early sales point to strong consumer adoption. And we believe this product will be additive to our overall gummy portfolio.

In November, as we previously disclosed, we launched two infused pre-rolls in Canada. The first, under the Spinach brand, is our Fully Charged Atomic GMO, which comes in a five pack with 0.5 gram per pre-roll. We also launched a CBG-infused pre-roll under the Spinach FEELZ brand, Tropical Diesel CBG, which comes in a three a pack with 0.5 gram per pre-roll. These new pre-rolls are quickly climbing the market share ranks led by our Fully Charged Atomic GMO infused pre-roll.

Our pre-roll market share grew by 40 basis points sequentially from the third quarter to 1.4% in the fourth quarter. We have lagged the market in pre-rolls. With our extensive work in this category and the launch of infused pre-rolls, we believe that we now have the right foundation. The moves we made in 2022 to improve our near-term competitive position in pre-rolls are just the beginning of the work we're doing in the category. We believe, like the edibles category, pre-rolls will be a category where product differentiation will drive brand separation, and one of our top priorities is to create next generation borderless products.

We're doing extensive work to develop a portfolio of products that will separate us from the competition based on several factor, including reducing harshness, improving consistency and hitting on consumer preferences around flavor and potency.

In the vape category, we achieved 4.8% market share in the fourth quarter, up 40 basis points in Q3, climbing to number six in market share. We'll look to build on that momentum in 2023 with a continued push to include rare cannabinoids in our base and drive innovation, leaning on our winning formulations across the portfolio.

While flower in the Canadian market continues to be heavily weighted to 28 gram bags, we continue to defend market share in the 3.5 gram segment, with our GMO Cookies SKU, the highest ranking 3.5 gram SKU in the country, at number six in the overall dry flower category. We had a 5.1% share of the overall dried flower category in the fourth quarter, making Spinach the number three brand in flower.

In Q4, GrowCo reported a preliminary unaudited revenue of approximately $2.4 million from non-Cronos customers. And in the full year, GrowCo had revenue of approximately $21 million from non-Cronos customers. Our 50% share of GrowCo's net income, which is accounted for under the equity method of accounting, equated to $3.1 million in 2022. Cronos previously provided GrowCo with a credit facility, which currently has $73.8 million outstanding following the repayment of principal of $3.1 million by GrowCo as of December 2022.

In addition to principal repayments, Cronos also received $2.2 million interest payments from GrowCo in 2022, which totaled $5.2 million in cash payments to Cronos. The strong financial performance of GrowCo yielding equity pickup, principal payback and interest payments to Cronos is an important component to our overall financial picture and I believe is an under-appreciated part of our story. We are very pleased with how quickly GrowCo achieved profitability and are excited that they're making significant strides in continuously improving their operations.

GrowCo's performance and cultivation continues to be strong, hitting north of 30% THC potency on recent harvests, which is a testament to our JV's complementary capabilities in cultivation and downstream processing, and our investment in genetic breeding and tissue culture.

Turning to Israel, our PEACE NATURALS products continue to be strong performers. This past quarter we launched two new flower SKUs, Miami Sky and Atomic Sour, powered by our flower genetics and breeding program, which continues to set us apart from the competition in Israel. Our end market sales and marketing strategies have resonated and our products have become synonymous with quality and consistency, driving the brand's success.

Turning to the US market, we ceased the production of both Happy Dance and PEACE+ to streamline the brand portfolio and their operations to focus on adult-use product formats under the Lord Jones brand. We are pleased to move forward in 2023 with a leaner portfolio of brands and a mix of products that we feel confident will evolve and build our brand portfolio over time.

We want to maintain the Lord Jones brand equity we've built in the US and ensure that when the time is right, we can bring other cannabinoids in and reengage with a consumer base that is looking for a high quality hemp-derived products.

