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OTHER PARTICIPANTS

- W. Andrew Carter - Analyst
- Michael Freeman - Analyst
- Vivien Azer - Analyst
- John Zamparo - Analyst
- Nadine Sarwat - Analyst
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## MANAGEMENT DISCUSSION SECTION

**Operator**

Good morning. My name is Chris, and I will be your conference operator today. I would like to welcome everyone to Cronos Group's 2022 Third Quarter Earnings Conference Call. Today's call is being recorded.

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

**Shayne Laidlaw**

Thank you, Chris; and thank you for joining us today to review Cronos Group's 2022 third quarter financial and business performance. Today, I am joined by our Chairman, President and CEO, Mike Gorenstein; and our CFO, Bob Madore. Cronos Group 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**

Thanks, Shayne; and good morning, everyone. I'd like to start our call today by discussing the strategic realignment we have been working on this year. We've taken steps to cut costs, as you've seen within our operating expense structure and continue refining our budgeting and capital allocation processes to improve further. Our slimmer cost structure and more targeted approach to growth across segments helps ensure that we're allocating funds to the right products and initiatives.

All new investments share a common goal: Profitably grow Cronos with a focus on borderless products and brands that can adapt to new markets as they open. Thanks to continuous efforts and reinforcing our start-up mentality, we remain on track to hit our cost-savings target of $20 million to $25 million in operating expenses in 2022. As we complete the budgeting process for 2023, we remain keenly focused on cutting additional costs throughout our business to provide a firm footing for Cronos to build its borderless product portfolio and enable long-term sustainable growth.

A key area of focus for us has been adapting our supply chain. The build-out of downstream processing capability at GrowCo is progressing with flower packaging up and running, and we continue to be pleased with the cultivation performance at GrowCo and our other CMO providers. In third quarter, GrowCo reported to us preliminary unaudited revenue of approximately $5.8 million to non-Cronos customers. And as a reminder, GrowCo has been repaying its senior secured loan, which is now approximately $73 million. These loan receivables, combined with our balance sheet of approximately $890 million in cash and short-term investments, and strategic investments in Cronos Australia and PharmaCann, set us up well to enter new markets as they open.

Balance sheet management through economic uncertainty is paramount. And our desire to maintain a significant industry-leading cash balance ahead of potential global strategic growth opportunities has guided many of our decisions year-to-date. To maximize the benefits of our balance sheet, we have repositioned a significant portion of our cash into short-term investments to take advantage of the higher interest rate environment.

Growth via innovation continue to be a theme for us. In Canada, our Spinach brand is winning in the edible and vape categories. And we expanded on our offerings in these two categories with Spinach FEELZ, CBN gummy, and vape products. We're excited that this portfolio of rare cannabinoids continues to grow. And with a best-in-class product development team, we believe we can continue to provide consumers with superior and differentiated products, utilizing rare cannabinoids.

Further leveraging rare cannabinoids to expand our portfolio will continue to be pivotal for our ongoing new product launches. Having, most recently, announced the achievement of the equity milestone for THCV, we are pleased with the product development progress across categories and look forward to sharing more details on new product launches in the future.

This quarter, we also received the results of an important third-party verified study, which evaluated the sustainability and impact of traditional method of cannabis extraction and their own proprietary fermentation methods. The results were clear. The environmental footprint of growing plant indoors is high, and using innovative fermentation processes dramatically lower the environmental impact of cannabinoid production. These results show a striking advantage for the fermentation method, as the average percentage carbon footprint saving of the fermentation method is 99.8%.

While our industry is young, it's never too early to lead and invest in technology that helps contribute to a greener future. While fermentation enabled us to make a smaller environmental impact, it also allows us to leverage rare cannabinoids, making way for unique and new experiences through proprietary blend of cannabinoids. The fact that we're able to create great new products while being environmentally friendly is a win-win for Cronos.

Despite a challenging macro environment in Canada, driven by disruptions at our provincial customers in Ontario and British Columbia, our team continued to push new innovations and drive profitable growth. To make up for these disruptions, we strive to maintain supply continuity with customers. Although those efforts resulted in higher labor and shipping costs, we expect that the focus we put on making sure our products were on the shelf will pay dividends over the long-run.