Before turning it over to James, I want to highlight the performance of our approximately 10% equity investment in Australia. Please note that Cronos Australia recently changed its name to Vitura Health Limited, trading on the ASX under the symbol VIT. Vitura continues to execute, boasting a record first half of 2023 with gross revenue of AUD 57.6 million and EBITDA of AUD 11.8 million.

The medical market continues to grow in Australia and Vitura's positioned incredibly well to take advantage of the market opportunity. As of the end of 2022, our stake in Vitura was approximately $22 million, which we believe is an under-appreciated asset on our balance sheet.

Last, but certainly not least, I would like to congratulate and introduce you to James Holm, our new CFO, who joined us in November of 2022. James brings to Cronos roughly 20 years of experience in various finance and accounting roles at leading companies across industry. He's been immensely impactful to our business during his first four months and we look forward to having him as part of the team helping steer Cronos forward.

With that, I'd like to pass it on to James to take you through our financials.

James Holm

Thanks, Mike, and good morning, everyone. I'm very pleased to be joining my first earnings call with Cronos and I'm looking forward to all the great things we are going to accomplish. Turning to 2022, on a consolidated basis, we increased revenue 23% year-over-year to $91.9 million, with strong performance in the Rest of the World segment, highlighted by Israel and Canada.

Constant currency consolidated net revenue increased 28% to $95.2 million. Our Rest of the World segment recorded net revenue in 2022 of $86.7 million, representing a 34% increase year-over-year. On a constant currency basis, Rest of the World net revenue increased 40% to $90.1 million. The United States segment decreased 48% year-over-year to $5.2 million, driven by the shift in product and promotional strategy as part of the realignment.

Now I will review our fourth quarter 2022 results in relation to the prior-year period. The company reported consolidated net revenue in the fourth quarter of $22.9 million, an 11% decrease from the prior-year period. Constant currency consolidated net revenue decreased 4% to $24.8 million. The revenue change was primarily driven by a decline in the adult use Canadian market, driven by lower cannabis flower sales, largely attributable to an adverse price mix shift, a decline in revenue in the US segment driven by the strategic repositioning of that business and the impact of the weakened Canadian dollar against the US dollar during the period, partially offset by growth in cannabis flower sales in the Israeli medical market.

Consolidated gross profit in the fourth quarter was negative $0.2 million, representing a $2.2 million decline versus the prior-year period. The decline was primarily driven by lower cannabis flower sales in Canada, largely driven by adverse price mix shift, and an increase in inventory reserves in the US segment as we transition away from the beauty category, and lower fixed cost absorption and packaging changes in the ROW segment. This is partially offset by increased sales of cannabis flower in Israel, a favorable mix of cannabis extract products that carry a higher margin profile than other product category, and lower cannabis biomass cost.

Consolidated adjusted EBITDA in the fourth quarter was negative $21.2 million, representing a $6.1 million improvement versus the prior year period. The improvement was primarily driven by a decline in expenses across general and administrative, sales and marketing and research and development.

Turning to our reporting segments. In the Rest of the World segment, we reported net revenue in the fourth quarter of $22 million, a 3% decline from the prior year period. Constant currency net revenue in the Rest of the World segment increased 5% to $24 million. Revenue change was primarily driven by declining cannabis flower sales in Canada, largely attributable to the mix shift from 3.5 gram offering to 28 gram offering, and the impact of the weakened Canadian dollar against the US dollar during the period. This was partially offset by growth in cannabis extract in Canada and cannabis flower sales in the Israeli medical market.

Gross profit for the Rest of the World segment in the fourth quarter was $1.3 million, representing a $1.1 million decline from the prior year period. The decline was primarily driven by lower fixed cost absorption, packaging changes, and an adverse price mix shift in the Canadian flower market, partially offset by growth in cannabis extracts in Canada, increased flower sales in Israel and lower biomass costs. Adjusted EBITDA in the Rest of the World segment for the fourth quarter was negative $13.4 million, representing a $1.2 million improvement from the prior-year period. The improvement versus the prior year was primarily driven by a decrease in research and development, and general and administrative expenses.