The following market share commentary will all be referencing Hifyre data. In the flower category, 28-gram bags have come to dominate the market, making up 7 of the top 10 SKUs. Spinach once again the number one ranked dried flower SKU in September, with our 28-gram Wedding Cake offering, achieving a nationwide flower market share in Q3 of 6.4%, up 50 basis points from last quarter, making us the number three brand nationally in flower.

28-gram flower typically carries a lower-margin profile. Despite this impact to our financials, it is important that when selling into the provinces and building relationships with retailers, that we have a full product portfolio that they are looking for. Our 28-gram products are winning on quality, not just being the cheapest. We are confident that over the long run, in partnership with GrowCo and other contract manufacturers, we can improve on the margin profile of the category.

Moving to edibles, Spinach continues to expand market share, up 100 basis points from last quarter to 15.3% and 19.8% market share when looking at just the gummies category. Five spinach gummy SKUs are in the top 15, including the number one and number two market share positions on a per SKU basis. We continue to be more efficient and targeted with our SKU launches in edibles, driving market share gains with limited cannibalization, which is exemplified by our Spinach FEELZ rare cannabinoid focused gummy additions, which are quickly climbing market share ranks.

In vapes, we expanded market share by 70 basis points versus last quarter to 4.1%, driven by the wave of new products we brought to market this year, including the Blackberry Kush CBN vape, the Tropical Diesel CBG vape, and Atomic Sour Grapefruit vape.

In pre-rolls, despite not being where we want to be yet, we had several innovations and SKU assortment changes that we expect to change the trajectory of this category for us. This overhaul will include new packaging; market-aligned pricing; and innovative, new infused pre-roll offerings that just shipped last week.

These new Spinach pre-rolls include a THC-boosted product called Atomic GMO, which is a crossbreed of two of our best-selling flower offerings, Atomic Sour Grapefruit and GMO Cookies; as well as the CBG-infused pre-roll under the new Spinach FEELZ sub-brand. We are very excited to get our new pre-roll product assortment into the retail channel, so our sales team can do what they do best.

Turning to Israel, our PEACE NATURALS products continue to win in the market. Our team in Israel grew reported net revenue 88% year-over-year to $7 million. And on a constant currency basis, net revenue in Israel increased 98% year-over-year to $7.4 million. We've had incredibly positive patient reactions to our newest strain launches, Cocoa Bomba, Wedding Cake and GMO Cookies, in addition to our packaging redesign, which allows for additional information on the terpene profiles of our products.

Israel's patient count continues to grow as well, adding approximately 1,500 new medical cannabis patients in September, nearing a total of 120,000 patients. This is the third consecutive month we have seen patient growth of approximately 1,500 or greater. The reacceleration and year-over-year growth for patient permits provides a good foundation for growth in the Israeli market for us to capitalize on.

Earlier this year, our brand PEACE NATURALS launched an ad campaign in partnership with the Warriors 4 Life in Israel. The campaign called on mayors to restrict or stop traditional firework shows that cause distress and anxiety to medical patients and those with PTSD as a result of conflict and war, a serious problems faced by many veterans in the country. We are proud to have been awarded a prestigious Clio Award for this campaign in the Social Good category. Congratulations to our deserving PEACE NATURALS team in Israel and the amazing Warriors 4 Life do for our veterans.

I want to take a moment to shed light on our US business performance. As you have heard over the past couple of quarters, we have completely shifted away from our beauty category focused portfolio. All inventory that is beauty-focused is being worked through in the wholesale and DTC channels as we shift the focus of these brands to adult-use product formats. We continued improving our cost structure in the US and believe it is important to focus our investments only in areas that will give us an advantage in adult-use product formats. We are focused on creating borderless products and brands that can easily be adapted to emerging cannabis markets as they become commercially viable opportunities. The pivot in our US business further drives us towards our singular focus of creating adult-use cannabinoid products.

Looking to the adult-use cannabis market opportunity, we are pleased to see progress by the Biden Administration last month to issue pardons for minor cannabis-related offenses at the federal level and urging governors to do the same. These actions represent a small, but important step towards healing the harms done by cannabis prohibition in the United States. We believe cannabis should be legal and that a comprehensive and reasonable regulatory framework should be put in place for the industry. As legalization efforts continue across the US, we are committed to using our voice to lead the industry forward responsibly, and we will continue to be an integral part of the conversation. We're proud to support responsible legalization efforts and meaningful social justice reform.

Moving to Australia, where we have an approximate 10% stake in Cronos Australia, the team is executing at a high level in early stages of the market development. During our third quarter, Cronos Australia announced a $0.01 per share cash dividend, which yielded Cronos approximately $390,000 in October. Having a long-term, low-capital investment such as Cronos Australia start to pay capital back is a big positive.

Cronos Australia also recently reported strong financial results, with revenue in September hitting a record AUD 9.9 million, which is a run rate of nearly AUD 120 million annually. To continue to drive long-term growth, they recently brought a new state-of-the-art distribution center online. With a growing infrastructure, expanding medical market and strong team, we look forward to Cronos Australia's continued growth and market penetration.

And last, but certainly not least, I would like to congratulate Jeff Jacobson on his expanded role and promotion to Chief Growth Officer. Jeff has been with Cronos since 2016 and most recently served as SVP, Head of Growth, North America. In addition to Jeff's oversight of the marketing and sales functions, in his new role, he will oversee North American operations. Given the speed at which this industry moves, we believe having one leader guide the process from the point of idea creation to getting the product on the shelf will lead to better results for us going forward. Congrats to Jeff on this new role.

With that, I would like to pass it to Bob to take you through our financials.

**Robert L. Madore**

Thanks, Mike; and good morning, everyone. Company reported consolidated net revenue in the third quarter of 2022 of $20.9 million, a 3% increase from the third quarter of 2021. Constant currency consolidated net revenue increased 7% to $21.8 million. Revenue growth year-over-year was primarily driven by an increase in net revenue in the Rest of the World segment driven by cannabis flower sales in Israel and cannabis extract sales in Canada, partially offset by reduced sales in the US and lower cannabis flower sales in Canada driven by adverse price/mix. Consolidated gross profit for the third quarter of 2022 was $1.2 million, representing a $1.9 million improvement from the third quarter of 2021.

The gross margin was positive 6%, up from a negative 4% last year. The improvement versus prior year was primarily driven by increased revenue in the ROW segment, mainly driven by cannabis flower in Israel; a favorable mix of cannabis extract products that carry a higher margin profile than other product categories; and lower cannabis biomass costs, which were partially offset by lower fixed cost absorption due to the timing of the wind down activities at the Peace Naturals Campus and lower revenue in the US segment.

Consolidated adjusted EBITDA for the third quarter of 2022 was negative $21.7 million, representing a $25.1 million improvement from the third quarter of 2021. The improvement versus prior year was primarily driven by decreases in general and administrative, sales and marketing and research and development expenses as a result of the company's strategic realignment initiative and an improvement in gross profit.

Now, turning to our segments. In the Rest of the World segment, we reported net revenue in the third quarter of 2022 of $20.4 million, an 11% increase from the third quarter of 2021. Constant currency net revenue in Israel increased 98% to $7.4 million, while constant currency net revenue in Canada was down 2% to $13.9 million. Revenue growth year-over-year was primarily driven by increased flower sales in Israel and increased cannabis extract sales in Canada.

These gains were partially offset by lower cannabis flower sales in Canada, driven by an adverse price mix shift. Gross profit in the Rest of the World segment for the third quarter of 2022 was $3.1 million representing a $2.6 million improvement from the third quarter of 2021. The gross margin was positive 15% up from positive 3% last year. The improvement versus prior year was primarily driven by increased cannabis flower revenue in Israel, higher cannabis extract sales in Canada that carry a higher gross margin than other product categories; and lower cannabis biomass costs partially offset by lower fixed cost absorption due to the timing of wind down activities at the Peace Naturals Campus.