Turning to the US segment, we reported net revenue in the fourth quarter of $850,000, a 73% decrease from the prior-year period. The decline year-over-year was driven by a reduction in promotional spending and SKU rationalization due to the strategic realignment of our US business. Gross profit in the US segment for the fourth quarter was negative $1.5 million, representing a $1 million decline from the prior year period. The decline year-over-year was primarily due to lower sales volumes and increased inventory reserves associated with discontinued product, as we transition away from beauty products and focused on adult-use product formats.

Adjusted EBITDA in the US segment for the fourth quarter was negative $4.3 million, representing a $4 million improvement from the prior-year period. The improvement versus prior year was primarily driven by a decrease in sales and marketing, and general administrative expenses.

Turning to the balance sheet, the company ended the quarter with approximately $878 million in cash and short-term investments, which is down approximately $11 million from the third quarter of 2022. As foreign exchange rate volatility has impacted our P&L, it's also had a large impact on our balance sheet. If you apply the FX rate for the period ended December 31, 2021 to the current period balance sheet, we would have approximately $914 million in cash and short-term investments, an approximately $36 million difference.

Last year, we made significant strides to reduce spending and improve our cash burn rate. We started 2022 with the target to reduce cash operating expenses by $20 million to $25 million, which we were able to surpass by $3.7 million, saving a total of $28.7 million throughout 2022. Our free cash flow improved by approximately 43% in 2022 versus prior year, driven by operating expenses, savings, and an approximate 60% reduction in CapEx, which was down to $5 million in 2022. As we embark on 2023, we are setting a new goal to reduce cash operating expenses by an additional $10 million to $20 million. We continue to be thoughtful in our approach to cost reduction, to not hamper our growth or our ability to execute on building borderless products.

With that, I'll turn it back to Mike.

Michael Ryan Gorenstein

Thanks, James. Before getting to questions, I want to level set what's under the Cronos umbrella and where things stand today. We closed the year with $878 million in cash and equivalents and zero debt. With the move in interest rates, we expect to generate significant interest income from our cash in 2023. Our Canadian business reached $56 million in revenue in 2022.

And within that business, our Spinach brand has the following market share ranks provided by Hifyre data for January of 2023. Overall, Spinach is the number three cannabis brand; in edible, the number one brand; in flower, the number three brand; in pre-rolls, the number nine brand and quickly taking share and in vape, the number six brand and also gaining ground.

We have a leading brand in Israel totaling revenue of $30.5 million in 2022. We have a 6.3% stake in PharmaCann, one of the largest private US MSOs currently on our books for $49 million. We have an approximate 10% stake in Vitura, a leading publicly traded Australian medical cannabis provider worth approximately $22 million as of year-end.

We own 50% of the equity in Cronos GrowCo which is profitable and they paid us $5.2 million in principal and interest payments in 2022. We ended the year with a remaining balance of approximately $86 million on our combined loans to GrowCo and its partners.

GrowCo has a growing book of business outside of sales of Cronos, reporting to us they sold $21 million to non-Cronos customers in 2022. We have a growing portfolio of intellectual property associated with fermentation of cannabinoids, patent pending product formulations, and a constantly growing portfolio of genetics. We own real estate and multiple licensed facilities free from any encumbrances. And finally, we have an exclusive partnership with Altria on a global basis.

At the close of market yesterday, Cronos traded at a market cap of approximately $794 million, an enterprise value of approximately negative $84 million. I don't believe there's a cannabis company today that has more under-appreciated value than Cronos.

With that, I open the line for questions.

QUESTION AND ANSWER SECTION

Operator

Thank you. At this time, we will conduct the question-and-answer session. First up is Michael Freeman of Raymond James. Michael, your line is open.