Adjusted EBITDA in the Rest of the World segment for third quarter of 2022 was negative $11.4 million, representing an $18.3 million improvement from the third quarter of 2021. The improvement versus prior year was primarily driven by a decrease in general and administrative expenses and an increase in gross profit.

Turning to US segment. We reported net revenue in the third quarter of 2022 of $500,000 a 76% decrease from the third quarter of 2021. The decrease year-over-year was primarily driven by a reduction in sales as result of a decrease in professional spend and SKU rationalization efforts as the company implements its realignment of the US business. Gross profit for the US segment for the third quarter of 2022 was negative $2 million, representing a $700,000 decline from the third quarter of 2021. The decline year-over-year was primarily due to lower sales volumes and increased inventory reserves driven by the realignment activities.

Adjusted EBITDA in the US segment in the third quarter of 2022 was negative $4.9 million, representing a $7.3 million improvement from the third quarter 2021. The improvement versus prior year was primarily driven by decreases in sales and marketing, general and administrative, and research and development expenses driven by the reduction in beauty category focused R&D.

Now, turning to our balance sheet. The company ended the quarter with approximately $890 million in cash and short-term investments. 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 rates for the period ended December 31, 2021, on the current period balance sheet, we would have approximately $940 million in cash and short-term investments. It's approximately $50 million difference.

We made significant strides to reduce spending and improve our cash burn rate. Our free cash flows improved by over 50% versus same period last year, driven by operating expense savings and a 35% reduction in CapEx, which was down to $1.6 million in the third quarter.

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

**Michael Ryan Gorenstein**

Thanks, Bob. We started in Canada to learn and build a borderless product portfolio. The lineup of products we've created to-date continue to win, driving market share gains for Cronos across categories, giving us confidence that they can win in any market. Despite certain challenges in Canada that drag on profitability, proving out our capabilities and building an elite team remain top priorities.

In Israel, our team continues to fight for and win market share, which is a testament to our branding and product quality. Having a team on the ground is a big differentiator for us, and you will see us continue to leverage that strength in Israel as the market continues to grow and evolve. As we continue to execute on our strategic realignment, I'm encouraged that we have maintained our innovation progress with a leaner cost structure.

I want to thank our dedicated employees, who continue to stay focused on the long-term plan. We remain singularly focused on winning in the adult-use cannabis market globally. And our industry-leading balance sheet affords us the opportunity to selectively invest and build our platform in new markets as they open.

With that, I'll open the line for questions.

**QUESTION AND ANSWER SECTION**

**Operator**

Thank you. We ask that you please limit yourself to one question and one follow-up. Stand by as we compile the Q&A roster. One moment, please, for our first question. Our first question will come from Andrew Carter of Stifel. Your line is open.

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**Analyst:**W. Andrew Carter

**Question – W. Andrew Carter:** Hey. Thanks. Good morning. I wanted to drill down on the Spinach bags, which has been kind of the vast majority of your growth in kind of in the headset trends. Obviously, it shows some diminishing returns. First, is that profitable on a gross margin basis? And is the theory there like an attachment rate that allows you to get the other Spinach products, whether it be pre-rolls, vapes, on the shelf, and this is just the cost of doing business? Thanks.

**Answer – Michael Ryan Gorenstein:** Sure. Thanks, Andrew. Yeah – no, it is positive gross margin, and I think there's a few things. One, we do look at it, and it is important from a utilization perspective to be able to have sort of the outflow for the supply chain. But also, when you think about utilization for us, it does drive a lot of value in the GrowCo equity that we have to make sure that we're utilizing the facility.

But also, I think it's important for the strength of the brand and for some of the other products we're launching. Getting familiarity with some of the new strain will certainly fuel some of the work that we do in pre-roll and vapes. So I think when you look at it overall for the portfolio and value driver, certainly there. And I take your point on 28 grams versus 3.5 grams, but I think we have to look at what consumers want and respond to it.