Analyst: Michael Freeman

Question – Michael Freeman: Hi. Good morning, Mike, and James, and Shayne. Thanks very much for taking our questions. I wanted to first ask – I mean, we have a great interest in your partnership with Ginkgo Bioworks and the commercialization of rares. I wonder after many quarters selling rares in a just distributed through your products, I wonder if you could describe at a high level the impact you've seen in as it relates to sales and market penetration of these rares?

Answer – Michael Ryan Gorenstein: Yeah. Thanks. No, I think it's been a great impact. I don't think it's a coincidence that we've used rares in our derivative products with a heavy focus on edibles and we've achieved number one market share. I think it gives a halo to the brand. It allows us to put out a number of SKUs that are really differentiated that others aren't really offering. And I think it also gives us the momentum to be able to continue building on the portfolio. We really have a lot more iteration and we still think there's a lot of exciting product and the best is yet to come.

So I think it's a key differentiator. I think that the results can be seen just in what we've been able to put out over the last year. So we're really excited about it and I think the retailers and consumers are as well.

Question – Michael Freeman: That's terrific. Thank you. Now turning to the US, where we saw some disappointing results in the Congress at the end of last year. And it looks like the time line for any sort of major reform in the US has been pushed out. I wonder if you could frame for us your plans regarding entering the US, which is very prominent in your historical strategic plans. I'm wondering if that has changed to focus more on other geographies, given the events of late last year.

Answer – Michael Ryan Gorenstein: No, it hasn't changed. I think that, we didn't expect a movement regardless of whether or not SAFE passed, we didn't expect anything necessarily to change. I still think that, the rescheduling announcement was an unappreciated catalyst.

But overall, we focused on making sure that we have the right portfolio of borderless product because, as you'll see in any market, certainly there's an initial wave of excitement with whoever can supply the market first, because there's always that imbalance. But as the market starts to reach a supply demand equilibrium, what really matters is who has the best branded products.

And for us, making sure that we continue to have a optionality with a strong balance sheet and that great portfolio of product, we're ready to move into markets that they open. So when we think about that, that's Israel and that growth we think can continue there. We think Australia, there's certainly some tailwinds. Germany, of course, and the US but other markets that start to open up faster is – we'll be ready to move.

Operator

Thank you. Stand by for our next call. Our next call comes from William Carter of Stifel. William, you're open.

Analyst:W. Andrew Carter

Question – W. Andrew Carter: Hey. Thanks. This is Andrew on for William. Just wanted to ask real quick, first off, I wanted to ask about the gross margin in the quarter. The compression accelerated. Were there any onetime issues? And just is that gross margin, does it inflect significantly from here because just kind of get an idea of what really changes that. I know you said volume deleverage, but volume in flower has been helped by the pricing. Just anything you'd help on that. Thanks.

Answer – James Holm: Sure. Thanks, Andrew. So yeah, the primary drivers of decline in the gross profit in the ROW segment were adverse price mix shift in the cannabis flower and lower sales in the US business. We also did have an increase in US reserves due to the strategic repositioning of the portfolio, more focused on the adult use product formats, right, to the one timers you alluded to. And then we had lower fixed cost absorption and packaging changes in the ROW segment, again, onetime issues as you alluded to. However, those negative impacts were partially offset by strength in cannabis flower sales in Israel, as well as the growth of cannabis extract sales in Canada that carry a higher margin profile than other product category.

Israel gained significant operating leverage in our cost structure, going from $13.4 million in revenue in 2021 to $30.5 million in revenue in 2022 for 128% increase. And then lastly, we benefited from lower cannabis biomass costs, as we continue to leverage our joint venture with Cronos GrowCo, right? So we do not anticipate obviously to the extent you can such things but don't anticipate any future onetimers there. So hopefully more of a normalization on the gross margin profile.

Answer – Michael Ryan Gorenstein: Yeah. Thank you, James. Just to add that one other thing that we talked about a bit last quarter, as we were transitioning from PEACE NATURALS to GrowCo, there were a number of supply chain disruptions that hit us. And so from an efficiency perspective, filling order, we saw a bit of it in the top line as well. That did overall affect the margins. So we think we'll get back to normalization now that we've sort of settled it and having the same warehouse and distribution we had before and being able to optimizing the fill.

Question – W. Andrew Carter: Thanks. Second question I wanted to ask, because you guys – kind of your comments at the end there did underscore some of the kind of X checks you've made on your strategy in terms of just market share products, but obviously the market is very different than what we thought it would be five years ago. So I guess I would ask with the cash on hand, do you see a sense of urgency to go out there and offer a more tangible case? Like, what do you think about like the kind of landscape of assets across the cannabis landscape, Canada and elsewhere, many of them broken assets? We saw some interesting deals last week. Anything – any perspective you can give on that? Thanks.

Answer – Michael Ryan Gorenstein: Sure. Look, so there are a number of assets, I think, that are attractive. Some of those assets need to be separated from other pieces that would I'd say otherwise take away the value of what's there. We've expected that to have happened faster. I think that we're getting closer and closer, depending which market you're talking about, there's different types of assets. But I just want to stress the thing that we will continue to be focused on is what is going to have long-term stickiness from a consumer perspective.

So we aren't really focused on supply chain assets. It's really on branded products. And I think that there are some that are out there, but there's, I think, still some work to do and still some movement before a number of those are attractive. But there are still a smaller set of them that we couldn't make moves on.

Operator

Thank you. One moment for our next question. Our next question comes from John Zamparo of CIBC .

Analyst: John Zamparo

Question – John Zamparo: Thanks. Good morning. I wanted to ask about the PEACE NATURALS facility and the decision to remain there. And Mike, you referenced the continually evolving landscape in this sector. And I wonder, what was it specifically maybe in late Q3 or early Q4 that led to the decision to keep part of that facility running. It seems like you're keeping a number of functions, so I wonder, was it that costs escalated at third party providers or is there an element of control that you want to maintain or something proprietary? Just curious about the change here.

Answer – Michael Ryan Gorenstein: Sure. Thanks. I think there's a number of things. I think, first and foremost, we wanted to make sure that we have the capabilities to be able to execute today and also in the future. And I think as part of that, the distribution warehousing is really important.

There are some R&D activities that we want to make sure we can maintain. And also some of the proprietary products we just want to keep manufacturing in-house, we saw an advantage to that. But another big factor, I think, is that given the success that GrowCo's been having, quicker they reach profitability, with still a lot of optimization to go, us moving into GrowCo did in a way sort of crowd and limit the potential for expansion at GrowCo but also sort of cap the growth that I think that we'd be able to have. So I think staying gives us the short term ability to I think execute better, fill orders, have better margins, but also longer term for both us and GrowCo to be able to continue seeing grow. And that was really the deciding factor.

Question – John Zamparo: Okay. That's helpful. Thank you. And then my follow-ups on the rares strategy, and I wonder what success looks like for you here. And I think I've asked in the past about this, but I wonder if you have an update on exactly who is buying these? Is there an element of repeat customers? Is a lot of it trial because of novelty purposes? I wonder if you have any insights on the consumer within your rares portfolio.

Answer – Michael Ryan Gorenstein: Yeah. I think we are seeing repeat. We have a whole sub brand that's dedicated to rares and you're seeing success there. I think when we talk about what success means, it's the fact that you're able to have this incremental set of SKUs where you're not only cannibalizing your other SKUs because someone's looking for a targeted effect, I think that's really important.

I think it's a really key part of differentiation, it's the key part of the overall portfolio construction. So whether it's CBN, CBG. I think CBG, we're extremely excited about. And now being able to start iterating and adding and combining different cannabinoids, I think that's where you're going to see the next level of success that we'll be able to have. But in a market, you walk into a lot of the dispensaries, everything looks the same. Being able to ask something that's different something that's more targeted. When people are asking for effects, you can get something that's actually got a little bit more backing than just indica or sativa. I think that's really important to knowledgeable consumers.