**Question – W. Andrew Carter:** Thanks. Second question I wanted to ask about the cost savings, the $20 million to $25 million achieved this year. Can you give us a sense of how much of those $20 million to $25 million hit the P&L this year? Therefore, how much is incremental next year? And you did allude to further optimization savings. I wanted to make sure I understood that you could have more.

And I know that you said kind of the US is important for your future business, but that's $8 million of cost, if I got that right, a quarter. Is that just the cost that's going to be embedded with you until something changes, until you hit some kind of disruptive; or is even those $8 million – or therefore, $30 million annualized savings in scope as well? Thanks.

**Answer – Michael Ryan Gorenstein:** Sure. So when we think about the US, there's still – we see opportunity there. I wouldn't say that we are real happy with the cost structure versus what the contribution is today, but we do see opportunity in the US. So, it's still a business that we're working on and making sure that we're making it as lean as possible, and basically transforming something that's a positive contributor.

I'll let Bob speak to where we are overall in the $25 million. But part of that, when I talk about further opportunities, is just because we had the plan in the beginning of the year, doesn't mean we're not constantly looking for any incremental savings, evaluating everything we do to find places that we can improve our bottom line.

**Answer – Robert L. Madore:** Yeah. Thanks, Mike. I'll just add a little more color on that. Listen, we're very confident in our ability to hit the $20 million to $25 million in cost savings. Those are actual realized cost savings in this fiscal year versus the prior year. We're in the middle of and working through our 2023 budget process. And as Mike pointed out in his prepared comments, we're very focused on continuing to become more efficient and effective. Our realignment strategy and restructuring activities are really going to be a big contributor to improve not just gross margin, but also operating efficiencies, too. So, we're anticipating additional savings beyond the $20 million and $25 million we realized this year, going into 2023 also.

**Question – W. Andrew Carter:** Thanks. I'll pass it on.

**Operator**

Thank you. One moment, please, for our next question. And our next question will come from the line of Michael Freeman of Raymond James. The line is open.

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**Analyst:**Michael Freeman

**Question – Michael Freeman:** Hey. Good morning, Mike, Bob and Shayne. Thanks for taking our questions here. I was glad to see the launch of a CBG-infused pre-rolls, products involving CBN, product development with THCV. I wonder if you could provide us an update on if there's any new strategic thinking on how you are considering deploying cultivated cannabinoids through your partnership with Ginkgo. Thanks.

**Answer – Michael Ryan Gorenstein:** Sure. Thank you. We actually think things could be going well as far as uptake for the product. And a lot of the strategy for the product pipeline we've had in motion does involve heavily, those products. So, we've seen great response to the edibles and to the vapes. And we're just shipping some of the rare cannabinoid this week – or sorry, last week with pre-rolls. We just feel like those are the three main categories that make sense to have the rare cannabinoids in.

Now it's – some of the cannabinoids we've been developing that haven't been on market, starting to come out. So, just given when we look at, say, CBG FEELZ gummy having a 1.9% market share just on a single SKU basis, we think the strategy is working and we think that the portfolio will continue to gain strength as there's more and more new differentiating cannabinoids that we can add to the roster.

**Question – Michael Freeman:** Okay. Great. Thank you. And then, as a follow-up, I was reading that your exit from Peace Naturals Campus is going to be pushing into 2023. I wonder if you could provide us a update on that.

**Answer – Michael Ryan Gorenstein:** Sure. While we think the bulk of the transition should still be done this year, there's just been some delays with getting some of the CMOs up and running to go to handle the capacity. And for us, what we think is most important is making sure that we're able to maintain the products on shelf, be able to kind of keep the top line momentum, so that when the transition completes, we can fully realize the benefits of the cost savings.

So, we're being careful in making sure that we're not rushing. We expect still the first half of next year that the transition should be complete and noting that it's definitely a gradual transition. But we have completed our cultivation activities at PEACE NATURALS.

**Question – Michael Freeman:** Okay. Thank you. If you would entertain just one more. Thinking about your US strategy, I wonder if you could shed some light on your internal thinking, especially in light of Canopy's recent move to execute US investments by way of HoldingCo and if these changes your view on the US outlook.