Operator

Thank you. One moment for our next question. Our next question comes from Vivien Azer of Cowen.

Analyst: Vivien Azer

Question – Vivien Azer: Thank you. Good morning. Mike, I was wondering if you could comment please, on the recent announcement from the OCS around the change to their margin profile. And how you guys are thinking about that in regards to your pricing as well as the competitive landscape? Thanks.

Answer – Michael Ryan Gorenstein: Sure. And I think it's pretty early to see what the effect on the competitive landscape will be. I think overall, it's a step in the right direction. I think it's really good to see acknowledgement that there's structural challenges in the industry and that there are a lot of struggles for LPs to basically be sustainable and hit profitability. I still think that there's a lot more that needs to be done. But it is appreciated seeing that happen but it's still pretty early to see is this something where a price is taken? Is this something where if you end up basically seeing the value from it, we'll probably be able to have a better idea that by next quarter.

Question – Vivien Azer: Okay. That's helpful. And then just on my follow up, a lot of call outs on innovation, which was all makes good sense in particular, given some of the differentiation that you guys are able to bring with your genetics and the rare cannabinoids. But in lieu of your continued focus on cost, can you just articulate how you guys think about kind of inventory management, SKU rationalization and what kind of regulators you've put in place to manage that? Thanks.

Answer – Michael Ryan Gorenstein: Sure. One of the things that we've done and I think it's been really helpful is the structure that we have with GrowCo where it's not us cultivating and then trying to find a way to sell product we have, whether or not it hits our spec. So when you're managing to grow all on your own, it would be okay, we need to – our spec for a certain strain might be 26% to 30% and it comes in at 31% or at 24% and suddenly you can't sell it and you have to figure out what to do.

When you're in more of a sourcing model, I think that makes it much more efficient. So less risk of inventory write-downs. And I think that's been one of the most helpful things that we've seen and also having multiple markets that can be pushed to. But GrowCo being able to then sell to third parties really has optimized things.

Operator

Thank you. One moment for our next question. The next question comes from Tamy Chen of BMO Capital Markets. Tamy, your line is open.

Analyst: Tamy Chen

Question – Tamy Chen: Thank you. Good morning. First question, a bit of a follow up on someone else had asked. Mike, curious if you could speak right now specifically to the Canadian market. You talked about the adverse price mix trends that the market itself is still more weighed to 28 gram. There was talk about the OCS announcement, a small step in the right direction. But how would you, at this point, characterize the Canadian recreational market? It just seems like the progression towards more aggressive pricing and more squeezing of margins by everybody is just continuing on that trend. Is that the way you see it?

Do you feel like there is anything on the horizon or something eventually that will possibly improve the fundamentals in this market? And is your strategy at this point is just to continue to invest in the things like the rare cannabinoids as your point of differentiation?

Answer – Michael Ryan Gorenstein: Sure. That's a great question. And it's not just rare cannabinoids. And I think on this one, I'd point to the edibles category as an example. If you look overall, we were able to achieve number one – number one in edibles and we're not doing that as a value brand. And we're certainly not the ones we're participating in a race to bottom on price. And we were able to do that even while you have chewable extract, which is really finding ways to undercut the sort of more traditional edible prices. And I think that just shows that when you have differentiated products and this is really the further you get away from flower, the easier it is to differentiate and be able to take market.

What I think that means going forward and this is why we have such a focus on borderless product is you're going to have to continue doing that in each category. And when I think of the flower category, certainly genetics matters. But I think that you're going to see pre-rolls as really the area we're able to differentiate.

And you see that it's similar to tobacco. The pipe tobacco is not a really big category, but you see cigarettes that separate. I think that there's a ton of opportunity for differentiation in pre-rolls. I think it's a very similar category to edibles. I think that there will be some really segmented brands that able to separate. It's going to be very product focused. And if you're not able to do that, I think you start getting closer and closer to selling a commodity. And the fact that we've seen a shift to 28-gram bags just supports that.

Question – Tamy Chen: Got it. Okay. And wanted to circle back on Andrew's question, talking about your cash position. It is a sizable amount of cash. And so I just wanted to ask directly, how do you think about that? Any plans with that, aside from funding your current operations? Thank you.

Answer – Michael Ryan Gorenstein: Sure. Yeah, I think obviously with this move in interest rates, I do think you'll start to see pretty significant interest income, but I think that's probably the less interesting part of the answer you're looking for. What I can tell you is that we will remain disciplined, and one of the things that we are not looking at is assets where it is purely just price competition and a race to the bottom. Someone being able to grab market share is not important if they're not able to generate cash. We think overall about what we're able to do. Its how do we become cash flow positive? We aren't thinking about adjusted EBITDA.

So those assets are very specific, what we're looking at. We're seeing how they fold in, both today and in the future. And in cannabis, having cash I think is a very rare and very valuable thing. So I think that we are in a extremely fortunate position. We certainly get quite a lot of inbound. There are a lot of assets available, but we are still going to continue to be disciplined like we had in the past and make sure that anything we have is a really strong fit. We can't dwindle our position on things that only last for a year.

Operator

Thank you. One moment for our next question. Our next question comes from Nadine Sarwat of Bernstein. Nadine, you're open.

Analyst: Nadine Sarwat

Question – Nadine Sarwat: Hi. Thank you for the question. Two from me, please. First one on gross margin, I know you mentioned those onetime impacts in the quarter. Is there a way that you could help size those onetime impacts, or perhaps put another way, what would your gross margin have been without those? And how should we think about a normalized gross margin once those all drop out going forward for each of your segments?

And then my second question is on Israel. You continue to have robust performance in that country in contrast to many of your peers. So could you just give us an update on the underlying trends that you are seeing in that market and how you expect that to develop over this year? Thank you.

Answer – James Holm: Sure. Yeah. So on the margin, right, we did allude to there were one time impacts due to the US repositioning of the portfolio, so we had increased inventory reserves. And that we did have some fixed cost absorption issues due to the supply chain issues that Mike had highlighted earlier where we were shifting supply chain around, right, to our contract manufacturers. And then we did have packaging changes in the ROW segment.

So I could say that the gross margin would have been significantly higher without those. We do anticipate a normalization without those, right? So kind of back to what we would have expected for the 2022 year, and we're expecting that in 2023 and, obviously, guiding towards hopeful improvement there with all of the actions we're taking. And I'll hand it over to Mike for the Israel question.

Answer – Michael Ryan Gorenstein: Yeah. Thanks, James. So we're really happy to see the results, our Israel team continues to have. I'll say this that we're very definitely set up than I think the peers we have in Canada just because I think most have typically looked at it as sort of an outlet to move excess products, where we looked at it as an opportunity to create a long-term business and build a brand. We've had boots on the ground in Israel for a long time. They've now been able to achieve distribution in nearly all the pharmacies that are currently selling cannabis. And it's a very attractive industry both for businesses and patients right now.

I think one thing also when you look at the future and where it goes, in January, there was an announcement that you might see from the government starting a push for a new regulatory change that would significantly open up the market in terms of the patient count and pharmacies. But then within a week, actually, there the health minister that had been leading that charge, his position is in flux and there's now someone out there. So there's – it's a fluid situation, but I do think that there is a good chance that we see a regulatory change in Israel that does expand the market further. It's still early to tell on timing, but it's something we're hopeful of.

Question – Nadine Sarwat: Great. Perfect. Thank you.

Operator

Thank you. I would now like to turn the call over to Mike Gorenstein.

Thanks for taking the time, everyone, and have a great day.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.