**Answer – Michael Ryan Gorenstein:** Yeah. I think, for us, we're in a different situation than a lot of peers, given that we have a strong investment with PharmaCann today. But most of our dry powder is still maintained on the balance sheet. We have a lot of flexibility not having any debt. And we do look at it still as making sure we have the right product portfolio. And ultimately, when you look at the US, just how do we get out our product portfolio and how do we find new products to add to it.

We think that there's certainly a lot of momentum with the Biden announcement. But we're looking at structures that fit us best. And I think you'll see us getting closer and closer to that. So, we're really excited about the US opportunity. And we still feel that it is a branded product opportunity. And things are going to continue moving more toward the CPG-looking market.

**Question – Michael Freeman:** That's great. Thanks. I'll pass it on.

**Operator**

Thank you. And one moment for our next question. Our next question will come from Vivien Azer of Cowen. Your line is open.

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**Analyst:**Vivien Azer

**Question – Vivien Azer:** Hi. Thank you. Good morning. I wanted to follow-up on the rare cannabinoids. While it's clearly early days for you, Mike, I know you're a keen observer of the US marketplace, where products featuring rare cannabinoids are more available. So, I'd like to just get your impressions on what you see from a category (00:30:06) perspective and whether you think that'll apply to Canada? Thank you.

**Answer – Michael Ryan Gorenstein:** Sure. It's a great question. And I think one of the challenges that let us work down this pathway is it's still very difficult to get enough availability of some of those rare cannabinoids. There are some cannabinoids that are easier to get in the US now, like CBN and CBG. But we look at some of the ones, THCV for example, that you're just not seeing commercial availability and being able to resume supply.

But we've seen that even outside of the traditional cannabis channels, cannabinoids like CBN, once consumers have now learned what CBN does, there is a lot of uptake of it, and it does provide a differentiator and really like standalone branded products. So, we continue to believe that it's a great opportunity and a good way to escape, call it, commoditization of products.

**Question – Vivien Azer:** Understood. And so, my follow-up and pivoting to Israel, please. It's nice to hear that the market has re-accelerated. Would love to get an updated view of where you think market penetration can go in Israel. Thanks.

**Answer – Michael Ryan Gorenstein:** Sure, yeah. I think, we did have those temporary kind of stop for a few months, and we've seen things start to turn back on. We think that things are now headed back in the right direction. The market's looking good growth-wise, and it's really – the thing to watch is what's happening with patient growth. How much would that reaccelerate (00:31:48)? We just had an election last week which we think give more certainty to have things move forward politically. And we're very optimistic. We think that our ability to continue outpacing the growth of the market on the wholesale channel and also the market continue to grow is – gives us a bright future.

**Question – Vivien Azer:** Thank you.

**Operator**

Thank you. One moment, please for our next question. The next question will come from John Zamparo of CIBC Capital Markets. Your line is open.

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**Analyst:**John Zamparo

**Question – John Zamparo:** Thanks. Good morning. I also wanted to touch on the Israeli market. And can you talk about the pricing dynamics here, and do you think you're taking share in Israel?

**Answer – Michael Ryan Gorenstein:** Sure, yeah. I think there are still been some limited pricing pressure, but it's relieved compared to what we had a quarter or two ago. So you're seeing some of the excess supply work its way through the system, and I think we are taking share. I think that we stand out when it comes to quality. I think that the brand is recognized as being a leader, and we're continuing to perform.

So I think that the combination of having better quality, but also now getting back to patient growth is generally improving the dynamic there. And I think there was sort of a lesson that was learned as far as we did have a big shortage in Israel. So there was a lot of activities to bring in whatever products local companies could find. And I think now, there's a little bit more skepticism in what product is coming in. So we see those macro dynamics continuing to improve, and we've already seen them improve over the last couple months.

**Question – John Zamparo:** Okay. That's helpful. Thanks. And then, my follow-up is on gross margin, and apologies if I missed it. But can you say what this was, either consolidated or Rest of World if you back out the PEACE NATURALS exits?

**Answer – Michael Ryan Gorenstein:** Yeah. Bob, do you want to go and take that one?

**Answer – Robert L. Madore:** Yeah. No, definitely. We really feel confident in the trajectory of our margin profile. There are a lot of pluses and some minuses that transpired in the quarter. But as you guys talked about a second ago, Israel's margin has remained strong and is growing as that business continues to grow in revenues. We're experiencing lower biomass costs through our relationship partnership with GrowCo, and that's going to be a long-term, sustainable-type savings versus history, past experience.

As cannabis extracts continue to become a bigger part of our business in Canada, it'll continue to have favorable margin trends. They have higher margins than other product categories. And that was offset, particularly in this quarter, by a few things. One was we realized and recorded a $1.8 million decline in gross profit dollars sequentially from Q2 in the US business. And a lot of that was driven by taking inventory reserves, discounting product as we work through discontinued SKUs and product categories.

We had, and we experienced in the ROW segment, lower fixed cost absorption this particular quarter with the slight delay in our transition out of Stayner facility, as we've talked about a little bit. We also discussed in the call the adverse price/mix shifts in the Canadian flower categories that's driven by the 28-gram bags that drove some of the margin impact in the quarter.

And then, lastly, and again another like period-based anomaly, we believe. During this quarter – in the third quarter, we did some – began downstream processing of some rare cannabinoids that haven't reached their milestones yet on efficiency. But we think speed-to-market for this product and the differentiation that's going to create is a great investment and will have a long-term ROI. So there are lot of pluses that are going to be sustained and sustainable and a lot of minuses. And I would say, most of the minuses incurred in the quarter were just period expenses, and I don't consider they're going to be things that carry forward long term.

**Answer – Michael Ryan Gorenstein:** Thanks. Thanks, Bob. Just to follow up, just on the rare cannabinoid point. What you're seeing here, if you remember, last year, we amended the agreement so that if we wanted to commercialize the cannabinoid early before the productive (00:36:56) was hit that we had the option to issue one-third of the equity upon commercialization. And so, what you could see is back there, as we were excited about a cannabinoid that we wanted to get in the market early.

**Question – John Zamparo:** Understood. That's helpful. Thank you.

**Operator**

Thank you. And one moment for our next question. Our next question will come from Nadine Sarwat of AllianceBernstein. Your line is open.

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**Analyst:**Nadine Sarwat

**Question – Nadine Sarwat:** Hi. Thank you. Good morning, everybody. Two questions for me. So, first, you stated that you expect pre-roll innovation to be your next big driver of growth. And I know you called out those two products in particular. So given that that segment is already pretty crowded, what gives you the confidence that your brands are going to win in that space and drive that growth you're talking about?

And then, my second question, your US revenues, they continue to fall. You've explained that very clearly as part of your realignment plan. Could you give us any clarity as to how we should think about that segment a little bit more long term? Should we think of this quarter as a bottom? Is there more declines to come? How can we expect it – when should we expect it to actually start growing again? Thank you.

**Answer – Michael Ryan Gorenstein:** Good. Thanks. For the first question, look, I think, every category in cannabis, either is crowded or will quickly become crowded until there is ultimately differentiation and you see companies start to set apart. So, when we think about the way that we're entering, taking similar approaches in other category, it's about really focusing on what we think consumer want. It's making sure that the brand is going to perform well and that we have a really, really good product. So, there's a lot of innovation that come in pre-rolls.

But one of the reasons you're seeing some movement there is there's an opportunity to differentiate, able to provide a lot of value to consumers as far as the complexity of the product with different terpenes and flower and the convenience. So, I think it's ultimately the same. You could have said that edibles is really crowded, and I think we've performed well. And I think that pre-rolls is a very large category with a lot of runway and opportunity. So, we're excited about it. And I think that this is only the beginning. We have a lot that we'll be coming out for the next couple years. And I think it's going to continue to take share from flower.

As far as the US, I think it's still something that you'll see in transition. I mean, we are going to be focused on continuing to skinny down and get to a place where we're focused on just the adult-use product format. And I think, you'll then see it start to grow when we're able to get the right innovation back in the market and we have the infrastructure proper. I think that while we would limit the format, what we can do as far as product SKUs is something where you see the growth come from.

There's cannabinoids beyond CBD that we think are able to stand out and provide more growth. I think it's very hard to differentiate with only CBD, and it's similar to what we see in the THC-type products. So, I think being able to use a lot of different cannabinoids is what's going to drive the growth there.

**Question – Nadine Sarwat:** All right. Thank you.

**Operator**

Thank you. And one moment, please, for our next question. Our next question will come from the line of Andrew Bond of Jefferies. The line is open.

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**Analyst:**Andrew Bond

**Question – Andrew Bond:** Hey. Good morning, Andrew Bond on the line for Owen Bennett. Thanks for taking our question. I wanted to touch – revisit on the comments you made about the sizable dry powder you have on the balance sheet and prospects for M&A. Obviously, valuations in the industry across the board have been coming down. Can you give any more detail around what opportunities you might be evaluating valuation levels you are seeing? And can you remind us of kind of how your focus is in terms of assessing how you'd like to deploy that cash? Thank you.

**Answer – Michael Ryan Gorenstein:** Sure thing. It's a great question. I think valuations certainly are coming down. And I think that one of the things that we probably think about differently here is we're, again, looking at what happens in a world where state borders fall and when there's the equilibrium of supply and demand.

So, we're looking when – what's going to stand out when you're able to always find a location, if you're able to go and pick up product. What's it look like in a mature market? And for us, that come down to branded products. So, we haven't really changed in our thinking there. Still looking to see what the best opportunities are. And you see every – every quarter, you're seeing separation and you're seeing that kind of maturity in a lot of the market.

So, we're not as interested in, okay, here's a brand new market. Look at that huge sizable margin spread. Because you'll see that, that will compress as you're able to get more supply on the market. And that, over time, that starts to shift, as with any other consumer product industry, towards what the best branded products are.

**Question – Andrew Bond:** Got it. Thank you, Mike. I'll pass it on.

**Operator**

Thank you. One moment, please, for the next question. Our next question will come from Matt Bottomley of Canaccord Genuity. Your line is open.

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**Analyst:**Matt Bottomley

**Question – Matt Bottomley:** Good morning, all. Thanks for the question here. Just one follow-up for me, Mike, just on one of your comments in the Q&A here that you anticipate a lot of different product categories, particularly in Canada, to eventually become saturated, which I would agree with.

In the current regulatory environment do you think a lot of the gains Cronos has done – particular in the edible category, there's been one or two of your peers, which edible seem to be a category where there's been some growth here. What's your view on how that category in particular is going to trend? Obviously, dried bud kind of fell off a cliff, particularly at the value segment.

Do you think kind of branded products, as limited as they are in Canada, are a little more protected from that; or are you anticipating over the next 12, 16 months there's going to have to be additional pivots even in the categories that are doing well for you right now?

**Answer – Michael Ryan Gorenstein:** Yeah. Sorry, just to clarify what I meant there. It was a great question. What I meant by saturated is there's not going to be an opportunity in cannabis, just given how large of an industry and all the potential, where you're going to be the only one who moved in and say like you're one of three companies that are offering pre-rolls. There's an opportunity, you can expect everyone's going to go chase it.

But what I do think and what I like about pre-roll, and I'll just tie that with edibles is, the further you get from flower, the more differentiation you can have. And I think edibles is probably about as far along that differentiation curve as you can get. So pre-rolls is certainly right up there. But I don't think you're going to see a lot of change in edibles. And it's not a coincidence if you look at the US, because edibles is probably more than any other category. We can see consistent brands that are popping up across different states, even though they aren't necessarily your traditional multistate operator. I think you'll see that with pre-rolls.

So, I think there's more innovation to come outside of just gummies in Canada. But I think it started off saturated. If anything, you're seeing leaders emerge, and there's much more stickiness than something like flower.

**Question – Matt Bottomley:** Got it. Thank you.

**Operator**

Thank you. And this will conclude the Q&A session of today's call and will also conclude today's conference call. Thank you, all, for participating. You may now disconnect and have a pleasant day.

Thank you.

**Operator**

Welcome.